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GOVERNMENT DEBT MANAGEMENT AGENCY PTE LTD.

DEBT MANAGEMENT REPORT

▪ 2008 ▪

FOREWORD

The objective of the 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 and report on government debt and to describe the developments in the Hungarian government securities market during 2008.

The year 2008 was a particularly difficult one for government debt management. Contrary to expectations, the international crisis in capital markets that began in 2007 (the sub-prime crisis) did not prove to be transitory and was not followed by recovery in 2008; instead it became a general financial and economic crisis in some aspects similar to the Great Depression of 1929-33, and as of 2009 the end of this crisis is still not clearly in sight. The financial crisis had a particularly severe effect on the financial markets of the Central and Eastern European region, including that of Hungary. Characteristics that had previously been among Hungary's advantages – such as the open banking system and capital market and a large share of foreign investors – increased the country's vulnerability. In October 2008, when the crisis deepened and the markets of Hungarian government bonds froze, the government requested financial assistance from the International Monetary Fund, the European Commission and the World Bank. By the end of the year a small part of the IMF/EC loan was used for financing the public debt. We must note here, however, that Hungary is not the only country suffering from the financial crisis: several countries are now receiving assistance from the IMF and the European Commission. On the other hand, this financial assistance is also a guarantee of the long-term financeability of the budget and government debt.

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. Thus fiscal data in this report should be still considered preliminary when this report goes to print.

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 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%) constitutes 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 actual payment. 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.

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

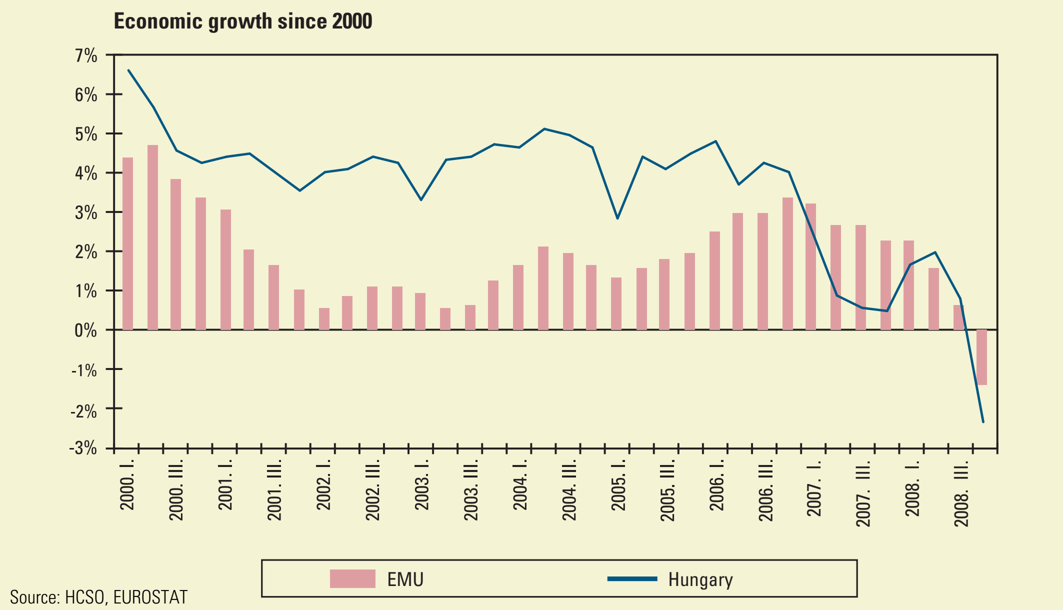
- Government bonds and retail government securities are recorded at nominal value.
- Discount treasury bills are recorded at the so-called average sale price (at discount value), which is recalculated after every transaction involving the security concerned.
- Repo and reverse repo transactions actually 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 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 partly on information provided by ÁKK.

I. MACROECONOMIC DEVELOPMENTS IN 2008

THE ECONOMY

In 2008 the Hungarian economy grew by 0.3% – a further deceleration in growth relative to 2007. Due to the deepening global recession, the volume of GDP in the last quarter of the year was actually lower than in the same period for the previous year. The low rate of growth was caused by a large fall in both consumption and fixed-asset investment, but it was to some extent counterbalanced over the entire year by good performance in the exports sector.



Source: HCSO, EUROSTAT

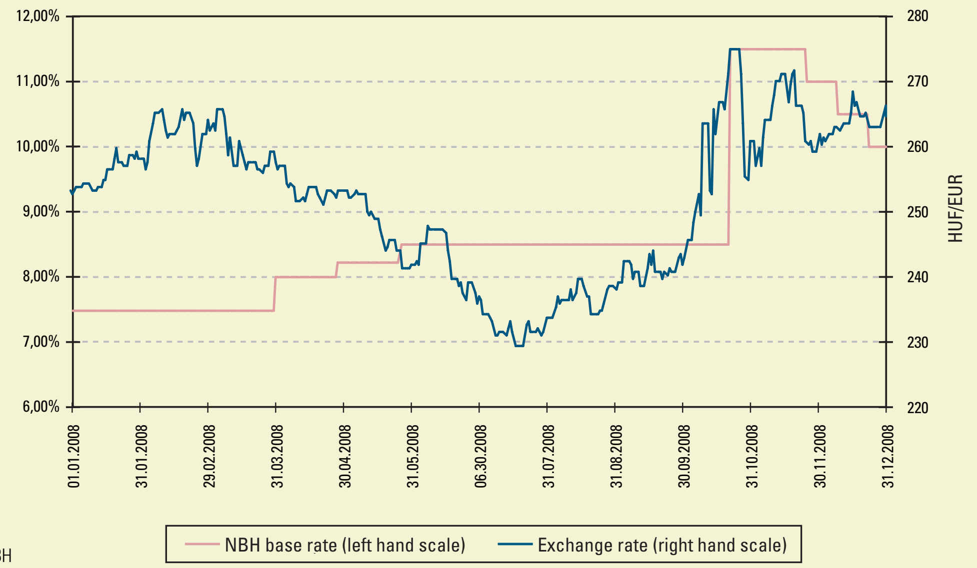
In 2008 total household consumption dropped relative to the previous year, primarily due to stagnating real wages and the increasing unemployment rate. Capital expenditure decreased by 2.6% in 2008, mainly due to a reduction in motorway construction, slowing of residential construction and lower expenditures in the processing industries. However, a significant increase in expenditure on machinery, equipment and vehicles – i.e. assets directly related to production – improved the capital expenditure indicator to some extent.

Foreign demand was an important factor promoting economic growth. The volume of exports increased at a much slower rate than in previous years – a result of the deteriorating international economic climate. Imports, however, influenced by the decrease in capital expenditure as well as reduced consumption, increased at an even slower rate than exports. Relative to the previous year, over the whole of 2008 exports and imports increased by 4.6% and 4.0% respectively. As exports increased faster than imports, the international trade balance showed a surplus. A good harvest in 2008 led to a 43% increase in agricultural production compared to the previous year, and this played a significant role in the Hungarian national economy's performance: without it, 2008 would have seen an overall shrinking gross domestic product.

FISCAL AND MONETARY DEVELOPMENTS

According to the 2008 Budget Act, the cash-flow based deficit of the central government was projected at HUF 1,118 billion, or 4.0% of GDP. Due to favourable fiscal developments the Ministry of Finance gradually adjusted downwards its forecast for 2008's annual deficit. Finally, the total government budget deficit – excluding local authorities – was only HUF 910 billion, or 3.4% of GDP, lower than in the previous year.[1] However, the financing activity was rendered extremely difficult by the increasingly severe global credit crisis resulting from an escalation of the sub-prime crisis from mid-2007.

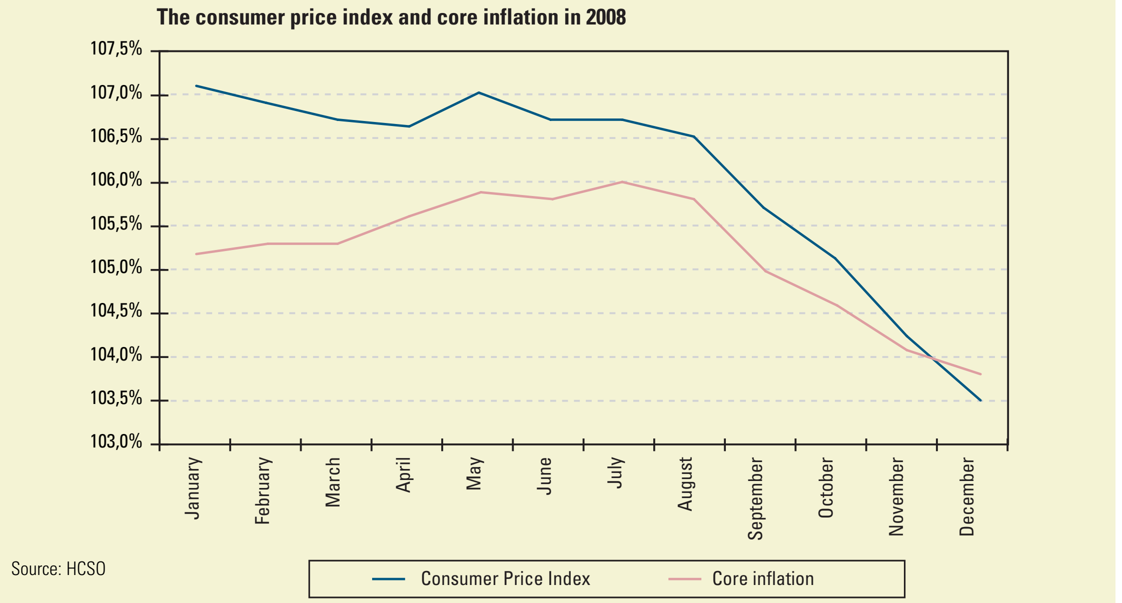
The central bank base rate and the exchange rate in 2008



Source: NBH

In the first half of 2008 the Hungarian currency weakened slightly from an exchange rate of 250 HUF/EUR to 265 HUF/EUR, but by mid-year it had strengthened to 230 HUF/EUR. In the spring of 2008, in order to tackle the risk of inflation, the National Bank of Hungary increased its base rate in several steps from 7.5% to 8.5%. The relatively high returns on forint investments and the abolition of the forint's fluctuation band on 26 February 2008 probably also played a role in the currency's improved performance in this time period. However, the trend was broken in autumn 2008 when, after the bankruptcy of Lehman Brothers the international economic crisis became more severe, the forint fell to 275 HUF/EUR. In order to protect the forint's exchange rate, the Central Bank increased its base rate by 300 basis points to 11.5%. After several measures by the Government and the EUR 20 billion amount of international financial assistance by the IMF, the European Commission and the IBRD were announced, the forint recovered. Subsequently the Central Bank started to reduce the base rate in several steps by a total of 150 basis points, to 10.0% until the end of the year. The domestic currency closed 2008 at a rate of 265 HUF/EUR.

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



Source: HCSO

In the first half of 2008 the consumer price inflation fluctuated between 6.6% and 7.1% due to globally high food, household energy and oil prices. Over the second half of the year, the consumer price index dropped rapidly as a result of a significant reduction in food prices due to a good harvest, a reduction in energy and oil prices due to deteriorating global growth expectations and weak domestic consumption demand coupled with a strengthening forint. The inflationary effect of a later weakening forint was not immediately felt in domestic prices. The December/December inflation rate was 3.5%. Average inflation over the whole of 2008 was 6.1%, which compares with 8.0% in 2007.

DEVELOPMENTS IN THE FINANCING POSITION OF THE ECONOMIC SECTORS

In 2008 the ratio of net domestic savings over GDP dropped to 0.8% from 1.7% in 2007. This reduction in households' savings was caused by generally lower incomes together with increasing volume of consumption smoothing by taking on new loans. At the same time, the net financing requirement of the corporate sector increased from 3.9% in 2007 to 5.4% of GDP, while capital expenditure actually dropped. Therefore, the lower financing requirement of the public sector was balanced out by the increase in corporate financing requirements and the reduction in household savings. As a result, the national economy's external financing requirement increased in 2008.

All in all, the current account deficit in 2008 reached EUR 8.9 billion, or 8.4% of GDP. As in 2007, long-term foreign resources (FDI, reinvested corporate profits) contributed to a high proportion of the external financing requirement, one third of which came from the inflow of foreign direct investment. In 2008 the country's net foreign debt increased by a total of EUR 6.9 billion, to EUR 56.3 billion.

DEVELOPMENTS IN THE GOVERNMENT SECURITIES MARKET

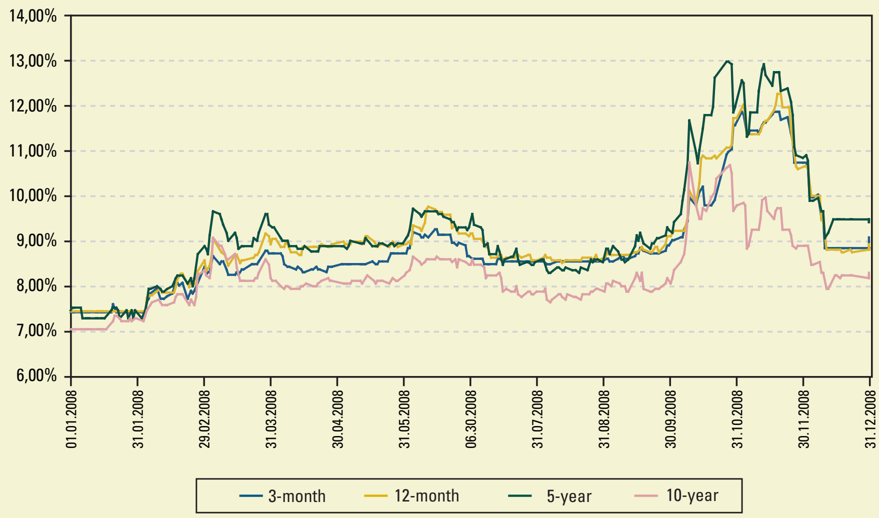
The development of the international sub-prime crisis into a global credit crisis, which began in 2007, intensified in 2008 and had a determining effect on the government securities market. The loss of liquidity played a role in significantly increasing government securities yields in H1 2008. In order to manage the liquidity problems, ÁKK announced that it would increase the volume of short-term government securities and reduce bond issuance and that it would also speed up foreign currency borrowing.

In autumn 2008, after the bankruptcy of Lehman Brothers, the situation in the international capital markets deteriorated rapidly. The Hungarian government securities market – as many other government securities markets in the region and in Western Europe – saw a dramatic drop in secondary market liquidity. Large amounts of capital were moved out of emerging markets and a major sell-off of HUF government securities by foreigners – totalling HUF 900 billion in October and November – affected Hungary particularly severely. The exchange rate of the forint fell and liquidity problems returned to the Hungarian government securities market. After an unsuccessful bond auction in October, in order to reduce pressure, ÁKK cancelled the government bond auctions planned for the remaining part of the year, and the National Bank of Hungary began purchasing government securities in the secondary market and concluded an agreement with primary dealers in order to stimulate the secondary market.

As an additional measure to support financing, the Hungarian Government concluded an agreement with the International Monetary Fund, the European Commission and the World Bank about financial support totalling EUR 20 billion in autumn 2008.

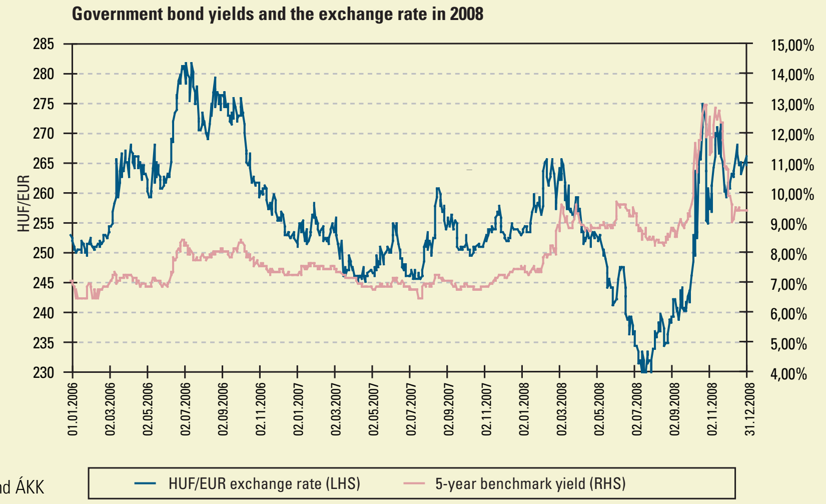
Over the entire year, HUF government securities yields increased significantly. Short-term benchmark yields were 148 to 158 basis points higher than a year before. Medium-term yields increased by even more. Relative to the beginning of the year medium-term (3 to 5-year) yields grew by 205 basis points, while the yields of the longest term securities (10 to 15-year) increased by 87 to 120 basis points.

Government securities benchmark yields in 2008



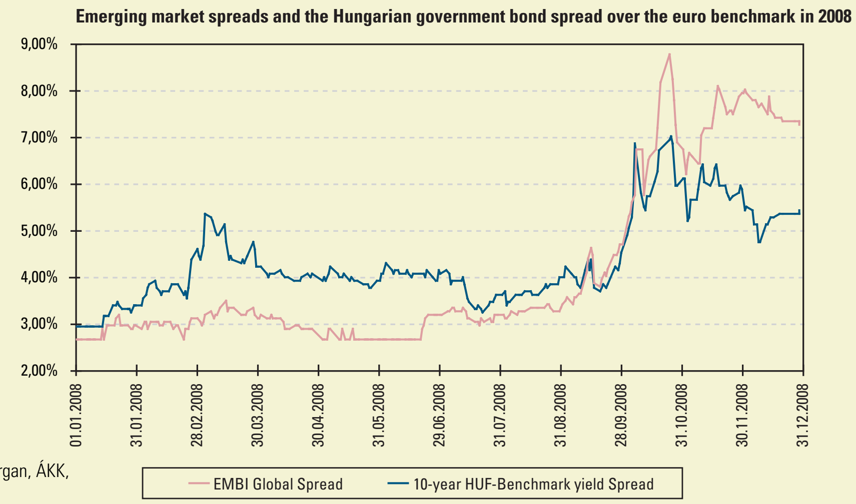
Source: ÁKK

Yield movements generally followed international events, resulting in smaller rises in March and June. Forint yields increased sharply after the bankruptcy of Lehman Brothers. The 'flight to quality' intensified among investors, resulting in the sale – and hence yield increase – of emerging market corporate and government securities. In the case of medium-term Hungarian government bonds yields exceeded 13% – a level not seen since the end of 1999. At the end of 2008, after the announcement of the crisis management measures of the Hungarian government and the international financial loan facility and in a time of an improvement in international capital markets Hungarian yields dropped below 10% across the board.



Source: NBH and ÁKK

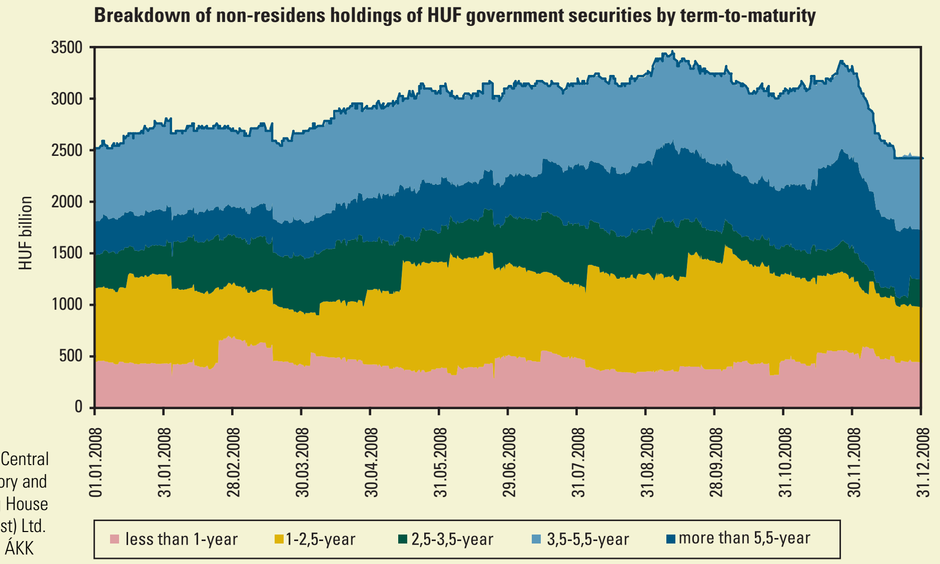
The strong influence of the international capital markets is evidenced by the close link between the fluctuations of the HUF bond yield spread and the EMBI yield spread[2]. From January to September 2008 the 10-year forint yield spread tracked the EMBI spread relatively closely, although it was somewhat higher. After the bankruptcy of Lehman Brothers, however, both forint and EMBI spreads grew sharply, with forint yields approaching seven percentage points and the EMBI spread nearing nine percentage points. Thanks to the autumn measures described above, the situation in the Hungarian government securities market improved and the 10-year yield spread dropped to around 5.3%, while the EMBI spread decreased to around 7.0 % by the end of 2008.



Source: JPMorgan, ÁKK, Bloomberg

As a result of the wave of secondary market sell-offs in October and November, the non-resident holdings of government securities fell by a total of HUF 782 billion in 2008, and amounted to HUF 2,459 billion at the end of the year. The proportion of foreign-owned HUF government debt fell from 31% to 23,5%. Combined with foreign-owned foreign currency debt 52% of total government debt was owned by non-residents.

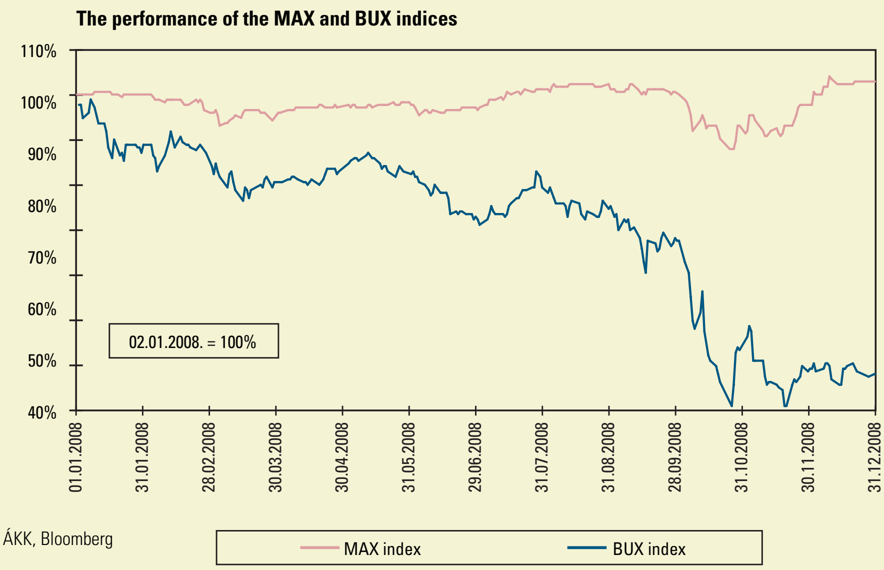
[2] The EMBI (Emerging Markets Bond Index) Global spread is the spread of the yields of emerging market foreign currency bonds relative to US Treasury bonds, as calculated by JPMorgan.



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

THE STOCK MARKET

The Hungarian stock market performed poorly in 2008. Fluctuations in Hungarian stock prices largely reflected changes in the international investment climate.



Source: ÁKK, Bloomberg

During the first three quarters of the year the BUX (the main index of the Budapest Stock Exchange) fell significantly, as a result of the worldwide recession, the deteriorating economic prospects for Western Europe and our region, an unfavourable international investment climate and liquidity problems. The same was true for other stock exchanges in the region. After the bankruptcy of Lehman Brothers, stock exchanges fell globally and the downward trend of the Hungarian stock exchange index accelerated. After the announcement of the international loan package there was a period of moderate recovery, but overall the BUX index ended the year having fallen by a significant 53%

II. DEBT MANAGEMENT STRATEGY IN 2008

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 2008 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 ratio. 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.
- 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 in the case of repo operations in the HUF market.

Certain types of risk are characterised by trade-offs, i.e. decreasing one type of risk leads to an increase of the other type (as, for instance, between interest rate and exchange rate risk when financing in forint or in foreign currency). Other risk types are linked directly, i.e. they increase and decrease together (e.g. refinancing risk and interest rate risk). 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 2008 the composition of the central government debt fully conformed to the benchmarks.

1. THE HUF DEBT/ FOREIGN CURRENCY DEBT COMPOSITION

Since 2004 the debt management strategy has used an optimal portfolio model to establish inter alia a forint/foreign currency ratio within the total government debt that minimises the risks stemming from interest rate and exchange rate fluctuations. As in 2007, the goal in 2008 was to keep the foreign currency debt ratio in the 25-32% range. At the end of 2008 the ratio of foreign currency debt was 30.6%, which was within the optimal range but higher than the level at the end of 2007 (28.4%). This increase was the result of stronger reliance on external funding due to the financial crisis in 2008.

2. THE CURRENCY COMPOSITION OF THE FOREIGN CURRENCY DEBT PORTFOLIO

In order to minimise cross-currency risk, ÁKK has 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%. If the Republic obtains funding in a non-euro currency, ÁKK uses swap transactions to convert them into euro obligations. At the end of 2008, in compliance with the benchmark, 99.9% 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 also uses interest rate swap transactions to achieve the desired interest rate composition. At the end of 2008 the ratio of fixed interest rate debt within foreign currency debt was 65%, which conformed to the benchmark.

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 modifying the proportion of short and long-term instruments, as short-term ones are considered to be floating rate instruments since they have the same characteristics. At the end of 2008 the ratio of fixed interest rate HUF debt was within the reference range at 75.2%.

5. DURATION OBJECTIVES

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.

When duration is short, larger yield fluctuations influence interest expenditure more rapidly, i.e. in times of higher interest rate volatility interest expenditure also fluctuates significantly. If duration is longer, the effects of interest rate changes on interest expenditure are smoothened over several years. This makes interest expenditure more predictable. 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 2008 duration stood at 2.56 years, within 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 2008, see Chapter VI.

7. STRATEGIC PRINCIPLES

Like most foreign government debt management institutions, ÁKK uses financing instruments and sales techniques 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. In 2008 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).

III. THE FINANCING REQUIREMENTS IN 2008

ÁKK published its 2008 Annual Financing Strategy and Financing Plan in the publication entitled 'Debt Management Outlook 2008', which was based on the financing plan approved by the Minister of Finance in January 2008.

THE COMPONENTS OF THE FINANCING REQUIREMENT

Act no. CLXIX of 2007 related to the 2008 budget of the Republic of Hungary (hereinafter the 2008 Budget Act) projected a cash-flow based deficit of HUF 1,118 billion for the 2008 budget 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 insurance funds and extra-budgetary funds[3]. 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.

From a financing perspective, the cash-flow approach is the relevant one, since it shows the actual financing requirement and it fundamentally determines annual changes in government debt. Due to Hungary's membership of the EU, however, the accrual-based data accounted in accordance with ESA 95 is also calculated.

Central government financing essentially involves keeping the Single Treasury Account balance at a level that ensures the state's solvency by covering all Treasury payments, while also providing liquidity reserves against unforeseen financing shocks (e.g. international financial crises). The STA is held at the National Bank of Hungary. According to a principle stipulated in the Maastricht Treaty of the European Union, the Central Bank must not finance the Government, i.e. the consolidated balance of all Treasury accounts held at the Central Bank must not be negative.[4]

ÁKK ensures that there is always an adequate balance of the Single Treasury Account based on liquidity forecasts received from the Hungarian State Treasury (Treasury) and other institutions, but it also has the task of managing any temporarily free cash 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, 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 is renewed several times a year. Over recent years, cash-flow based financing requirements were as follows:

Cash-flow based borrowing requirements in 2003-2008 — HUF billion

	2003	2004	2005	2006	2007	2008
Balance of the central government budget	-733.6	-890.0	-544.7	-1,958.4	-1394.4	-874.7
Balance of the Social security funds	-342.9	-422.9	-469.8	-124.7	35.6	-73.4
Balance of the Extrabudgetary funds	18.8	27.9	30.4	50.1	63.0	28.0
Balance of the central government	**-1.057.7**	**-1,285.1**	**-984.1**	**-2,033.0**	**-1295.8**	**-910.0**
Capital transfer to the NBH	-82.9	0.0	-1.1	-14.8	-20.6	-2.8
Privatisation revenues and capital transfers	42.0	166.5	0.0	268.7	67.3	3.1
Net pre-financing of European Union transfers	0.0	-12.8	-169.0	-35.8	217.8	29.2
Net financing requirement	**-1,098.6**	**-1,131.3**	**-1,154.2**	**-1,814.9**	**-1031.3**	**-880.5**
Redemption of Treasury bills	-3,635.2	-4,277.7	-4,265.7	-5,078.6	-4424.9	-4,669.5
Long term debt redemption	-1,809.6	-1,253.2	-1,885.0	-1,856.3	-1817.5	-1,280.4
Gross financing requirement	**-6,543.4**	**-6,662.2**	**-7,304.9**	**-8,749.7**	**-7273.7**	**-6,830.4**

Source: Hungarian State Treasury, ÁKK

[3] 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.
[4] For details, see Article 16, paragraph (1) of Act no. LVIII of 2001 on the National Bank of Hungary.

THE NET FINANCING REQUIREMENT

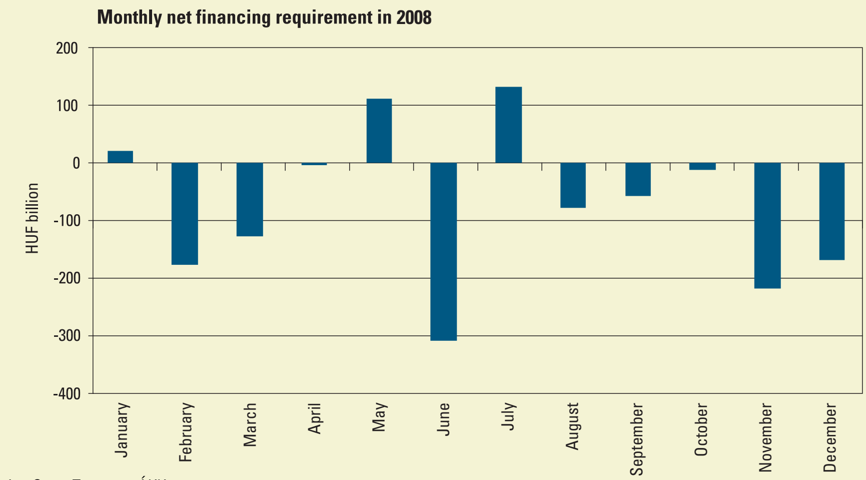
In 2008 the total cash-flow based deficit of the central government was HUF 910 billion (or 3.4% of GDP according to preliminary data), while the total net financing requirement amounted to HUF 881 billion (or 3.3% of GDP). The actual net financing requirement was significantly less than both the target stipulated in the 2008 Budget Act and the forecast published in the annual financing plan prepared in January 2008.

Cash-flow based borrowing requirements in 2008 - projection and outturn

	Plan of January 2008 (HUF billion)	Outturn in 2008 (HUF billion)	Change compared to plan (per cent)
Balance of the central government budget	-1,131.0	-864.7	76.4%
Balance of the Social Security funds	15.0	-73.4	-490.6%
Balance of the extrabudgetary funds	4.9	28.0	572.0%,
Balance of the central government	**-1,111.2**	**-910.0**	**81.9%**
Capital transfer to the NBH	-2.8	-2.8	100.0%
Privatisation revenues and capital transfers	33.9	3.1	9.1%
Net pre-financing of European Union transfers	-102.8	29.2	-28.4%
Net financing requirement	**-1,182.9**	**-880.5**	**74.4%**
Redemptions of Treasury bills	-3,681.1	-4,669.5	126.8%
Redemptions of long-term debt	-1,351.4	-1,280.4	94.7%
Gross financing requirement	**-6,215.4**	**-6,830.4**	**109.9%**

Source: Hungarian State Treasury, ÁKK

The smaller than forecast net financing requirement was the result of a better than expected balance of the central government, as well as a net surplus of transfers from the European Union. On the other hand, the HUF 3 billion privatisation revenue was below the targeted amount.



Source: Hungarian State Treasury, ÁKK

Even though the first quarter still showed a substantial deficit, the monthly breakdown of the net financing requirement of the central government was significantly more favourable than in previous years (indicating fiscal consolidation), reducing the burden on liquidity management. However, the smoother net financing requirement was counterbalanced by the unfavourable situation in the international capital markets, which made financing from the market significantly more difficult.

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.
All redemptions of HUF government securities were higher than planned, while foreign currency redemptions were essentially as planned.

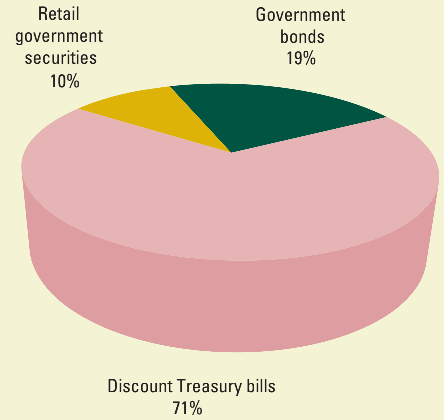
Government debt redemptions in 2008 — **HUF billion**

	2007	2008 planned	2008 fact
Redemptions of domestic debt	**6,116.1**	**4,863.9**	**5,785.7**
Treasury bonds	1,254.5	1,102.1	1,118.0
Discount Treasury bills	3,837.6	3,207.8	4,072.1
Retail securities	609.5	553.8	595.5
Loans	414.4	0.2	0.2
Redemptions of foreign currency debt	**126.3**	**168.6**	**162.2**
Bonds	0.6	0.0	0.0
Loans	125.7	168.6	162.2
Total	**6,242.4**	**5,032.5**	**5,947.9**

Source: ÁKK

Within the HUF debt portfolio, discount treasury bills contributed to 71% of the total forint redemptions of HUF 5,786 billion, due to their renewals within the year. The higher-than-planned redemption of discount treasury bills was the result of their increased issuance, in order to offset a decline in bond sales due to the liquidity crisis. In the case of government bonds and forint loans, redemptions were essentially as planned.

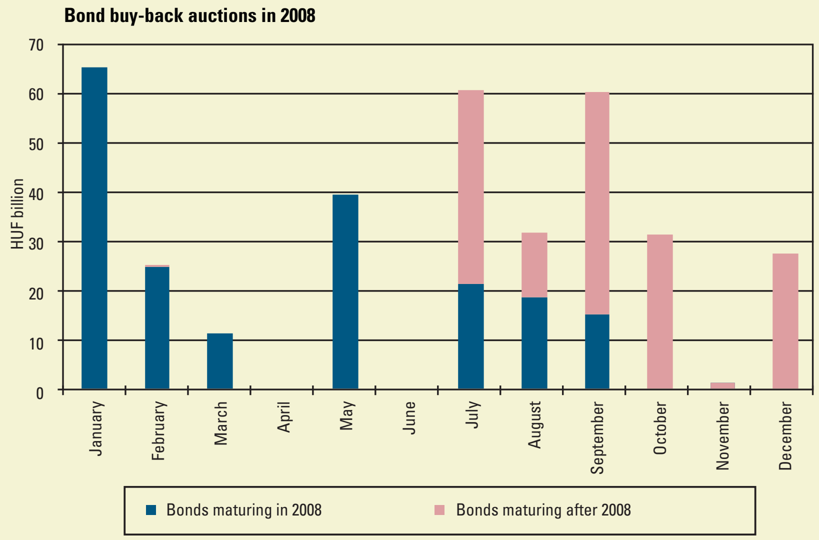
Composition of HUF debt redemptions in 2008



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. In 2008 ÁKK bought back before their maturity a total of HUF 348 billion bonds with a remaining maturity between 6-12 months on seventeen occasions. 45% of the repurchased bonds had an original maturity after 2008, i.e. these buy-backs also helped smooth maturities from one year to another.



Source: ÁKK

The lower forint value of foreign currency redemptions is purely the result of a more favourable exchange rate; the amounts of these redemptions in foreign currency were as planned.

IV. FINANCING

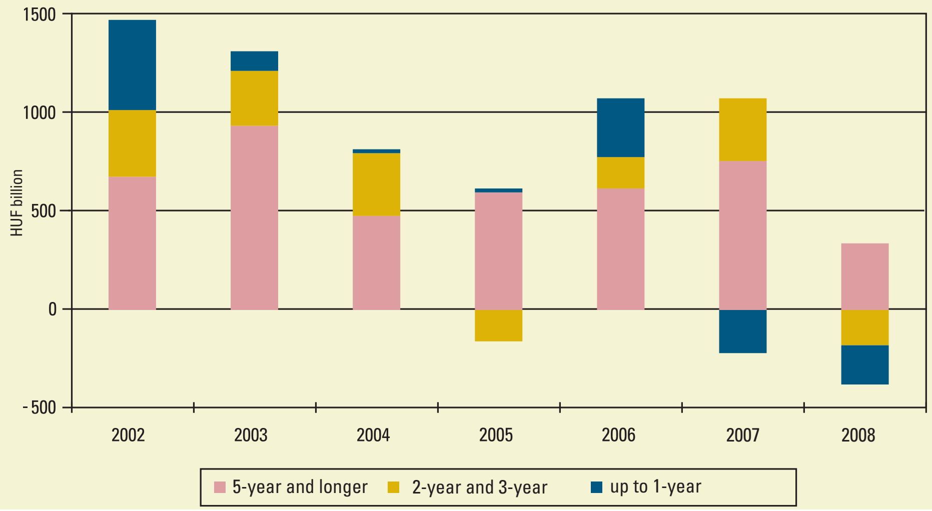
The issuance of government securities and the drawdowns of loans were planned and implemented in accordance with the approved debt management strategy and benchmarks. However, debt management activities were significantly influenced by the current macroeconomic environment and the situation in the government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

In 2008 the HUF denominated issuance (excluding repo transactions) amounted to HUF 5,834 billion, while foreign currency issuance was HUF 2,424 billion. In an unfavourable international capital market, stable and secure financing over the last quarter was also facilitated by the credit facilities from the IMF and the EC. In November 2008 HUF 1,301 billion was drawn from the IMF facility, while in December, HUF 524 billion was drawn from the facility provided by the EC. Only a smaller part, HUF 262 billion of these amounts was used for financing, the remainder was deposited with the NBH.

Net HUF denominated financing totalled HUF 48 billion, while net foreign currency financing amounted to HUF 699 billion, i.e. the total net issuance in 2008 was HUF 748 billion (excluding repo transactions and the IMF/EC loans). With the IMF/EC loans included (even though that a large part of these was not used for debt financing), the total net foreign currency issuance was HUF 2,262 billion, and the total net issuance was HUF 2,310 billion.

The main instruments of net financing – in both HUF and foreign currency issuance – were government securities. Within the HUF issuance, the role of short-term debt increased in line with international trends, due to the international capital market crisis. The net issuance of retail securities in 2008 totalled HUF -8 billion, while the net balance of discount treasury bills was also negative (HUF -194 billion).

Breakdown of net domestic securities issuance by tenor



Source: ÁKK

In 2008 the volume of both HUF and foreign currency loans increased. The stock of HUF loans increased by HUF 74 billion, while that of foreign currency loans grew by HUF 11 billion, as a result of drawing down new project financing loans.

FORINT FINANCING

The total amount of gross HUF issuance was higher than the target in the January 2008 plan. This was partly due to discount treasury bill issuance well above plans, and partly due to an increase in demand for retail government securities; on the other hand, the issuance of bonds was below target.

Gross government debt issuance in 2008

HUF billion

	2007	2008 planned	2008 fact (actual financing)	2008 fact (total issuance)
Issuance of domestic debt	**6,740.5**	**5,574.1**	**5,834.1**	**5,834.1**
Treasury bonds	2,305.7	2,035.4	1,293.5	1,293.5
Discount Treasury bills	3,734.3	2,858.3	3,878.3	3,878.3
Retail securities	496.9	554.9	587.8	587.8
Loans	203.7	125.5	74.4	74.4
Issuance of foreign currency debt	**352.6**	**557.9**	**861.4**	**2,422.5**
Bonds	297.06	507.2	426.4	424.7
Loans	55.56	50.7	173.0	173.0
IMF/EC loan drawdowns	0.00	0.0	262.0	1,824.8
Total issuance	**7,093.1**	**6,132.0**	**6,695.5**	**8,256.6**

Source: ÁKK

GOVERNMENT BONDS

As in previous years, ÁKK aimed to meet most of the financing requirement through the issue of 3-, 5-, 10- and 15-year government bonds in 2008 as well. However, because of the international credit crisis, demand for longer maturity government bonds deteriorated repeatedly, and ÁKK was gradually forced to reduce its bond issuance plans. By the beginning of October demand had dropped to a very low level, and no further government bond auctions were held from the end of October.

Until October 2008 bond auctions were held every two weeks, and each type of bond was put up for auction every six weeks except for 15-year bonds, which were sold every 12 weeks. A total of HUF 1,270 billion of bonds were sold via the auctions – 38% short of the planned HUF 2,035 billion. The Treasury network sold bonds totalling HUF 24 billion, which brought the total bond issuance (excluding repo transactions) to HUF 1,294 billion. With HUF 1,118 billion in government bond repayments, the net HUF bond issuance was HUF 176 billion in 2008, 82% short of the originally planned net issuance of HUF 954 billion.

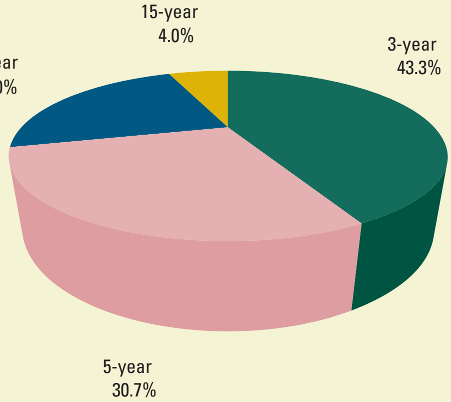
Domestic bond series issued in 2008 at auctions (HUF billion)

Code	Tenor	Number of auction in 2008	Auctioned amount (HUF billion)	End-of-years series volume (HUF billion)
2011/C	3 years	7	550	556
2012/C	5 years	7	390	656
2019/A	10 years	7	280	280
2023/A	15 years	3	50	200

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).

Breakdown of gross domestic bond issuance at auctions by tenor in 2008



Source: ÁKK

HUF LOANS

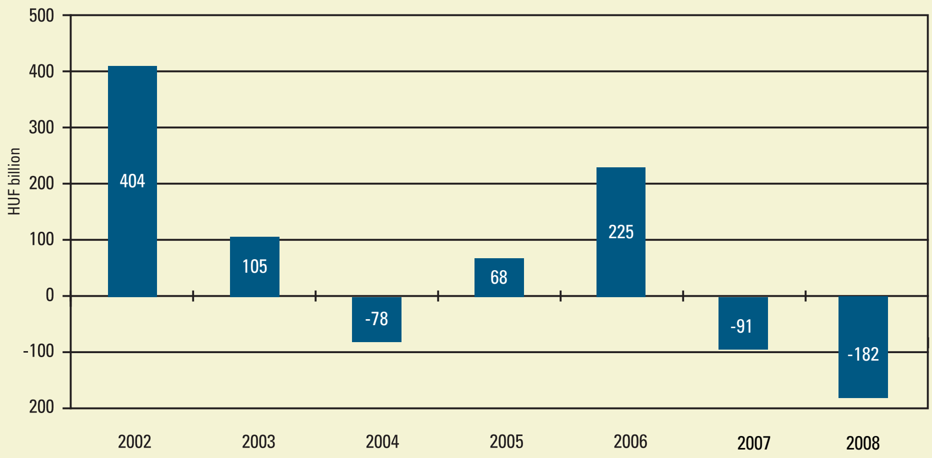
The European Investment Bank (EIB) extended loans totalling HUF 74 billion for the financing of infrastructure developments in 2008. As the ratio of floating rate debt had been decreasing within the HUF portfolio due to fixed rate bond issuances, these long-term floating rate loans had a beneficial effect on debt structure in the past few years. Since October 2008, however, their main advantage is their long tenor and predictability.

DISCOUNT TREASURY BILLS

The 3-, 6- 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. Based on a strategic decision in 2007 ÁKK phased out the issuance of the 6-month T-bill in 2008, the stock of which matured in 2008. 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. Beside the types of treasury bills mentioned above, ÁKK also uses so-called liquidity discount treasury bills of even shorter tenor (usually 6 weeks).

In 2008 ÁKK sold discount treasury bills in a total of HUF 3,878 billion; HUF 3,540 billion at auctions and HUF 338 billion through the Treasury network. Due to their short duration, discount treasury bills are renewed several times a year, which makes the net sales figures more useful for analysis than gross issuance data. In 2008 the outstanding volume of discount treasury bills dropped by HUF 182 billion, a decrease that was smaller than the original plan of HUF 349 billion. Until October, ÁKK had supplemented the loss in financing caused by falling bond sales by selling more discount treasury bills, thus the third quarter even brought a slight increase in their stock rather than the planned reduction. However, due to the government securities market disturbances in October, T-bill sales also fell. This resulted in a significant decrease in their volume although to a smaller extent than originally planned.

Net sales of discount treasury bills between 2002-2008 (incl. repos)



Source: ÁKK

RETAIL SECURITIES

One of the strategic objectives of ÁKK is to issue retail government securities aimed at small investors. A specific distribution network is in place to make government securities – generally considered to be the most secure investment – available to the general public around the country. These special instruments allow ÁKK to reach an alternative market. The role of retail securities is strategically important, because several years of experience indicate that demand for them tends to move in the opposite direction to the demand for securities in the capital market. Therefore, the combined use of the two types of government securities makes financing more balanced.

Over most of 2008 the one-year yield had an increasing trend, and this was followed in the second half of the year by an increase in the outstanding amount of retail securities. Commercial banks (also wishing to attract households' savings) competed strongly with retail government securities, so retail sales eventually increased by less than expected. ÁKK sold HUF 248 billion in Interest Bearing Treasury Bills and HUF 340 billion in Treasury Savings Bills. The outstanding volume of Interest Bearing Treasury Bills increased by HUF 10 billion over the year, while that of Treasury Savings Bills fell by HUF 19 billion.

FOREIGN CURRENCY FINANCING

During 2008 ÁKK issued three foreign currency bonds in the international capital markets on behalf of the Republic of Hungary. The three issues raised a total of HUF 426 billion (EUR 1.8 billion). One of these issues – worth EUR 1.5 billion – was the Republic of Hungary's largest single bond issue to date.

Foreign exchange bond issuance of the Republic of Hungary in 2008

Currency	Size	Date of issue	Maturity date	Maturity(years)	Coupon
CHF	150,000,000	20.05.2008	21.05.2013	5	3.50%
CHF	200,000,000	20.05.2008	21.05.2016	8	4.00%
EUR	1,500,000,000	11.06.2008	11.06.2018	10	5.75%

Source: ÁKK

Although the majority of foreign currency bonds are issued in the euro market (the most important strategic market for Hungary), ÁKK also aims to broaden its investor base – both geographically and among sectors – by issuing bonds in other markets. One means of reaching new investor segments is to issue in currencies other than the main foreign currency, the euro. In 2008 alongside the mentioned eurobond, two bonds were also issued in Swiss francs.

In 2008 the government drew HUF 148 billion in project financing foreign currency loans from international financial organisations. The loans drawn from the European Investment Bank (EIB) and the Council of Europe Development Bank (CEB) were used to finance projects in environmental protection, flood protection, infrastructure development, education and healthcare.

Foreign currency loans were drawn in a total value of HUF 1,825 billion (SDR 4.2 billion and EUR 2 billion) from the IMF/EC credit line, of which HUF 262 billion (EUR 1 billion) was used for financing. At the end of 2008 the balance of foreign currency deposits at the National Bank of Hungary (i.e. the part of the loans drawn that were not used for financing) was HUF 1,484 billion, which included funds reserved for a HUF 600 billion "bank rescue" package.

Transactions in connection with the IMF/EC/WB loan package in 2008:

2008	IMF	EU
Total volume of the loan facility (in the given currency)	10,537,500,000	6,500,000,000
Currency	SDR	EUR
Date of drawdown	12.11.2008	09.12.2008
Amount drawn (in the given currency)	4,215,000,000	2,000,000,000
Amount drawn (in HUF)	1 300,767,686,823	524,020,000,000
Balance of FX deposits there of, as at end-2008 (in HUF)	1,218,790,304,354	264,780,000,000

In contrast with the HUF 389 billion net foreign currency debt issuance projected in the January financing plan, the actual net foreign currency debt issuance totalled HUF 699 billion (ca. EUR 2.8 billion). Out of this sum, foreign currency bond issuance accounted for EUR 1.8 billion (HUF 426 billion), while net foreign currency loan drawdowns accounted for some EUR 1 billion (HUF 273 billion).

V. THE GOVERNMENT DEBT IN 2008

The Government Debt Management Agency Pte. Ltd. manages the central government debt and the liquidity of the central government. In view of the fact that the Social Security funds and the extra-budgetary funds also keep their funds on the Single Treasury Account and that their net financing requirements are met using the STA, the debt actually managed by ÁKK is the central government debt (hereinafter 'government debt', or 'debt')[5].

In 2008 the government debt, including repo operations, grew by HUF 2,518 billion (16.2%) to HUF 18,104 billion from end-2007. In addition to the increased financing requirement of the central government, the relatively large rise in the debt was caused by the loans drawn from the IMF/EC package (a large part of which was not used for financing but was deposited in foreign currency), the exchange rate difference due to the conversion of debt in foreign currency to forints and other items such as the balance of repo transactions at the end of the year. HUF 1,035 billion of the increase was actually used for financing, while a significantly larger amount – HUF 1,484 billion – was deposited with the NBH in foreign currency.

Central government debt — **HUF billion**

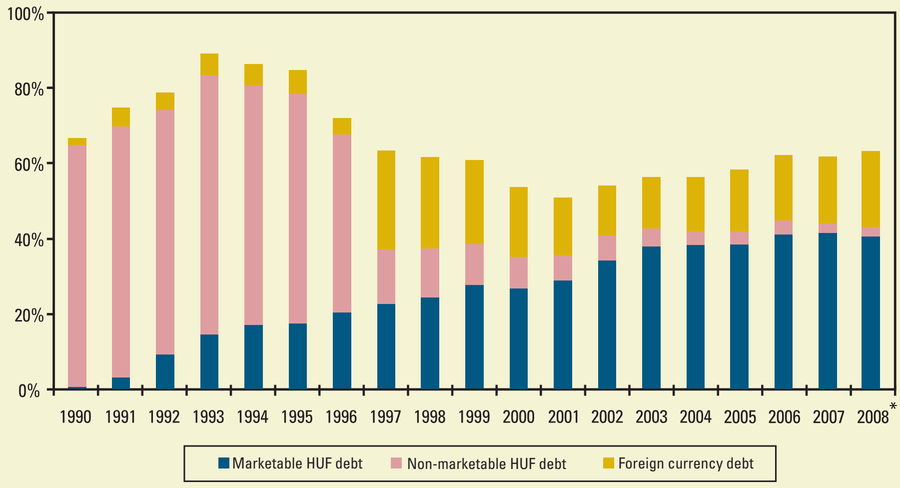
	2007		**2008**		**Change**
HUF denominated debt	**11 103.8**	**71.2%**	**11 250.6**	**62.1%**	**146.8**
Loans	145.7	0.9%	219.9	1.2%	74.2
Government bonds	8 738.0	56.1%	9 001.6	49.7%	263.6
Discount Treasury bills	1 664.9	10.7%	1 482.4	8.2%	-182.5
Retail securities	555.2	3.6%	546.6	3.0%	-8.5
Foreign exchange denominated debt	**4 472.6**	**28.7%**	**6 774.8**	**37.4%**	**2 302.2**
Loans	846.5	5.4%	2 529.4	14.0%	1 682.9
Bonds	3 626.1	23.3%	4 245.5	23.5%	619.3
Total central government gross debt	**15 576.4**	**99.9%**	**18 025.4**	**99.6%**	**2 449.0**
Other obligations	**9.1**	**0.1%**	**78.5**	**0.4%**	**69.4**
Grand total of central government gross debt	**15 585.5**	**100.0%**	**18 103.9**	**100.0%**	**2 518.4**
Part of the IMF/EC loans placed as FX deposits	0.0		1 483.6		1 483.6
Central government net debt (FX deposits subtracted)	**15 585.5**		**16 620.3**		**1 034.8**

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% 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. After a slight improvement in 2007, the indicator increased again in 2008. According to preliminary data, the debt/GDP ratio grew from 61.3% at the end of 2007 to 68.4% at the end of 2008. However, excluding the HUF 1,484 foreign currency deposits so as to obtain a figure that is comparable with previous years, the debt ratio is only 62.8%; this means that GDP-proportional debt would have increased by 1.5% (see chart).

[5] See Act no. XXXVIII of 1992 on Public Finances and its several amendments.

The public debt/GDP ratio and its breakdown between 1990-2008



Source: ÁKK

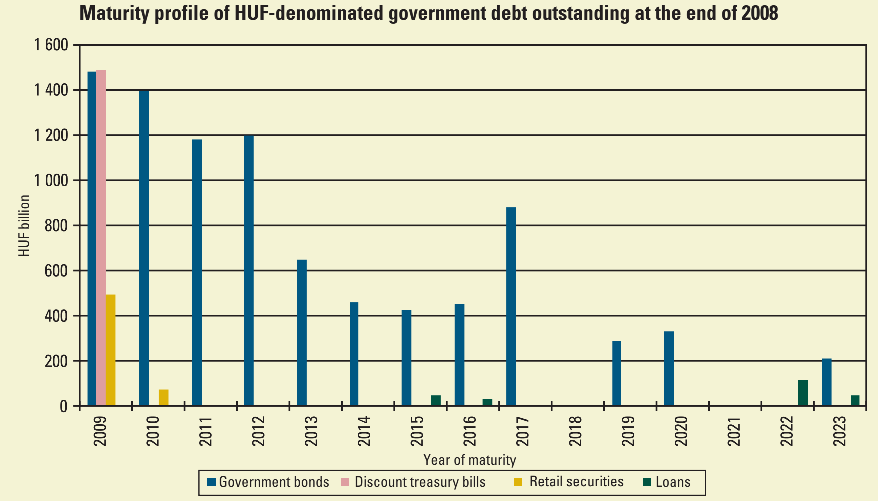
*The figure for 2008 does not include the amounts drawn from the international loan package that were not used for financing but were deposited in foreign currency with the NBH.

CHARACTERISTICS OF THE HUF DEBT PORTFOLIO

During 2008 the HUF-denominated debt – which amounted to almost two-thirds of government debt – increased by HUF 147 billion (1.3%) to HUF 11,251 billion. At the end of 2008 50% of the entire debt was in long-term HUF government bonds. The total domestic bond portfolio of HUF 9,002 billion consisted of thirty-four bond series, so the average size of a series was HUF 265 billion (EUR 1 billion), with six series having volumes in excess of HUF 500 billion (EUR 2 billion). In comparison, one year earlier the total domestic bond portfolio was worth HUF 8,738 billion and was spread across thirty-seven series, of which only four exceeded HUF 500 billion, giving an average size of HUF 236 billion. The portfolio of marketable bonds was concentrated further in 2008, in line with the strategic objective of stimulating liquidity in the secondary market.

There were eighteen series of discount treasury bills in the market at the end of 2008, with an average volume of HUF 82 billion. Out of these six series had a volume in excess of HUF 100 billion, their average volume being HUF 173 billion. The total portfolio of retail government securities was worth HUF 547 billion at the end of December, which corresponded to 3% of the total debt.
The non-marketable component of the HUF bond portfolio continued to decrease in amount and proportion in 2008 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 431 billion, which was only 2.4% of the total HUF denominated debt.

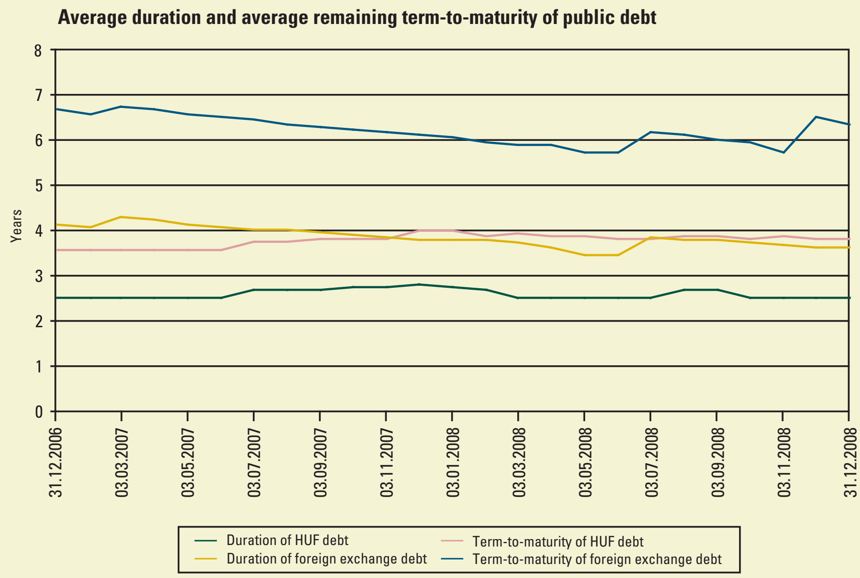
At the end of 2008, 31% of the HUF denominated debt was falling due within one year, an additional 13% within two years, but 35% had a 5-year or longer remaining term-to-maturity. Due to the decrease in bond sales caused by the financial crisis, the maturity structure of the debt deteriorated and renewal risk increased, as the proportion of debt expiring within a year grew by 4 percentage points during 2008 and the ratio of debt expiring in at least 5 years' time dropped by 4 percentage points in 2008.



Source: ÁKK

At the end of 2008 the ratio of fixed interest rate government securities within all HUF denominated government securities was 75%, up by 2 percentage points relative to the previous year.

Due to the reduced sales of long-term bonds the average remaining term-to-maturity of the HUF debt portfolio decreased in 2008. The duration of the HUF debt shortened more, dropping from its previous high level to the middle of the benchmark range, near the optimal level. The duration of the entire HUF denominated debt portfolio declined from 2.83 years at the end of 2007 to 2.61 years by the end of December 2008, while the average term-to-maturity decreased from 4.04 to 3.88 years.



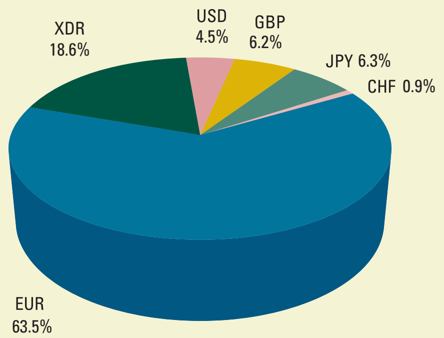
Source: ÁKK

CHARACTERISTICS OF THE FOREIGN CURRENCY DEBT PORTFOLIO

The gross foreign currency government debt increased by HUF 2,302 billion in 2008, reaching HUF 6,775 billion (EUR 25.6 billion) by the end of the year. Accordingly, within the gross government debt, the ratio of foreign currency debt (excluding marked-to-market deposits) was 37.5% (32% without the IMF/EC deposits) at the end of 2008. The modest depreciation of the forint against the euro during 2008 caused a relatively small increase of HUF 156 billion in the HUF equivalent of the foreign currency debt, meaning that the increase in foreign currency debt was largely due to new transactions.

The volume of foreign currency bonds reached HUF 4,245 billion by the end of the year, a significant increase over the previous year's figure of HUF 3,626 billion. On the other hand, due to the large amount of loans received from the IMF/EC, the ratio of bonds within the foreign currency debt dropped markedly in 2008, down to 63% from 81% at end-2007. On 31 December 2008 there were twenty-two series outstanding of the Republic's foreign currency bonds, eleven of which were issued in euro, one in US dollar, two in Swiss franc, three in Pound sterling and five in Japanese yen. In accordance with the applicable strategy and benchmark, all non-euro bonds have been converted to euro liabilities through swap transactions.

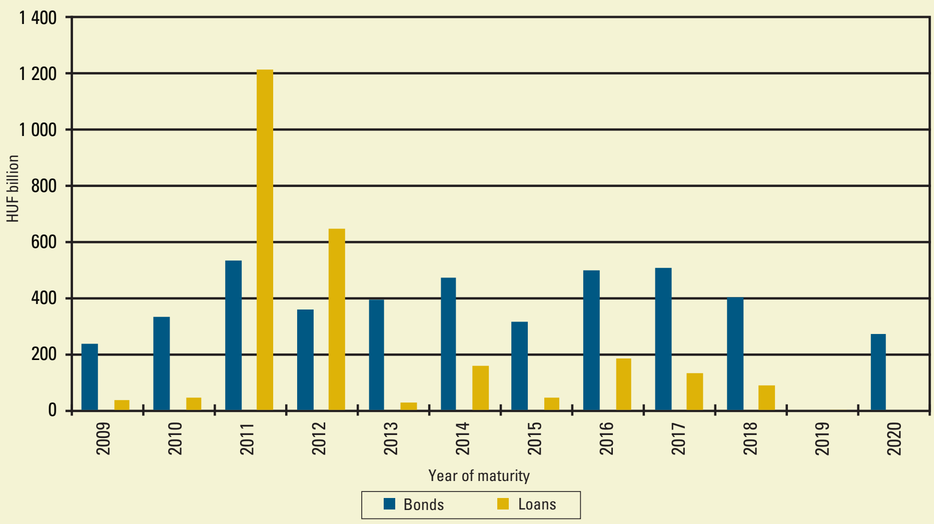
Breakdown of the foreign exchange debt by currencies before swaps at the end of 2008



Source ÁKK

The proportion of foreign currency loans within the foreign currency debt increased from 19% to 37% in 2008. The foreign currency loan portfolio consisted of long-term project financing loans from international financing institutions (e.g. EIB and CEB loans), and the IMF/EC loans received at the end of 2008. The loan portfolio also included credit lines for liquidity management and other purposes.

Maturity profile of the foreign exchange denominated government debt outstanding at the end of 2008



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 2008 65% of foreign currency liabilities had fixed interest rate and 35% 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 increased by 0.3 years to 6.4 years, while its duration declined by 0.1 years to 3.7 years.

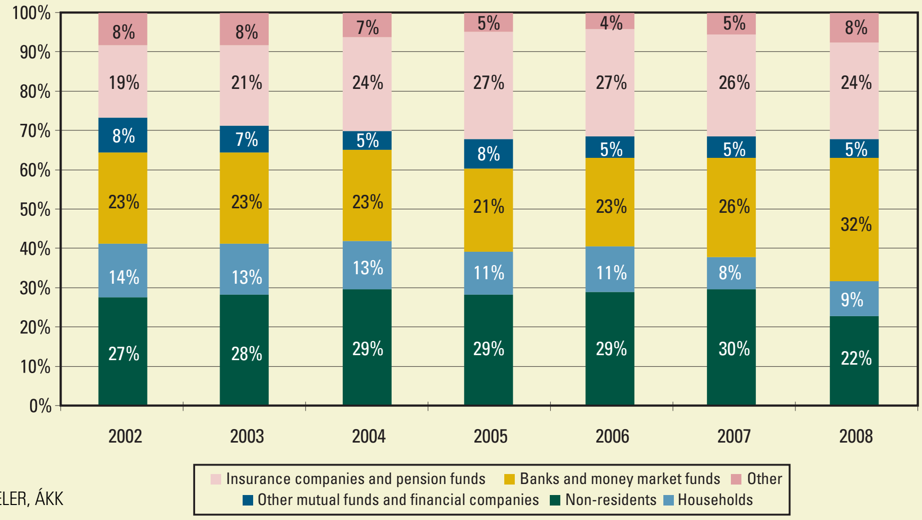
OTHER OBLIGATIONS

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 government debt along with other obligations. As of 31 December 2008 marked-to-market deposits placed with ÁKK totalled HUF 79 billion.

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 2008. The two traditionally most important groups of investors – pension funds and non-residents – reduced their holdings significantly, which had a decisive effect on the development of the government securities market in 2008. As a result of their massive selling in October 2008, the holdings of non-resident investors dropped to a level not seen in the last four years. The decrease in foreign investors' and pension funds' holdings was largely absorbed by commercial banks and capital market funds, and to a lesser extent by retail investors, making banks become the most important group of investors.

Ownership structure of HUF-denominated government securities



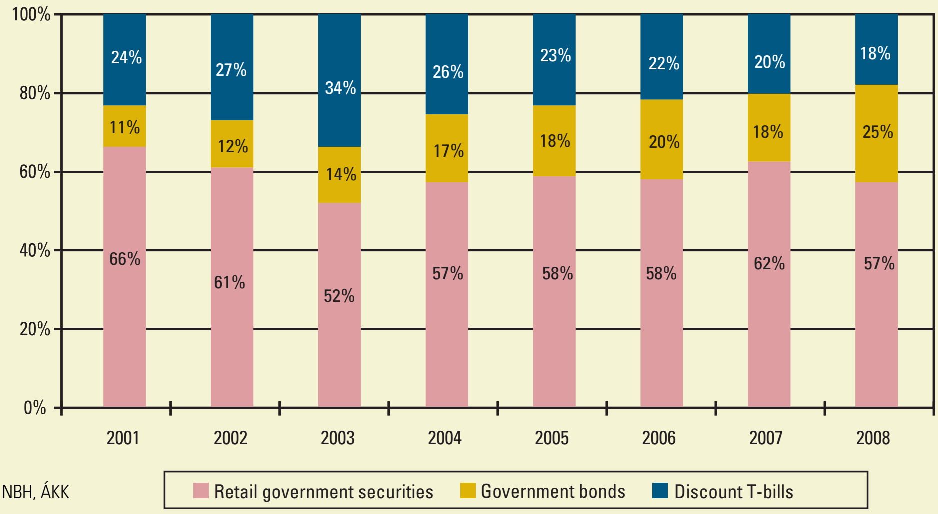
Source: NBH, KELER, ÁKK

Banks, insurance companies and pension funds had been the most stable investor sectors through years, though the latter reduced their portfolios of government securities due to the restructuring of pension fund portfolios in 2008. The combined holdings of insurance companies and pension funds amounted to HUF 2,614 billion at the end of the year.

As described in Chapter I of this report, non-residents' government securities holdings dropped by HUF 782 billion to HUF 2,459 billion during 2008, which represented a return to a level last seen at the end of 2004. The duration of their holdings remained at 3.4 years, while the average remaining term-to-maturity thereof also remained constant at 4.3 years in 2008. Both of these values are substantially higher than those of the entire stock of marketable HUF government securities. Non-resident holdings within the total amount of HUF government bonds and discount treasury bills dropped from 30% to 22% in 2008.

Households increased their total government securities holdings in 2008 by HUF 45 billion relative to 2007. While their holdings of retail government securities dropped by HUF 9 billion and their portfolio of discount treasury bills decreased by HUF 21 billion, their holdings of government bonds increased by HUF 75 billion. Thus the proportion of bonds within their government securities investments reached an all-time high and exceeded that of discount treasury bills. Retail government securities still contributed the largest share of government securities held by households.

Breakdown of the government securities portfolio of households



Source: NBH, ÁKK

VI. LIQUIDITY MANAGEMENT

LIQUIDITY MANAGEMENT OBJECTIVES

Under the Public Finances Act, liquidity management of the central government is the task of ÁKK.[6] 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 (sometimes in excess of HUF 100 billion).[7]

As a result of the magnitude of budgetary transactions in the Single Treasury Account, a significant 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 in these fluctuations can reduce the risks of financing greatly. The correlation between money market liquidity, short-term interest rates and the Single Treasury Account balance is at its strongest during end-of-month tax payments and during Treasury outlays at the beginning of each month. During tax payments the liquidity of the banking system decreases and the balance of the Single Treasury Account increases. With the decrease in market liquidity short-term interest rates also rise. The ensuing cash outflow via liquidity management instruments restores necessary liquidity to the money market. As a result, short-term interbank interest rates increase only slightly or not at all. On the other hand, when the STA balance is falling (e.g. at the beginning of the month due to salary payments), cash is raised via liquidity management instruments and the process has the opposite effect.

The goal of AKK's STA-smoothing and liquidity management activities is to keep the STA's end-of-day balance at the optimal level according to the benchmark, or to keep it within a certain limited range around the benchmark. This is accomplished by placing any excess cash into the money market if the STA balance becomes too high, and raising extra cash from the money market if the balance is too low.

LIQUIDITY MANAGEMENT INSTRUMENTS

In 2008 ÁKK set the target range of the Single Treasury Account at +/- HUF 50 billion around the optimal balance.[8] However, this target is interpreted less stringently than the other benchmarks as, for instance, ÁKK only invests temporary excess liquid funds if the banking system has sufficient demand for that. In 2008 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 3-month discount treasury bills at auctions;
- temporary use of stand-by and other loan facilities;
- with the funds drawn from the international credit package, the amount of liquid foreign currency funds available to ÁKK increased significantly.

The choice and mix of these instruments is a function of the time horizon of the fluctuation that ÁKK wishes to manage. Bond buy-backs and discount treasury bills are useful for smoothing fluctuations in a relatively longer term, while liquidity discount treasury bills are effective for short-term adjustments. ÁKK uses repo transactions to achieve very short-term goals (including daily balances), namely to keep the STA end-of-day balance within the target range. The repo transactions used in 2008 had a tenor of either one day (tom-next, spot-next, overnight) or seven days (spot-week).

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

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

[8] 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.

Drawdowns from stand-by and revolving foreign currency loan facilities are used when a large amount of liquid funds is needed temporarily (e.g. large bond maturities or prefinancing transfers received from the European Union).

LIQUIDITY MANAGEMENT EXPERIENCE IN 2008

Sales of liquidity discount treasury bills took place relatively evenly throughout the year: ÁKK sold these on six occasions in the first half of the year and six times in the second half of the year. At the twelve auctions liquidity discount treasury bills were issued in a total amount of HUF 396 billion, compared with HUF 245 billion sold at six auctions in 2007. In addition to supplying extra liquidity, liquidity discount treasury bills also served to reduce fluctuations in the STA balance.

Liquidity repo transactions represent ÁKK's main tool for fine-tuning the end-of-day balance of the Single Treasury Account. In 2008 the use of repo transactions increased significantly relative to the previous year growing to HUF 12,414 billion, or 19% above the 2007 total of HUF 10,038 billion. ÁKK concluded repo transactions on 247 days during the year. Reverse repo (money placement) transactions were more frequent (151 days) than repo (borrowing) transactions (96 days).

The objective of keeping the STA balance within the allowed range of fluctuation was met on 214 days out of 254 working days (84%). This was an improvement compared to the 77% achievement rate in 2007, and the best annual success ratio since liquidity management activity was introduced in 2004.

An important development was the introduction of overnight repo transactions in March 2008, which contributed to the improvement of STA smoothing in 2008.

STAND-BY REPO TRANSACTIONS

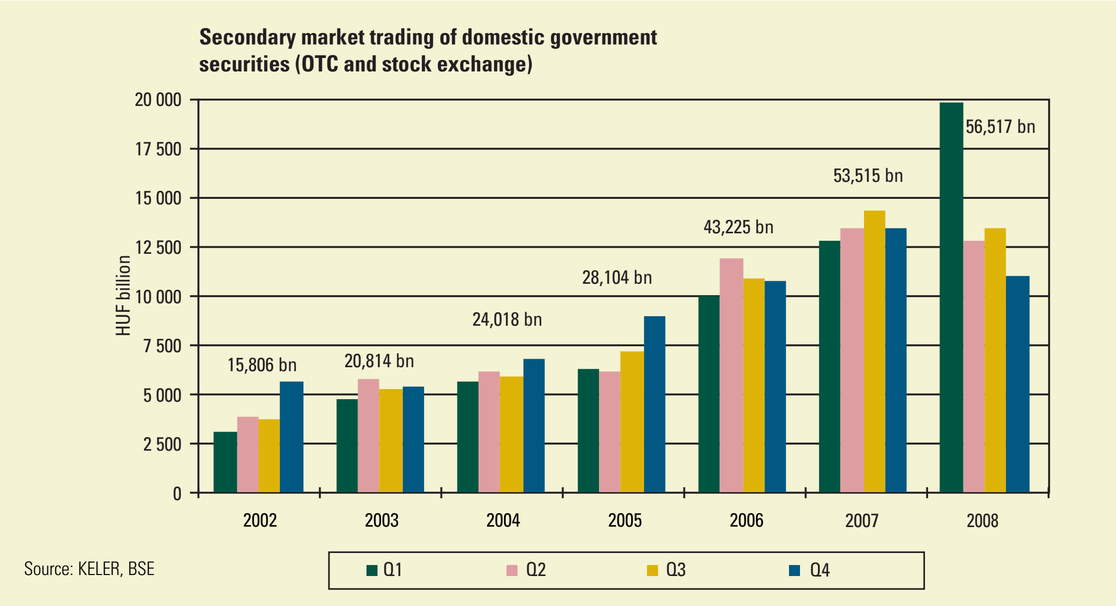
ÁKK concludes repo transactions not only for liquidity management purposes. The objective of the so-called stand-by repo transactions is to support the price quotation of primary dealers and to promote trading in government securities. If a primary dealer needs temporary access to a quoted government 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 to appropriate cash collateral in a one-week repo transaction.

In 2008 the stand-by repo facility was used by authorised partners less frequently than in the previous year, but the total amount involved was approximately the same: 1,050 repo transactions of that type were concluded with a total value of HUF 442 billion, compared to 1,202 transactions totalling HUF 449 billion in 2007.

VII. THE SECONDARY MARKET OF HUNGARIAN GOVERNMENT SECURITIES

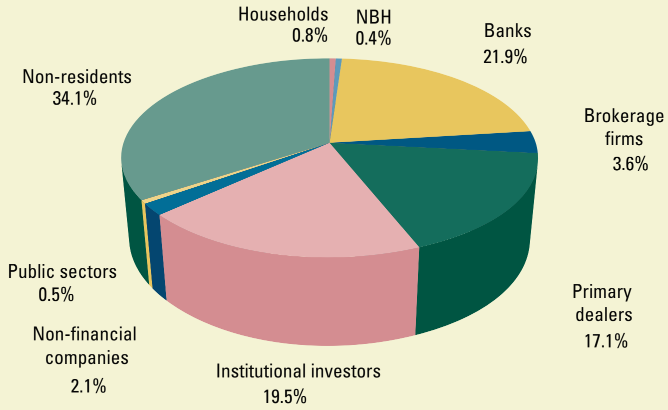
TRADING DATA

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 2008 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 56,517 billion in 2008, out of which 92% was in government bonds and 8% in discount treasury bills. This turnover figure compares with the HUF 11,031 billion volume of the total portfolio of HUF-denominated securities in circulation in the secondary market, meaning that these securities changed hands on an average of five occasions over the year. Turnover in the secondary market continued growing in 2008, albeit at a rate slower than before . The increase in turnover was mostly realised in the first quarter, as the secondary market trading of government securities decreased dramatically afterwards.
In 2008 government securities trading on the Budapest Stock Exchange (BSE) amounted to HUF 385 billion.



Primary dealers conducted transactions in Hungarian government securities totalling HUF 50,392 billion, i.e. they were involved in the great majority of all deals. They conducted about 34% of these transactions with foreign investors, a slight decrease compared to the figure of 35% for 2007.

Breakdown of primary dealers' secondary market turnover in government securities by investors in 2008



Source: Primary dealers, ÁKK

In 2008 the average size of deals with primary dealers (excluding retail transactions) was HUF 704 million. As in the past, non-resident investors had the largest average transaction size, at HUF 1,250 million. Over the year, the 5-year 2012/C government bond had the largest turnover (HUF 6,030 billion), followed by the 2010/D and 2011/C 3-year bonds. The title 'Primary Dealer of the Year' for 2008 was awarded to ING Bank N.V.

MARKET DEVELOPMENT

In 2008 ÁKK applied several measures to promote the operation and development of the primary and secondary markets. The auction calendar of government securities was revised and the volumes of bond series were increased on the basis of international experience and in line with the improving budget deficit. Increasing the volume of bond series and reducing the number of new series issued was successful in 2008 (the volumes of two series exceeded HUF 650 billion), but other targets were not or only partly achieved. The international capital market crisis had a fundamental effect on trends in government debt management and on market financing. The characteristics of the government securities markets emerging after the international capital market crisis are still taking shape, but it is already clear that improvement in the operation of the secondary market is needed, and that issuers must show great flexibility during their financing operations. ÁKK continuously analyses international and domestic processes in the government securities market and aims to re-establish market financing and increase secondary market liquidity.

THE SECONDARY MARKET OF GOVERNMENT SECURITIES ISSUED IN FOREIGN CURRENCIES

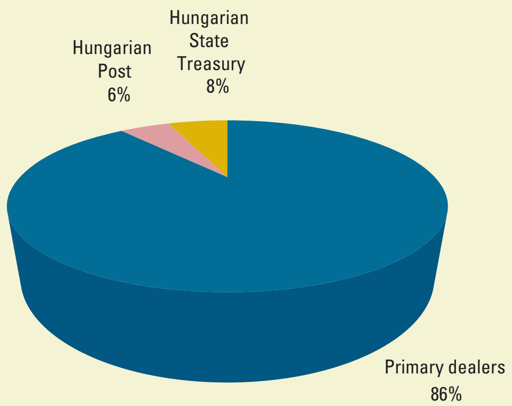
The foreign currency bonds of the Republic of Hungary are traded on international electronic trading platforms and the interbank (OTC) market. Some leading financial institutions quote two-way prices for the euro-denominated bonds of the EU member states that joined the European Union in 2004, using the so-called NewEuroMTS electronic trading platform.

At the end of 2008 Hungary and Poland had nine each, Lithuania had four, Slovakia had three, Cyprus and the Czech Republic had two each, while both Bulgaria and Romania had one series of euro bonds traded on NewEuroMTS. Turnover of Hungarian euro bonds totalled around half a billion euros on this platform, which is barely a fifth of the total 2007 turnover. Just as on the MTS platforms of EMU countries, trading in Hungarian euro bonds fell significantly from October 2008, and bid-ask spreads also widened. Deteriorating conditions in the secondary-market trading led to an increased role of the less transparent OTC trading.

VIII. THE INSTITUTIONAL FRAMEWORK FOR THE ISSUANCE OF GOVERNMENT SECURITIES

ÁKK sells government securities through intermediaries. In the domestic market, the Hungarian State sold almost 86% of HUF-denominated government securities through its primary dealers.

Intermediaries of domestic securities issuance in 2008



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.

As of 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, the primary dealer status also guarantees exclusive rights.

PRIMARY DEALERS AT THE END OF 2008:

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.

The most important obligation of primary dealers – and at the same time also an exclusive right – is active participation in the issuance of government bonds and discount treasury bills through regular bidding at auctions. ÁKK requires them to purchase a certain minimum percentage of the amounts sold at auction during a half-year period.

Another important task for primary dealers is quoting two-way (bid and ask) prices for government securities, thereby ensuring liquidity and transparency of the market, while providing continuous access to government securities for investors.[9]

Primary dealers are also required to submit regular reports to ÁKK on their government securities trading and on their financial positions.

THE EXCLUSIVE RIGHTS OF PRIMARY DEALERS

Only primary dealers may:

1. directly submit bids at government bond and discount treasury bill auctions and submit offers at bond buy-back auctions;[10]
2. directly submit non-competitive bids at 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 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, Interest Bearing Treasury Bills.

In addition to primary dealers, ÁKK also uses the branch network of the Hungarian State Treasury and Hungarian Post for selling certain government securities.

THE BRANCH NETWORK OF THE HUNGARIAN STATE TREASURY

The State Treasury's branch network is involved in the trading of government securities in order to make them directly available to the general public and small investors. The Treasury network also has other functions, including depository tasks and the redemption of physical form government bonds that have already matured.

Instructed by ÁKK, the 19 Treasury branch offices in Budapest and at county seats continuously quote purchase prices for publicly issued bonds, discount treasury bills and Interest Bearing Treasury Bills until the third working day before their maturity, and quote sale prices for publicly issued government bonds and discount treasury bills with a remaining term-to-maturity exceeding 14 days.

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.

[9] 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.
[10] Other investors may submit bids at an auction indirectly, through a primary dealer.

THE HUNGARIAN POST OFFICE NETWORK

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 both printed government securities designed specifically for small investors.

THE DEALERS OF INTERNATIONAL BOND ISSUES

There are no specialized groups of dealers in either the primary or secondary markets for the foreign currency bonds of the Republic of Hungary. The investment banks or credit institutions chosen to be the lead managers of issues are selected individually for each transaction

IN 2008 THE LEAD MANAGERS WERE AS FOLLOWS*:

BNP Paribas (EUR)
Citigroup (EUR)
ING Bank N.V. (EUR)
ABN AMRO (CHF)
Credit Suisse (CHF)

* In 2008 there were two international bond issues of a total of 3 bonds, with three lead managers for the euro and two lead managers for the double Swiss franc transaction. The currency of the issue is shown in parentheses.

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).[11]

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 now 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 co-ordinated by 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 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.

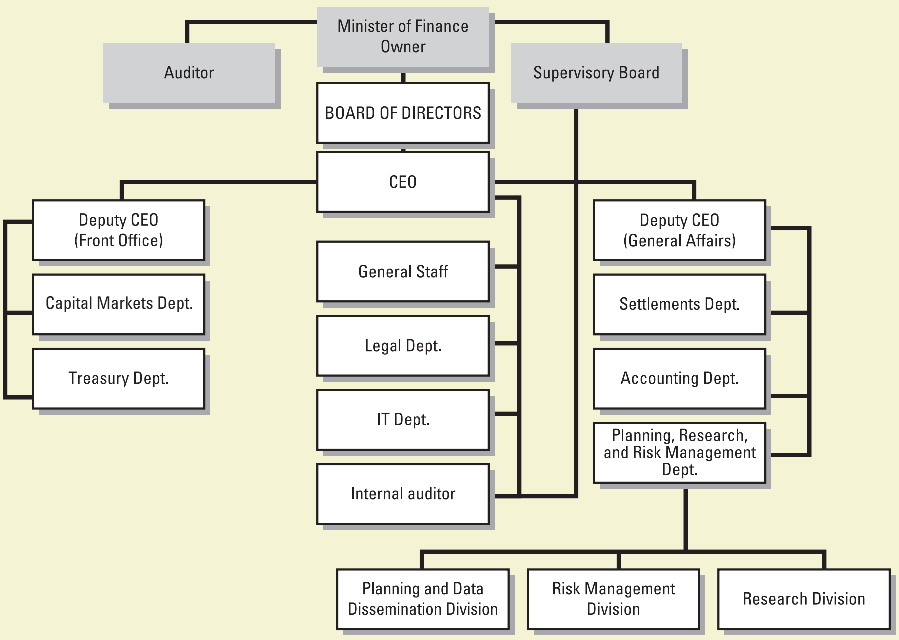
[11] The most important provisions concerning the financing of the deficit and government debt management, effective as of 1 December 2008, are provided in Section 4 of the Appendix.

THE 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).

Organisational structure of ÁKK



X. THE INFORMATION SERVICES OF ÁKK

ÁKK is required by law to provide information to the general public about the government debt and the developments in the government securities market. It fulfils these tasks using several channels, the main ones being its website, other electronic communications systems and its publications.

THE ÁKK WEBSITE

The website at www.akk.hu[12] provides a wide range of content for anyone interested in the government securities market or the government debt. ÁKK's goal is to present already on its homepage 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 (e.g. Treasury quotations). 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 works with databases, 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 and the volumes of various types of instruments. 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.

[12] 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 year in question);
- Debt Management Outlook publications (from the beginning of the year in question);
- quarterly reports (from the second month of the quarter in question);
- desktop issuance calendar (from December of the year preceding the year in question).

Monthly reports are only 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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APPENDIX

1. The central government gross debt as at 31.12.2008 (HUF million)

HUF denominated debt

Hungarian Government Bonds	Maturity	Coupon	Outstanding amount
2009/A	12.08.2009	Floating rate	1 861.80
2009/B	12.02.2009	9.50%	100,788.21
2009/C	24.06.2009	7.00%	244,879.79
2009/D	12.10.2009	8.25%	357,770.27
2009/E	24.04.2009	6.25%	234,227.57
2009/F	12.08.2009	6.50%	523,157.86
2010/A	12.08.2010	Floating rate	1,752.11
2010/B	12.10.2010	6.75%	373,263.18
2010/C	12.04.2010	6.75%	485,857.35
2010/D	24.08.2010	6.25%	526,442.58
2011/A	12.02.2011	7.50%	212,238.33
2011/B	12.10.2011	6.00%	397,563.55
2011/C	22.04.2011	6.75%	555,721.77
2012/A	31.12.2012	8.40%	5,705.72
2012/B	12.06.2012	7.25%	527,423.18
2012/C	24.10.2012	6.00%	656,062.38
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%	437,144.17
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%	400,849.11
2015/A	12.02.2015	8.00%	413,539.88
2016/A	31.12.2016	Floating rate	26,720.00
2016/B	02.01.2016	Floating rate	9,000.00
2016/C	12.02.2016	5.50%	432,750.11
2017/A	24.11.2017	6.75%	203,586.65
2017/B	24.02.2017	6.75%	670,273.75
2019/A	24.06.2019	6.50%	280,174.19
2020/A	12.11.2020	7.50%	326,146.68
2023/A	24.11.2023	6.00%	200,092.50
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	163.77
Total	**8,991,079.53**
Repos with government bonds (repos actually increase or decrease the total amount)	10,500.00
Discount Treasury Bills	**1,482,434.18**
Out of which matured, but unclaimed discount Treasury bills	0.00
Repos with discount Treasury bills (repos actually increase or decrease the total amount)	1,338.73
Interest Bearing Treasury Bills	**238,339.74**
Out of which matured. but unclaimed	673.82
Treasury Savings Bills (1-year)	**230,375.26**
Treasury Savings Bills (2-year)	**77,867.46**
HUF loans	**219,900.00**
Matured, but unclaimed other retail government securities	56.73
Total HUF debt	**11,250,552.89**

Foreign currency debt

	Outstanding amount (HUF million)	Outstanding amount (EUR million)
Foreign currency loan	**26,478.00**	**100.00**
Loans granted by International Financial Institutions*	**2,454 001.61**	**9,268.08**
of which: IMF and EC loans	**1,755 492.75**	**6,630.01**
Loans assumed from the market*	**48,904.63**	**184.70**

Foreign currency bonds:

	Currency	Maturity date	Maturity (years)	Coupon	Outstanding amount (HUF million)	Outstanding amount (EUR million)
105	EUR	16.02.2009	10	4.375%	132,390.00	500.00
112	EUR	27.06.2011	10	5.625%	264,780.00	1,000.00
113	EUR	06.02.2013	10	4.50%	264,780.00	1,000.00
114	EUR	27.09.2010	7	4.00%	264,780.00	1,000.00
115	EUR	29.01.2014	10	4.50%	264,780.00	1,000.00
116	GBP	06.05.2014	10	5.50%	136,180.00	514.31
117	JPY	18.06.2009	5	1.09%	104,115.00	393.21
118	EUR	28.10.2011	7	3.625%	264,780.00	1,000.00
120	USD	03.02.2015	10	4.75%	281,865.00	1,064.53
121	EUR	24.02.2020	15	3.88%	264,780.00	1,000.00
122	GBP	09.05.2017	12	5.00%	136,180.00	514.31
123	JPY	12.07.2010	5	0.62%	62,469.00	235.93
124	JPY	12.07.2012	7	0.96%	93,703.50	353.89
125	EUR	02.11.2012	7	3-month EURIBOR+0.05%	264,780.00	1,000.00
126	EUR	18.07.2016	10.5	3.50%	264,780.00	1,000.00
127	JPY	18.03.2013	7	1.67%	104,115.00	393.21
128	GBP	30.03.2016	10	5.00%	136,180.00	514.31
129	EUR	04.07.2017	10	4.375%	264,780.00	1,000.00
130	JPY	26.10.2017	10	2.11%	52,057.50	196.61
131	CHF	21.05.2013	5	3.50%	26,667.00	100.71
132	CHF	20.05.2016	8	4.00%	35,556.00	134.29
133	EUR	11.06.2018	10	5.75%	397,170.00	1,500.00
Total					**4,081,668.00**	**15,415.32**

Out of which: cross-currency swaps	163,746.21	
Kingdom of Hungary 1924 bond issue	36.44	
Total foreign currency debt	6,774,834.89	
Total central government debt	18,025,387.78	
Other obligations of ÁKK (marked-to-market deposits placed at ÁKK)	78,514.85	
Grand total	18,103,902.63	

* 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

Moody’s, Standard and Poor’s and Fitch Ratings all assigned a ‘negative’ rating outlook to the long-term foreign currency debt of the Republic of Hungary at the end of 2008.

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+

At the end of 2008 Moody’s and Standard and Poor’s assigned a ‘negative’, while Fitch Ratings assigned a ‘stable’ rating outlook to the long-term domestic currency debt of the Republic of Hungary.

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*

ACT NO. XXXVIII OF 1992 ON PUBLIC FINANCES

(...)

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 Companies Act (Act No. CXLIV, 1997).

(4) The shareholder's rights are exercised by the Minister responsible for public finances, 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 may hold positions on ÁKK's Board of Directors and Supervisory Board.

(6) The scope of responsibility of the Supervisory Board of ÁKK does not include the evaluation of 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 out of effect]

(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 Article 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 Article 113/A of the Act on Public Finances.

(...)

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 councils and local minority councils, 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.

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

(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 debt of the central government.

(2) Extra-budgetary funds, Social Security funds and local authorities 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 finances;

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 about the developments of the government securities market in accordance with the Government Decree referred to in Section 112;

h) upon a separate authorisation by 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	2007	2008
	A) Fixed assets	**84,436**	**85,381**
I	**Intangible assets**	**30,865**	**28,022**
II	**Tangible assets**	**49,578**	**48,028**
III	**Invested financial assets**	**3,993**	**9,331**
	B) Current assets	**367,140**	**404,593**
I	**Inventories**	**0**	**0**
II	**Receivables**	**2,514**	**8,965**
III	**Securities**	**0**	**0**
IV	**Cash and cash equivalents**	**364,626**	**395,628**
	C) Accrued and deferred assets	**16,305**	**11,880**
	Assets in total	**467,881**	**501,854**

	Liabilities	2007	2008
	D) Capital and reserves	**354,914**	**354,914**
I	**Subscribed capital**	**300,000**	**300,000**
IV	**Profit reserve**	**35,886**	**54,914**
VII	**Balance-sheet profit or loss**	**19,028**	**0**
	E) Provisions	**4,356**	**0**
	F) Liabilities	**76,710**	**117,425**
I	**Subordinated liabilities**	**0**	**0**
II	**Long-term liabilities**	**0**	**0**
III	**Short-term liabilities**	**76,710**	**117,425**
	G) Accrued and deferred liabilities	**31,901**	**29,515**
	Liabilities in total	**467,881**	**501,854**

Budapest, 31 March 2009

Ferenc Szarvas
CEO

II. PROFIT AND LOSS ACCOUNT data in HUF thousand Appendix

	Liabilities	2007	2008
I	**Net sales revenue**	**836,267**	**885,573**
III	**Other revenue**	**5,669**	**5,899**
IV	**Material expenses**	**160,367**	**179,200**
V	**Personnel expenses**	**638,539**	**672,482**
VI	**Depreciation and amortisation**	**44,492**	**39,257**
VII	**Other expenses**	**4,882**	**3,886**
A	**OPERATING PROFIT OR LOSS**	**-6,344**	**-3,353**
B	**PROFIT OR LOSS FROM FINANCIAL TRANSACTIONS**	**29,929**	**37,648**
C	**PROFIT OR LOSS ON ORDINARY ACTIVITIES**	**23,585**	**34,295**
D	**EXTRAORDINARY PROFIT OR LOSS**	**-80**	**-12**
E	**PROFIT OR LOSS BEFORE TAXATION**	**23,505**	**34,283**
XII	**Tax payable**	**4,477**	**6,333**
F	**PROFIT OR LOSS AFTER TAXATION**	**19,028**	**27,950**
23	**Approved dividends**	**0**	**27,950**
G	**BALANCE-SHEET PROFIT OR LOSS**	**19,028**	**0**

Budapest, 31 March 2009

Ferenc Szarvas
CEO

6. SENIOR OFFICIALS OF ÁKK AT THE END OF 2008

Members of the Board of Directors:

Dr. Álmos Kovács, chairman
Mrs. Imre Karácsony, member
Ferenc Szarvas, member

Members of the Supervisory Board:

Zoltán Sághy, chairman
Balázs Romhányi, member
Dr. Béla Jónás, member

The Company's auditor:

KPMG Hungária Kft.
Budapest, 1139 Váci út 99.

Responsible auditor:

Gábor Agócs,
Audit Director

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