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GOVERNMENT DEBT MANAGEMENT AGENCY PTE LTD.

DEBT MANAGEMENT REPORT

▪ 2006 ▪

FOREWORD

This report describes the public debt management of the Republic of Hungary in 2006. Besides funding operations it includes the evolution of the government debt and the government securities market in order to fulfil the strategic objective of transparency by providing information on debt management for market participants, investors and decision-makers.

2006 was a challenging year for the Republic of Hungary since the run-up to the general elections in the first half of the year coincided with the deterioration of the fiscal position. After these demanding months for debt management a new period started with an updated Convergence Programme by the re-elected government aiming to stabilize the fiscal situation and, on a longer term, to establish the foundations for the EMU membership of the Republic of Hungary. The commitment of the government to improve fiscal position was followed by legislation, investors' confidence returned and foreign investors' participation in the domestic public debt market grew rapidly. One can say that the basic objectives for 2006 were met and the financing of the deficit was reached at the lowest possible costs in the long term while running acceptable risks.

Ferenc Szarvas
Chief Executive Officer

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GENERAL INFORMATION

Both deficit and debt figures are considered to be preliminary until the Parliament approves the Act on Final Accounts in the last quarter of the following year. Most of the data are cash-flow based, while some are accrual-based in this report. Expenditures and revenues on a cash basis are accounted for in the period when they are actually paid or received, regardless of which period the economic contents of the transactions relate to. On the other hand, on accrual basis the amount of an expenditure or revenue item that concerns several periods is divided pro rata among the periods.

From a debt management point of view, interest expenditures are generally calculated according to these two methods. In the case of a bond with annual coupon payment, the total interest expenditure for the year on cash basis is stated for the year in which it was actually paid. On accrual basis, however, the interest is divided into two parts and is charged to both years involved depending on the proportion of the interest period falling on one year and the other.

ÁKK records government debt on the basis of the Hungarian accounting standards, which can be summarised as the following:

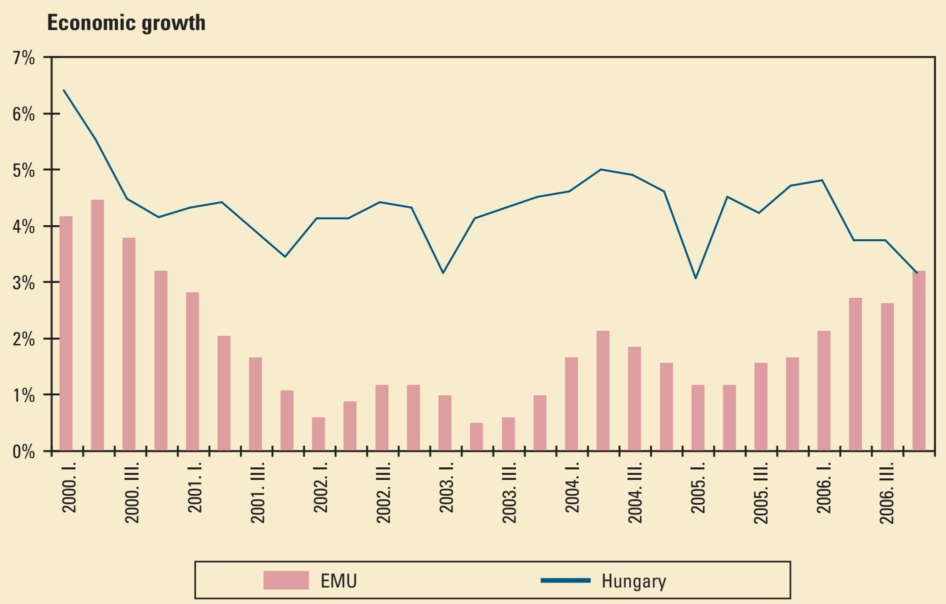
- Government bonds and retail securities are recorded at nominal value.
- Discount Treasury bills are recorded at the average sales price – basically at discount value – which is calculated daily after the transactions.
- Repo and reverse repo transactions increase or reduce government debt.
- Foreign currency debt is presented after cross-currency swap transactions and converted to HUF at the official NBH mid exchange rate at the end of the month/year.
- The debt recorded by ÁKK covers the debt of the central government (i.e. it excludes that of municipalities) and is not consolidated (does not include the debt of state-owned enterprises or other public entities).

The debt statistics published by ÁKK are based on the Hungarian accounting standards and differ from statistics prepared by the European Union, due to differences in methodology. Debt figures according to the ESA'95 principles are calculated and published by Eurostat on the basis of information provided by the Ministry of Finance, the Hungarian Central Statistical Office (HCSO) and the NBH jointly, relying partly on ÁKK's figures.

I. MACRO-ECONOMIC DEVELOPMENTS IN 2006

THE ECONOMY

The Hungarian economy grew by 4.0 per cent in 2006, somewhat slower than in previous years. The slower growth rate was the result of fiscal consolidation measures effective from the last quarter of 2006. However the structure of economic growth improved in 2006 compared to previous years. Net export was the driver of economic growth, the dynamics of consumption decelerated and the volume of investments also fell.



Source: Central Statistical Office (CSO), Eurostat

The main driver of economic growth was the strong external demand in 2006. Both the volume of exports and imports grew rapidly (by 18 per cent and 12.6 per cent respectively), but the gap between the dynamics of exports and imports resulted in the improvement of the current account deficit to GDP ratio from previous year's 6.9 per cent to 5.8 per cent in 2006.

In 2006 the amount of gross investments fell by 1.8%, mainly as a result of the significant decrease of public investments in the second half of the year, the deceleration of home building activity and the falling investments of the manufacturing sector. Household consumption grew only by 1.2% in 2006, the lowest figure since 1997. The deceleration was caused mainly by the increase of household savings.[1] Real wages grew by 3.5%, i.e. at slower pace compared to the previous year due to increased tax levels. The fiscal consolidation measures (tax-, social security contributions- and price subsidy reductions) actually caused falling real wages in the last quarter of 2006.

[1] In recent years the HCSO revised upwards the consumption figures compared to the first releases significantly; this is possible in case of 2006 data as well.

FISCAL AND MONETARY DEVELOPMENTS

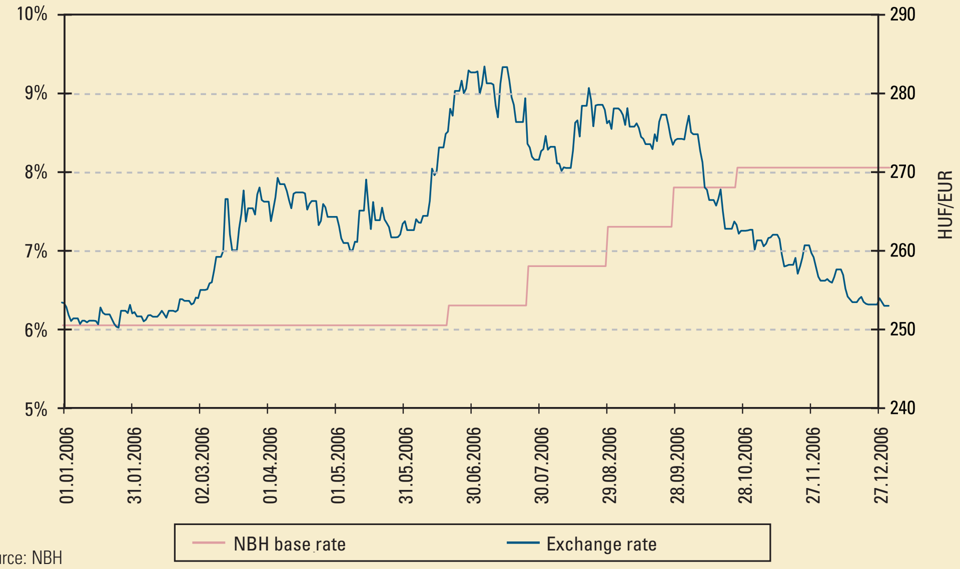
The original cash-flow based government deficit target for the year 2006 was HUF 1,581 billion equalling 6.8% of GDP. Two-thirds of the originally planned deficit accumulated in the first 4 months of the year. After the general elections held in April 2006 the new government revised the projected public deficit and introduced measures aimed at reduction of the budget deficit. However, despite a fiscal correction program of HUF 350 billion the public deficit target was revised upwards. The unfavourable budgetary situation caught market participants by surprise, so there was a mixed reaction to the austerity measures. After the implementation of the actual budgetary measures and the approval of the Convergence Programme by the European Union the market's assessment of the fiscal policy improved. The preliminary cash-flow based deficit of the central government was HUF 2,033 billion, or 8.6 per cent of GDP in 2006.

The net financing requirements of the government were high in 2006[2]. Although, as a result of higher mortgage and consumer loans, the net lending position of households decreased in 2006 (to 3.0% from 4.3%), it was still significant. The net borrowing requirement of the enterprises decreased to 2.1% from 4.5% of GDP in 2005 due to a decrease in investments.

Altogether the consolidated financing needs of the resident sectors amounted to 5.8% of GDP; the current account deficit declined to EUR 5.2 billion. The share of long-term foreign investments (FDI, re-invested corporate profit) amounted to approximately half of the external financing needs. The net external debt of the country rose by EUR 5.9 billion to EUR 30.1 billion by the end of 2006.

In the first half of 2006 the Hungarian forint (HUF) depreciated gradually, partly as a result of political uncertainties related to the elections and partly reflecting the general sentiment towards emerging markets. The central bank raised the central bank base rate gradually from 6% to 8% reacting to both internal (growing risk of inflation and inflation expectations) and external (lower global and regional risk appetite) factors. By the end of 2006 the Hungarian forint appreciated back to the level it was at the beginning of the year (around 250 HUF/EUR).

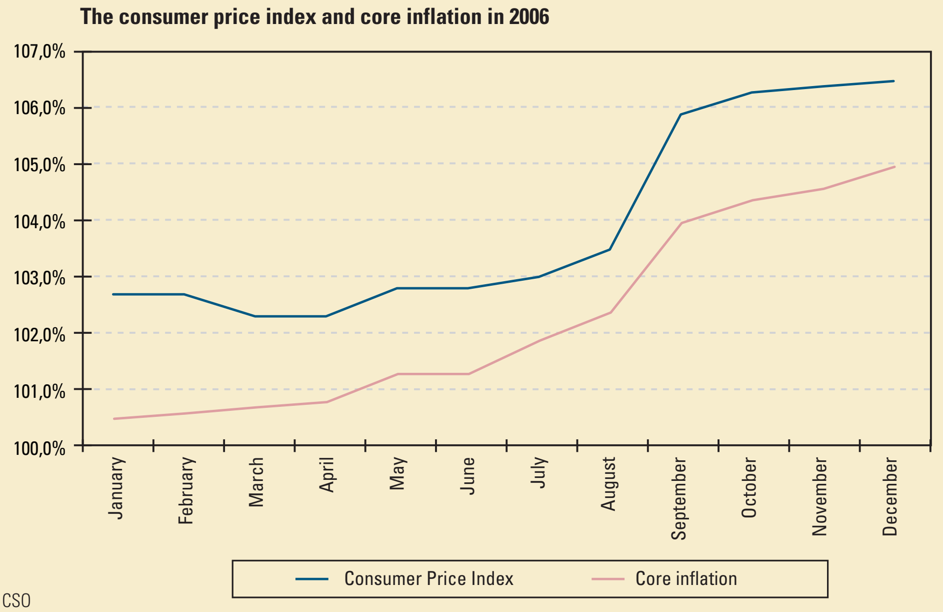
Monetary conditions in 2006



Source: NBH

[2] Components of the net financing requirement are presented in detail in Chapter V.

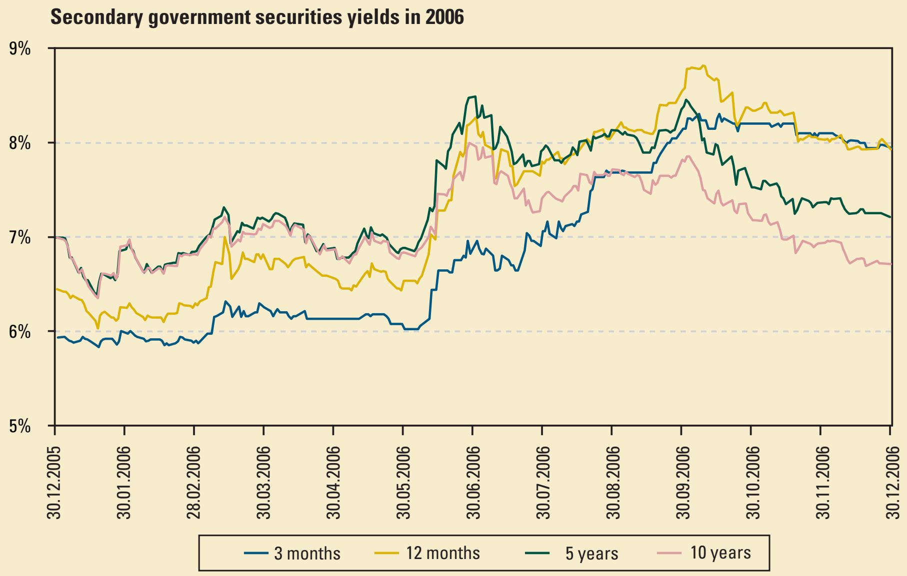
At the beginning of 2006 the inflation rate fell to its lowest level in decades as a result of VAT decreases. The slow consumption dynamics and the relatively strong foreign exchange rate proved to be important disinflationary factors. Since May 2006 the inflation rate increased significantly driven by growing food and regulated energy prices, VAT and indirect tax raises effective from September 2006. These tax hikes increased the price level by 1.5%. 12-month inflation rate amounted to 6.5% by the end of the year. Core inflation rose significantly, too. Average annual inflation was 3.9% in 2006, compared to 3.6% in 2005.



Source : CSO

DEVELOPMENTS IN THE GOVERNMENT SECURITIES MARKET

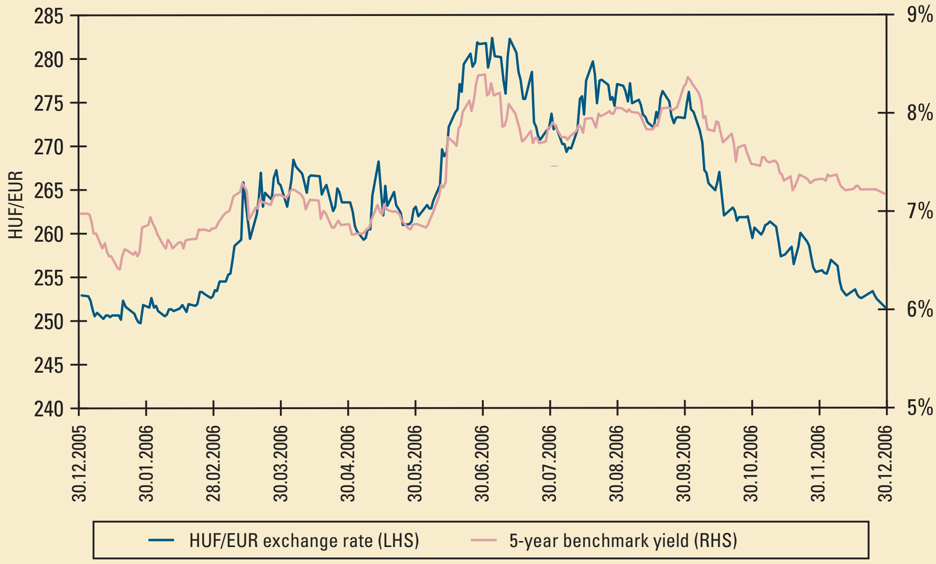
There was a significant increase in short-term government securities yields in 2006. At the end of the year, short-term benchmark yields – following the interest rate hikes by the central bank – were 154-197 basis points higher than a year before. The rise in bond yields was more moderate. Middle-term (3-5 years) bond yields grew 25-64 basis points, the longest term (10-15 years) bond yields rose by 26-29 basis points in 2006.



Source: ÁKK

Rates in the money market started to rise before the general elections in a less supportive global environment. On the short end of the yield curve the rising central bank base rate supported the higher rates. In the autumn of 2006 the global environment turned more favourable; moreover, positive reactions towards the Convergence Programme and later the approval of the budget for the year 2007 improved the investors' attitude and led to decreasing forint yields. The last months' falling yields reflected the increasing global risk appetite, too. During this period short-term yields moved closely to the central bank base rate.

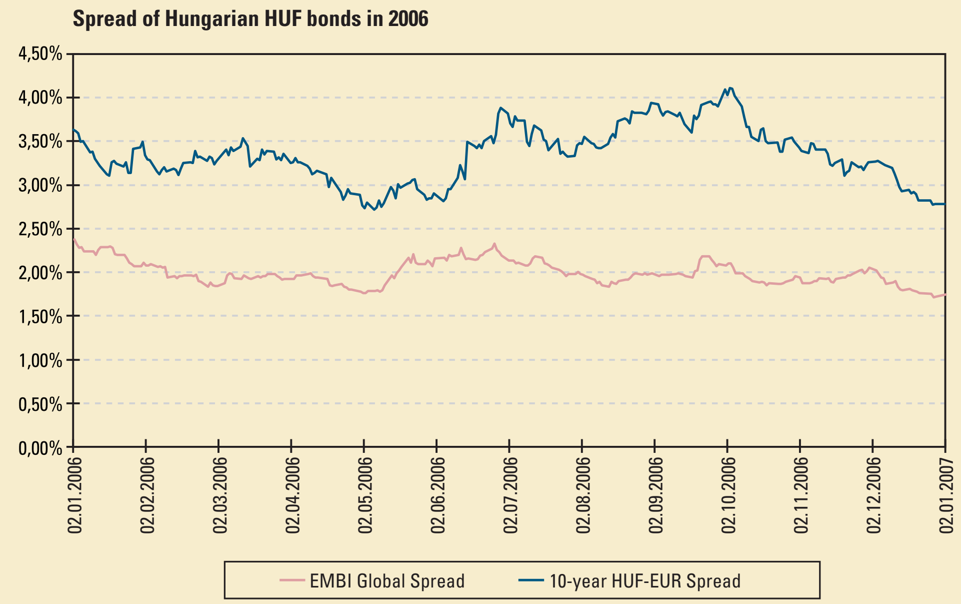
Government securities yields and the exchange rate



Source: NBH, ÁKK

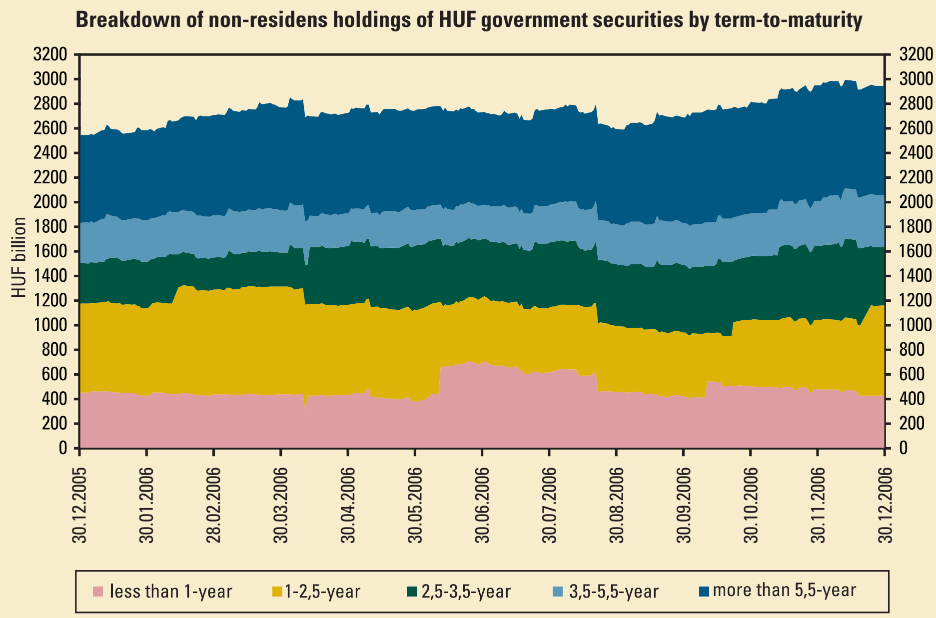
The forint premia and the compound premia of the emerging market bond indices (the EMBI Global spread[3]) moved in parallel with the global capital markets. The Fed's interest rate policy and market expectations concerning this policy had a significant effect on global markets. This effect on both the EMBI spread and Hungarian yields was clearly seen during the year of 2006 – amid the turning of the political cycle. With low interest rates and high liquidity worldwide the capital inflow into emerging markets jumped during the first part of the year, and the risk premia in these markets dropped to record low levels in May. Since May 2006 the market participants anticipated – partly driven by quickly growing energy prices – higher US inflation and as a result tighter Fed monetary policy than previously expected. Higher ECB rates were also expected as a result of inflation risk and improving confidence indices. This decreased the demand for emerging market and Hungarian assets, and interest rate premia increased. Hungarian interest rate spread also increased significantly mainly as a result of uncertainties about Hungarian fiscal policy. In the second half of the year emerging market yield spreads decreased slightly, which was not followed by the Hungarian yield spread. Only during the last months of 2006 did Hungarian yield spreads fall in parallel to the decreasing emerging market yield spread as a result of the introduction of fiscal deficit decreasing measures. The 10 year spread over the Bund rose to 4.09% in October, and fell to 2.76% by the end of 2006.

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



Source: NBH, ÁKK, Bloomberg

The volume of HUF government securities held by non-residents grew by HUF 399 billion to HUF 2,937 billion (EUR 11.6 billion) at the end of the year. The share of non-resident holdings within the forint denominated debt did not change significantly (growing from 28% to 29%). Foreigners owned 47% (HUF and foreign currency added) of the total debt portfolio.



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

II. THE DEBT MANAGEMENT STRATEGY IN 2006

Government debt management activities are based on a debt management strategy approved yearly by the Minister of Finance. The debt management strategy for 2006 was prepared on the basis of an optimal portfolio model completed in 2004.

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

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

Both the size of public debt and the financing requirements of the budget are external factors for ÁKK, i.e. they are determined by the fiscal policy. ÁKK cannot influence the deficit substantially; the selection of the actual cost-risk profile of the debt may have only a small effect on that.

The most important risk factors are:

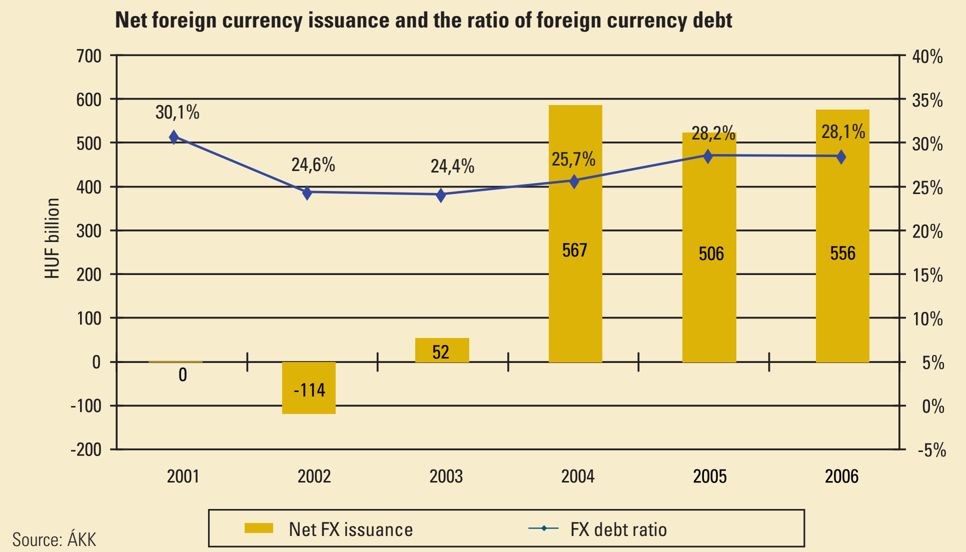
- Renewal or refinancing risk arises out of renewal of maturing debt and meeting the net financing requirements. In extreme cases, the refinancing risk means liquidity (insolvency) risk, otherwise it translates to interest rate risk.
- The interest rate risk is associated with the change in the level of government securities yields.
- The liquidity risk appears in the fluctuation of the cash-flows of the central government and in the money market operations of debt management.
- The exchange rate risk arises out of changes in the exchange rates of the HUF and the euro and in the cross exchange rate of various other foreign currencies.
- Credit risk or counterparty risk is an important risk factor in case of hedging operations concluded directly with partners in the international capital markets and the repo activity in the HUF market.

Between certain risks there is a trade-off, i.e. the increase of one type of risks leads to the decrease of an other (e.g. interest rate and exchange rate risk), or certain risk types can move parallel, meaning that if one risk increases, the other risk increases as well (for instance, between financing and interest rate risk). ÁKK developed benchmarks reflecting its strategic objectives for certain segments of its activities by taking into account risks and costs together. The benchmarks approved by the Minister of Finance also help to quantify strategic objectives, i.e. those formulate intermediate targets.

In December 2004, ÁKK revised the debt management strategy based on (1) the change in the investment environment and (2) a new in-house developed optimum portfolio model.

THE RATIO OF FX DEBT /HUF DEBT

The ratio of the foreign currency denominated debt should be in a target range of 25-32% of the total public debt. As a consequence of the EUR 2.2 billion net foreign currency issuance, at the end of 2006 the ratio of FX debt/total debt stood at 28.1, i.e. at the middle of the targeted band.



Source: ÁKK

THE CURRENCY COMPOSITION OF THE FOREIGN CURRENCY DEBT PORTFOLIO

In order to mitigate the cross currency risk the currency composition of the FX debt portfolio should correspond to the composition of the currency basket of the Hungarian forint, i.e. 100% euro. If the Republic raises funds in a currency other than the Euro, those shall be converted into euro using cross-currency swaps. At the end of 2006 100% of foreign currency debt was in Euro.

FIXED/FLOATING RATE COMPOSITION OF THE FX DEBT

The objective of this benchmark is to optimize the relationship between interest cost and risk. The optimal mix was defined as 66% fixed and 34% floating rate with a narrow tolerance band around these levels. Having concluded interest rate swaps ÁKK set the actual interest rate composition at 66.2%-33.8%, by the end of 2006.

FIXED/FLOATING RATE COMPOSITION OF THE HUF DEBT

The fixed rate elements within the HUF-denominated debt should be between 61-83%. As ÁKK refrains from concluding IRS in the domestic market the only way it can influence the fixed/floating mix of the HUF portfolio is by changing the weight of short- and long-term instruments in the issuance. (Short-term instruments with a maturity of less than one year are also considered as floating rate debt.) The proportion of the fixed-rate HUF debt stood at 68.4% at the end of 2006.

DURATION OBJECTIVE

The strategic objective is to keep the duration of the HUF portfolio in the range of 2.5 +/- 0.5 years. The duration is important in two aspects: the renewal risk, and the interest rate sensitivity. Short term-to-maturity and floating interest rate result in yield changes appearing sooner in interest expenditure so the higher interest rate volatility considerably increases the fluctuation of interest expenditures of the budget. Lengthening the duration reduces the interest rate sensitivity so it may support the stability of fiscal policy. At the end of 2006 the duration of the HUF portfolio was 2.62 years.

OPTIMAL BALANCE OF THE SINGLE TREASURY ACCOUNT (STA)

The optimal level of the STA should serve as a liquidity reserve in adverse market conditions. ÁKK manages actively the liquidity of the STA in order to keep the end-of-day actual balance within a range of +/- HUF 50 billion around the optimal level.

PRINCIPLES USED IN DEBT MANAGEMENT

Simplicity, transparency and liquidity are the main principles that determine the activity of ÁKK.

To maintain simplicity, ÁKK uses a small number of instruments that have plain vanilla structures in a transparent and market conform way. In order to ensure transparency, ÁKK sells HUF bonds and discount Treasury bills at auctions, based on an annual issuance calendar, published in advance for given year. Regarding liquidity, ÁKK aims to maintain a liquid secondary market of government securities. The establishment of the primary dealer system also served this purpose. Using the two-way price quotations of the primary dealers with a maximized spread, investors are able to buy and sell government securities continuously at real market prices during the trading session. ÁKK promotes appropriate liquidity also by building up large volume series of individual government securities. In order to achieve this, ÁKK reopens series of bonds that are fungible with already outstanding securities until the volume reaches HUF 400-500 billion, corresponding to about EUR 1.5-2.0 billion.

III. THE FINANCING REQUIREMENTS IN 2006

The 2006 financing plan was approved by the Minister of Finance in January 2006 and published by ÁKK in the publication "Debt Management Outlook 2006".

COMPONENTS OF THE FINANCING REQUIREMENT

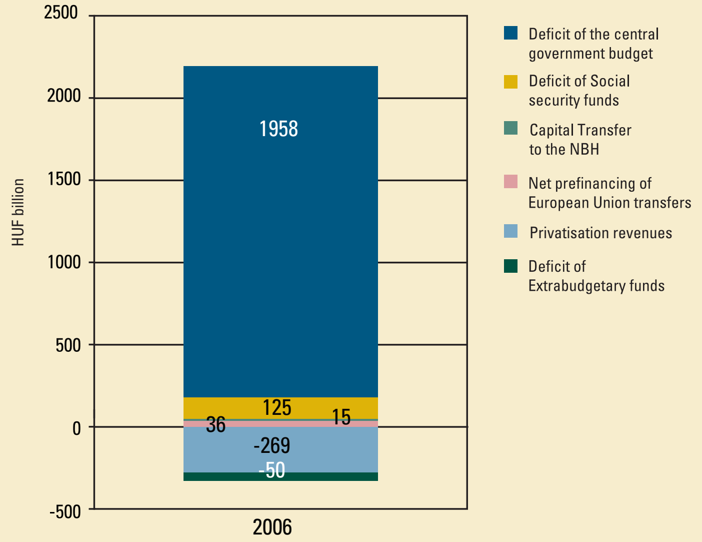
The Budget Act for the year 2006 (law no. CLIII of 2005) planned a deficit of HUF 1,581 billion of the central government for 2006 on a cash basis. The balance of the central government consists of the consolidated balance of the central government budget, the social security funds[4] and the extrabudgetary funds[5].

ÁKK is responsible for financing the deficit of the central government excluding the financing of the local governments, as municipalities are responsible for their own budget, financing and debt management operations.

For financing purposes, cash-flow based deficit figures are relevant as they show the actual financing requirements and these figures determine primarily the nominal growth of the government debt during the year. At the same time, accrual-based deficit figures are also disclosed according to the ESA'95 methodology. Accrual-based data provide a better picture on the fiscal policy for economic analysis.

The total annual net financing requirement is made up of the cash-flow based balance of the central government and other payments and receipts like privatisation revenues, transfers to the central bank, EU funds etc. The total gross financing requirement, in addition, includes renewal of maturing debt.

Total net financing requirement in 2006



Source: ÁKK

[4] Health Insurance Fund and Pension Fund

[5] Central Nuclear Fund, Employment Fund, Miklós Wesselényi Flood and Inland Waters Prevention and Compensation Fund, Homeland Fund and Research and Technology Innovation Fund

In 2006 the financing requirements on cash-flow basis were as follows:

Cash-flow based borrowing requirement in 2001-2006

						billion HUF
	2001	**2002**	**2003**	**2004**	**2005**	**2006**
Balance of the central government budget*	-402.9	-957.7	-733.6	-890.0	-544.7	-1,958.4
Balance of the Social security funds	-28.8	-100.9	-342.9	-422.9	-469.8	-124.7
Balance of the Extrabudgetary funds	-2.3	1.4	18.8	27.9	30.4	50.1
Balance of the central government*	**-434.1**	**-1,057.1**	**-1.057.7**	**-1,285.1**	**-984.1**	**-2,033.0**
Capital transfer to the NBH	0.0	-250.2	-82.9	0.0	-1.1	-14.8
Privatisation revenues and capital transfers	0.0	0.0	42.0	166.5	0.0	268.7
Net pre-financing of European Union transfers	0.0	0.0	0.0	-12.8	-169.0	-35.8
Net financing requirement	**-434.1**	**-1,307.3**	**-1,098.6**	**-1,131.3**	**-1,154.2**	**-1,814.9**
Redemption of Treasury bills	-2,004.5	-2,888.6	-3,635.2	-4,277.7	-4,265.7	-5,078.6
Long term debt redemption	-990.9	-1,053.4	-1,809.6	-1,253.2	-1,885.0	-1,856.3
Gross financing requirement	**-3,429.4**	**-5,249.3**	**-6,543.4**	**-6,662.2**	**-7,304.9**	**-8,749.7**

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

Source: Hungarian State Treasury, ÁKK

NET FINANCING REQUIREMENT

The total cash-flow based deficit of the central government in 2006 – including debt assumptions – amounted to HUF 2,033 billion (8.6% of GDP) according to preliminary figures, while the total net financing requirement accounted to HUF 1,815 billion (7.6% of GDP). The actual net financing requirement on a cash basis was some 28% higher than the original plan, however, the total gross financing requirement was only 18% higher than the originally planned amount, due to privatisation revenues of HUF 269 billion that exceeded the original estimates.

Cash-flow based borrowing requirement in 2006 - projection and outturn

	Plan January 2006 (HUF billion)	Outturn in 2006 (HUF billion)	Change compared to plan (per cent)
Balance of the central government budget	-1,568.5	-1,958.4	124.9%
Balance of the Social security funds	-31.8	-124.7	392.1%
Balance of the Extrabudgetary funds	17.0	50.1	294.7%
Balance of the central government	**-1,583.3**	**-2,033.0**	**128.4%**
Capital transfer to the NBH	0.0	-14.8	0.0%
Privatisation revenues and capital transfers	150.0	268.7	179.1%
Net prefinancing of European Union transfers	17.4	-35.8	-205.7%
Net financing requirement	**-1,415.9**	**-1,814.9**	**128.2%**
Redemption of Treasury bills	-4,308.9	-5,078.6	117.9%
Long term debt redemption	-1,701.6	-1,856.3	109.1%
Gross financing requirement	**-7,426.5**	**-8,749.7**	**117.8%**

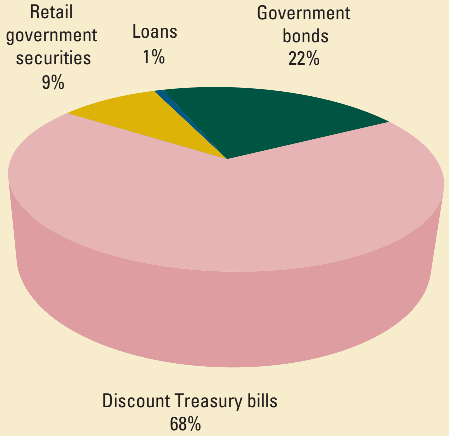
Source: Hungarian State Treasury, ÁKK

Capital transfer to the National Bank of Hungary and the pre-financing of EU transfers increased the net financing requirement.

REDEMPTIONS

Gross redemptions depend mostly on the type of debt issued earlier, especially on the issuance of short-term debt (i.e. debt with a maturity of less than one year).
Within the domestic currency denominated debt, similarly to earlier years, Discount Treasury Bills were renewed several times a year, accounting to about two-thirds of the repayments of HUF 6,704 billion, while other instruments had a much lower proportion.

Composition of HUF debt redemptions in 2006



Source: ÁKK

In 2006, all redemptions in HUF-denominated government securities and loans were higher than planned in January of 2006, while debt redemptions in foreign currencies were in line with plans.

Government debt redemptions in 2006*

(HUF billion)

	2005	2006 plan	2006 fact
Total domestic debt	**5,582.2**	**5,790.5**	**6,704.4**
Treasury bonds	1,100.4	1,424.6	1,467.6
Discount treasury bills	3,696.2	3,791.9	4,563.1
Retail securities	592.2	573.6	613.4
Loans	193.4	0.3	60.3
Redemption of foreign currency debt	**568.5**	**220.0**	**231.0**
Bonds	249.6	195.8	205.8
Loans	318.9	24.2	25.2
Total redemptions	**6,150.7**	**6,010.5**	**6,935.4**

*Including repos

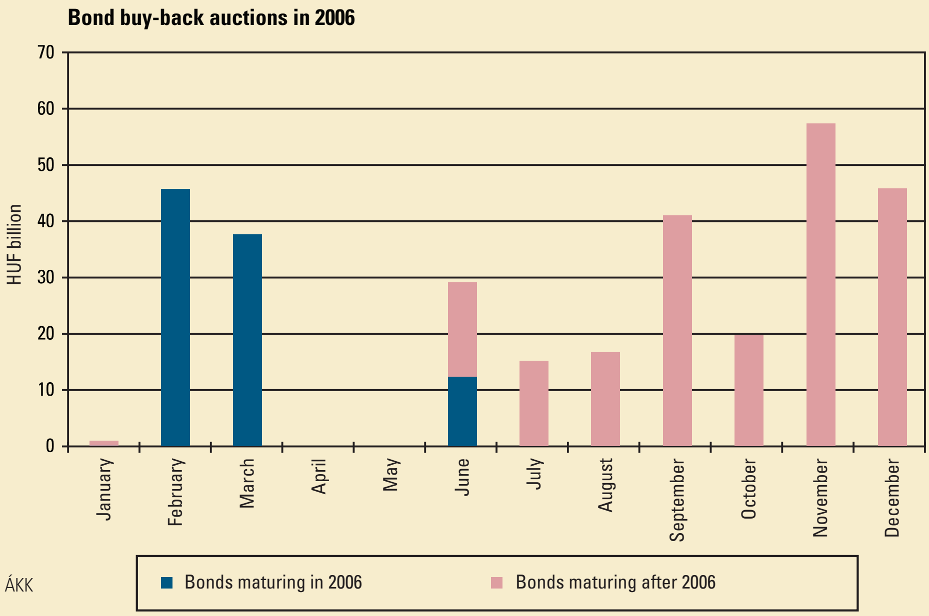
Source: ÁKK

As a result of more bond buy-backs, redemptions of government bonds were higher than planned. ÁKK also issued more liquidity T-bills and 3-month Discount Treasury Bills than planned for liquidity management purposes, which resulted in higher than expected total discount T-bill redemptions during the year. The loans assumed from the Hungarian Motorway Corporation (NA Zrt.) in November of 2006 were prepayed in the same month accounting for the majority of the HUF 60.3 billion of loan repayments in 2006. Prepayment is a standard measure in relation to loans assumed by the Republic since most assumed loans have a spread over the government yield-curve.

Out of the total foreign currency debt redemptions of HUF 231 billion bonds made up HUF 206 billion (USD 750 million and USD 100 million) and loans accounted for HUF 25 billion.

BOND BUY-BACKS

The renewal risk, arising from large bond redemptions can be reduced by buying back some of the bonds before maturity. ÁKK organized 18 reverse auctions in 2006, where a total of HUF 310 billion were accepted. 69% of the buy-backs involved bonds maturing after 2006, thus smoothing repayments between years.



Source: ÁKK

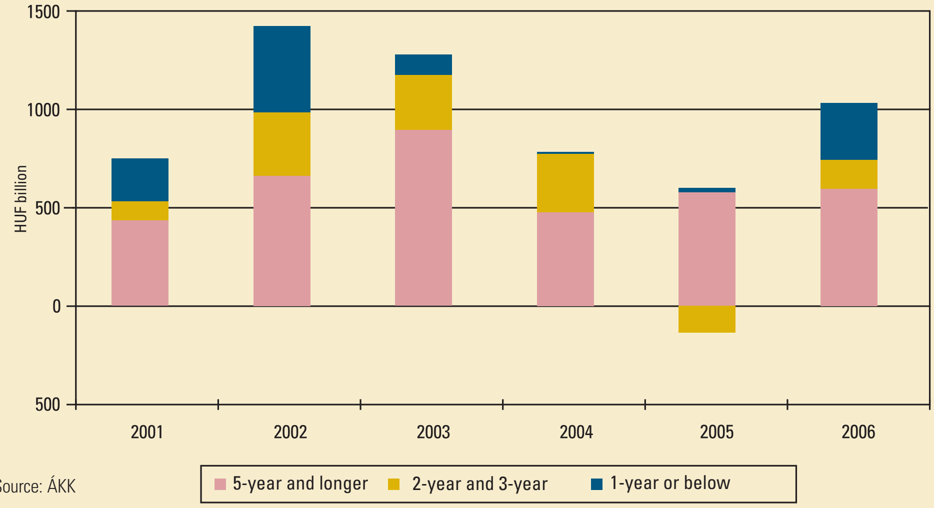
Bonds bought back in 2006 included the gas utility bonds in an amount of HUF 2 billion, in line with legal obligations (laws no. LVI. of 2001 and LXIII. of 2002).

IV. FINANCING

In 2006 gross issuance of HUF-denominated instruments (excluding repos, but including debt assumptions) amounted to HUF 8093.8 billion, while that of foreign currency denominated instruments made up HUF 787.1 billion. Total net issuance in 2006 was HUF 1,973.5 billion (excluding repos); out of which net HUF-denominated issuance was HUF 1,417.4 billion and net issuance in foreign currencies was HUF 505.7 billion.

The main instruments in financing were government bonds, both in the domestic and international markets. Net issuance of Discount Treasury bills was HUF 225 billion including repos, and the outstanding stock of retail securities rose by HUF 78.7 billion in 2006.

Breakdown of net domestic securities issuance by tenor



Source: ÁKK

The volume of both HUF and foreign currency denominated loans increased in 2006. The stock of HUF-denominated loans rose by HUF 355.6 billion (as a balance of loan assumptions of HUF 415.9 billion and prepayments of HUF 60.3 billion). Foreign currency denominated project financing loan drawdowns exceeded redemptions by HUF 86.2 billion in 2006. No loans were raised from the international markets for general financing purposes.

PLANNED AND ACTUAL GROSS AND NET DOMESTIC FINANCING

The total amount of gross HUF issuance was above the announced plans. That was primarily the result of higher HUF bond and T-bill issuance and loan assumptions.

Gross government debt issuance in 2006*

	2005	2006 plan	(HUF billion) 2006 fact
Total domestic debt	**6,126.8**	**6,860.3**	**8,100.9**
Treasury bonds	1,620.9	2,024.0	2,207.2
Discount treasury bills	3,763.7	4,022.1	4,786.0
Retail securities	552.6	576.1	691.8
Loans	189.6	238.0	415.9
Redemption of foreign currency debt	**1,074.2**	**609.4**	**787.1**
Bonds	974.8	505.0	675.8
Loans	99.4	104.4	111.4
Out of which: loan assumptions	0.0	0.0	0.0
Total issuance	**7,201.0**	**7,469.7**	**8,888.0**

*Including repos

Source: ÁKK

ÁKK issued only fixed government bonds with 3, 5, 10 and 15-year tenor in 2006. Bond auctions were held every two weeks. A total of HUF 2,181 billion of bonds were sold via auctions. The total issuance of government bonds, including sales in the Treasury network (HUF 21 billion) and excluding repos amounted to HUF 2,202 billion.

Net HUF denominated bond issuance amounted to HUF 735 billion, substantially above the HUF 440 billion in 2005 (figures are rounded). The 67% increase in net sales was the result of higher gross issuance, since redemptions remained approximately the same.

ÁKK sold two series of 3-, 5- and 10-year bonds and only one series of the 15-year bond in 2006. According to the strategy, secondary market liquidity is helped by issuing bond series with a size of HUF 400-500 (ca. EUR 1.5-2 billion) and in the case of the 15-year bond the target size is HUF 250 billion (ca. EUR 1 billion).

Bond series issued in 2006 (HUF billion)

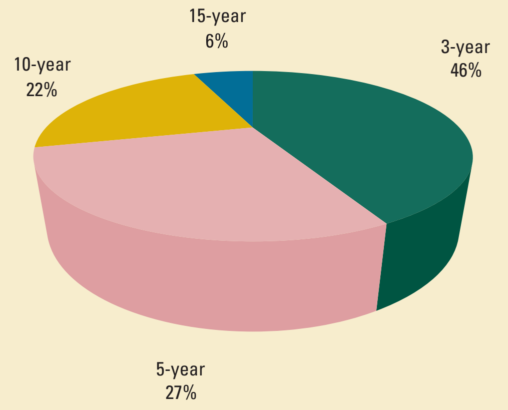
	Maturity	No of auctions	Auctioned amount (HUF billion)	Size of the series* (end of 2006)
2009/E	3-year	6	450	455
2009/F	3-year	7	535	538
2011/B	5-year	8	395	396
2012/B	5-year	4	190	190
2016/C	10-year	9	331	433
2017/B	10-year	4	150	150
2020/A	15-year	6	130	326

*Excl. repos

Source: ÁKK

The structure of gross bond issuance by tenor corresponded to that of the previous year, i.e. the increase of the total sales volume was realised evenly among the different tenors.

Breakdown of gross domestic issuance by tenor in 2006

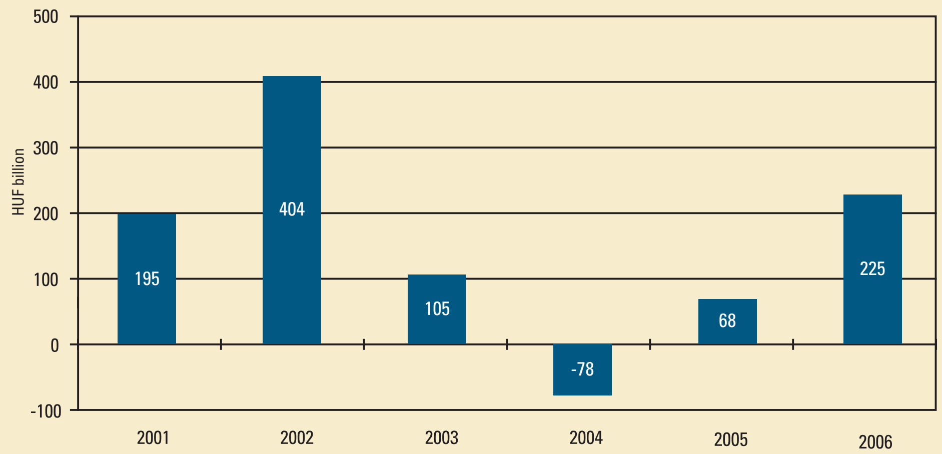


Source: ÁKK

DISCOUNT TREASURY BILLS

The 3, 6 and 12-month and very short term liquidity Discount Treasury bills are used primarily for liquidity management purposes. In 2006, ÁKK sold Discount Treasury bills in a total amount of HUF 4,784 billion; of which HUF 4,537 billion were issued at auctions, and HUF 246 billion were sold in the Treasury network. Due to their short tenor discount Treasury bills are renewed several times over the year, making net sale figures more useful for analysis than gross issuance. According to the plans, the net issuance of discount Treasury Bills was HUF 230 billion, thus the outcome of HUF 225 billion is in line with the projection.

Net sales of discount treasury bills between 2001-2006



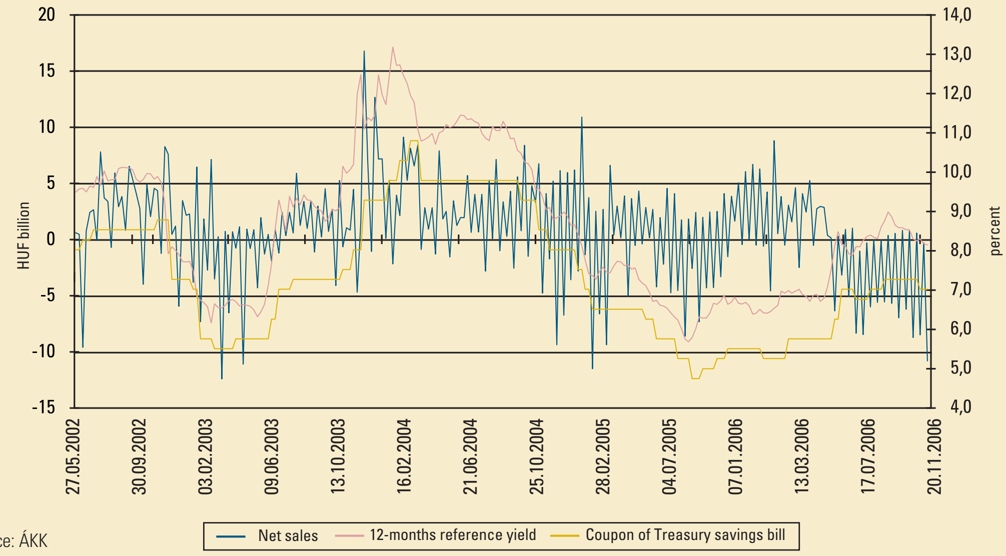
Source: ÁKK

RETAIL SECURITIES

Household savings can be channelled more easily into budget financing by using retail securities than via wholesale. Using a special distribution network, retail securities are easily accessible all over the country.

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

Market yields, coupon of retail government securities and net issuance of retail government securities



Source: ÁKK

That characteristic of the retail securities could be observed in 2006 as well. In a period of rising yields the stock of retail securities increased by HUF 79 billion. ÁKK sold HUF 309 billion of Interest Bearing Treasury Bills and HUF 383 billion of Treasury Savings Bills. The stock of Interest Bearing Treasury Bills was HUF 87 billion higher, while the stock of Treasury Savings Bills was HUF 8 billion lower at the end of 2006 than a year before.

PLANNED AND ACTUAL GROSS AND NET FOREIGN CURRENCY FINANCING

In the course of 2006 ÁKK on behalf of the Republic of Hungary issued three bonds on four occasions in the international capital markets raising a total of HUF 676 billion (EUR 2.5 billion)[6].

Foreign exchange bond issuance of the Republic of Hungary in 2006

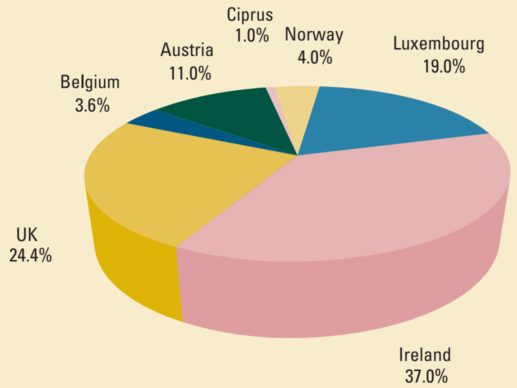
Currency	Size	Date of issue	Maturity date	Maturity (years)	Coupon
EUR	1,000,000,000	18.01.2006	18.07.2016	10	3.50%
JPY	50,000,000,000	17.03.2006	18.03.2013	7	1.67%
GBP	500,000,000	30.03.2006	30.03.2016	10	5.00%
EUR	500,000,000	27.09.2006	02.11.2012	7	3-month EURIBOR+0.05%

Source: ÁKK

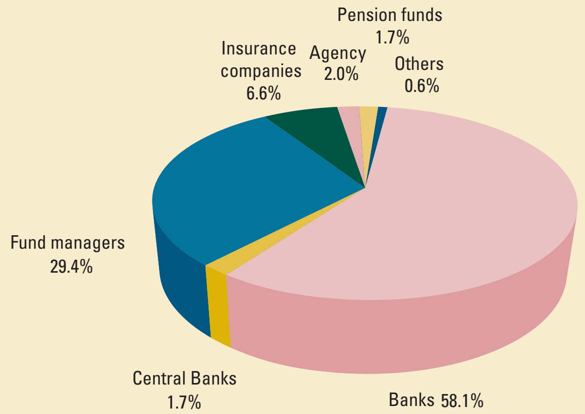
The strategic objective of ÁKK is to broaden its investor base both geographically and institutionally.

[6] The last transaction in 2006 was a reopening of a bond series issued in 2005.

Distribution by geography of the 2016 GBP bond issue - after allocation



Distribution by investor of the 2016 EUR bond issue - after allocation



One way to acquire new investors is to issue securities in currencies other than euro. This objective was reached by the issuances in GBP and JPY in 2006. In order to achieve the benchmark for the currency composition of the foreign currency debt portfolio consisting 100 per cent euro ÁKK concluded cross-currency swaps related to the non-euro denominated bonds.

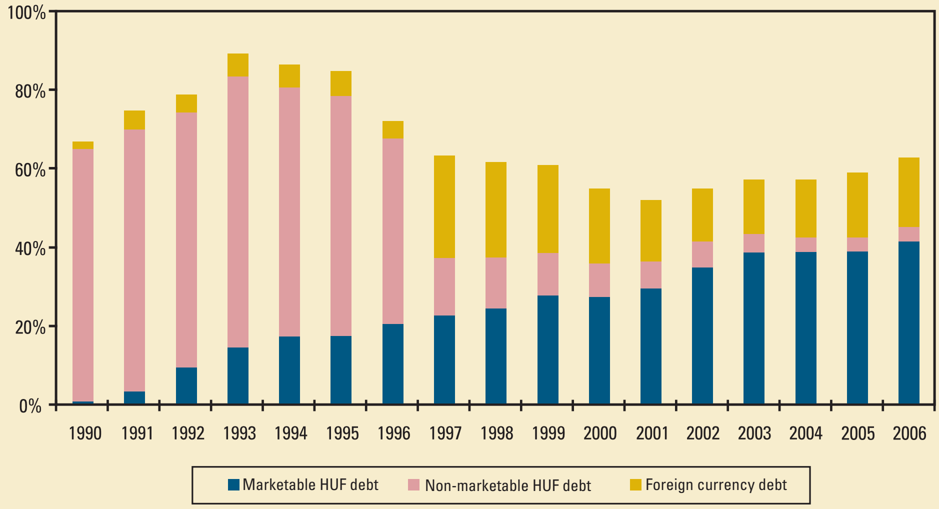
Project financing loans from international financing institutions totalled HUF 112 billion in 2006. The loans from the European Investment Bank (EIB) and the Council of Europe Development Bank (CEB) were aimed at financing projects for flood protection, integration of Hungarian minorities and financing of the 4th underground line in Budapest.

In 2006 net foreign currency issuance amounted to HUF 556 billion (about EUR 2.1 billion), higher than the net HUF 389 billion planned in January. Out of the net foreign currency issuance net bond issuance amounted to EUR 1.8 billion (HUF 469 billion), net drawdown of loans totalled EUR 0.3 billion (HUF 87 billion). The higher net issuance was the result of the additional issuances decided after the revision of the fiscal position.

V. GOVERNMENT DEBT IN 2006

ÁKK manages the debt of the central government. Since the extrabudgetary funds have a surplus and the deficit of the social security funds is automatically financed by the central government budget as provided for by law, the debt managed is the **debt of the central government** (hereinafter: government debt, debt).

The public debt/GDP ratio and its breakdown between 1990-2006



Source: ÁKK

The debt/GDP ratio (debt ratio), which expresses the economic burden of public debt in comparison to the country's economic performance, reached its peak in 1993 and started to decrease following the economic policy stabilisation in the middle of the 1990s. The decline ended in 2001, since then there has been a modest increase year by year. In 2006, the debt/GDP ratio increased to 61.9% from 58.5% at the end of 2005. By the end of 2006, government debt amounted to HUF 14,706 billion. In comparison with the end of 2005 – including debt assumptions, marked-to-market deposits and repos – government debt increased by HUF 1,940 billion (15.2%). The size of government debt is also influenced by exchange rate movements, debt assumptions and outstanding repo transactions. The difference between the annual financing requirement and the actual financing together with the balance of other transactions is reflected in the changes in the balance of the STA.

Since the end of 2004 ÁKK has been concluding derivative (swap) transactions directly in the international financial markets. In order to limit counterparty risks associated with those transactions, ÁKK uses Mark-to-Market agreements, which include that counterparties may have to place collateral deposits at each other according to their net position in order to limit counterparty risk exposure. These deposits are not for general financing purposes, however, according to the Hungarian accounting standards the deposits placed at ÁKK are included in the government debt and are recorded under "other liabilities". Marked-to-market deposits by ÁKK totalled HUF 6 billion at the end of 2006.

Gross government debt

	2005		2006		Change
HUF-denominated debt	**9,153.5**	**71.7%**	**10,552.3**	**71.8%**	**1,398.8**
Loans	0.8	0.0%	356.4	2.4%	355.6
Bonds	7,033.0	55.1%	7,772.5	52.9%	739.5
Discount treasury bills	1,530.9	12.0%	1,755.9	11.9%	225.0
Retail securities	588.7	4.6%	667.4	4.5%	78.7
FX-denominated debt	**3,590.7**	**28.1%**	**4,124.4**	**28.0%**	**533.7**
Loans	720.6	5.6%	803.7	5.5%	83.1
Bonds	2,870.1	22.5%	3,320.7	22.6%	450.6
Total	**12,744.2**	**0.0%**	**14,676.7**	**99.8%**	**1,932.5**
Marked-to-market deposits at ÁKK	**21.4**	**0.2%**	**29.0**	**0.2%**	**7.6**
Grand total	**12,765.6**	**100.0%**	**14,705.7**	**100.0%**	**1,940.1**

Source: ÁKK

Other liabilities also include the accrued interest of the loans assumed from National Motorway Corporation in December of 2006, totalling 23 billion.

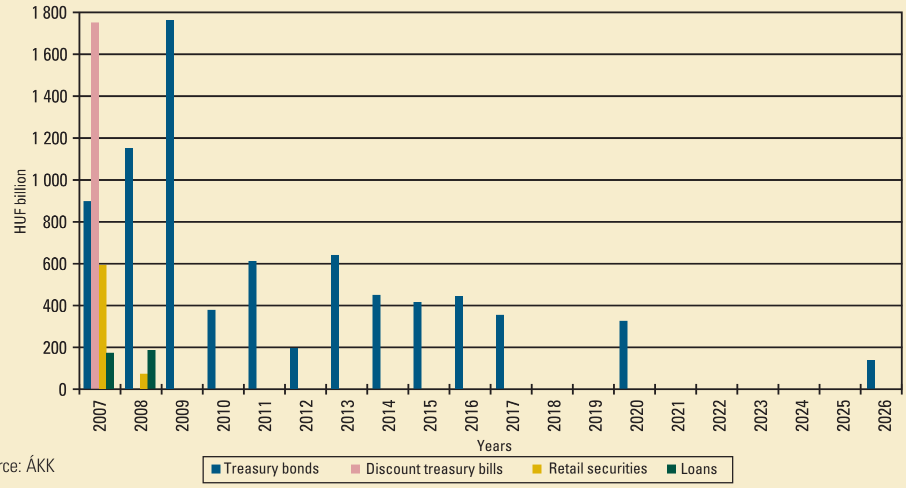
CHARACTERISTICS OF THE HUF DEBT

The HUF debt portfolio, which amounted to nearly three-quarters of government debt, increased by HUF 1,399 billion (15.3%) to HUF 10,552 billion in 2006. At the end of 2006 there were 40 marketable bond series outstanding (HUF 7,773 billion) accounting for about three-quarters of the total HUF debt. While the average bond series had a volume of HUF 194 billion, 16 series had a volume of more than HUF 250 billion (EUR 1 billion). For comparison, the portfolio of bonds amounting to HUF 7,033 billion one year earlier consisted of 42 series with an average size of HUF 167 billion and only 15 series exceeded HUF 250 billion (EUR 1 billion).

At the end of 2006 there were 19 series of Discount Treasury bills outstanding with an average size of HUF 93.6 billion. The size of 9 series exceeded HUF 100 billion, while the average volume of the remaining 10 series – all of those being 3-month discount Treasury bills - was HUF 28 billion.

The non-marketable HUF debt continued to decrease both in terms of amount and proportion in 2006. Non-marketable bonds amounted to HUF 528.3 billion, making up a mere 3.6% of the total HUF debt at the end of the year.
At the end of 2006 32.4% of the HUF debt portfolio was due within one year, another 13.4% had a term-to-maturity of between 1-2 years and more than one-third (34%) was due in at least five years.

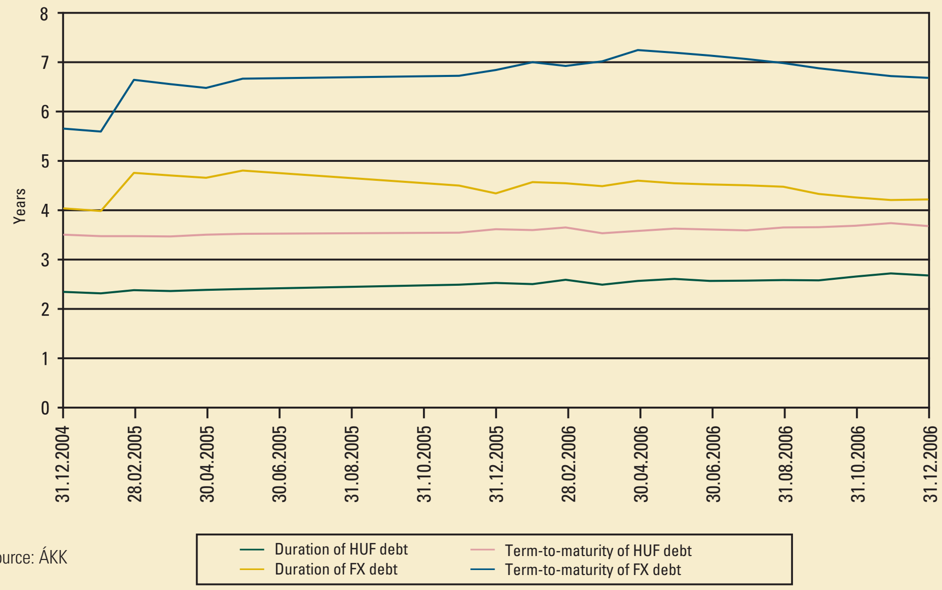
Maturity profile of HUF-denominated government debt outstanding at the end of 2006



Source: ÁKK

In the course of the year the duration of the total HUF debt portfolio increased from 2.46 years to 2.62 years by the end of December 2006. The average remaining term-to-maturity also increased from 3.57 to 3.64 years during 2006.

Average duration and average term-to-maturity of public debt



Source: ÁKK

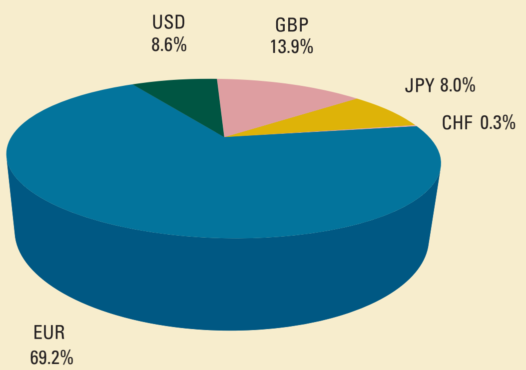
CHARACTERISTICS OF THE FOREIGN CURRENCY DEBT

The HUF value of the central government's foreign currency debt portfolio increased by HUF 534 billion in 2006 and amounted to HUF 4,124 billion (EUR 16.3 billion) at the end of the year.

The increase in foreign currency debt was due to the high net foreign currency issuance. The strengthening of the exchange rate of the Hungarian forint in itself caused a decrease in the HUF value of the foreign currency debt by HUF 23 billion in 2006.

Foreign currency bonds amounted to HUF 3,321 billion at the end of the year and their weight within foreign currency debt increased from 80% to 80.5% in 2006. On 31 December 2006, the portfolio of foreign currency bonds consisted of 18 bonds, 9 of which were denominated in euro, 2 in USD, 3 in GBP and 4 in Japanese yen.

Breakdown of the FX debt by currency before swaps at the end of 2006

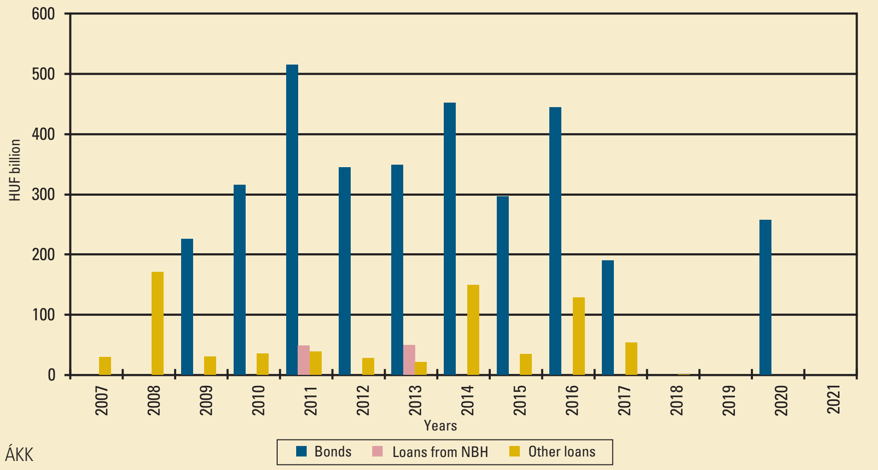


Source: ÁKK

The foreign currency loan extended by the National Bank of Hungary in 1997 amounted to HUF 96 billion after swaps, or 2.3% of the foreign currency debt.

The proportion of foreign currency loans from international banks decreased from 17.4% to 17.2% within the foreign currency debt in 2006. For liquidity management purposes ÁKK had a EUR 450 million revolving stand-by credit facility agreement in place with no outstanding amount at the end of 2006.

Maturity profile of the FX government debt outstanding at the end of 2006



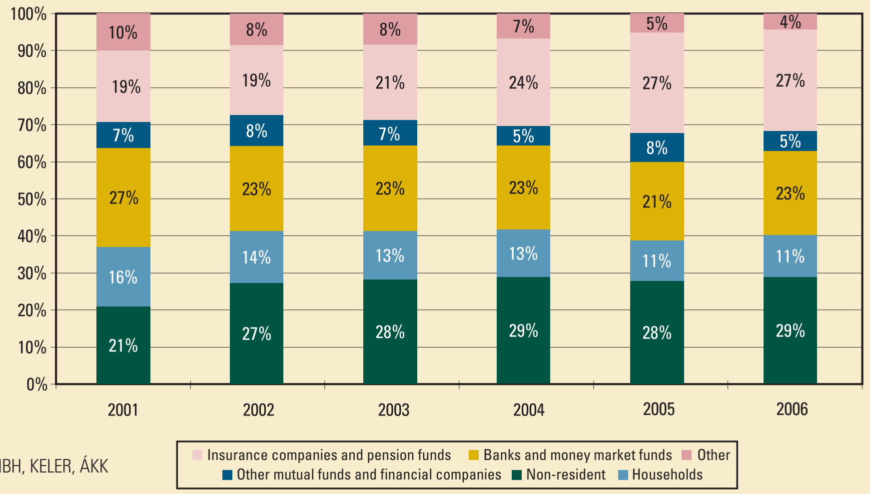
Source: ÁKK

The duration of the foreign currency portfolio decreased in 2006 from 4.3 to 4.19 years, while the average term-to-maturity declined from 6.9 years at the beginning to 6.7 years by the end of the year.

THE OWNERSHIP STRUCTURE OF THE DOMESTIC GOVERNMENT DEBT

Non-residents continue to hold the largest proportion of domestic government securities, in close competition with insurance companies and pension funds, with credit institutions and money market funds lagging behind. The share of retail investors remained the same in 2006 and they still continue to be the fourth largest group of government securities holders. According to the trend of past years the most stable investors are insurance companies, pension funds and non-residents.

Ownership structure of HUF-denominated government securities



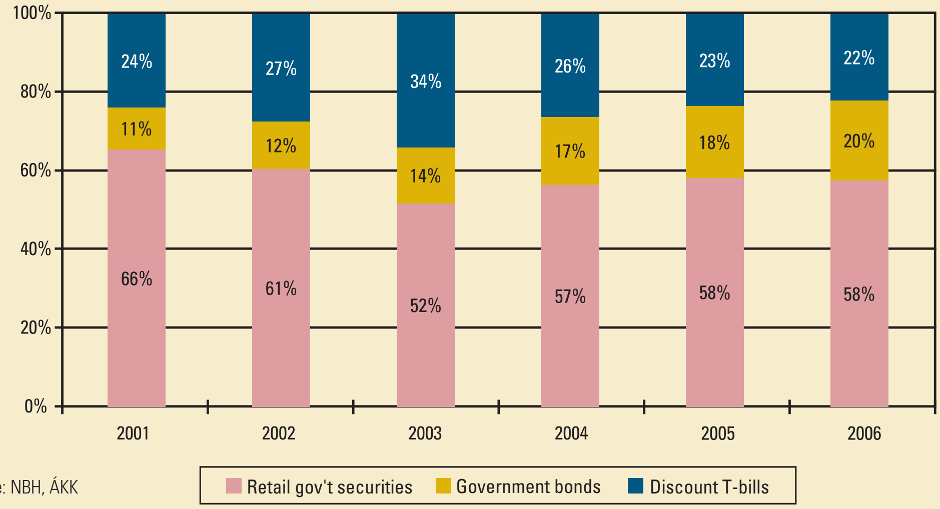
Source: NBH, KELER, ÁKK

In 2006 non-resident investors increased their holdings of domestic securities by HUF 399 billion to HUF 2,938 billion. The duration of foreign investors' stock increased from 3.3 years at the end of the 2005 to 3.5 years and the average term-to-maturity also increased from 4.2 years to 4.3 years in 2006. Non-resident holdings of total HUF government bonds and Discount Treasury bills increased to 30.8% in 2006, from 29.6% at the end of 2005.

After non-residents, insurance companies and pension funds are the second largest investor group in the domestic government securities market; their share had remained the same and the securities held by them reached HUF 2,800 billion[7]. Both insurance companies and pension funds traditionally hold a considerable part of their portfolios in Hungarian government securities.

Since 2002 retail investors have been increasing their portfolio of government securities by HUF 100 billion per year. In 2006 however, their total government securities holdings grew by HUF 149 billion; retail securities holdings were up by 79 billion, government bond holdings by HUF 53 billion, and discount Treasury bills by 17 billion. Retail government securities still had the largest share in the government securities portfolios of households, but significant amounts of discount Treasury bills and government bonds were also owned directly by retail investors.

Breakdown of the government securities portfolio of households



Source: NBH, ÁKK

The domestic market for Hungarian debt is well balanced in international comparison, the role and participation of long-term, strategic investors (like insurance companies, pension funds and mutual funds) is significant.

[7] ÁKK's estimates based on data from the NBH.

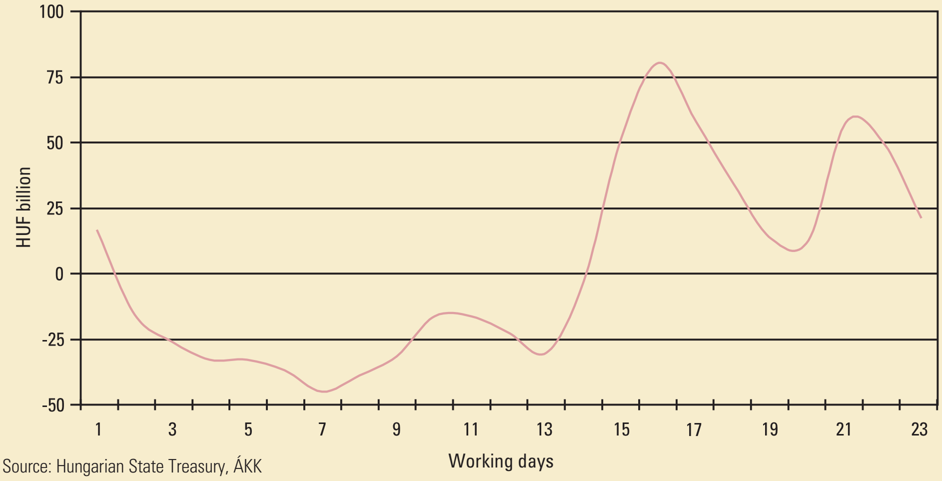
VI. LIQUIDITY MANAGEMENT

The 2003 amendment to the Public Finances Act assigned the task of liquidity management of the central government to ÁKK and made the necessary instruments, such as repos available for this purpose. ÁKK started this activity at the beginning of 2004 and its objective was to develop its liquidity management activity in 2006.

THE OBJECTIVES OF LIQUIDITY MANAGEMENT

ÁKK has two objectives in liquidity management. First objective is to ensure the sufficient daily liquidity of the cash account of the budget even in case of adverse budget or securities market events, i.e. to maintain an optimal balance of the Single Treasury Account (STA). The second objective is to reduce the fluctuation of the daily cash balance, which is caused by the cyclic nature of budget revenues, expenditures and debt transactions[8]. This fluctuation has a considerable effect on the liquidity of the banking system as well.

Monthly movement of the STA balance relative to the average in 2001-2006, excluding debt transactions



Source: Hungarian State Treasury, ÁKK

THE SET OF LIQUIDITY MANAGEMENT INSTRUMENTS

These two objectives were formulated as one of ÁKK's benchmarks. This benchmark provides a target range for the daily balance of the STA. The target range is +/- HUF 50 billion (ca. EUR 200 million) around the optimum STA balance which represents a considerable reduction of the fluctuations experienced in earlier years[9]. Currently, in order to manage the fluctuations caused by debt operations and to tailor the end-of-day STA balance into the target range ÁKK uses the following instruments:

- Repo and reverse repo transactions with government securities;
- The issuance of liquidity discount Treasury bills with usually 6-week tenor, issued as required for very short-term money needs;
- Active use of bond buy-backs (reverse auctions);
- Active adjustment of the volume of the 3-month and 6-month discount Treasury bills;
- A foreign currency stand-by facility.

[8] The task of harmonising primary budget expenditures and revenues and forecasting their consolidated daily balance lies with the Hungarian State Treasury.

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

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

Drawdowns from the standby facility serve mainly the purpose of bridging the time gap between foreign currency outflows and inflows on the STA (e.g. funds paid to and received from the European Union) and also to help managing large bond redemptions[10].

RESULTS AND EXPERIENCE IN 2006

Even though the tools used by ÁKK in liquidity management did not change in 2006, the effectiveness of this activity improved in many aspects.
In 2006, ÁKK sold liquidity Discount Treasury bills at 23 auctions in an amount totalling HUF 836 billion, up from HUF 455 billion a year before. The issuance of liquidity Treasury bills decreased the volatility of the primary balance of the STA by 8%. Besides that the issuance of liquidity discount treasury bills helped financing the deficit in the first half of 2006 as deficit figures were higher than forecast.

The major tool for fine-tuning the STA balance into the target range is the liquidity repo. Repo tenders were concluded on 209 occasions in 2006. ÁKK used reverse repo (money placement) on 112 days, repos (money borrowing) less frequently on 97 days. Total amount of repo transactions in 2006 reached HUF 6,034 billion, up from HUF 4,326 billion in 2005. The repo transactions of ÁKK significantly contributed to the development of the domestic repo market (measured by daily average repo turnover).

The objective of maintaining the daily STA balance in the target range was reached on 173 days out of the total 252 working days (69%) in 2006. The performance of smoothing was somewhat less effective compared to 2005 due to unplanned increases in the budget deficit.

Without liquidity management the volatility of the STA would have been HUF 148 billion, but after cash management transactions the volatility decreased by 40% to HUF 88 billion. Relative standard deviation decreased in 2006 to 23% from 24% a year before.

[10] A more detailed description of ÁKK's liquidity management activity can be found in the „Debt Management Report – 2004" published by ÁKK.

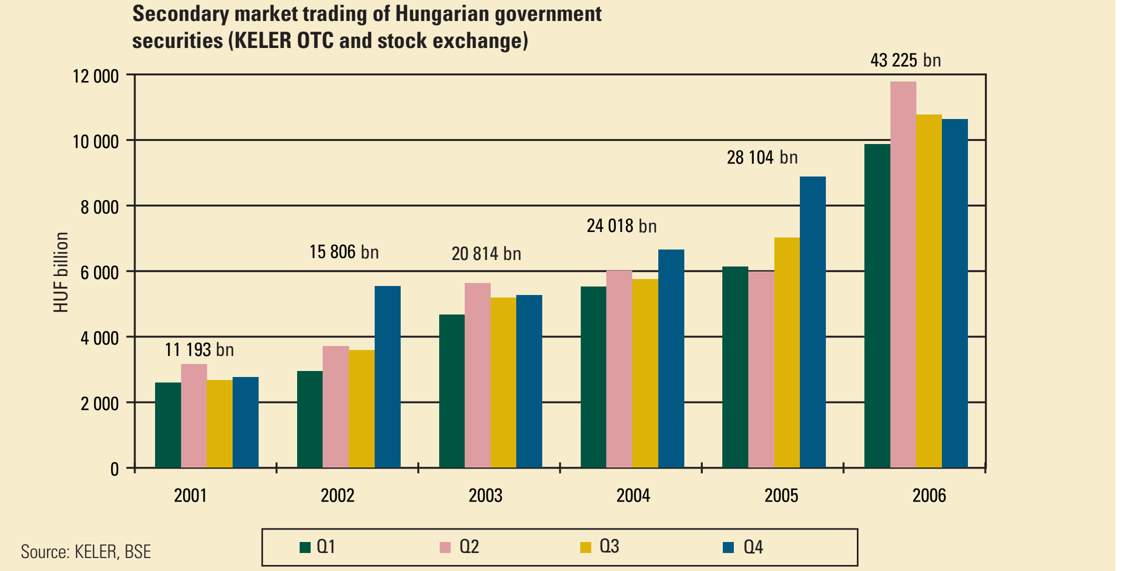
VII. THE SECONDARY MARKET OF GOVERNMENT SECURITIES

THE SECONDARY MARKET OF HUF GOVERNMENT SECURITIES

TURNOVER

Primary dealers quote two-way prices both in the Budapest Stock Exchange's trading system (MMTS) and directly to investors in the over-the-counter (OTC) market and conclude government securities transactions on both markets.

The vast majority of secondary trade in government securities in 2006 took place in the OTC market. Total OTC turnover of government securities amounted to HUF 43,062 billion with government bonds accounting for 86% and discount Treasury bills for 14%. That means that secondary market turnover was 4.5 times the volume of outstanding

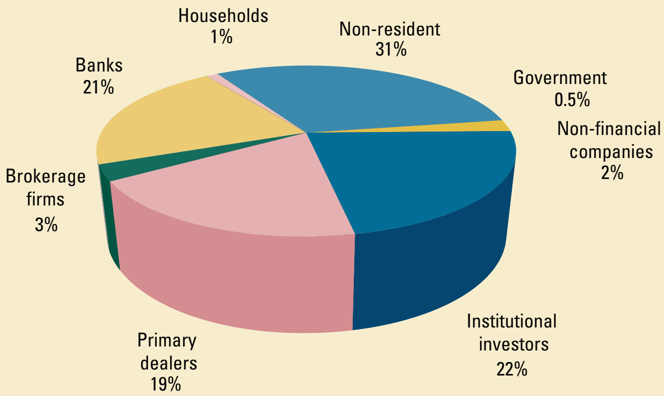


Source: KELER, BSE

government securities in 2006. OTC turnover in 2006 was HUF 15,055 billion or 54% higher than in the preceding year. Government securities were traded at a much lower amount (ca. HUF 163 billion) on the Budapest Stock Exchange (BSE).

Primary dealers made a turnover of HUF 36,939 billion in Hungarian government securities. About 31% of their government securities turnover involved non-resident investors, a ratio equal to that a year before.

Breakdown of primary dealers' secondary market turnover in government securities by investors in 2006



Source: ÁKK

The average size of primary dealers' secondary market deals – excluding those with retail investors – was HUF 551 million (EUR 2.2 million) in 2006. Non-resident investors had the largest average deal size with HUF 913 million (EUR 3.6 million). In the course of the year, the 3-year 2009/E bond had the largest turnover with HUF 3,200 billion, followed by the 10-year 2016/C bond and the 5-year 2011/B bond.

In February 2007, ÁKK published the ranking of the primary dealers and its repo partners based on their activities in 2006[11]. ÁKK awarded prizes in the following categories: the primary dealer with the largest market share in the primary market of Hungarian Government Bonds and that of Discount Treasury bills; the primary dealer with the highest secondary market share; ÁKK's repo partner with the largest repo turnover and the primary dealer that increased its primary market share the most dynamically. The „Primary dealer of the year" prize was awarded for the third time, based on the rankings achieved in each category; for 2006, like in 2005, the prize went to ING Bank Zrt.

In 2004 ÁKK introduced a stand-by repo facility to support primary dealers' price quotation and to provide a last resort facility for settlements. If a primary dealer needs government securities subject to price quotation but cannot obtain them in the market, ÁKK is ready to provide the needed government securities in a one-week repo transaction. Stand-by repo facility transactions were concluded in an amount of HUF 460.6 billion in 1133 transactions. (In 2005 there were 382 transactions concluded totalling HUF 80.8 billion).

THE SECONDARY MARKET OF GOVERNMENT SECURITIES ISSUED IN FOREIGN CURRENCIES

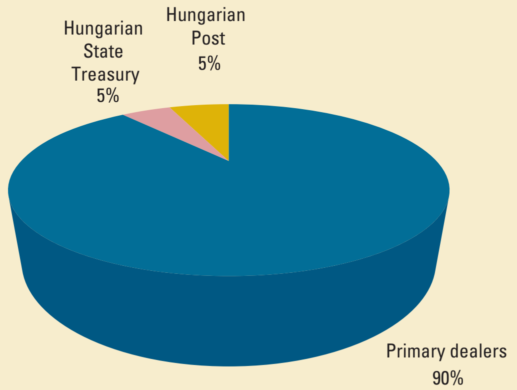
There is no special group of dealers in the secondary market for foreign currency bonds of the Republic of Hungary, but a number of banks make market in the New EuroMTS, a platform specially designed for trading the Euro-denominated bonds of the new EU-member states. By the end of 2006, the Republic of Hungary had eight bonds traded in the NewEuroMTS. (Poland had seven, Slovakia had three, Cyprus, the Czech Republic, Lithuania had two and Slovenia had one.) Trading in Hungarian Eurobonds on the platform amounted to EUR 6 billion in 2006.

[11] The list can be found on ÁKK's website under "Press releases".

VIII. THE INSTITUTIONAL STRUCTURE OF GOVERNMENT SECURITIES ISSUANCE

ÁKK sells government securities through intermediaries. In the domestic market the majority of HUF government securities are sold via the primary dealers.

Intermediaries of domestic securities issuance in 2006



Source: ÁKK

THE PRIMARY DEALER SYSTEM

The primary dealer system was set up in 1996 in order to improve the transparency and liquidity of the issuance and trading of government securities. Since May of 2004 any investment bank or credit institution that has its seat in a European Union member state may become a primary dealer for Hungarian government securities if it meets the contractual requirements and signs a primary dealer contract with ÁKK.

THE GROUP OF PRIMARY DEALERS AT THE END OF 2006:

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

The most important exclusive right and, at the same time, an obligation of the primary dealers is to participate in the auctions of government bonds and discount Treasury bills. In this respect, ÁKK requires the primary dealers to buy 3 per cent of the auctioned amounts sold during a half yearly period.

Another important task of primary dealers is to quote two-way (bid and ask) prices for government securities, thereby ensuring liquidity and transparency both on the stock exchange and in the OTC (over-the-counter) market[12]. ÁKK

[12] 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.

provides a stand-by repo facility exclusively for the primary dealers to help market-making activity. Primary dealers also have to report on their trading turnover in government securities and provide information about their financial position to ÁKK.

Furthermore, primary dealers who have a broad distribution network may conclude a separate agreement with ÁKK in respect of issuance and trading of Interest Bearing Treasury Bills designed for retail investors[13].

THE GROUP OF PRIMARY DEALERS WHERE RETAIL SECURITIES ARE AVAILABLE AT THE END OF 2006:

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

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

THE BRANCH NETWORK OF THE HUNGARIAN STATE TREASURY

In the 19 branches of the State Treasury retail investors can invest in government bonds, discount Treasury bills and the 1-year Interest Bearing Treasury Bills.

THE BRANCH NETWORK OF THE HUNGARIAN POST

The Hungarian Post participates in the sale and redemption of Treasury Saving Bills. These retail securities with a tenor of one or two years are available in printed form and can be bought and redeemed in over 2,800 post offices throughout the country.

INTERNATIONAL BOND ISSUES

Investment banks and credit institutions are selected to lead manage each foreign currency bond issue of the Republic. Placement of the bonds is usually supported by the members of a syndicate group organised by the lead managers.

IN 2006 THE LEAD MANAGERS FOR THE INTERNATIONAL ISSUES OF THE REPUBLIC WERE[14]:

Barclays Capital (GBP)
BNP Paribas (EUR)
Daiwa Securities SMBC (JPY)
Deutsche Bank (GBP)
Dresdner Kleinwort Wasserstein (EUR)
HSBC (EUR)
Lehman Brothers (GBP)
Nikko Citigroup (JPY)
UBS Investment Bank (EUR)

[13] Interest-Bearing Treasury Bills as well as the Treasury Saving Bills are continuously available government debt instruments developed for and sold specifically to retail investors.
[14] Four international bond issues with 2-3 lead managers for each transaction. In the parentheses see the currency of the issuance

IX. THE INSTITUTIONAL FRAMEWORK AND TASKS OF GOVERNMENT DEBT MANAGEMENT

The main legal framework of government debt management is set by Act XXXVIII of 1992 on Public Finances (hereinafter: Public Finances Act). This law authorises the Minister of Finance to ensure implementation of the budget, the financing of the deficit, the continuous solvency of the state budget, recording the debt and debt service of the central budget and repayments of debt. The annual Budget Acts specify this authorisation by assigning the duties of financing and debt management in the current year to the Minister's scope of authority. The Minister of Finance performs these tasks through the Government Debt Management Agency Pte. Ltd. (ÁKK) based on the provisions of the Public Finances Act[15].

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

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

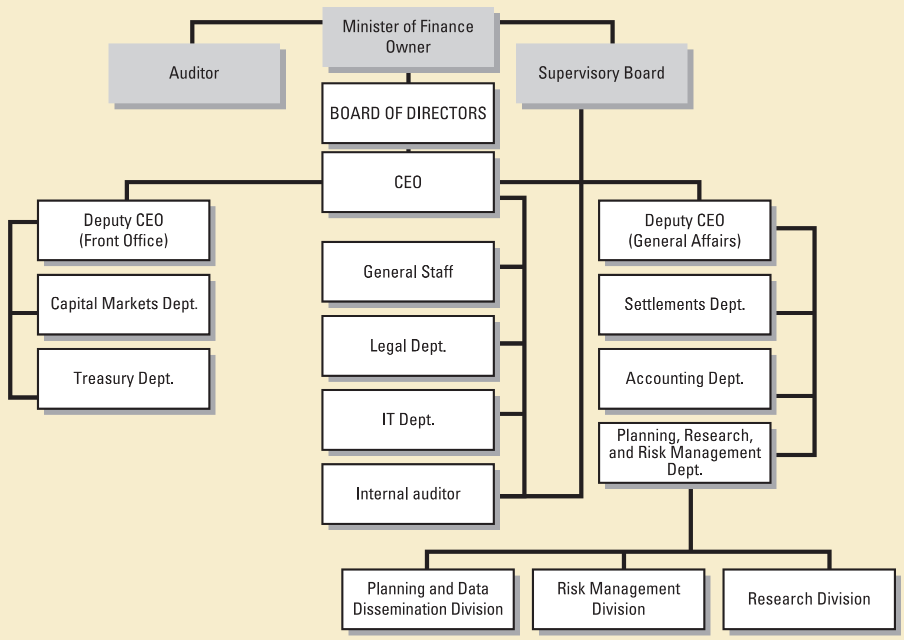
TASKS OF ÁKK

According to the Public Finances Act, the activities of ÁKK – among others – include the following major tasks:

- Elaboration of a long-term financing strategy in line with the economic policy, which determines the purpose of debt management and the means of its implementation.
- Preparation of the annual and medium-term financing plans based on the annual Budget Act and in line with the strategy.
- Performing the required financing operations, i.e. organising and implementing both domestic and international government securities issuance and raising of foreign currency loans.
- Handling and managing the temporarily free cash funds of the state (liquidity management).
- Effecting debt redemptions and interest payments.
- Organisation and continuous development of the government securities market (the primary dealer system, sales channels, secondary market, etc.).
- Cooperation in determining the financial terms and conditions of borrowings with a state guarantee; on request, organisation of transactions with individual guarantees; keeping a secondary database of the state guarantees (the Hungarian State Treasury is primary registrar of such guarantees).

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

Organisational structure of ÁKK



X. INFORMATION SERVICE OF ÁKK

The Public Finances Act makes ÁKK responsible for informing the general public about the developments of government debt and the government securities market.

Therefore ÁKK publishes up-to-date, daily data on its Internet website and via other electronic communication systems.

ÁKK'S INTERNET WEBSITE

As of 1 March 2004, the Government Debt Management Agency Ltd. revamped its www.akk.hu[16] website, giving it a new structure and renewing its contents. ÁKK's goal was to make sure that the most important data could be found easily on the home page, including the latest news, the volume of public debt, information on the most recent and upcoming auctions and the daily price quotations.

Other pages include information on ÁKK, the characteristics of government securities; a separate section is devoted to retail securities and there is detailed information on the issuance and trading of government securities.
The „Government securities" section includes the cash flows of outstanding government securities. The „Market information" menu contains the issuance calendar for the current year; the results of auctions and a wide range of secondary market information. Since the website operates with databases, historical data and data series can be queried on most of these pages.

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

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

OTHER ELECTRONIC PLATFORMS

In addition to its web page, ÁKK publishes auction and price quotation data also on the information pages of Bloomberg and Reuters.

PRESS CONFERENCES, PUBLISHING IN THE PRESS

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

PUBLICATIONS

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

- Annual reports (from the middle of the year that follows the given year)

[16] Also available at: www.gdma.hu

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

Monthly publications are accessible only in electronic form as of 2004; they can be viewed and downloaded from ÁKK's website.

For further information concerning the publications, please contact:

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ANNEX

CENTRAL GOVERNMENT DEBT

1. Central government debt on 31 December 2006 (HUF million)

HUF-denominated debt

Treasury bonds	Maturity	Coupon	Outstanding amount
2007/A	31.12.2007	3.50%	4,000.00
2007/B	12.12.2007	floating rate	24,000.00
2007/C	12.08.2007	floating rate	1,691.68
2007/D	12.06.2007	3.50%	303,521.82
2007/E	12.08.2007	floating rate	2,445.11
2007/F	12.04.2007	3.50%	194,917.34
2007/G	12.10.2007	3.50%	355,415.18
2008/A	24.10.2008	floating rate	55,022.33
2008/B	12.08.2008	floating rate	1,840.19
2008/C	12.06.2008	3.50%	405,854.52
2008/D	24.04.2008	3.50%	319,223.64
2008/E	12.08.2008	3.50%	368,553.74
2009/A	12.08.2009	floating rate	1,953.40
2009/B	12.02.2009	3.50%	99,927.05
2009/C	24.06.2009	3.50%	304,499.48
2009/D	12.10.2009	3.50%	366,175.30
2009/E	24.04.2009	3.50%	454,511.12
2009/F	12.08.2009	3.50%	537,637.66
2010/A	12.08.2010	floating rate	1,940.81
2010/B	12.10.2010	3.50%	371,301.77
2011/A	12.02.2011	3.50%	209,590.30
2011/B	12.10.2011	3.50%	395,811.01
2012/A	31.12.2012	3.50%	7,132.15
2012/B	12.06.2012	3.50%	190,051.36
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	3.50%	435,395.87
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	3.50%	400,535.28
2015/A	12.02.2015	3.50%	411,281.80
2016/A	31.12.2016	floating rate	33,400.00
2016/B	02.01.2016	floating rate	9,000.00
2016/C	12.02.2016	3.50%	432,456.93
2017/A	24.11.2017	3.50%	203,525.17
2017/B	24.02.2017	3.50%	150,008.38
2020/A	12.11.2020	3.50%	325,676.61
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			118.16
Total			**7,764,338.22**
Out of which repo			8,185.00
Discount Treasury Bills			**1,755,916.56**
Interest Bearing Treasury Bills			**306,511.70**
Treasury Savings Bills			**264,312.18**
Treasury Savings Bills II			**96,552.61**
HUF-loans			**356,426.00**
Other			**57.96**

Foreign currency debt

Annex

	in HUF million	in EUR million
Syndicated loan	**126,150.00**	**500.00**
Loans granted by International Financial Institutions*	**509,894.61**	**2,017.55**
Loans assumed from the market*	**71,768.94**	**283.97**

Bonds*

Code	Currency	Maturity date	Maturity (years)	Coupon	Outstanding amount (HUF million)	Outstanding amount (EUR million)
105	EUR	16.02.2009	10	4.375%	126,150.00	500.00
112	EUR	27.06.2011	10	5.625%	252,300.00	1000.00
113	EUR	06.02.2013	10	4.50%	252,300.00	1000.00
114	EUR	27.09.2010	7	4.00%	252,300.00	1000.00
115	EUR	29.01.2014	10	4.50%	252,300.00	1000.00
116	GBP	06.05.2014	10	5.50%	190,032.36	753.20
117	JPY	18.06.2009	5	1.09%	94,612.50	375.00
118	EUR	28.10.2011	7	3.625%	252,300.00	1000.00
120	USD	03.02.2015	10	4.75%	290,355.92	1150.84
121	EUR	24.02.2020	15	3.88%	252,300.00	1000.00
122	GBP	09.05.2017	12	5.00%	186,146.94	737.80
123	JPY	12.07.2010	5	0.62%	56,871.20	225.41
124	JPY	12.07.2012	7	0.96%	85,358.14	338.32
125	EUR	02.11.2012	7	3-month EURIBOR+0.05%	252,300.00	1000.00
126	EUR	18.07.2016	10.5	3.50%	252,300.00	1000.00
127	JPY	18.03.2013	7	1.67%	89,754.46	355.75
128	GBP	30.03.2016	10	5.00%	182,955.35	725.15
Total					**3,320,636.86**	**13,161.46**
Out of which FX swaps					**43,059.36**	

Loans from the National Bank of Hungary from the debt swap in 1997	**95,901.39**
Out of which FX swaps	14,011.74
Kingdom of Hungary 1924 bond issue	**54.11**
Total central government debt	**14,676,706.14**
Other liabilities of ÁKK (marked-to-market deposits by ÁKK and accrued interests of assumed loans)	29,016.23
Grand total	**14,705,722.37**

* With FX swaps

Annex

CREDIT RATING HISTORY OF THE REPUBLIC OF HUNGARY

Foreign currency 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+
20.09.2006	A1	BBB+	BBB+
21.12.2006	A1	BBB+	BBB+
22.12.2006	A2	BBB+	BBB+

Outlook was stable by Moody's and Standard and Poor's, while Fitch Ratings' oulook was negative at the end of 2006.

HUF 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-
20.09.2006	A1	BBB+	A-
21.12.2006	A1	BBB+	A-
22.12.2006	A2	BBB+	A-

Outlook was stable by Moody's and Standard and Poor's, while Fitch Ratings' oulook was negative at the end of 2006.

THE RELEVANT LEGISLATION GOVERNING ÁKK AND GOVERNMENT DEBT MANAGEMENT [17]

ACT NO. XXXVIII OF 1992 ON PUBLIC FINANCES

(…)

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

(2) The Founder of ÁKK Rt. is the Minister of Finance.

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

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

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

18/G. § (1) ÁKK Rt. 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 Rt. are:

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

b) Other revenues.

(3)

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

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

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

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

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

(…)

THE GOVERNMENT DEBT

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

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

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

[17] The translation serves information purposes. The structure of the original Hungarian text has been preserved.

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

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

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

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

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

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

c) Records the central government debt.

(2) In executing the above duties, the ÁKK Rt.:

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

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

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

d) Organises the secondary market of government securities;

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

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

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

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

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

j) Performs loan and deposit operations.

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

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

SECTION 3 OF ACT NO. CLIII OF 2005 ON THE BUDGET OF THE REPUBLIC OF HUNGARY FOR THE YEAR 2006

(…)

(1) The Minister of Finance shall be entitled by the Parliament to finance the deficit of the central government in the year 2006, to continuously ensure the liquidity of the Single Treasury Account (STA) and to manage the debt of the central government and the assets thereof administered by the Hungarian State Treasury.

THE FINANCIAL STATEMENTS OF ÁKK

I. BALANCE SHEET

in HUF thousand

	Assets	2005	2006
A)	Fixed assets	87,486	117,815
I.	Intangible assets	21,784	47,031
II.	Tangible assets	56,399	62,974
III.	Invested financial assets	9,303	7,810
B)	Current assets	266,580	288,094
I.	Inventories		
II.	Receivables	6,372	3,284
III.	Securities		
IV.	Cash and cash equivalents	260,208	284,810
C)	Assets of accruals	12,259	12,867
	Total assets	366,325	418,776

in HUF thousand

	Liabilities	2005	2006
D)	Capital and reserves	302,792	335,886
I.	Subscribed capital	300,000	300,000
VII.	Balance sheet profit or loss	2,792	33,094
E)	Provisions		
F)	Liabilities	55,026	67,035
I.	Subordinated liabilities		
II.	Long term liabilities		
III.	Short term liabilities	55,026	67,035
G)	Liabilities of accruals	8,507	9,710
	Total liabilities	366,325	418,776

II. PROFIT AND LOSS ACCOUNT

in HUF thousand

		2005	2006
I.	Net sales revenues	764,400	815,300
III.	Other incomes	4,152	15,153
IV.	Material expenses	158,184	152,059
V.	Personnel expenses	569,334	608,218
VI.	Depreciation and amortisation	56,018	42,524
VII.	Other expenses	5,002	8,626
A)	Operating profit or loss	-19,986	19,026
B)	Profit or loss from financial transactions	23,338	22,180
C)	Profit or loss on ordinary activities	3,352	41,206
D)	Extraordinary profit or loss		
E)	Profit or loss before taxation	3,352	41,224
XII.	Tax payable	560	8,130
F)	Profit or loss after taxation	2,792	33,094
23	Approved dividends		
G)	Balance sheet profit or loss	2,792	33,094

Annex

MEMBERS OF ÁKK'S BOARD OF DIRECTORS AND THE SUPERVISORY BOARD AT THE END OF 2006

Members of the Board of Directors:

Dr. Tamás Katona chairman
Péter Tabák
Dr. Tibor Draskovics
Ferenc Szarvas
Dr. László András Borbély

Members of the Supervisory Board:

Zoltán Sághy chairman
Balázs Romhányi
Dr. Béla Jónás

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GOVERNMENT DEBT MANAGEMENT AGENCY PTE LTD.

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