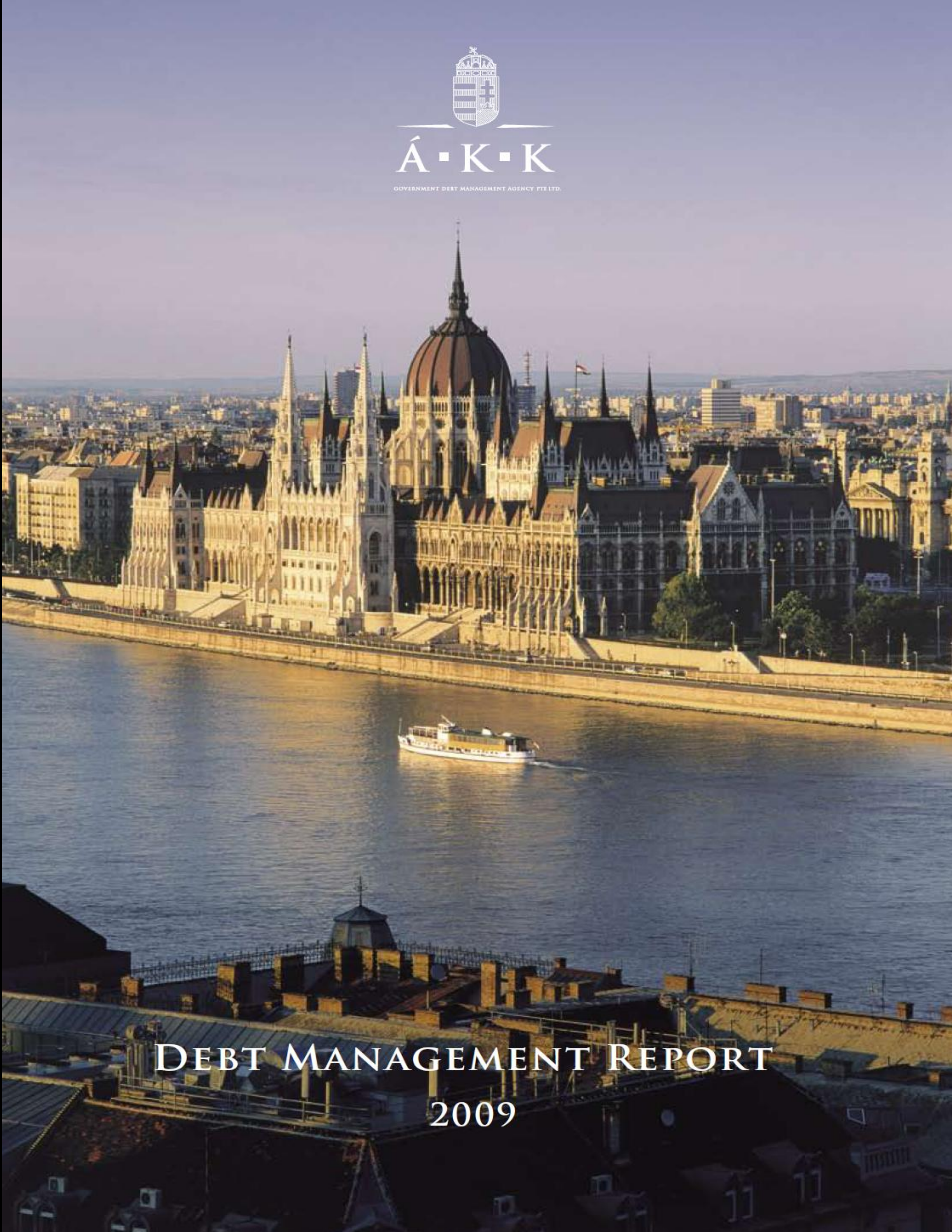

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GOVERNMENT DEBT MANAGEMENT AGENCY PTE LTD.

DEBT MANAGEMENT REPORT

2009

FOREWORD

The objective of this annual Government Debt Management Report of the Government Debt Management Agency Pte. Ltd. (ÁKK) is to inform investors and other stakeholders in the government securities market about the financing of the central government, to analyse the characteristics of the government debt and to describe the developments in the Hungarian government securities market during 2009.

2009 was a particularly important year for public debt management. The international financial crisis hit hard the Hungarian securities market in 2008; due to the substantial capital outflow and domestic bond sell-off by non-resident investors, the government bond market had frozen. Therefore, on the basis of the well-functioning Treasury bill and retail securities market and the international assistance provided by the International Monetary Fund and the European Commission, the basic objective of Hungarian public debt management was to restart and develop the local government bond market in 2009.

This was not an easy goal, because in March 2009 a new round of the crisis reached the capital markets of Hungary, and new measures had to be implemented to stabilize the market. In a relatively short time the bond market recovered and developed fast in the middle of 2009, characterized by falling yields and increased demand at auctions and the new non-competitive phase after the bond auctions. The return to market financing was underlined by the success of an (originally unplanned) international bond issuance in June 2009. The improved sentiment about the Republic of Hungary can be clearly seen with the CDS spread falling from 600 bps at the beginning of the year to below 250 bps by the end of the year.

It is clear that the most important objectives for last year were achieved, however, the tasks ahead of the Hungarian debt management are still challenging for a small and very open economy in the era of international financial turbulences.

Ferenc Szarvas
Chief Executive Officer

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GENERAL INFORMATION

Both deficit and debt data are preliminary until the Act on Final Accounts for the relevant year is approved by Parliament, which is usually during the fourth quarter of the following year. Fiscal data used in this report was still preliminary when this report was compiled.

Some of the data in this report are cash-flow based and some are accrual-based. When using the *cash-flow approach*, expenditures and revenues are accounted for the very period in which they are actually paid or received, regardless of the periods to which their economic content relates. Under the *accrual approach* on the other hand, the amount of an expenditure or revenue item related to several periods is divided up on a pro rata basis and allocated to the relevant periods.

From the perspective of government debt management, interest expenditure is the most significant budgetary item. Using the cash-flow approach for a bond with annual interest payments, each coupon payment is stated for the year in which it is actually disbursed. Using the accrual approach, on the other hand, the interest payment is divided into two parts and stated partly in one calendar year and partly in the next, to the proportion of the interest period falling on one year and on the other. Selling government bonds at auctions below par value (i.e. the clean net price not including accrued interest is below 100 per cent) is a special case of interest expenditure. In this case, under the cash-flow approach, the discount relative to the nominal value is accounted as interest expenditure on the day of settlement, and thus it may increase total annual interest expenditure significantly in the year of the issuance. Using the accrual approach, on the other hand, the discount as interest expenditure is accounted over the entire term of the bond proportionally (for a 10-year bond, for instance, over a period of 10 years), resulting in a much more even burden on the budget during the life of the bond.

ÁKK publishes data about government debt in accordance with Hungarian accounting standards, the principles of which are summarised as follows:

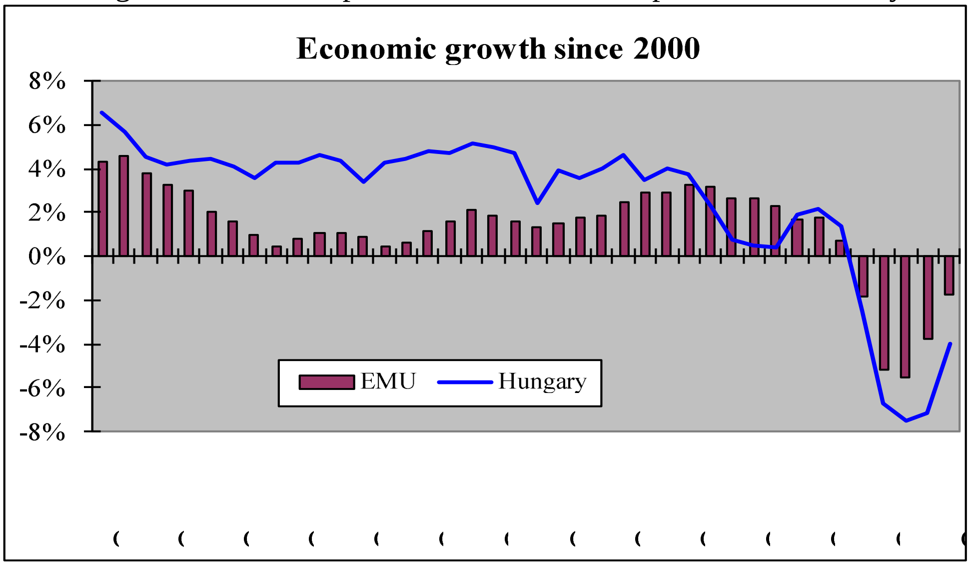
- Government bonds and retail government securities are recorded at nominal value.
- Discount treasury bills are recorded at the *average sale price* (at discount value), which is recalculated after every transaction involving the security concerned.
- Repo and reverse repo transactions actually increase or reduce outstanding government debt.
- Foreign currency debt is taken into account after swaps and is converted into HUF at the official exchange rate published by the National Bank of Hungary (NBH) at the end of the month or year in question.
- The debt calculated by ÁKK is the central government gross debt (i.e. it does not include either local government debt or the debt of state-held enterprises) and it is not a consolidated indicator (i.e. debt between various public sector subsystems is not netted).

The debt data published by ÁKK in accordance with Hungarian and international accounting standards differ from the debt data used by EUROSTAT (the European Union’s institute of statistics), which is calculated according to different principles and is essentially the result of statistical calculations. Public debt data calculated in accordance with ESA ‘95 principles is jointly produced and published by the Hungarian Central Statistical Office (HCSO), the National Bank of Hungary and the Ministry of Finance, and is based only partly on information provided by ÁKK.

I. MACROECONOMIC DEVELOPMENTS IN 2009

ECONOMIC GROWTH

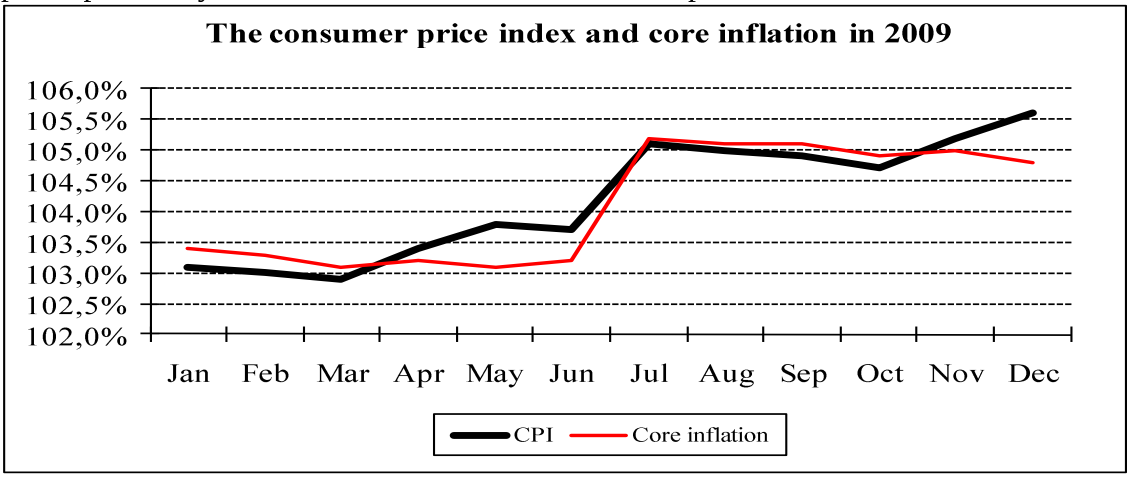
In 2009 the Hungarian economy experienced a deep recession with real GDP declining by 6.2 per cent, like many other economies in the CEE region. This contraction was caused by a large fall in both domestic consumption and fixed-asset investment, which were clearly the result of the international financial crisis. However, the net export improved due to the large decline of imports as a result of slowing local consumption and stock build-down, with exports decreasing to a lower extent. Due to the agreement between the Hungarian government and the IMF/European Commission the fiscal policy remained strict, providing little room for the government to implement measures to help economic activity in 2009.



Source: HCSO, EUROSTAT

INFLATION

Inflation was low in H1 2009 as a result of low domestic demand and the 12-month CPI figure reached a minimum of 2.9 per cent in March. Inflation jumped significantly in the middle of the year because of fiscal restrictions (increasing VAT and excise taxes) and higher petrol prices. By the end of 2009 inflation rose to 5.6 per cent.

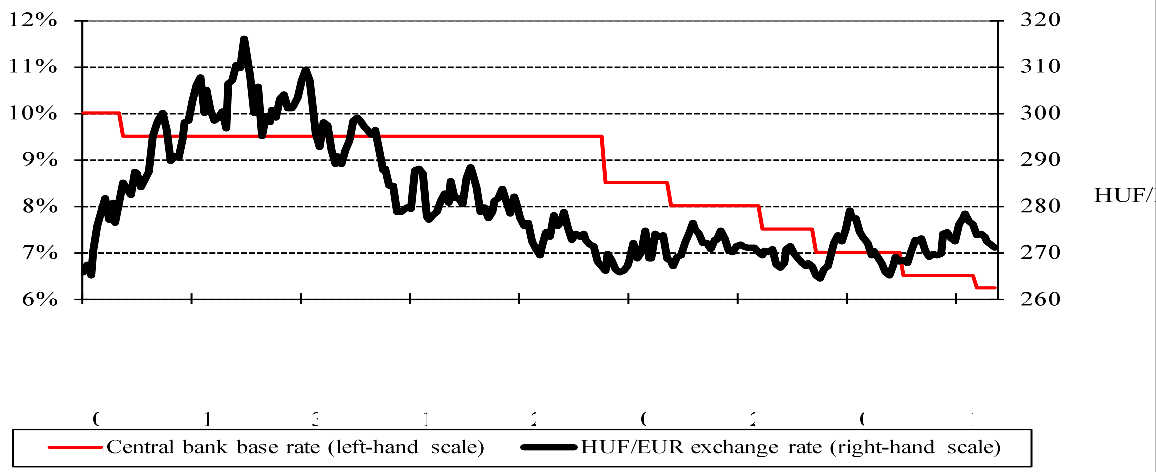


Source: HCSO

MONETARY DEVELOPMENTS

The National Bank of Hungary continued its monetary easing started at the end of 2008 with a 50 basis point (bp) decrease of the base rate down to 9.5 per cent in January. In the first quarter of 2009 the Hungarian currency weakened significantly from an exchange rate of 265 HUF/EUR to 316 HUF/EUR, as a result of the new wave of the international financial crisis in March. By the middle of the year capital markets recovered and the exchange rate of the HUF strengthened to 270 HUF/EUR and yields came down. As a reaction to more stable market conditions and modest inflationary expectations the NBH reduced its base rate by a total of 325 bp to 6.25 per cent in H2 2009 in several steps. The exchange rate fluctuated around the 270 HUF/EUR level in H2 2009.

The central bank base rate and the exchange rate in 2009



Source: NBH

FISCAL POLICY

The central government budget deficit in 2009 – excluding local authorities – was HUF 921 billion, or 3.5 per cent of GDP, one of the lowest in the European Union.[1] However, maintaining the fiscal position in such an extremely difficult economic situation required several restrictive measures (tax increases, elimination of the 13-month pension and salary of public employees, reduction of several social benefits etc.).

DEVELOPMENTS IN THE FINANCING POSITION OF THE ECONOMIC SECTORS

In 2009 domestic savings improved significantly which resulted in a net external savings position of 1 per cent of GDP. The current account also showed a surplus of EUR 0.2 billion (0.2 per cent of GDP). The improving savings position was due both to the higher savings of households (rising from 1.2 per cent of GDP to 3.4 per cent in 2009) and the previous 4.8 per cent net financing requirement of enterprises turned to 1.2 per cent net savings. The savings position of the public sector basically remained the same.

[1] The components of the net financing requirement are described in detail in Chapter III.

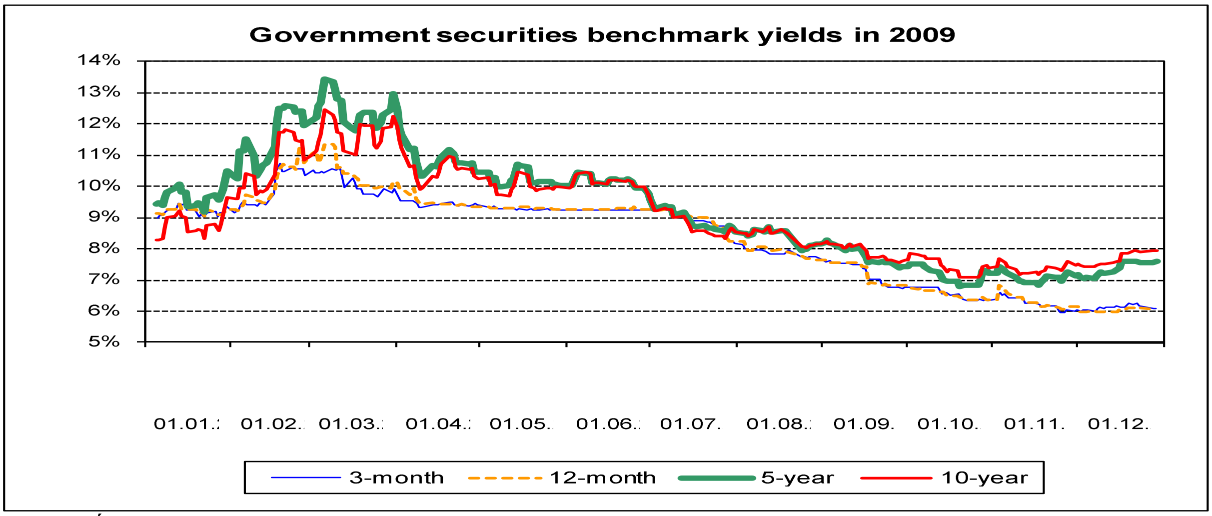
DEVELOPMENTS IN THE GOVERNMENT SECURITIES MARKET

The developments in the Hungarian government securities market were influenced by the international capital markets. ÁKK announced to restart the primary bond market (auctions) gradually in H1 2009 (T-bill and retail debt primary markets worked as normal during the whole crisis period). After the slow stabilisation in early 2009 ÁKK announced its first bond auction in February. The sudden loss of market liquidity happening shortly afterwards, however, made government securities yields significantly rise again and secondary market trading turnover decline. In order to stabilize the bond market experiencing a similar shock like October 2008, ÁKK announced and executed a large (approximately EUR 2 billion) bond buy-back program. With a gradually improving bond market ÁKK was able to restart regular bond auctions in April and reduced its bond buy-back program back to its normal secondary market operation used for smoothening maturities.

From the middle of 2009, the primary bond market continued to operate as before the crisis and Hungary returned to market financing. Bond auctions were well bid and ÁKK was able to regularly increase auctioned amounts. Secondary markets also developed, with moderate turnover but tighter spreads. However, with lower trading limits of primary dealers the liquidity of the secondary market was still insufficient for larger deals and the primary market had a larger role to play for investors wishing to buy Hungarian debt.

SECONDARY MARKET YIELDS

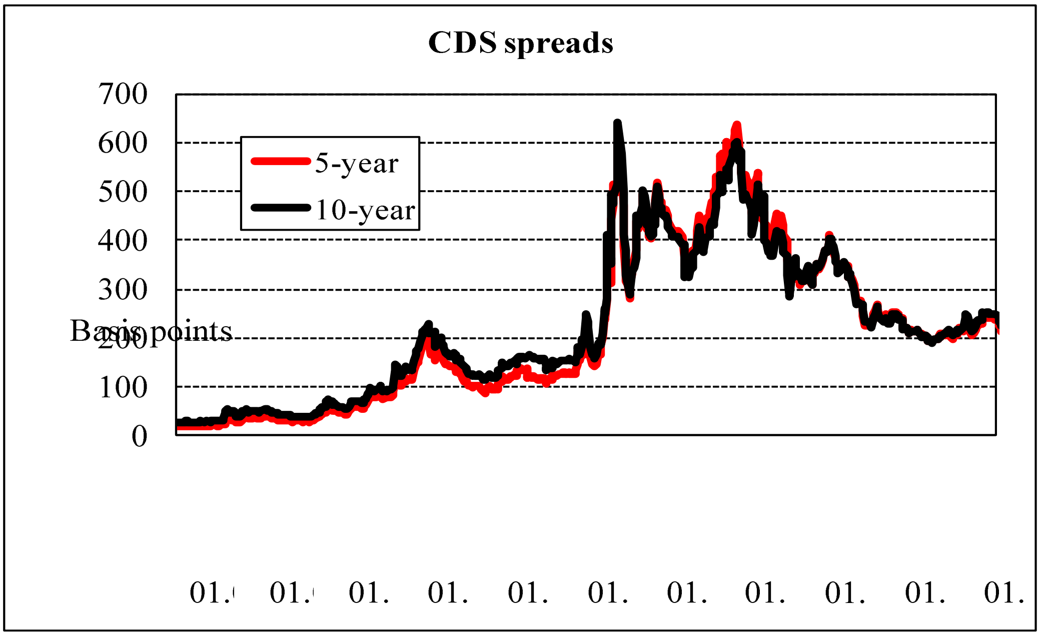
Over the entire year, HUF government securities yields were very volatile, but altogether the short-term yields decreased by 3 per cent and the long-term yields by 1.0-1.5 per cent. Yield movements generally followed international events, resulting in substantial rises in March (like in October 2008) to around 12 per cent, the yield of the 3-year tenor even reached 14 per cent. In Q2 yields came down into the 9-10 per cent range with market stabilisation. Further yield decline followed as a result of investors' improving sentiment and the gradual cuts of the NBH base rate until November to the 7 per cent area. At the end of the year yields started to rise again due to investors' worries associated with the financial problems of Dubai and Greece.



Source: ÁKK

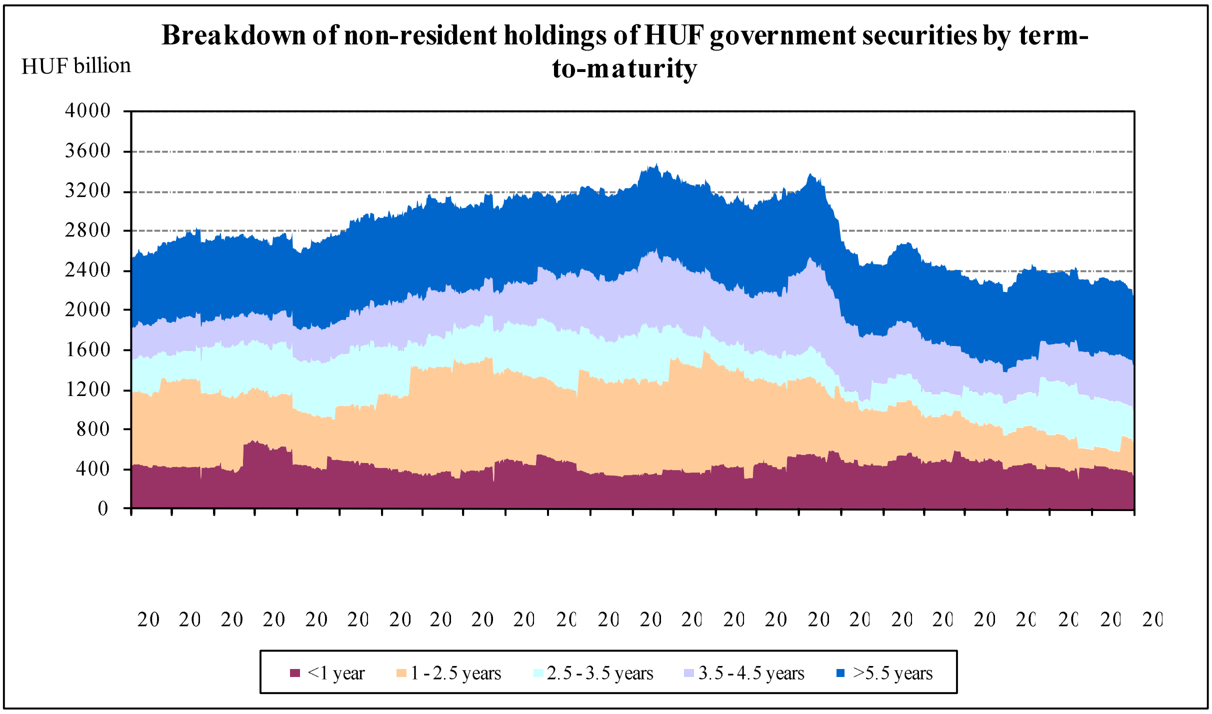
CDS SPREAD DEVELOPMENT

After a short recovery at the beginning of the year, liquidity in the EU government securities markets dried up again in the spring of 2009. The situation deteriorated mainly due to international factors, but the Hungarian political situation also worsened investors' sentiment. The 5-year CDS spread went up from 405 bp to 638 bp in March. From the summer of 2009 investors' sentiment improved in the global money and capital markets, with monetary easing programmes and the improving expectations on global growth. Since Hungarian macroeconomic figures also improved and by returning to market financing the IMF/EC loan assistance was no longer used, CDS spreads also improved significantly. The 5-year CDS spread declined to 238 bps by the end of 2009.



THE PARTICIPATION OF NON-RESIDENTS IN THE LOCAL BOND MARKET

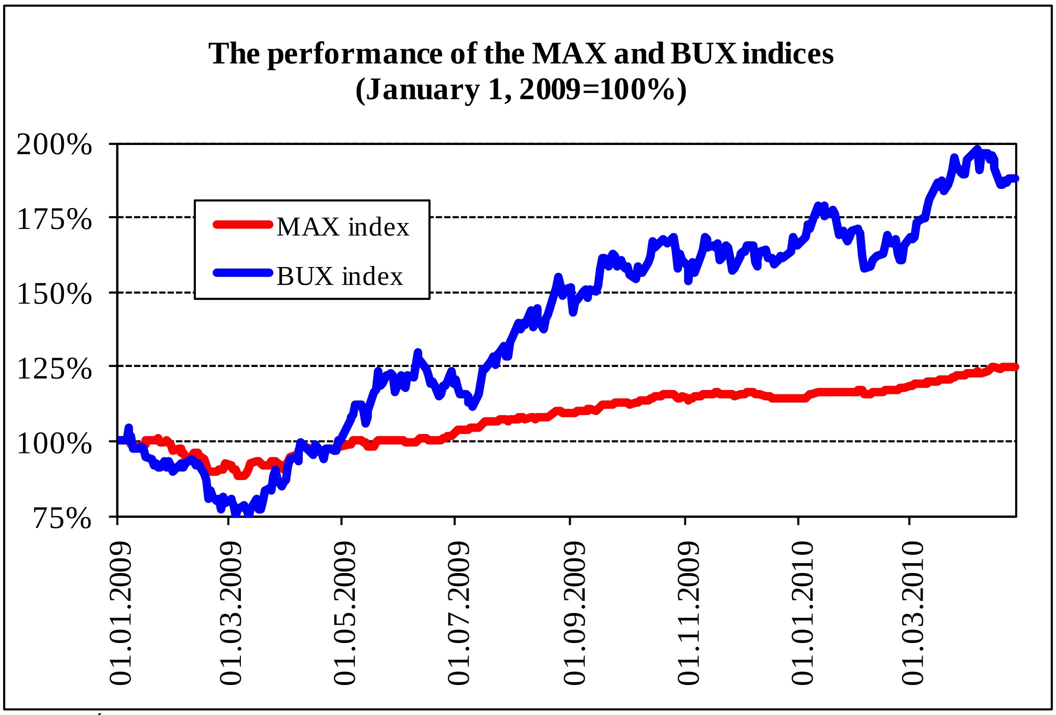
After a large sell-off of HUF 782 billion (or EUR 2.9 billion) of local government securities in 2008 non-resident investors further reduced their exposure in 2009, but in a more modest way. Their portfolio declined by HUF 303 billion (EUR 1.1 billion) to HUF 2156 billion. In January-February their holdings increased by about HUF 250 billion, which was followed by a moderate sell-off in the last part of H1 2009, but the size of their portfolio was relatively stable in the remaining part of the year. Non-resident holdings amounted to 21 per cent of the size of the local government bond market, slightly less than the 22 per cent at the end of 2008. That stock meant 11 per cent of all Hungarian public debt, which together with the foreign exchange debt and the IMF/European Commission loan facility resulted in the fact that 59 per cent of all Hungarian public debt was owned by non-resident investors.



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

THE STOCK MARKET

The main Hungarian stock market index (BUX) fell below 10.000 points in Q1 2009. After a low point in March the index started a strong recovery and surpassed the 20.000 mark. The total yearly performance of the BUX index reached a substantial 73 per cent, but it was still not enough to regain the loss suffered in 2008.



Source: ÁKK, Bloomberg

II. DEBT MANAGEMENT STRATEGY IN 2009

ÁKK plans and performs its financing transactions in accordance with the Debt Management Strategy approved each year by the Minister of Finance. The Government Debt Management Strategy for 2009 was prepared on the basis of an optimal portfolio model used since 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.

In the trade-off between costs and risks, the aim is to develop a debt structure with the most favourable long-term cost-risk characteristics. The emphasis is on the long term: no transaction may be done to achieve lower costs in the short term at the expense of higher costs or greater risks in the future.

The most important risk factors are as follows:

- *Refinancing risk* consists of the risk of renewing maturing debt and the risk associated with meeting net financing requirements. In extreme cases, refinancing risk may become liquidity risk, but in general it is only interest rate risk.
- *Interest rate risk* relates to fluctuations in the yields of government securities.
- *Liquidity risk* is the result of fluctuations in the cash-flows of the central government and the capital market operations of debt management.
- *Foreign exchange rate risk* arises out of fluctuations of the exchange rates of the forint versus the euro, as well as various other foreign currencies.
- *Credit risk (counterparty risk)* is an important risk factor in the case of hedging transactions concluded directly with partners in the international capital markets and of repo operations in the domestic money market.

ÁKK has developed various benchmarks (reference values) reflecting its strategic objectives partly based on an optimal portfolio model so as to be able to consider risks and costs together. In order to filter out short-term effects, these benchmarks are generally calculated as 90-day moving averages. The benchmarks approved by the Minister of Finance are also used to quantify strategic objectives and to set intermediate targets. During the course of 2009 the composition of the central government debt conformed to the benchmarks with the exception of the domestic/foreign currency debt ratio benchmark.

1. THE DOMESTIC DEBT/ FOREIGN CURRENCY DEBT COMPOSITION

Since 2004 the debt management strategy has used an optimal portfolio model to establish inter alia a domestic/foreign currency ratio within the total government debt that minimises the risks stemming from interest rate and exchange rate fluctuations. The original goal in 2009 was to maintain the foreign currency debt ratio within the 25-32 per cent range, but debt management was allowed to exceed that ratio under the difficult situation of the international financial crisis. Due to the use of the IMF/European Commission international loan program the ratio of foreign currency debt reached 38.6per cent at the end of 2009.

2. THE CURRENCY COMPOSITION OF THE FOREIGN CURRENCY DEBT PORTFOLIO

In order to minimise cross-currency risk, ÁKK aimed (as in previous years) to ensure that the foreign currency debt portfolio corresponds to the composition of the Hungarian forint's currency basket – i.e. that it should comprise euro obligations only, with a maximum deviation of 5 per cent. If the Republic obtains funding in a non-euro currency, ÁKK uses swap transactions to convert it into euro obligations. At the end of 2009, in compliance with the benchmark, 99.1 per cent of foreign currency debt was in euros.

3. FIXED/FLOATING RATE COMPOSITION OF THE FOREIGN CURRENCY DEBT

The aim of the interest rate benchmark for the foreign currency debt is to determine the optimal ratio of fixed and floating interest rate obligations, so as to reduce interest costs while also avoiding excessive interest rate risk. ÁKK uses interest rate swap transactions to achieve the desired interest rate composition. At the end of 2009 the ratio of fixed interest rate debt within foreign currency debt was 65.4 per cent, which conformed to the benchmark (62.7-67.7 per cent).

4. FIXED/FLOATING RATE COMPOSITION OF THE HUF DEBT

ÁKK can primarily influence the fixed/floating interest rate ratio of the HUF debt portfolio by its issuance structure. At the end of 2009 the ratio of fixed interest rate HUF debt was within the reference range at 68 per cent (61-83 per cent).

5. DURATION OBJECTIVE

The average remaining term-to-maturity of the public debt is important for two reasons: firstly, large amounts of debt expiring within a short period of time carry refinancing (renewal) risk; secondly, the average term-to-maturity expresses the re-pricing risk of debt and exposure to interest rate changes. When the debt portfolio is examined from this perspective, the duration (or *Macaulay duration*) concept is used. This also shows the sensitivity of the portfolio to interest rates, i.e. the re-pricing effect induced by interest rate changes. ÁKK's strategic objective is to keep the duration of the HUF debt portfolio within a +/- 0.5-year range around 2.5 years. At the end of 2009 duration stood at 2.5 years, in the middle of this range.

6. OPTIMAL BALANCE OF THE SINGLE TREASURY ACCOUNT

The strategic objective is to maintain a secure level of funds on the Single Treasury Account (STA), which also affects the liquidity management of the State. Accordingly, ÁKK determines the optimal balance of the Single Treasury Account, and the end-of-day STA balance is kept within a range of HUF 50 billion around that amount. For a detailed description of the characteristics of liquidity management in 2009, see Chapter VI.

7. STRATEGIC PRINCIPLES

ÁKK executes its financing policy governed by the three main principles of simplicity, transparency and liquidity. In the interest of simplicity and transparency, ÁKK only issues a limited number of plain vanilla instruments in a transparent manner that conforms to market practice, i.e. it sells fixed coupon forint bonds and zero-coupon discount treasury bills according to a fixed annual issuance calendar announced in advance.

As regards liquidity, ÁKK aims to ensure that government securities have a sufficiently liquid secondary market, as this influences further issuances. The possibility of selling government securities before maturity is exceptionally important for investors. There are two requirements for a liquid secondary market: continuous two-way price quotation that reflects real market prices, and the existence of sufficiently large volumes of government securities series (benchmarks). In order to achieve this, ÁKK reopens individual series – i.e. it issues additional bonds and discount treasury bills that are fully fungible with previously issued series. The targeted volume of bond series was around HUF 500-750 billion (approximately EUR 2-3 billion), with greater volumes targeted for securities with a longer tenor (5 or 10 years). This practice was enhanced in 2009 by ÁKK's policy to reopen old bonds series at bond auctions.

III. THE FINANCING REQUIREMENTS IN 2009

THE COMPONENTS OF THE FINANCING REQUIREMENT

The most important part of the net financing requirement is the deficit of the central government. The balance of the central government consists of the balances of three subsystems of government administration: the central government budget, social security funds and extra-budgetary funds[2]. ÁKK is responsible for financing the central government and maintaining its liquidity, while local authorities – the fourth major subsystem of the public sector – manage their own budgets, financing and debt management.

The total annual net financing requirement financed by ÁKK is the sum of the central government deficit and other, extra-budgetary transfers (privatisation revenues, transfers from the EU, special transfers to the NBH, etc.) The gross financing requirement, in addition, also includes debt redemptions, the majority of which is contributed by short-term debt, which may be renewed several times a year. During recent years, cash-flow based financing requirements were as follows:

Borrowing requirements between 2006-9				
	2006	**2007**	**2008**	**2009**
Central government balance	-1958,4	-1394,4	-864,7	-739,9
Balance of the Social Security funds	-124,7	35,6	-73,4	-151,0
Balance of the extra-budgetary funds	50,1	63,0	28,0	-30,4
Net financing need of the central government	**-2033,0**	**-1295,8**	**-910,0**	**-921,3**
Capital transfers to NBH	-14,8	-20,6	-2,8	0,0
Privatisation revenues	268,7	67,3	3,1	1,1
Net EU transfers	-35,8	217,8	29,2	35,7
Total net financing requirements	**-1814,9**	**-1031,3**	**-880,5**	**-884,5**
Short term debt redemptions	-5078,6	-4424,9	-4669,5	-4406,6
Long term debt redemptions	-1856,3	-1817,5	-1280,4	-2349,4
Gross financing requirements	**-8749,7**	**-7273,7**	**-6830,4**	**-7640,5**

Source: Hungarian State Treasury, ÁKK

THE NET FINANCING REQUIREMENT

In 2009 the total cash-flow based deficit of the central government was HUF 921 billion (or 3.5 per cent of GDP according to preliminary data), while the total net financing requirement amounted to HUF 885 billion (or 3.4 per cent of GDP). The actual central government deficit exceeded the original target due to the economic decline, however, the net financing requirement was only slightly higher than the plan due to the more favourable balance of other operations.

[2] The definitions of the government sub-systems and the tasks of ÁKK are stipulated in Act no. XXXVIII of 1992 on Public finances, as amended several times. Certain relevant provisions are quoted in Part 4 of the Appendix of this publication.

Borrowing requirements in 2009 - plans and outurn	Plan January 2009 (HUF billion)	Outturn (HUF billion)	Outturn/Plan (per cent)
Central government balance	-660,7	-739,9	112,0%
Balance of the Social Security funds	19,0	-151,0	-795,7%
Balance of the extra-budgetary funds	-8,9	-30,4	342,9%
Net financing need of the central government	**-650,6**	**-921,3**	**141,6%**
Capital transfers to NBH	-166,4	0,0	0,0%
Privatisation revenues	0,0	1,1	0,0%
Net EU transfers	-50,7	35,7	-70,4%
Total net financing requirements	**-867,7**	**-884,5**	**101,9%**
Short term debt redemptions	-3962,3	-4406,6	111,2%
Long term debt redemptions	-1824,5	-2349,4	128,8%
Gross financing requirements	**-6654,4**	**-7640,5**	**114,8%**

Source: Hungarian State Treasury, ÁKK

REDEMPTIONS

Redemptions in any given year are largely the function of debt financing operations in previous periods, and by the sale of short-term instruments renewed within the year. Prepayments, buy-backs of bonds and the early repurchasing/redemption of retail securities and other securities in the Treasury network may also influence the final sum.

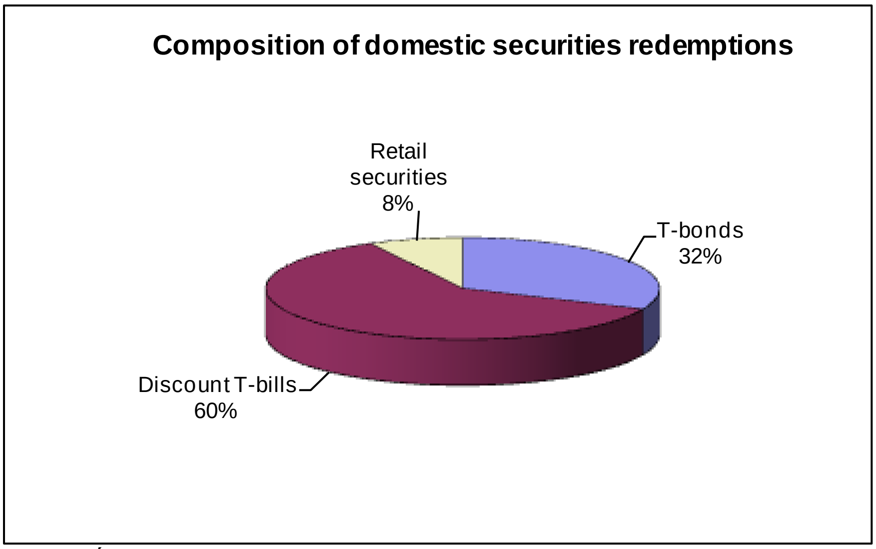
Government debt redemptions

HUF billion

	2008	*2009 plan*	*2009 outcome*
Domestic debt	**5 785,7**	**5 524,9**	**6 444,6**
T-bonds	1 118,0	1 538,8	2 041,0
Discount T-bills	4 072,1	3 461,7	3 900,4
Retail securities	595,5	524,4	503,3
Loans	0,2	0,0	0,0
Foreign currency debt	**162,2**	**261,8**	**311,4**
Bonds	0,0	227,5	276,5
Loans	162,2	34,3	34,9
Total	**5 947,9**	**5 786,7**	**6 756,0**

Source: ÁKK

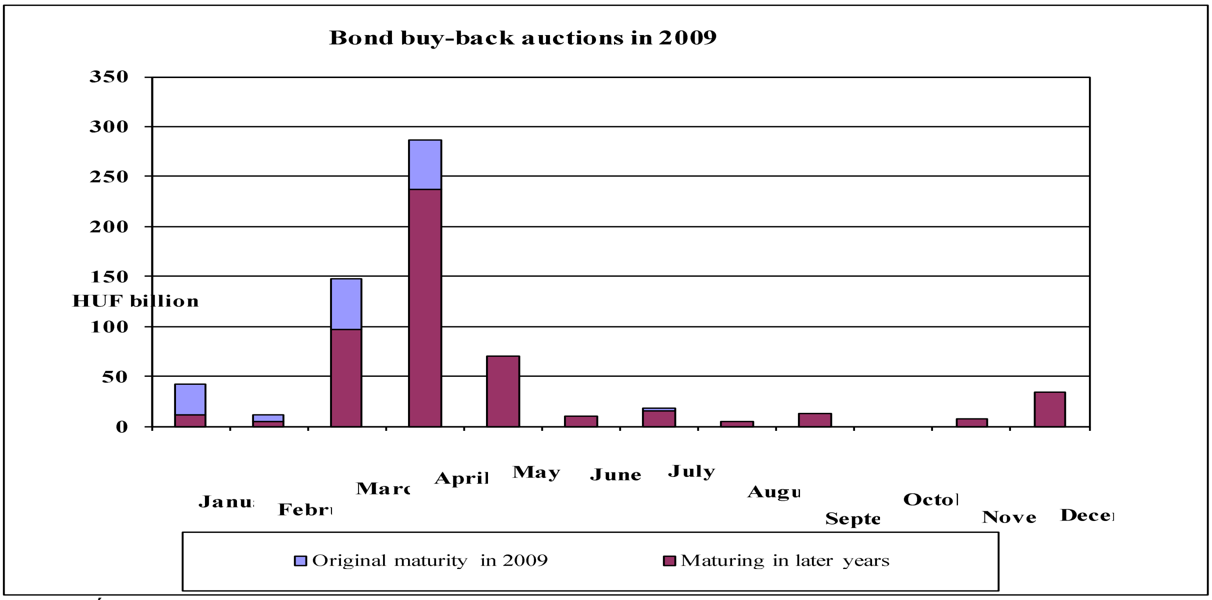
Within the HUF debt portfolio, discount treasury bills contributed to 60 per cent of the total forint redemptions of HUF 6,445 billion, due to their renewals within the year. The higher-than-planned redemption of discount treasury bills was the result of their increased issuance as a reaction of increased demand for short term securities. The redemptions of bonds increased as a result of market stabilisation measures (bond buy-back program). In the case of international bonds ÁKK executed a small buy-back program at the end of the year to smoothen the maturity profile.



Source: ÁKK

BOND BUY-BACKS

A large series of bonds maturing at a given time creates refinancing risk. This risk can be reduced by repurchasing a proportion of the bonds before maturity. ÁKK's normal financing plan therefore includes a regular bi-weekly bond buy-back program. In Q2 2009, however, ÁKK implemented a large scale (about HUF 500 billion or almost EUR 2 billion) unplanned domestic bond buyback program to stabilize the local bond market. In 2009 eventually ÁKK bought back before their maturity a total of HUF 647 billion bonds with a remaining maturity of up to 3 years on 26 occasions (that clearly differs from the operations of 2008 when ÁKK bought back bonds of HUF 348 billion with a remaining maturity between 6-12 months on seventeen occasions). 78 per cent of the repurchased bonds had an original maturity after 2009, i.e. these buy-backs also helped to smooth maturities from one year to another and reduced the volume of outstanding bonds maturing in 2010-2, which reduced medium term refinancing needs. A new instrument to improve refinancing is bond exchange auction. ÁKK held its first such operation in Q4 2009 exchanging HUF 15 billion of a short term bond for a medium term bond.



Source: ÁKK

IV FINANCING

The issuance of government securities and the drawdowns of loans were planned and implemented in accordance with the approved debt management strategy and benchmarks. However, debt management activities were significantly influenced by the current macroeconomic environment and the situation in the government securities market – in particular the effects of the international capital market crisis, and the temporary suspension of local bond auctions – as well as changes in the financing requirement over the year.

In 2009 the HUF denominated issuance (excluding repo transactions) amounted to HUF 5,675 billion, while foreign currency issuance was HUF 1,998 billion including the use of the IMF/European Commission loan facility.

Gross debt issuance

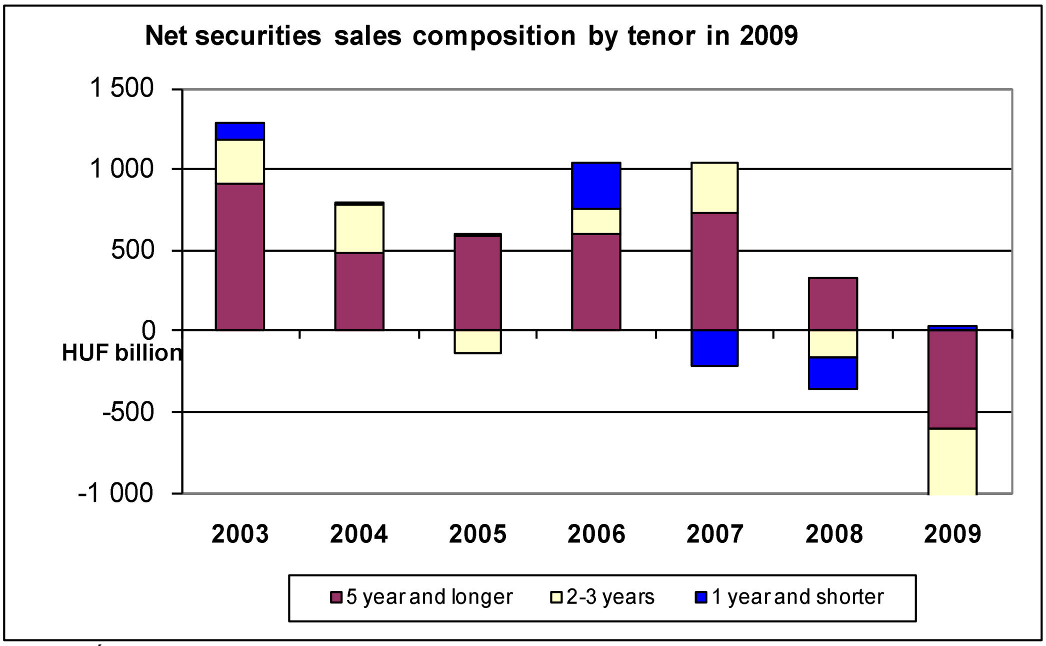
HUF billion

	2008	2009 plan	2009 outcome
Domestic debt	**5 834,1**	**4 942,9**	**5 675,0**
T-bonds	1 293,5	805,3	1 020,1
Discount T-bills	3 878,3	3 559,4	4 065,8
Retail securities	587,8	529,1	370,3
Loans	74,4	49,1	218,8
Foreign currency debt	**2 422,5**	**1 586,0**	**1 997,5**
Bonds	424,74	0,0	267,9
Loans without IMF/EC loans	172,96	156,0	3,6
IMF/EC loans	1 824,80	1 430,0	1 726,0
Total	**8 256,6**	**6 528,9**	**7 672,4**

Source: ÁKK

Net HUF denominated financing totalled HUF -770 billion, while net foreign currency financing amounted to HUF 1686 billion, i.e. the total net issuance in 2009 was HUF 916 billion (excluding repo transactions).

The main instruments of net financing reflected the difficult international environment. Within the HUF issuance, the role of short-term debt increased in line with international trends, due to the international capital market crisis. The volume of discount Treasury bills increased by HUF 165 billion, while net issuance of retail securities in 2009 was HUF -133 billion. Due to the gradual rebuilding of the bond market and the exceptional bond buy-back program net issuance of HUF bonds was –1,021 billion. HUF loans from the European Investment Bank (EIB) and the Council of Europe Development Bank (CEB) provided long term net financing of HUF 219 billion.



Source: ÁKK

In 2009 the net foreign currency financing was provided by the IMF/European Commission loan facility. The originally unplanned EUR 1 billion bond refinanced maturing foreign currency bonds, the net foreign capital market issuance was HUF –9 billion. Net loan operations (excluding IMF/EC loans) amounted to HUF –31 billion. The net financing in foreign currencies was provided by a total of HUF 1,726 billion loan drawn-downs from the IMF/EC loan facility.

DOMESTIC FINANCING

GOVERNMENT BONDS

In 2009 ÁKK aimed to rebuild its local bond market after the suspension of auctions in October 2008. Until October 2008 bond auctions were held every two weeks, one or two tenor per auction day and each type of bond was put up for auction every six weeks except for 15-year bonds, which were sold every 12 weeks. The announced auction calendar fixed the maturities to be sold at the auctions.

After consultations with Primary dealers and market participants ÁKK decided to use a more flexible system to better suit investors' demand. Bond auctions were planned every two weeks (as before), but the tenors were not set in advance, only announced a week before, after consultations with PDs. The number of bond series sold at each auction was increased to 3 and the amounts announced decreased. That provided more frequent primary buying opportunities for investors, in a way substituting the illiquid secondary market. Usually the 3, 5 and 10-year tenors were offered and once the 15 year bond was also sold (replacing the 10 year tenor). ÁKK also used more actively its right to modify the accepted amount as a reaction to bids (+/- 34 per cent, and +/- 50 per cent if the announced amount was not more than HUF 10 billion). A new way to further react to volatile market demand was the introduction of non-competitive tenders in the afternoon of the auctions when successful bidders at the auction can buy additionally up to 40 per cent of their winning bids.

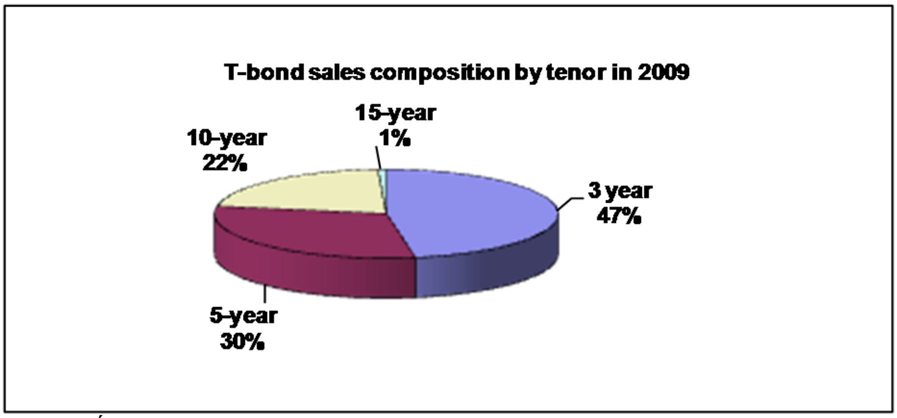
A total of HUF 946 billion of bonds were sold via auctions (HUF 782 billion at auctions and HUF 164 billion at non-competitive tenders). Total bond issuance – together with the retail sale of the Hungarian State Treasury – was HUF 1,020 billion, which after total maturity of 2,041 meant HUF –1,021 billion *negative* net issuance.

On-the-run bond series in 2009 (HUF billion)

	Tenor	No. of auctions	Auction sales in 2009	Non-competitive sales in 2009	Size (end of 2009)
2012/B	3-year	1	10	0	523
2013/D	3-year	9	120	32	590
2013/E	3-year	9	235	50	285
2015/A	5-year	19	237	50	705
2019/A	10-year	18	172	31	484
2023/A	15-year	1	7	1	204

Source: ÁKK

The target volumes of the bond series were between HUF 500 and 750 billion (EUR 2 to 3 billion) in line with the strategy, except for the 15-year bond targeted at HUF 250 billion (EUR 1 billion). As a more flexible reaction to investors' demand (more demand from banks and less from pension funds) the share of the 3-year tenor increased by 5 per cent, while the share of long term (10 and 15-year) bonds declined by 4 per cent.



Source: ÁKK

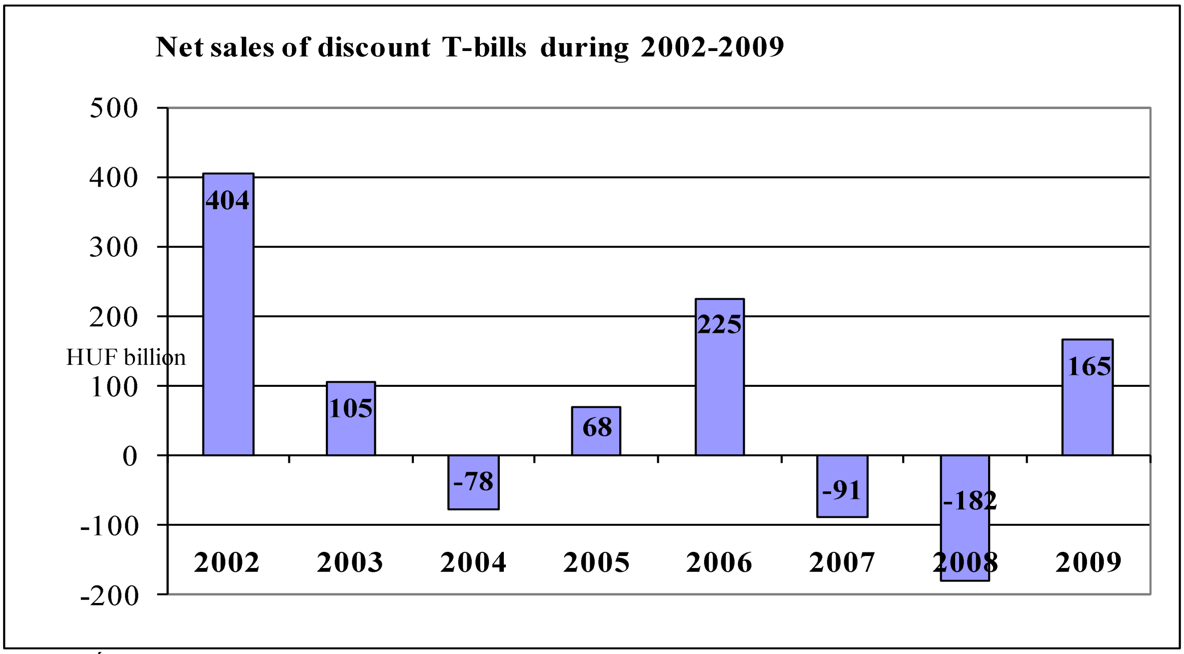
HUF LOANS

The EIB and the CEB extended loans totalling HUF 219 billion for the financing of infrastructure developments in 2009. As the ratio of foreign currency debt had been increasing within the total debt portfolio, these long-term loans drawn down in Hungarian Forints had a beneficial effect on the debt structure.

DISCOUNT TREASURY BILLS

The 3 and 12-month discount treasury bills are essentially short-term instruments for liquidity management that ÁKK uses to smooth out fluctuations in liquidity caused by the varying financing requirements over the year. In addition to liquidity management, the long-term outstanding stock of discount treasury bills contributes to long-term financing, and may also serve as an alternative source of financing. ÁKK also uses so-called liquidity discount treasury bills of even shorter tenor (usually 6 weeks).

In 2009 ÁKK sold discount treasury bills in a total of HUF 4,066 billion; HUF 3,738 billion at auctions and HUF 328 billion through the Treasury network. The high issuance volume is due to their short tenor; discount treasury bills are renewed several times a year. In 2009 the outstanding volume of discount treasury bills increased by HUF 165 billion.



Source: ÁKK

RETAIL SECURITIES

One of the strategic objectives of ÁKK is to maintain a retail government securities program, constituting a third financing channel beside the local and the international wholesale markets. In 2009, due to the fierce competition of banks for retail savings, the stock of retail government securities declined substantially. ÁKK sold HUF 156 billion in Interest Bearing Treasury Bills, HUF 214 billion in Treasury Savings Bills and HUF 32 billion in the new inflation-linked “Premium Government Bond”. Due to the high net maturities of the bills, the total retail debt stock declined by HUF 133 billion, but its average term to maturity increased.

FOREIGN CURRENCY FINANCING

During 2009 ÁKK issued one foreign currency bond in the international capital markets on behalf of the Republic of Hungary. This issue had not been planned, however, on the basis of investors’ view the Republic of Hungary decided to go to the market to show the increased investors’ confidence and to refinance maturing foreign currency securities.

Foreign currency bond issued by the Republic of Hungary in 2009

Currency	*Amount*	*Date of issuance*	*Maturity*	*Tenor (years)*	*Coupon*
EUR	1 000 000 000	28.07.2009	28.07.2014	5	6,75%

Source: ÁKK

In 2009 the government drew HUF 3.6 billion in project financing foreign currency loans from international financial organisations. The loans drawn from the EIB and the CEB were used to finance projects in infrastructure development and integration assistance.

Foreign currency loans were drawn and used in a total value of HUF 1,726 billion (XDR 2.2 billion and EUR 3.5 billion) from the IMF/EC credit facility. Besides these draw-downs EUR 1.5 billion was used from the funds previously placed at the National Bank of Hungary in 2008.

Transactions from the IMF/EC loan package in 2009

2009	IMF		European Commission
Size of loan facility (ccy million)	10 538	10 538	6 500
Currency	XDR	XDR	EUR
Date of drawdown	30.03.2009	29.09.2009	26.03.2009
Amount drawn (ccy million)	2 108	50	2 000
Amount drawn (in HUF million)	705 443	14 631	602 020

Source: ÁKK

Free deposits at the NBH also provided funds for the program to help stabilize the Hungarian banking system. Under the authorisation of the Law no. 104 of 2008 on the stabilisation of the banking system the Hungarian state could raise banks' capital and provide loans to financial institutions. In 2009 FHB bank received HUF 30 billion capital and 3 banks got loans (OTP Bank XDR 1.4 billion, FHB Bank EUR 400 million and MFB Bank XDR 514 million). The repayment schedule of these loans is based on the maturity of the IMF loans, therefore they partly finance future repayments. The unused part of the IMF/EC loan placed at the NBH provides an extra safety cushion for financing in the coming years. The volume of free deposits and on-lent loans were HUF 1,125 billion at the end of 2009.

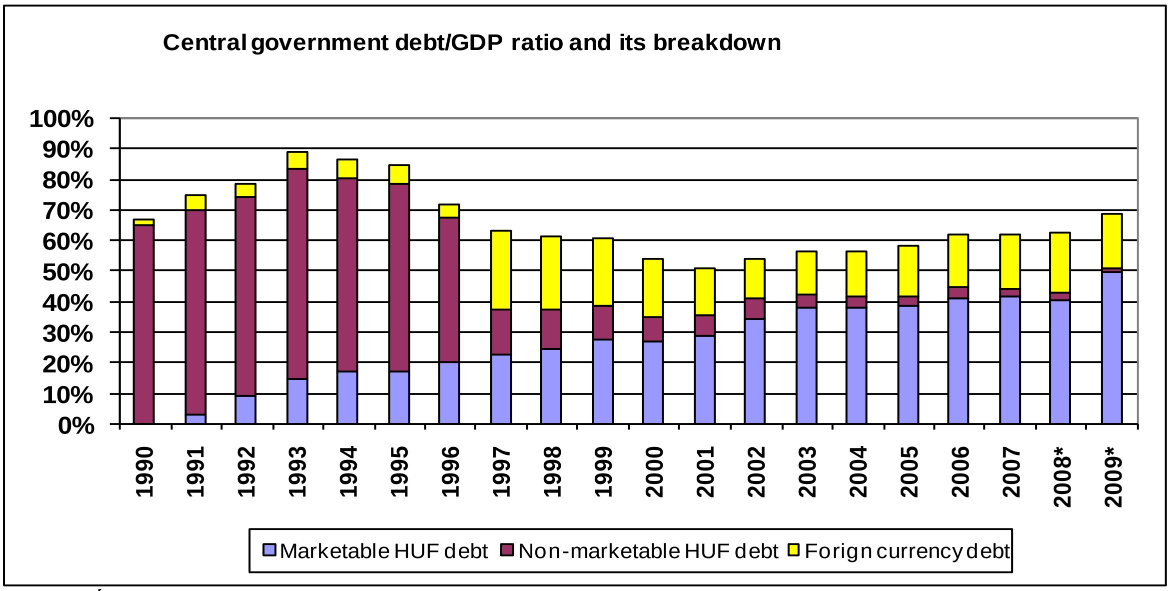
V. THE GOVERNMENT DEBT IN 2009

In 2009 the central government debt, including repo operations, increased by HUF 861 billion (4.8 per cent) to HUF 18,965 billion from end-2008. The rise of the debt stock was less than the net financing requirement of the central government, since a part of the financing requirement was financed by funds drawn in 2008.

Central government debt					HUF billion
	2008		2009		Change
Domestic debt	**11 250,6**	**62,1%**	**10 476,2**	**55,2%**	**-774,3**
Loans	219,9	1,2%	438,7	2,3%	218,8
Government bonds	9 001,6	49,7%	7 943,6	41,9%	-1 058,0
Discount T-bills	1 482,4	8,2%	1 647,3	8,7%	164,9
Retail securities	546,6	3,0%	446,6	2,4%	-100,0
Foreign currency denominated debt	**6 774,8**	**37,4%**	**8 468,5**	**44,7%**	**1 693,7**
Loans	2 529,4	14,0%	4 114,5	21,7%	1 585,2
Bonds	4 245,5	23,5%	4 354,0	23,0%	108,6
Total debt	**18 025,4**	**99,6%**	**18 944,8**	**99,9%**	**919,4**
Other obligations	**78,5**	**0,4%**	**20,1**	**0,1%**	**-58,4**
Grand total debt	**18 103,9**	**100,0%**	**18 964,9**	**100,0%**	**861,0**
Deposits at NBH and loans to banks from the IMF/EC loans	1 483,6		1 124,8		-358,8
Net central government debt	**16 620,3**		**17 840,1**		**1 219,8**

Source: ÁKK

The actual economic burden of government debt is expressed by the debt/GDP ratio (debt ratio), an indicator that peaked at 88.7 per cent in 1993, after the economic decline following the end of the centrally planned economy. From the mid 1990s the debt ratio decreased rapidly – thanks to the stabilisation of economic policy – until 2001, when it began to grow again. According to preliminary data, the debt/GDP ratio grew from 68.2 per cent at the end of 2008 to 72.7 per cent at the end of 2008. However, the net debt to GDP ratio (excluding the HUF 1,125 billion foreign currency deposits and on-lent loans) was 68.4 per cent (see chart).



Source: ÁKK

* The figures for 2008-9 do not include the amounts drawn from the international loan package that were not used for financing but were deposited in foreign currency with the NBH.

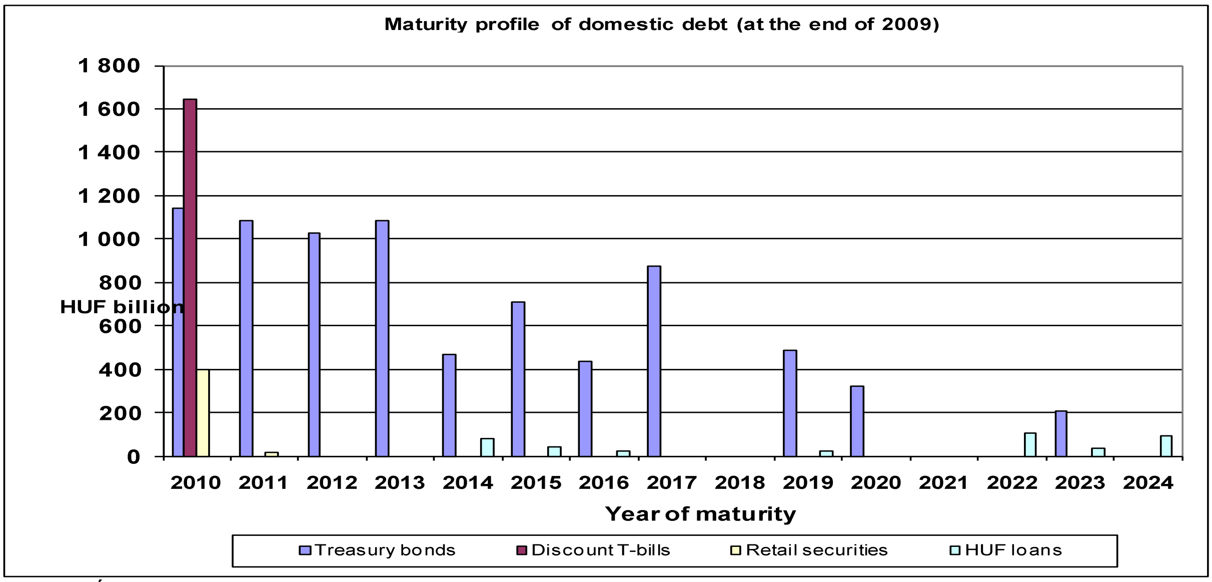
CHARACTERISTICS OF THE HUF DEBT PORTFOLIO

During 2009 the HUF-denominated debt – 55 per cent of all debt – decreased by HUF 774 billion (7 per cent) to HUF 10,476 billion. At the end of 2009 42 per cent of the entire debt was in long-term HUF government bonds. The total domestic bond portfolio of HUF 7,944 billion consisted of thirty bond series, so the average size of a series was HUF 266 billion (EUR 1 billion), with four series having volumes in excess of HUF 500 billion (EUR 2 billion). In spite of the declining outstanding stock ÁKK was able to maintain the average size of bond series by re-opening off-the-run bonds in the auction program.

There were eighteen series of discount treasury bills in the market at the end of 2009, with an average volume of HUF 92 billion. Out of these six series had a volume in excess of HUF 100 billion, their average volume being HUF 191 billion. The total portfolio of retail government securities was worth HUF 446 billion at the end of the year, which corresponded to 4 per cent of the total debt.

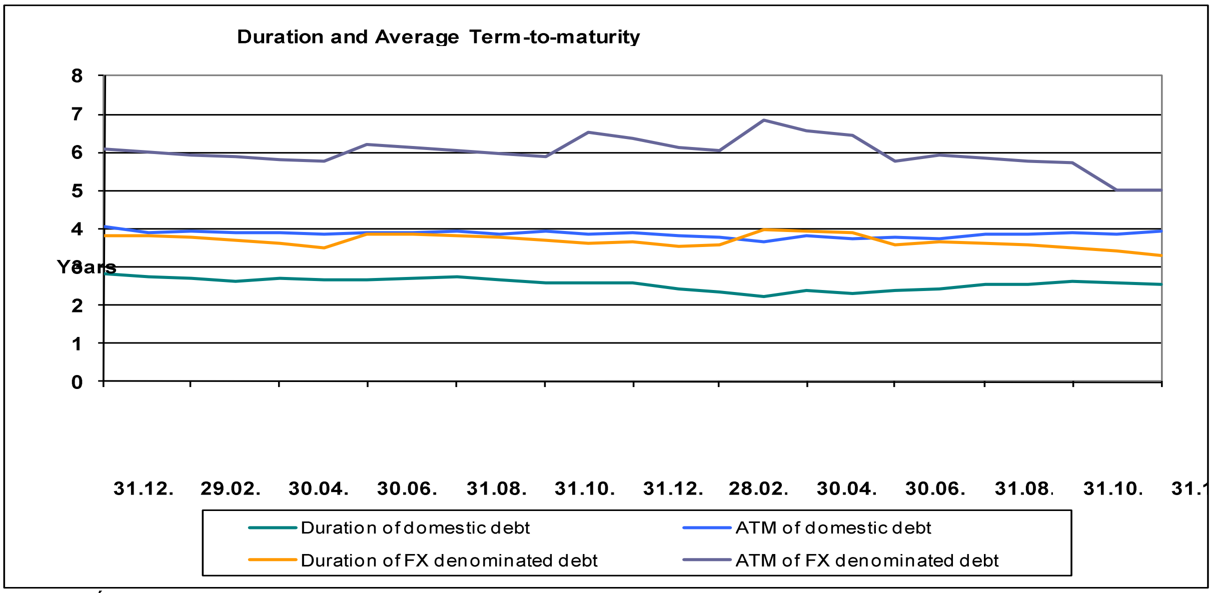
The non-marketable component of the HUF bond portfolio continued to decrease in amount and proportion in 2009 as well, as there are no new issuances of such government bonds and the existing portfolio matures continuously. The end-of-year volume of non-marketable government bonds was HUF 424 billion, which was only 4 per cent of the total HUF denominated debt. The volume of loans in Hungarian Forint doubled in 2009, the HUF 439 billion was 4.2 per cent of total HUF debt.

As a result of the restarted bond auctions and the large bond-buy back program, the bond maturity profile became more balanced. Medium term maturities until 2014 declined and are stable, while the ratio of maturities after 2014 grew substantially.



Source: ÁKK

At the end of 2009 the share of fixed interest rate government securities within all HUF denominated government securities was 68 per cent, down by 8 percentage points relative to the previous year. Also due to the reduced sales of long-term bonds the average remaining term-to-maturity of the HUF debt portfolio decreased in 2009. The duration of the entire HUF denominated debt portfolio declined from 2.61 years at the end of 2008 to 2.56 years by the end of December 2009, but was still higher than the benchmark value. The average term-to-maturity, however, increased from 3.88 to 3.93 years due to the higher volume of long term loans in the portfolio.

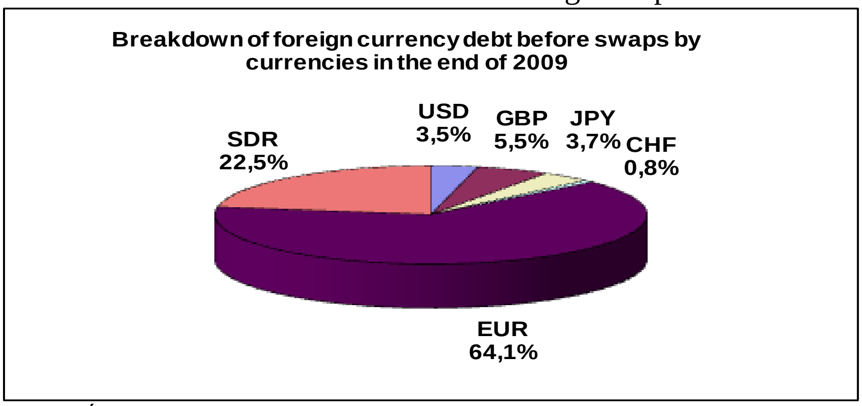


Source: ÁKK

CHARACTERISTICS OF THE FOREIGN CURRENCY DEBT PORTFOLIO

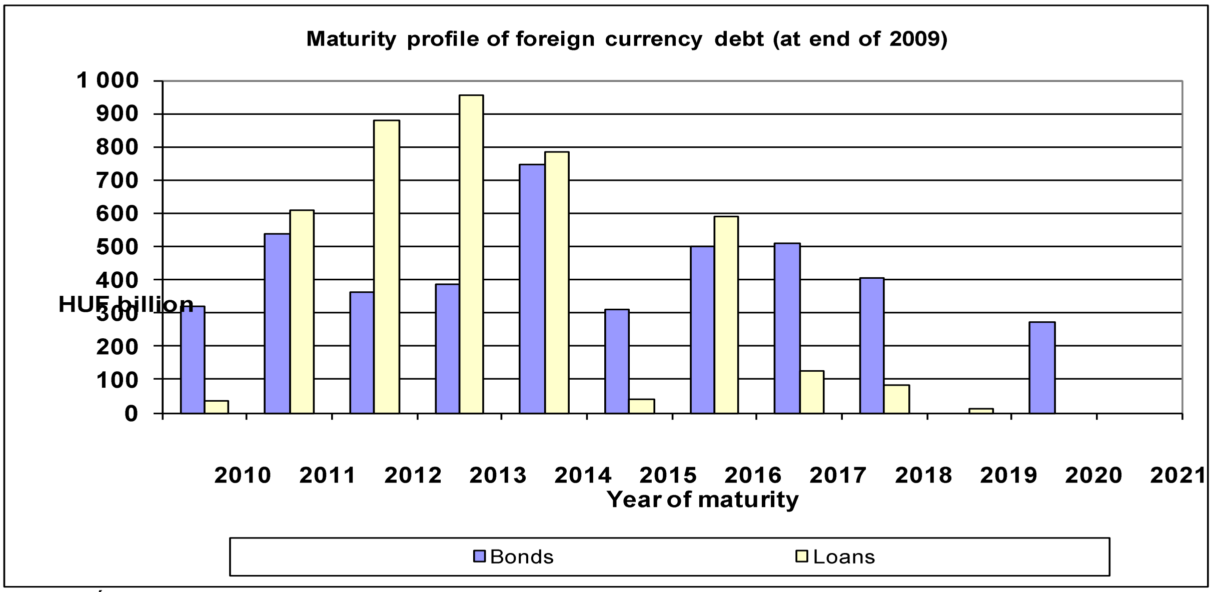
The gross foreign currency government debt increased by HUF 1,694 billion in 2009, reaching HUF 8,469 billion (EUR 30 billion) by the end of the year. Accordingly, within the gross government debt, the share of foreign currency debt (excluding marked-to-market deposits) was 44.7 per cent (41 per cent without the IMF/EC deposits) at the end of 2009. The increase in foreign currency debt was largely due to new transactions; revaluation had a minor effect on the value of foreign currency debt.

The volume of foreign currency bonds reached HUF 4,354 billion by the end of the year, a slight increase over the previous year's figure of HUF 4,246 billion. On 31 December 2009 there were twenty-two series outstanding of the Republic's foreign currency bonds, twelve of which were issued in euro, one in US dollar, two in Swiss franc, three in Pound sterling and four in Japanese yen. In accordance with the strategy and benchmarks, all non-euro bonds have been converted to euro liabilities through swap transactions.



Source ÁKK

The foreign currency loan portfolio of HUF 4,113 billion (EUR 15 billion) consisted of long-term project financing loans from international financing institutions (e.g. EIB and CEB loans), and the IMF/EC loans.



Source: ÁKK

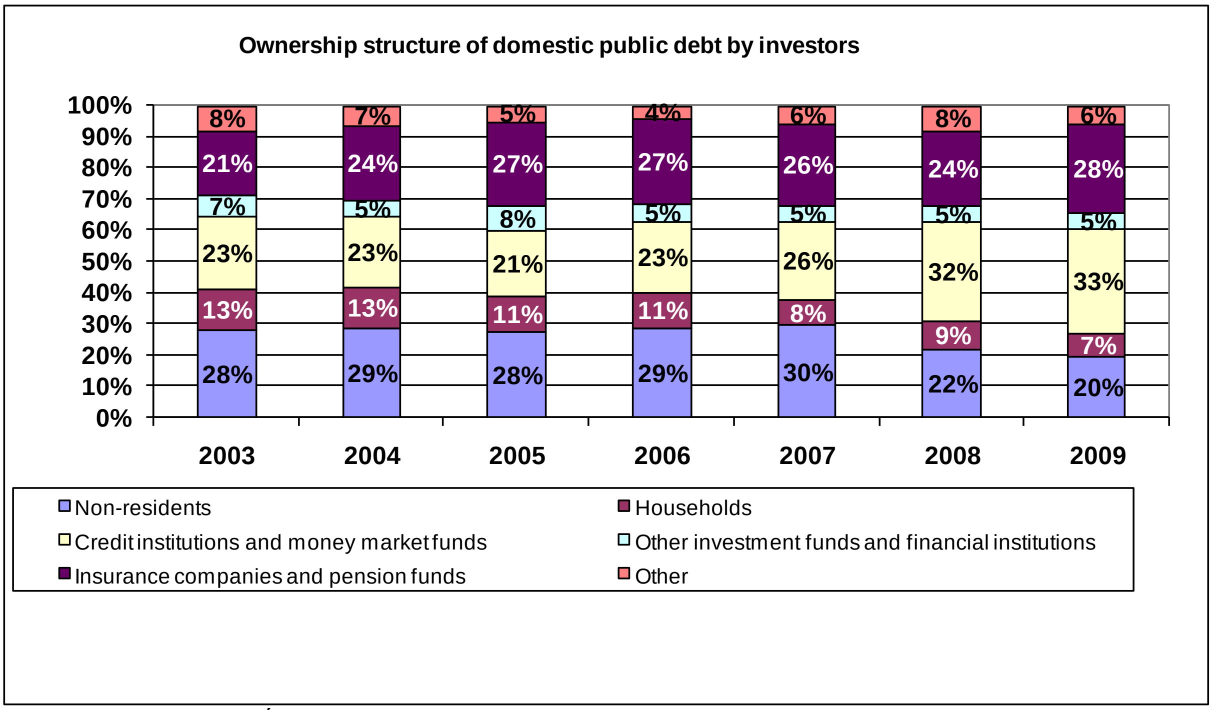
ÁKK uses swap operations not only to set the foreign currency mix, but also to optimise the interest rate composition of the foreign currency debt. As a result, at the end of 2009 65.5 per cent of foreign currency liabilities had fixed interest rate and 34.5 per cent had floating interest rate; this complied with the benchmark. By the end of the year the average remaining term-to-maturity of the foreign currency portfolio decreased by 1.3 years to 5.0 years, while its duration declined by 0.4 years to 3.3 years. The decline is the result of the shorter than average tenor of the IMF/EC loan facility.

OTHER OBLIGATIONS

In order to reduce counterparty risk associated with the swap transactions concluded by ÁKK, the swap counterparties place collateral covering the net value of their swap positions (these are the so-called marked-to-market deposits). The Republic of Hungary has bilateral mark-to-market agreements supplementing the ISDA Master Agreement. Such deposits placed with ÁKK are non-financing funds and they are shown as part of the government debt along with other obligations. As of 31 December 2009 marked-to-market deposits placed with ÁKK totalled HUF 20 billion (EUR 74 million).

THE OWNERSHIP STRUCTURE OF GOVERNMENT DEBT

According to statistics published by the National Bank of Hungary, the ownership structure of domestic government securities changed significantly in 2009. Non-resident investors reduced further their holdings, and after some increase in 2008 retail investors also reduced their portfolio. Pension funds, insurance companies, credit institutions and money market funds increased their portfolio, and the sector formed by the latter two investor groups remained the most important investor of Hungarian government securities.



Source: NBH, KELER, ÁKK

Banks, insurance companies and pension funds had been the most stable investor sectors for years, and they owned more than 60 per cent of government securities at the end of 2009. Non-residents investors – after two consecutive years of reduction – still play an important role in the domestic market. Their holdings declined by HUF 303 billion to HUF 2,155 billion, but they still preferred longer term securities. The duration of their holdings was 3.6 years, while the average remaining term-to-maturity thereof increased to 4.6 years in 2009. Both of these values are substantially higher than those of the entire stock of marketable HUF government securities.

Households decreased their total government securities holdings in 2009 by HUF 133 billion. While their holdings of retail government T-bills dropped, their portfolio of T-bonds increased with the successful debut of the 3-year inflation-linked “Premium Government Bond”.

VI. LIQUIDITY MANAGEMENT

LIQUIDITY MANAGEMENT OBJECTIVES

Under the Public Finances Act, liquidity management of the central government is also the task of ÁKK.[3] Due to the cyclical nature of budgetary revenues and expenditures, as well as debt transactions (such as debt servicing and issuance), the daily balance of the Single Treasury Account shows significant daily fluctuations.[4] As a result of the magnitude of budgetary transactions in the Single Treasury Account, a substantial amount of cash flows into and/or out of the economy every day. This in turn has a significant effect on the amount of free liquidity in the banking system and thus on short-term interest rates. The reduction of these fluctuations can reduce the risks of financing. The goal of ÁKK's STA-smoothing and liquidity management activities is to keep the STA's end-of-day balance within a certain limited range around the optimal level (the benchmark). This is accomplished by placing any excess cash into the money market if the STA balance is too high, and raising extra cash from the money market if the balance is too low.

LIQUIDITY MANAGEMENT INSTRUMENTS

In 2009 ÁKK set the target range of the Single Treasury Account at +/- HUF 50 billion around the optimal balance.[5] However, ÁKK only invests temporary excess liquid funds on the STA if the banking system has sufficient demand for that. In lack of sufficient demand ÁKK leaves the extra cash on its account. In 2009 ÁKK used the following instruments to manage the STA's end-of-day balance:

- repo and reverse repo transactions with government securities;
- the issuance of liquidity discount treasury bills, usually with a 6-week tenor;
- regular bond buy-backs;
- active adjustment of the volume of discount treasury bills at auctions;
- temporary use of revolving loan facilities and free FX deposits.

LIQUIDITY MANAGEMENT OPERATIONS IN 2009

Sales of liquidity discount treasury bills took place relatively evenly throughout the year: ÁKK sold HUF 565 billion on 13 occasions in 2009 (up from HUF 396 billion in 2008). In addition to providing extra liquidity, liquidity discount treasury bills also reduced fluctuations in the STA balance. Liquidity repo transactions are ÁKK's main tool for fine-tuning the end-of-day balance of the Single Treasury Account. In 2009 the use of repo transactions decreased significantly to HUF 9,523 billion from HUF 12,414 billion a year before, due to ample liquidity positions of both the Treasury and the banking system.

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[3] Article 113/A, paragraph (1), section b)

[4] The co-ordination of primary budgetary expenditures and revenues and the forecasting of their daily balances are tasks of the Hungarian State Treasury.

[5] In determining the target range, it must be noted that certain debt operations may increase the STA balance even in the longer term without affecting the banking system's liquidity. Such operations include the foreign currency transactions with the NBH, whereby the target range is adjusted, the upper limit is raised temporarily.

The objective of keeping the STA balance within the allowed range of fluctuation was met on 212 days out of 254 working days (83 per cent), a slight decline from 2008.

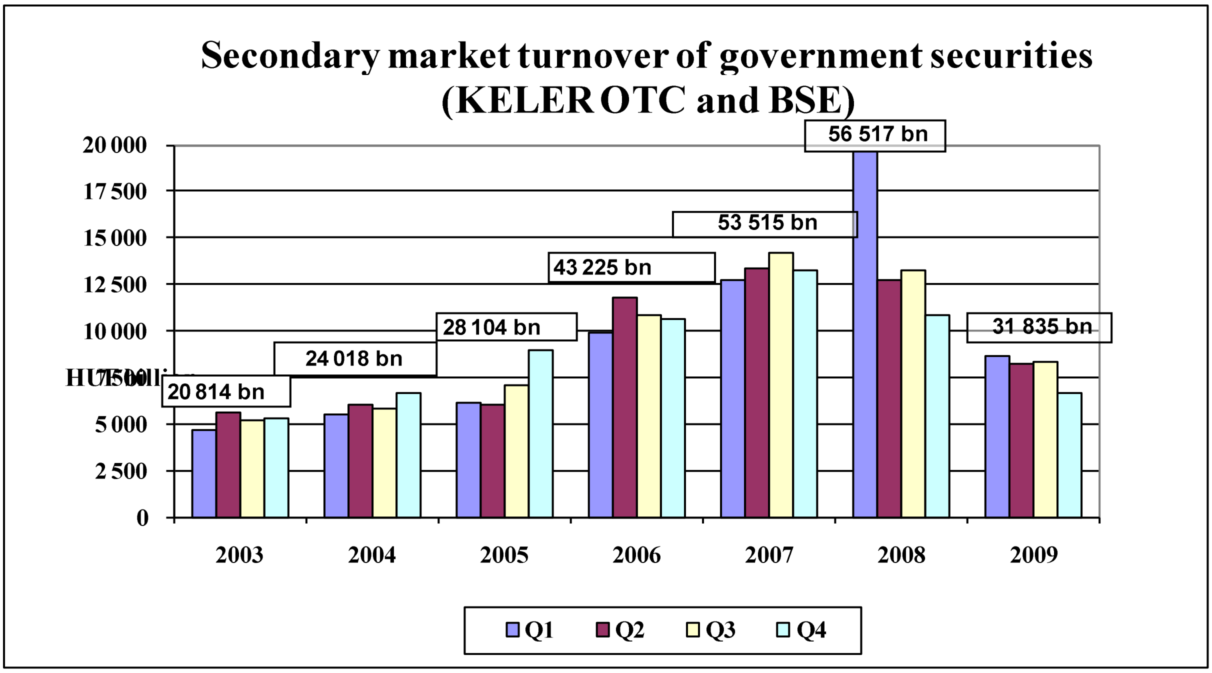
STAND-BY REPO TRANSACTIONS

ÁKK concludes repo transactions not only for liquidity management purposes. The objective of the so-called stand-by repo transactions is to support the price quotation of primary dealers and to promote trading in government securities. If a primary dealer needs temporary access to a quoted government security but it is unable to obtain it in the market, that dealer may approach ÁKK under a repo agreement framework, and ÁKK will provide the required security in exchange for appropriate cash collateral in a one-week repo transaction. In 2009 the stand-by repo facility was used by authorised partners more frequently and with higher amounts than in the previous year: 1,337 repo transactions of that type were concluded with a total value of HUF 500 billion, compared to 1,050 transactions totalling HUF 442 billion in 2008. The higher demand indicated more reliance on the facility provided by ÁKK instead of the less available market securities lending facilities.

VII. THE SECONDARY MARKET OF HUNGARIAN GOVERNMENT SECURITIES

TRADING DATA

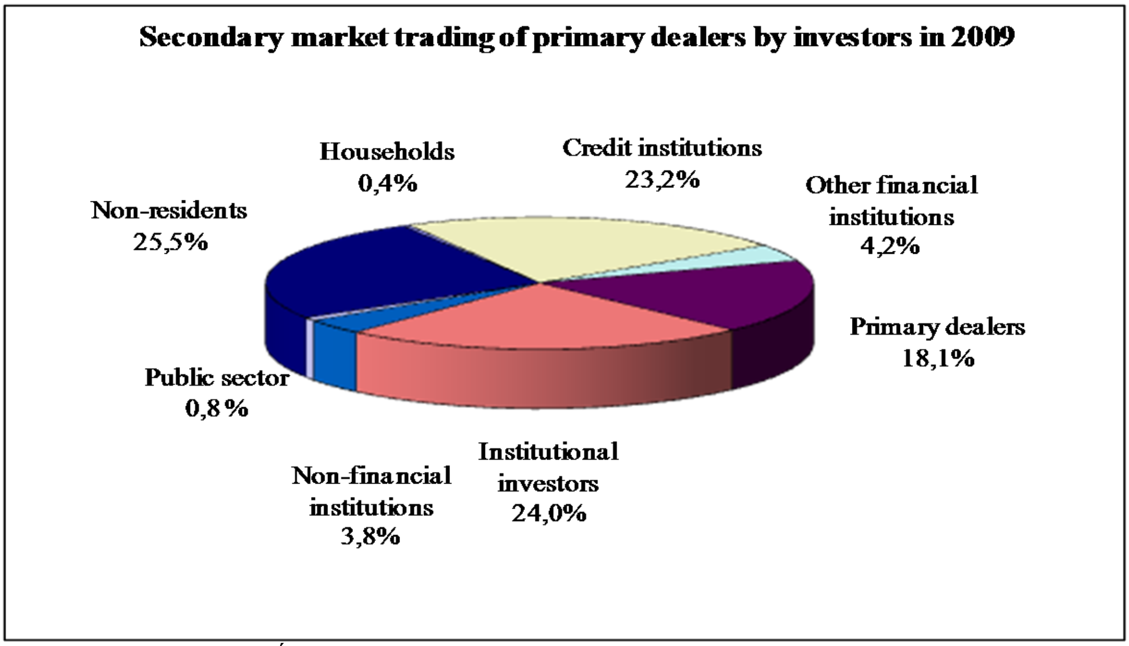
Primary dealers quote two-way prices in the Budapest Stock Exchange's electronic trading system (MMTS) and also directly to investors in the over-the-counter (OTC) market. As in previous years, the great majority of secondary trading in government securities took place in the OTC market in 2009 as well. According to data from the Central Clearing House and Depository (Budapest) Ltd. (KELER), the total volume of OTC trading in government securities was HUF 31,562 billion in 2009, out of which 77 per cent was in government bonds and 23 per cent in discount treasury bills. Turnover in the secondary market declined dramatically by 44 per cent due to the international financial crisis in 2009 reaching pre-2006 levels. In 2009 government securities trading on the Budapest Stock Exchange (BSE) amounted to HUF 273 billion.



Source: KELER, BSE

Primary dealers concluded transactions in Hungarian government securities totalling HUF 29,345 billion, i.e. they were involved in the great majority of all deals. They made about 26 per cent of these transactions with foreign investors, a significant decrease compared to the 34 per cent in 2008.

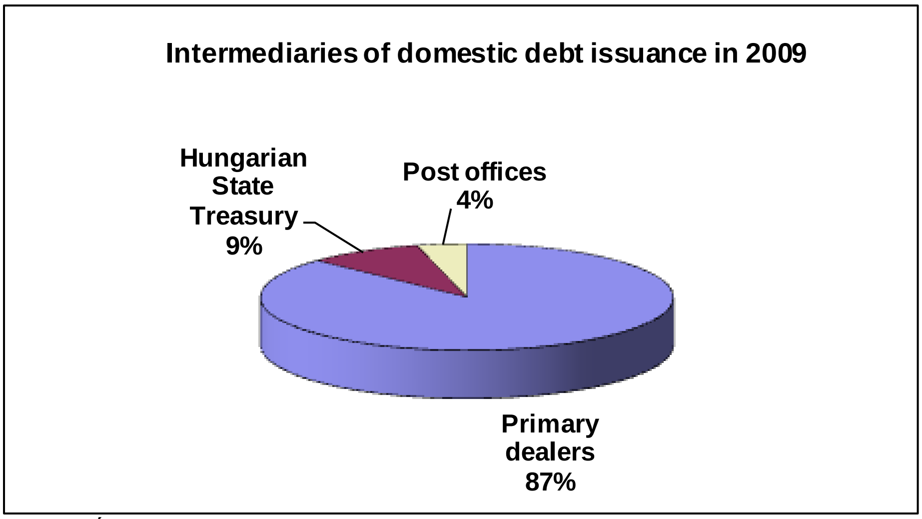
The average size of deals with primary dealers (excluding retail transactions) was HUF 557 million, down from HUF 704 million a year before. Over the year, the 10-year 2017/B government bond had the largest turnover (HUF 2,002 billion), followed by the 3-year 2011/C and 10-year 2019/A bonds. The most active Primary Dealer and the winner of the title 'Primary Dealer of the Year' for 2009 was awarded to ING Bank N.V.



Source: Primary dealers, ÁKK

VIII. THE INSTITUTIONAL FRAMEWORK FOR THE ISSUANCE OF GOVERNMENT SECURITIES

ÁKK sells government securities through intermediaries. In the domestic market, almost 87 per cent of HUF-denominated government securities were sold through the primary dealers.



Source: ÁKK

THE PRIMARY DEALER SYSTEM

The primary dealer system for government securities was set up in 1996 in order to establish a more secure institutional base for the financing of government debt, to reduce the costs of debt management and to improve the transparency and liquidity of the secondary market in government securities.
Since May 2004, any investment firm or bank registered in any European Union Member State may become a primary dealer in Hungarian government securities if it meets the contractual requirements and signs a primary dealer contract with ÁKK. Along with a number of obligations in the primary and secondary market, the primary dealer status also guarantees exclusive rights.

PRIMARY DEALERS AT THE END OF 2009:

CIB Bank Zrt.
Citibank Europe Plc.
Deutsche Bank Zrt.
Erste Bank Befektetési Magyarország Zrt.
ING Bank N.V.
Kereskedelmi és Hitelbank Zrt.
MKB Bank Zrt.
Magyar Takarékszövetkezeti Bank Zrt.
Országos Takarékpénztár és Kereskedelmi Bank Zrt.
Raiffeisen Bank Zrt.
UniCredit Bank Hungary Zrt.

Only primary dealers may:

1. directly submit bids at government bond and discount treasury bill auctions and submit offers at bond buy-back auctions and exchange auctions;[6]
2. directly submit non-competitive bids at auctions and submit bids at the non-competitive phase after bond auctions;
3. use the stand-by repo facility provided to primary dealers by ÁKK to support their secondary market trading and price quotation;
4. participate at the consultations organised by ÁKK;
5. use the title ‘primary dealer’.

In addition to their exclusive rights, primary dealers are also ÁKK’s main partners for international capital market transactions and liquidity management (repo) and other transactions. Primary dealers with broad distribution networks may also conclude a separate agreement with ÁKK for the trading of one of its retail government securities, the Interest Bearing Treasury Bills.

RETAIL DEBT PROGRAMS

The State Treasury’s branch network provides direct access to government securities for retail investors. Managed by ÁKK, the 19 Treasury branch offices in Budapest and the county seats quote two way prices (with certain limitations) for publicly issued bonds, Premium Government Bonds, discount treasury bills and Interest Bearing Treasury Bills. In December 2008 the Hungarian State Treasury’s government securities trading activity underwent significant developments. The Treasury’s securities call-centre service was expanded significantly and “WebTreasury”, the Hungarian State Treasury’s internet-based securities service was launched.

The Hungarian Post Office participates in the sale of two retail government securities. The 1-year tenor treasury bill called Treasury Savings Bill and the 2-year government bond called Treasury Savings Bill II are the only printed government securities designed specifically for retail investors.

THE DEALERS OF INTERNATIONAL BOND ISSUES

Lead managers of international bond issuance are selected from primary dealers individually for each transaction.

IN 2009 THE LEAD MANAGERS WERE AS FOLLOWS*:
Citigroup
ING Bank N.V.

* In 2009 there was one international bond issuance of a 5-year EUR 1 billion bond

[6] Other investors may submit bids at an auction indirectly, through a primary dealer.

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

The government debt management is regulated by Act no. XXXVIII of 1992 on Public Finances (the Public Finances Act). Among other provisions, this law authorises the minister responsible for the public finances (the Minister of Finance) to provide for the implementation of the budget, financing of the deficit, continuous solvency of the budget, the recording of the government's debt and repayment obligations, the repayment of debt and the management of any temporarily free state funds. Annual budget acts make this authorisation more specific by stipulating the annual financing requirement. According to the provisions of the Public Finances Act, the Minister of Finance performs these tasks through the Government Debt Management Agency Pte. Ltd. (ÁKK).[7]

Pursuant to an amendment of the Public Finances Act, the Government Debt Management Agency Pte. Ltd. was established on 1 March 2001 as the legal successor of a government agency that had performed the same tasks. The organisation, which operates as an independent corporate entity, is a single-member corporation limited by shares registered at the Court of Registration. Its shares may not be traded, the Hungarian State is their sole and permanent owner, and these ownership rights are exercised by the minister responsible for the public finances (the Minister of Finance). The rules governing ÁKK's operations are stipulated partly by the Public Finances Act – which prescribed its establishment – and partly by general legislation on the operation of companies. Accordingly, the management's activities are controlled by the Board of Directors, while ÁKK's operation is under the supervision of a Supervisory Board and an auditor pursuant to the corporate status. In addition to these internal management and audit mechanisms, the debt management activity is regularly audited by the State Audit Office. The operation of ÁKK is linked to the Ministry of Finance and the Hungarian State Treasury. The co-ordinated professional control of these organisations is implemented by the Minister of Finance.

According to the decision-making mechanism in place, the government debt management strategy, the annual financing plan and the benchmarks are approved by the Board of Directors, followed by approval from the Minister of Finance.

THE FOUNDATION AND THE ORGANISATIONAL STRUCTURE OF ÁKK

The Government Debt Management Agency was originally established in May 1995 as a budgetary institution under the supervision of the Ministry of Finance. In 1996 supervision of the agency was taken over by the Chairman of the Hungarian State Treasury. The amendment of the Public Finances Act that prescribed the foundation of ÁKK Ltd. allowed government debt management to be implemented through a more flexible organisation that was able to react better to market developments. The purpose of creating this separate institution was to implement the chosen strategy through a faster decision-making mechanism with clearly defined responsibilities and enhanced accountability. Within this system the Minister of Finance makes annual decisions about any revisions to the strategy, the performance indicators for the following year, and the annual financing plan of the central budget. Within

[7] The most important provisions concerning the financing of the deficit and government debt management, effective as of 1 December 2008, are provided in Section 4 of the Appendix.

the framework defined by these provisions, up to predetermined limits, the Board of Directors and the management of ÁKK make all other decisions.

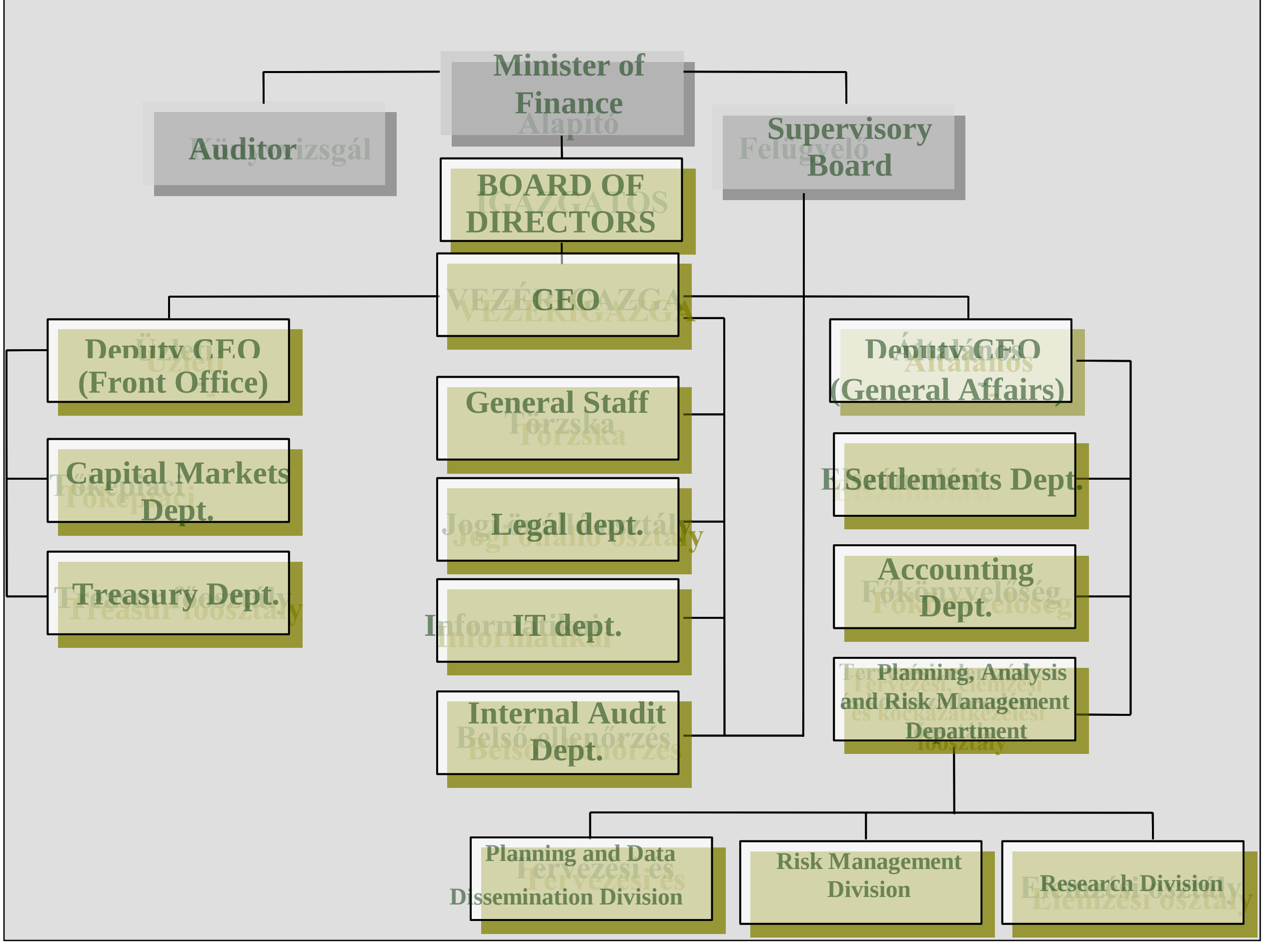
The organisational structure of ÁKK is similar to that of banks and investment companies. Market operations are conducted by the front office; deals are booked and settled by the back office; planning, risk management and the analysis of market and macroeconomic trends are tasks for the middle office, which is separated from the previous two.

THE RESPONSIBILITIES OF ÁKK

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

- developing a long-term financing strategy in line with economic policy, which determines the objectives of debt management and the means of their implementation;
- preparing the annual and medium-term financing plans and planning the annual interest expenditure based on the annual Budget Act and in line with the strategy;
- performing the required financing operations, i.e. organising and implementing both domestic and international government securities issuance and raising of loans;
- managing the temporarily free cash funds of the state (liquidity management);
- effecting debt redemptions and interest payments;
- organising and continuously developing the government securities market (the primary dealer system, sales channels, secondary market etc.);
- expressing its opinion on the financial terms and conditions of borrowings with a state guarantee; on request, organising transactions with individual guarantees (with a lesser role for guarantees prescribed by legislation).

The organisational structure of ÁKK



X. THE INFORMATION SERVICES OF ÁKK

ÁKK provides information to the general public about the central government debt and the developments in the government securities market. It fulfils these tasks using several media: its website, other electronic communications systems and its publications.

THE ÁKK WEBSITE

The website at www.akk.hu[8] provides a wide range of information for anyone interested in the government securities market or the government debt. Already the homepage shows the most important data, such as the latest news, the current volume of government debt, the latest auction results and daily market yields (benchmark fixings).

Other pages of the website provide information on ÁKK as a company, on the characteristics of government securities, a separate section covers retail securities and another offers a wide range of information on the trading of government securities.

The *'Government Securities'* menu provides access to the cash-flow tables of all government securities in the market, along with the latest public offerings. The *'Retail Securities'* menu provides information to small investors about retail government securities and the Treasury's security trading operation for retail investors. The *'Market Information'* menu contains the issuance calendar for the current year, the results of auctions and the most important secondary market information. The website provides databases as well, so historical data and time series of data can also be searched.

The *'Analyses, Statistics'* menu provides access to the publications of ÁKK in electronic (.pdf) format, along with an ample range of statistical data about, among others, government debt, the volumes of various types of instruments and securities trading statistics. The menu also contains the public analyses prepared by ÁKK.

A newsletter service is offered to registered users of the website free of charge. Subscribers receive newly uploaded data by e-mail or an e-mail notification about newly added contents.

OTHER ELECTRONIC PLATFORMS

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

PRESS CONFERENCES, MARKETING

ÁKK holds regular press conferences on annual financing, the ranking of primary dealers and on other special topics. The press conference materials can be found on ÁKK's website.

[8] The site is also available at www.gdma.hu

PUBLICATIONS

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

- annual reports (released in the third quarter of the year following the actual year);
- Debt Management Outlook publications (from the beginning of the actual year);
- quarterly reports (from the second month after the actual quarter);
- desktop issuance calendar (from December of the year preceding the actual year).

Monthly reports are available in electronic format on the ÁKK website from the end of the month following the month in question.

For further information on our publications, please contact

Ms. Edit Huszti or Mr. Ferenc Rusznák

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Hungary
Phone: (+361) 488-9438 or (+361) 488-9437
Fax: (+361) 488-9445
E-mail: husztie@akk.hu, rusznakf@akk.hu

APPENDIX

1. The central government gross debt as at 31.12.2009 (HUF million)

HUF denominated debt

Hungarian Government Bonds	Maturity	Coupon	Outstanding amount
2010/A	12.08.2010	Floating rate	1 737,60
2010/B	12.10.2010	6,75%	376 508,68
2010/C	12.04.2010	6,75%	364 201,79
2010/D	24.08.2010	6,25%	390 721,37
2011/A	12.02.2011	7,50%	213 782,25
2011/B	12.10.2011	6,00%	371 905,52
2011/C	22.04.2011	6,75%	496 535,07
2012/A	31.12.2012	8,40%	4 279,29
2012/B	12.06.2012	7,25%	523 242,16
2012/C	24.10.2012	6,00%	469 703,91
2012/I	25.01.2012	Floating rate	32 457,66
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%	590 218,16
2013/E	24.10.2013	7,50%	285 220,39
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%	416 067,82
2015/A	12.02.2015	8,00%	704 562,40
2016/A	31.12.2016	Floating rate	23 380,00
2016/B	02.01.2016	Floating rate	9 000,00
2016/C	12.02.2016	5,50%	425 647,86
2017/A	24.11.2017	6,75%	203 774,30
2017/B	24.02.2017	6,75%	670 457,64
2019/A	24.06.2019	6,50%	483 535,86
2020/A	12.11.2020	7,50%	322 947,34
2023/A	24.11.2023	6,00%	204 202,49
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			188,87
Total			**7 970 201,49**
Repos with government bonds (repos actually increase or decrease the total amount)			**5 820,00**
Discount Treasury Bills			**1 647 320,47**
Out of which matured, but unclaimed discount Treasury bills			**0,00**
Repos with discount Treasury bills (repos actually increase or decrease the total amount)			812,80
Interest Bearing Treasury Bills			**153 861,04**
Out of which matured, but unclaimed			1 197,87
Treasury Savings Bills (1-year)			**185 867,28**
Treasury Savings Bills (2-year)			**74 384,12**
HUF loans			**438 714,03**
Matured, but unclaimed other retail government securities			55,69
Total HUF debt			**10 476 224,11**

Foreign currency debt					**Outstanding amount (HUF million)**	**Outstanding amount (EUR million)**
Loans granted by International Financial Institutions*					**4 068 028,02**	**15 020,04**
of which: IMF and EC loans					***3 351 725,88***	***12 375,30***
Loans assumed from the market*					**46 499,06**	**171,68**
Government bonds						
Code	**Currency**	**Maturity date**	**Maturity (years)**	**Coupon**	**Outstanding amount (HUF million)**	**Outstanding amount (EUR million)**
112	EUR	27.06.2011	10	5.625%	270 840,00	1000,00
113	EUR	06.02.2013	10	4.5%	265 694,04	981,00
114	EUR	27.09.2010	7	4,00%	257 047,47	949,08
115	EUR	29.01.2014	10	4.5%	269 377,46	994,60
116	GBP	06.05.2014	10	5.5%	151 585,00	559,68
118	EUR	28.10.2011	7	3.625%	268 779,45	992,39
120	USD	03.02.2015	10	4.75%	282 105,00	1041,59
121	EUR	24.02.2020	15	3.875%	270 840,00	1000,00
122	GBP	09.05.2017	12	5,00%	151 585,00	559,68
123	JPY	12.07.2010	5	0.62%	61 089,00	225,55
124	JPY	12.07.2012	7	0.96%	91 633,50	338,33
125	EUR	02.11.2012	7	3M EURIBOR+0.05%	270 840,00	1000,00
126	EUR	18.07.2016	11	3.5%	270 840,00	1000,00
127	JPY	18.03.2013	7	1.67%	101 815,00	375,92
128	GBP	30.03.2016	10,0	5,00%	151 585,00	559,68
129	EUR	04.07.2017	10	4.375%	270 840,00	1000,00
130	JPY	26.10.2017	10	2.11%	50 907,50	187,96
131	CHF	21.05.2013	5	3.5%	27 351,00	100,99
132	CHF	20.05.2016	8	4,00%	36 468,00	134,65
133	EUR	11.06.2018	10	5.75%	406 260,00	1500,00
134	EUR	28.07.2014	5	6.75%	270 840,00	1000,00
Total					**4 198 322,43**	**14 501,12**
Out of which: cross-currency swaps					**155 649,68**	
Kingdom of Hungary 1924 bond issue					**27,82**	
Total foreign currency debt					**8 468 527,00**	
Total central government debt					**18 944 751,11**	
Other obligations of ÁKK (marked-to-market deposits placed at ÁKK)					20 113,46	
Grand total					**18 964 864,58**	
** With swaps*						

2. THE CREDIT RATING HISTORY OF THE LONG-TERM DEBT 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+
05.11.2007	A2	BBB+	BBB+
17.03.2008	A2	BBB+	BBB+
17.10.2008	A2	BBB+	BBB+
07.11.2008	A3	BBB+	BBB+
10.11.2008	A3	BBB+	BBB
17.11.2008	A3	BBB	BBB
02.03.2009	A3	BBB	BBB
30.03.2009	A3	BBB-	BBB
31.03.2009	Baa1	BBB-	BBB
02.10.2009	Baa1	BBB-	BBB

Moody's and Fitch Ratings assigned a 'negative', while Standard and Poor's assigned a 'stable' rating outlook to the long-term currency debt of the Republic of Hungary at the end of 2009.

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-
05.11.2007	A2	BBB+	A-
17.03.2008	A2	BBB+	A-
17.10.2008	A2	BBB+	A-
07.11.2008	A3	BBB+	A-
10.11.2008	A3	BBB+	BBB+
17.11.2008	A3	BBB	BBB+
02.03.2009	A3	BBB	BBB+
30.03.2009	A3	BBB-	BBB+
31.03.2009	Baa1	BBB-	BBB+
02.10.2009	Baa1	BBB-	BBB+

Moody's and Fitch Ratings assigned a 'negative', while Standard and Poor's assigned a 'stable' rating outlook to the long-term foreign currency debt of the Republic of Hungary at the end of 2009.

3. THE ADDRESSES OF PRIMARY DEALERS

Primary dealer	**Address**
CIB Bank Zrt.	Budapest, H-1027 Medve utca 4-14.
Citibank Europe Plc., Hungarian Branch Office	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 N.V.	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. SELECTED PARTS OF LEGISLATION GOVERNING THE LEGAL STATUS OF ÁKK AND GOVERNMENT DEBT MANAGEMENT*

<u>ACT NO. XXXVIII OF 1992 ON PUBLIC FINANCES</u>

(...)

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

(2) The founder of ÁKK is the minister responsible for public finances.

(3) The establishment and operation of ÁKK – unless otherwise provided by the present Act – are governed by the Act No. CXLIV of 1997 on Business Associations.

(4) The shareholder's rights are exercised by the Minister responsible for public finances, with the difference that the shareholder is not entitled to absorb 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 may hold positions on the Board of Directors and on the Supervisory Board of ÁKK.

(6) The scope of authority of the Supervisory Board of ÁKK does not include the report on the government debt management strategy, the associated performance indicators and financing plans.

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 to 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.

(3) *[Provision has been repealed]*

(4) The interests, costs, fees and other payments associated with government debt management are booked and paid by ÁKK to the charge of the current government debt chapter of the Annual 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 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 Article 113/A of the Act on Public Finances.

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

(…)

* This translation of the selected legal provisions serves only information purposes and is not an official translation.

THE GOVERNMENT DEBT

110.§ (1) For the purposes of the application of the present Act, all liabilities based on credit relationships shall constitute debt.

(2) The central government debt is the sum of the debt of the central government budget, extra-budgetary funds and Social Security funds.

(3) The debt of local authorities is the total debt owed by local governments and local minority governments, which shall be consolidated so as to net the debts between various local authorities.

(4) The debt of the general government is the sum of the central government debt and the debt of local authorities.

(5) When calculating the debt of the general government and the central government debt, debt between the subsystems shall be netted through consolidation.

(6) The Maastricht debt indicator is the debt indicator to be reported in accordance with Council Regulation (EC) No 3605/93 of 22 November 1993 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community.

111.§ (1) The minister responsible for public finances is responsible for managing, executing and recording the liabilities arising from the central government debt.

(2) Extra-budgetary funds, Social Security funds and local governments are responsible for independently managing, executing and recording the liabilities arising from their debt.

112.§ The minister responsible for public finances shall publish the central government debt and the general government debt, including both individual data of the subsystems and consolidated figures, on a regular basis, but at least quarterly, as stipulated in government decree. Local authorities shall provide data to enable the minister responsible for public finances to perform this task in the manner, with the frequency and with the content stipulated in government decree.

113.§

113/A.§ (1) In the sphere of government debt management, the minister responsible for public finances, through ÁKK:

a) ensures the solvency of the central government budget on the basis of the annual Budget Act and by taking into account the forecast rendered in subsection p) of paragraph (1) of Article 18/B;

b) ensures that the central 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) prepares the annual and middle-term financial plan of the central government budget, works out the strategy of government debt financing;

b) organizes, within the limits of the annual Budget Act, the issuance of government securities, borrowing of loans and debt assumptions which constitute the central government debt;

c) provides for the payment of the liabilities of the central government debt;

d) organizes the secondary market of government securities;

e) executes dealing on own account on the secondary government securities market, concludes securities lending, repo and reverse repo transactions, concludes prompt, forward, hedge- and swap, and derivative transactions, and executes custodial and deposit management tasks;

f) analyses the developments of the debt services borne by the central government and of the government securities market;

g) participates in the calculation of the general government debt, informs about the developments regarding the central government debt and the general government debt and the developments of the government securities market in accordance with the Government Decree referred to in Section 112;

h) upon authorisation by a separate law may organize issuance of debt securities secured by government suretyship or government guarantee, or may fulfil advisory tasks related thereto;

i) opines the terms and conditions of loans and bonds secured by individual government suretyship or guarantee;

j) executes credit and deposit transactions;

k) participates in performing duties related to borrowing loans and credits, and issuance of debt securities secured by government suretyship or guarantee. ÁKK is remunerated by the central government budget for such participation. The rate of such remuneration is at most 0.025 per cent of the principal amount of the underlying transaction. The Government shall determine the detailed regulation of such duties and remuneration of ÁKK in a decree;

l) may participate in performing duties – advice related to business strategy also implied – related to borrowing loans and credits, or issuance of debt securities of business organization owned by the state through majority ownership, and is entitled for a remuneration to such extent as determined in paragraph k) from such business organization.

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

(…)

5. THE BALANCE SHEET AND THE PROFIT AND LOSS ACCOUNT OF ÁKK

I. BALANCE SHEET

data in HUF thousand

	Assets	2008	2009
	A) Fixed assets	**85,381**	**62,305**
I	**Intangible assets**	**28,022**	**14,781**
II	**Tangible assets**	**48,028**	**39,113**
III	**Invested financial assets**	**9,331**	**8,411**
	B) Current assets	**404,593**	**438,219**
I	**Inventories**	**0**	**0**
II	**Receivables**	**8,965**	**1,573**
III	**Securities**	**0**	**0**
IV	**Cash and cash equivalents**	**395,628**	**436,646**
	C) Accrued and deferred assets	**11,880**	**12,743**
Assets in total		**501,854**	**513,267**

data in HUF thousand

	Liabilities	2008	2009
	D) Capital and reserves	**354,914**	**354,914**
I	**Subscribed capital**	**300,000**	**300,000**
IV	**Profit reserve**	**54,914**	**54,914**
VII	**Balance-sheet profit or loss**	**0**	**0**
	E) Provisions	**0**	**0**
	F) Liabilities	**117,425**	**114,627**
I	**Subordinated liabilities**	**0**	**0**
II	**Long-term liabilities**	**0**	**0**
III	**Short-term liabilities**	**117,425**	**114,627**
	G) Accrued and deferred liabilities	**29,515**	**43,726**
	Liabilities in total	**501,854**	**513,267**

Budapest, 29 March 2009

Ferenc Szarvas
CEO

II. PROFIT AND LOSS ACCOUNT

data in HUF thousand

	Liabilities	2008	2009
I	**Net sales revenue**	**885,573**	**947,735**
III	**Other revenue**	**5,899**	**1,236**
IV	**Material expenses**	**179,200**	**201,036**
V	**Personnel expenses**	**672,482**	**686,555**
VI	**Depreciation and amortisation**	**39,257**	**39,736**
VII	**Other expenses**	**3,886**	**3,466**

A	**OPERATING PROFIT OR LOSS**	**-3,353**	**18,178**
B	**PROFIT OR LOSS FROM FINANCIAL TRANSACTIONS**	**37,648**	**34,085**
C	**PROFIT OR LOSS ON ORDINARY ACTIVITIES**	**34,295**	**52,263**
D	**EXTRAORDINARY PROFIT OR LOSS**	**-12**	**-528**
E	**PROFIT OR LOSS BEFORE TAXATION**	**34,283**	**51,735**
XII	**Tax payable**	**6,333**	**10,495**
F	**PROFIT OR LOSS AFTER TAXATION**	**27,950**	**41,240**
23	Approved dividends	27,950	41,240
G	**BALANCE-SHEET PROFIT OR LOSS**	**0**	**0**

Budapest, 29 March 2010

Ferenc Szarvas
CEO

6. SENIOR OFFICIALS OF ÁKK ON 31 DECEMBER OF 2009

Members of the Board of Directors:

Dr. Tamás Katona, chairman
Dr. Álmos Kovács, member
Ferenc Szarvas, member

Members of the Supervisory Board:

Zoltán Sághy, chairman
Szabolcs Végh, member
Dr. Béla Jónás, member

The Company’s auditor:

KPMG Hungária Kft.
Budapest, 1139 Váci út 99.

Responsible auditor:

Gábor Agócs Audit Director

NOTES