**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

STRATEGY FOR HUNGARY

As approved by the Board of Directors at its meeting on 22 January 2008

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ABBREVIATIONS

AAK	State Motorway Management Company
EIB	European Investment Bank
EIF	European Investment Fund
ESCO	Energy Savings Company
ETS	Emissions Trading System
EU	European Union
EUR	Euro
FIDESZ	Alliance of Young Democrats
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GM	General Motors
HUF	Hungarian Forint
IAIS	International Association of Insurance Supervisors
IFC	International Finance Corporation
IFI	International Financial Institutions
IMF	International Monetary Fund
IOSCO	International organisation of Securities Commissions
IPO	Initial Public Offering
MAV	Hungarian State Railways
MAVIR	Hungarian Electricity System Operator
MDF	Hungarian Democratic Forum
MKB	Hungarian Foreign Trade Bank
MOL	Hungarian Oil and Gas Company
MSME	Micro, small and medium-size enterprises
MSZP	Hungarian Socialist Party
MT	Hungarian Telecom
MVM	Hungarian Power Companies Ltd
NATO	North Atlantic Treaty Organisation
NHH	National Telecommunications Authority
OECD	Organisation for Economic Co-operation and Development
OTP	National Savings Bank
PAYG	Pay As You Go
PCA	PCA-Budafok Cardboard Factory
PPP	Public Private Partnership
PSZAF	Hungarian Financial Supervisory Authority
SME	Small and medium size enterprises
SZDSZ	Alliance of Free Democrats
TSO	Transmission System Operator
TVK	Tisza Chemical Works
WWTP	Waste Water Treatment Plant

EXECUTIVE SUMMARY

Hungary continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Since the beginning of transition Hungary has made considerable progress in reforms with about 80 per cent of economic activity in private hands, an open foreign trade regime and liberal foreign investment conditions.

The macroeconomic environment in Hungary is dominated by large fiscal deficit and implementation of a reform package to restore balance in public finances. Economic growth slowed down to an estimated 0.9 per cent year-on-year in the third quarter of 2007, driven largely by a fall in consumer spending caused by higher taxes, tight monetary policy and hikes in utility bills. A collapse of public finances was averted last year by the introduction of fiscal austerity measures. As a result, the full-year fiscal deficit closed at an estimated 9.2 per cent of GDP in 2006 and at around 5.7 per cent in 2007. This has been achieved at the expense of substantial tax hikes which further increased the cost of doing business in Hungary. The current account deficit narrowed to an estimated 6.5 per cent of GDP in 2006, mainly on the basis of a smaller trade deficit. Driven by tax increases, inflation picked at 9 per cent in March 2007 and is expected to gradually decline in 2008.

The progress in structural reforms over the last year was driven by the need to reduce fiscal expenditures and decrease the deficit in government finances. The government outlined a number of ambitious medium-term structural reforms. The implemented measures include cuts in subsidies for prescription medicines, tightening of eligibility criteria for disability benefits, co-payment by healthcare patients and a move to reduce the number of hospitals. Further structural reforms awaiting implementation include changes in the healthcare insurance system, modifications of the early retirement and special pension rules, review of the tax system and introduction of a merit-based appraisal scheme in public and higher education.

Following the privatisation of Budapest Airport and Malev, the national airline, steps are being taken to complete restructuring of the national railway company and privatise some of its business lines. Pressure on fiscal discipline has also led to increased private-sector involvement in the provision of some public services, including healthcare, which is expected to lead to substantial efficiency gains and improvements.

Looking forward, a number of key challenges still require attention:

- Structural measures to reduce public expenditures need to be fully implemented to reduce the fiscal deficit and allow for a reduction of the tax burden in the medium term.
- Investments in the diversification of energy supply, in energy efficiency and renewable energy need to be promoted to enhance energy security, reduce energy intensity and meet environmental targets.
- Transport and environmental infrastructure need to be improved with the assistance of EU structural and cohesion funds, private-sector involvement and commercial co-financing from local sources. The development of municipal projects requires the strengthening of municipal administrative capacity and

cooperation, particularly among smaller municipalities, as well as improvements in procurement and project management standards.
- Financial institutions would benefit from the introduction of new products, increased efficiency of the pension fund system, and the diversification of their investment portfolios through the development of local equity markets and the introduction of new financial instruments.

As of 31 October 2007 the Bank had committed EUR 1.84 billion which attracted a further EUR 6.01 billion from sponsors and co-financiers. 2005 and 2006 were characterised by a slowdown in corporate investments due to the elections and the Government's fiscal stabilisation measures. The Bank continued its financing mainly under the EU/EBRD SME facility. As the new Government renewed its reform commitment, the Bank has found an increased number of new investment opportunities in its focal areas where its transition impact is the highest.

The Bank's activities in Hungary will be consistent with the strategic outline for the years 2006-2010 agreed upon in CRR 3 with respect to graduation and will be based on the following operational objectives:

- Support the involvement of the private sector in the provision of public services, including through public-private partnerships in the infrastructure area and also in cooperation with Cohesion/Structural Funds.

- Promote investments in the diversification of energy supply, in energy efficiency and renewable energy to enhance energy security, reduce energy intensity and meet environmental targets.

- Provide higher-risk products such as equity and structured debt for local corporations to fund their growth. Particular attention will be paid to local companies' investments in the context of cross-border expansion.

- Participate in the introduction of new capital market products by financial institutions and support innovative products/financial institutions that provide financing for SMEs.

- Actively manage the Bank's portfolio to maintain its high quality.

The Bank will continue to ensure that all EBRD operations in Hungary meet sound banking principles, have transition impact, are additional and are subject to the Bank's Environmental Procedures and incorporate, where appropriate, Environmental Action Plans.

1. THE BANK’S PORTFOLIO

1.1. Overview of activities to date

As of 31 October 2007, the Bank’s net cumulative commitments to projects in Hungary amounted to EUR 1.84 billion (of which EUR 209 million was through regional projects) and accounted for 5% of the Bank’s total commitments. Since the early years of the Bank’s presence in Hungary, the distribution of investments in the three major sectors of corporates, financial institutions and infrastructure has been well balanced as detailed in Annexes 1 and 2.

EBRD’s annual commitments in Hungary have had an uneven trend, with the last strategy period being on a similarly low level as investments in 2000 and 2001 compared to peak years in 2004-2005. However, the Bank’s participation in the first refinancing of a PPP motorway project in Central Europe and an equity investment in a private healthcare provider have represented pioneering projects for the Bank.

The current portfolio as of 31 October 2007 stood at EUR 547 million, representing 3% of the Bank’s total portfolio. The portfolio decreased significantly from EUR 800 million at the beginning of the new strategy period, predominantly as a result of the repayment of one large transaction (MOL Environmental Loan). Undrawn commitments stood at EUR 111 million, over 70% of which were related to EU/EBRD SME Facility transactions, and impaired assets stood at EUR 9 million. A substantial portion of the current portfolio relates to FI, a reflection of EBRD’s support to SMEs through bank and leasing company credit lines as well as its earlier role in the privatisation of the Hungarian banking sector and support of non-bank financial institutions. The second largest share of the portfolio is in transport, demonstrating the Bank’s significant role in supporting the PPP-based motorway programme in the country.

As of 31 October 2007, private sector and non-sovereign ratio were both at 90%. Equity investments represented 30% of the total portfolio. The portfolio risk rating remained very much the same (4.71) as at the time of the previous strategy’s approval (4.74).

From the adoption of the last strategy to 31 October 2007, the EBRD signed new projects with a total commitment of EUR 140 million (including regional allocations). The new projects represent a good mixture of products serving the developed Hungarian market (PPP, SME lines and equity).

Current Portfolio Stock (EUR million) – including Regional
(as of 31 October 2007)

No. of Projects	Portfolio	Undrawn Commitment	Operating Assets	Impaired Assets	Performing Assets
40	547	111	436	9	427

Current Portfolio by Industry (including regional projects)
(as of 31 October 2007)

Sector	**EBRD finance** (EUR million)	**Portfolio share**
Corporate	**59.7**	**11%**
Agribusiness	27.5	5%
General Industry	7.0	1.3%
Property, Tourism & Shipping	24.5	4.5%
Telecom, Informatics & Media	0.7	0.1%
Financial Institutions	**273.8**	**50.1%**
Bank Equity	15.9	2.9%
Bank Lending	59.8	10.9%
Non-Banking Financial Institutions	119.6	21.9%
Equity Funds	78.5	14.4%
Infrastructure	**213.6**	**39%**
Transport	185.2	33.9%
Municipal & Environmental Infrastructure	25.7	4.7%
Power & Energy	2.7	0.5%
TOTAL	**547**	**100%**
Of which debt	356.1	65.1%
Of which equity	189.6	34.7%
Of which guarantee	1.3	0.2%
Of which private	489.3	89.5%
Of which state	57.7	10.5%
Of which direct	426.4	78%
Of which regional	120.6	22%
Of which non-sovereign	489.3	89.5%
Of which sovereign	57.7	10.5%

1.2. Implementation of the previous country strategy

The Bank's country strategy for Hungary, approved in November 2005, set four main strategic priorities:

- Continue to work closely with local financial intermediaries on providing funding to the MSME sector.

- Provide higher-risk products such as equity and structured debt for local corporations to fund their growth, in particular in the context of cross-border expansion. Support foreign direct investment by medium-sized companies in the less developed regions by providing higher-risk products not offered by the private sector.

- Work on a limited number of high-quality public private partnerships in the infrastructure sector, including in cooperation with EU structural and cohesion funds.

- Identify and fund energy-saving projects and renewable energy projects.

Overall, the Bank partially achieved the operational objectives set out in the previous Country Strategy. In addition to investing in regional private equity funds also covering Hungary, the Bank continued its EU/EBRD SME programme with leasing companies in Hungary (3 new projects), participated in the successful refinancing of the M6 motorway concession and provided equity financing for a private operator of public hospitals. During the last strategy period, the Bank was working on building a pipeline of projects, focusing on energy security, including energy efficiency and renewable energy, on private sector involvement in the provision of public services and on new financial instruments in the financial institutions sector.

1.3 Transition Impact of the Bank's Portfolio and Lessons Learnt

1.3.1 The Financial Sector

Banking **–** The EBRD supported bank regulation, privatisation, the entry of strategic foreign investors and the improvement of corporate governance practices. It contributed directly to the re-capitalisation of the banking system. In addition, the Bank successfully pioneered new financial instruments, i.e. guarantees and exchangeable bonds, on the local market. A ***lesson learned*** from OTP Equity Investment is the need to keep the Bank's Mandate requirements in good balance. When the expected transition impact is only '*Satisfactory'*, the Bank shall apply particular scrutiny to substantiate *Additionality* in the project.

NBFI **–** Operations with pensions, life insurance and leasing activities contributed to a certain extent to the development of local capital markets. The loan provided to 'Tecnicredito Leasing' in 2001 helped the establishment of a consumer credit company and the expansion of its business activities as well as the entry of foreign market players into Hungary. A ***lesson learned*** from the project with Tecnicredito is the need to foresee, at the project appraisal stage, the risks that may result from operating in an unregulated environment.

SME & MSME **–** Through the Agricultural Restructuring Programme (ARP) the Bank provided loans and technical training to private SMEs. Since the Government was providing subsidised schemes to the sector, the Bank concentrated on leasing companies which showed a strong commitment to SME financing together with a portfolio of good quality and good regional outreach.

Private equity funds **–** The Bank was involved with most of the private equity funds operating in the country and has contributed to the training of locally-based staff. All mid-to-larger size regional funds have investments in Hungary and some produced attractive returns. In general, the private equity market is considered among the most developed ones in the region.

Overall, the transition impact within the *Financial* Sector is rated *Significant*.

1.3.2 The Enterprise Sector

Agribusiness – The Budapest Wholesale Market has helped to increase competition and transparency, to improve quality, and to introduce better hygiene standards. The investment in a local retail company 'Cora' increased competition in the hypermarket segment and improved supply capacities and management information systems in individual cases.

Natural Resources - Several Bank operations with the Hungarian Oil and Gas Company (MOL) led to significant skills transfer at corporate level and increased environmental standards. A ***lesson learned*** from the Bank's environmental loan to MOL is that the privatised company early on recognised its strategic locational advantage and was able to convert domestic and regional raw materials into high quality products meeting European requirements.

Industry – The EBRD equipped a large variety of companies up for privatisation with better corporate governance and financial and operational management. The progressive disengagement of the Bank is a good indicator of the improved investment climate, with commercial finance being more readily available. A ***lesson learned*** from the Bank's participation in the privatisation of the Hungarian automotive group 'Raba' is that privatisation structures in this case should have been designed in a way to allow strategic investors to gain control over the firm. Otherwise, the restructuring process and transition impact are likely to be undermined.

Property & Tourism – Apart from a few projects supporting the privatisation of a hotel chain and the financing of new business facilities, the Bank's involvement in the West End City Centre of Budapest had a strong demonstration effect. Regional investment funds provided liquidity and helped develop a secondary market for property.

Telecommunications - Significant transition impact was achieved through the privatisation of 'Matav', the state telecoms company in which the Bank participated. In addition, the Bank provided a loan to 'Invitel' in 2001, with the Company now being the strongest competitor to 'Matav'. A lesson learned from the project with Invitel, is that – despite a developed telecommunication regulatory environment - delays in the implementation of the key regulatory elements can slow down market expansion and competition, resulting in the incumbent maintaining a strong market share after market liberalisation.

Overall, the transition impact within the *Enterprise* Sector is rated *Moderate to Significant*.

1.3.3 Infrastructure

Energy Efficiency – The financing of three Hungarian ESCOs was broadly successful for entering the market and achieving visibility. The 1999-founded EBRD regional Energy Efficiency and Emissions Reduction Fund (EEERF), however, currently suffers from the failure to reach an agreement with the Hungarian Government on a planned deal to buy carbon credits.

MEI – The Bank's equity investment in the Budapest's wastewater services company achieved some know-how transfer and the introduction of new business standards but fell short of initial expectations with regard to transition impact. A loan to MOL to outsource a water and wastewater treatment function achieved an important demonstration effect. A ***lesson learned*** from the Budapest Water Company project is that a more ambitious transition impact oriented approach should have been adopted along with an earlier involvement in the sector.

Transport - The Bank's involvement in the sector has been extensive but produced mixed results. In the road sub-sector, for instance, the M1-M15 Motorway project failed commercially and had a negative demonstration effect. Subsequent investments took the lessons learned and demonstrated the feasibility of a public-private partnership in road investments. A ***lesson learned*** from the M5 concession motorways project is the difficulty to produce reliable traffic forecasts in transition countries. The related risk requires some sort of state support or contribution to ensure the financial success of such projects. Risk-sharing between the State and the Concessionaire and the availability of fee payment under the restructured M5 project have proven to be successful and were thus applied to subsequent motorway concession projects in the country.

Overall, the transition impact within the *Infrastructure* Sector is rated *Moderate.*

1.4. Selected Lessons Learnt

- Equity investment in companies with no strategic investor should be subject to confirmation of quality excellence of management, medium-term corporate strategy and of good corporate governance structure – or related changes should be agreed upon in a shareholders' agreement. (Borsodchem, Raba)

- The EU/EBRD incentive-based SME programme helped to change the attitude of leasing companies to smaller clients and equipment leasing and thus speeded up the availability of funding to this segment.

- Subsequent involvement in projects in the same sector coupled with active sector policy dialogue and TC assistance can help shape government policy and bring innovative financing structures. (M0, M1/15, M5, M6)

1.5. Financial performance of the existing portfolio

The Bank's portfolio in Hungary is sound. During the last two years the quality of the Hungarian portfolio remained stable on a very good level with the overall portfolio risk category being 4.71 (compared to 4.74 at the time of the adoption of the previous country strategy). It reflects the Bank's portfolio management/clean-up efforts as well as the quality of the transactions signed during the past two years.

1.6. Mobilisation of co-financing

The Bank has mobilised EUR 6.01 billion in additional funds since it began operations in Hungary. In the past two years the mobilisation ratio increased from 4.25 to 9.05, but the increase can solely be attributed to the high mobilisation ratio (15.09) for the M6 motorway refinancing project.

2. OPERATIONAL ENVIRONMENT

2.1. The General Reform Environment

2.1.1. Political environment

The overall stability of the Hungarian political system has been maintained, despite a serious shock experienced during the riots of autumn 2006, which were triggered by the leaked revelations of Prime Minister Gyurcsány of the ruling Hungarian Socialist Party (MSZP) about the party's incomplete disclosure of the state of affairs in the country's economy prior to the 2006 parliamentary elections.

The MSZP-led centre-left coalition government, which won its second consequent mandate in the April 2006 parliamentary elections, has so far managed to sustain all manner of pressure - the above-mentioned riots, the unfavourable to MSZP outcome of the October 2006 local elections (which it lost to the opposition Fidesz), and recurring divisions within the governing coalition itself. It is keen to continue until the end of its mandate in 2010. The test for the balance of political forces will be the elections to the European Parliament, due in 2009.

The government may also face the test of a spring 2008 nation-wide referendum, which was initiated in 2007 by the opposition on issues related to the government's key reform areas, including healthcare and education. The main opposition party, Fidesz, seeks to capitalize on its current sweeping popular support. Although a negative result of the referendum is plausible, given that the questions, formulated by the opposition, are essentially populist (whether the citizens would like to pay fees for education and hospitals), the government maintains that such a defeat at the referendum could hamper reforms, but would not halt them. According to the authorities, the government would not be legally bound to resign in case of defeat at the above-mentioned referendum.

2.1.2. Economic development

Hungary successfully implemented major transition reforms in the early 1990s. Its dynamic enterprise and bank privatisation and favourable investment climate attracted significant foreign direct investment, including in green-field projects and major utilities. A few strong local corporates emerged in the late 1990s, now increasingly aspiring to a regional role, whereas the growing SME sector is still undercapitalised and is in dire need of innovation and improved management skills.

The progress in structural reforms over the last year has been dominated by the need to reduce fiscal expenditures and decrease the deficit in government finances. Following his re-election in 2006, Prime Minister Gyurcsány announced a fiscal consolidation plan based mainly on tax increases. The reforms started in summer 2006 with the announcement of a two-year freeze on salaries of public employees and a reduction in gas subsidies. Direct tax increases followed in autumn 2006 with hikes in employee social contributions, value-added tax and business taxation. In the medium term, social security and business taxes are expected to be the largest contributors to the increase in the public revenue base, accounting for more than half of the expected reduction in the fiscal deficit in 2007. While considered to be the first step in reducing the deficit, there has been a widespread concern that this plan may have a negative effect on international competitiveness. Even before the new tax rises, Hungary had the third highest labour tax level in the OECD.

The government has subsequently outlined a number of structural reforms aimed at medium-term expenditure reduction. Although the reform of the highly fragmented local administration may suffer delays as it requires the qualified-majority approval of legislative amendments by Parliament, other measures appear to be more successful. The implementation of reforms in other areas started with cuts in subsidies for prescription medicines, the tightening of eligibility criteria for disability benefits, the introduction of co-financing of services by healthcare patients and a move to reduce the number of hospitals. Further structural reforms outlined by the government and awaiting detailed implementation steps include the reform of the insurance system for healthcare financing, changes to the early retirement and special pension rules, a review of the tax system and the introduction of a merit-based assessment scheme in public and higher education. Nevertheless, the scale of expenditure cuts necessary to bring down the deficit and reduce the tax burden implies a long reform period which would have to last beyond the next parliamentary elections in 2010.

2.1.3. Environmental Issues

- **Legal Progress:** Hungary had achieved almost full alignment with the environmental *Acquis Communitaire* of the EC by its accession in May 2004. There were only four areas of derogation:
  1. Compliance with the large combustion plant directive, which has been achieved by the end of 2004.
  2. Compliance with the hazardous waste incineration directive, which has been achieved by June 2005.
  3. Compliance with the directive requiring 50% recycling of packaging materials has been achieved by end 2005.
  4. Compliance with the communal waste-water treatment directive is expected only by the end of 2015.
- **Ozone Protection:** Hungary is a party to the Convention for the Protection of the Ozone Layer and its amendments. The complete phase-out of ozone-depleting agents had been completed prior to EU accession.
- **Climate Change:** Hungary adopted a national greenhouse gas allocation plan and a legal framework for monitoring and permitting procedures in June 2005. A new Climate Change Strategy is under preparation and is expected to be approved in the beginning of 2008.
- **The National Environmental Programme 2003-2008** is being implemented timely.
- **A National Sustainable Development Strategy** has been presented to the Parliament and is expected to be adopted by June 2008.

- **Energy Policy:** a new Energy Policy for 2007-2020 is under discussion and might be presented to Parliament in 2008 for adoption.

2.1.4. Legal Reform

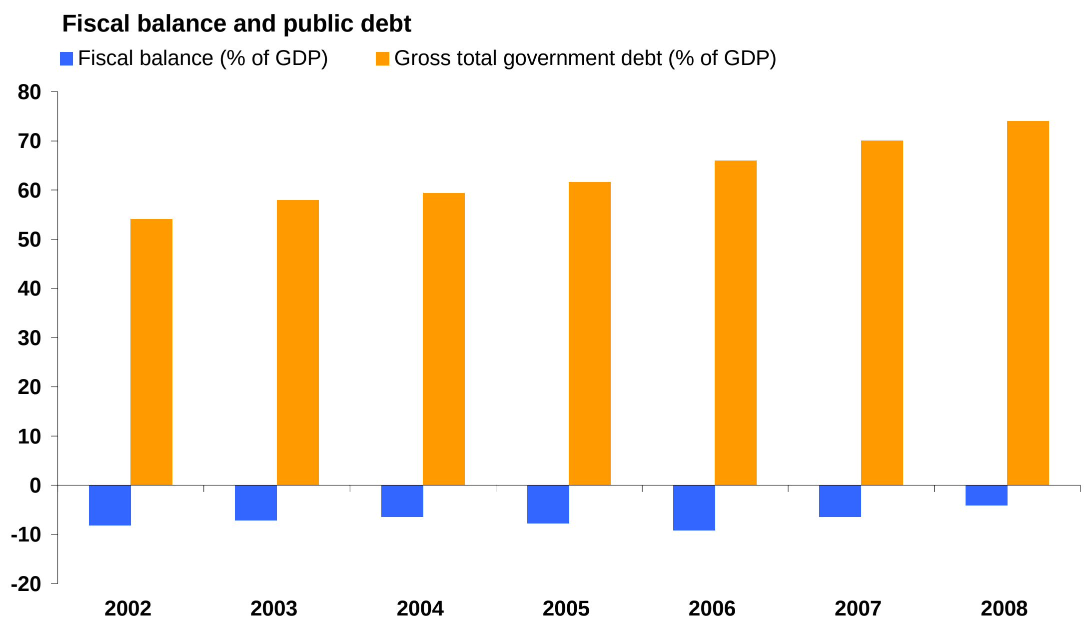
Over the past decade Hungary has introduced notable reforms to its legal environment. Accordingly, the legal system has strongly evolved towards an internationally acceptable level and Hungary is one of the most advanced EBRD countries of operations in terms of legal transition.

Hungary's laws are approaching international standards and are supported by properly established institutional mechanisms to implement them. In particular, the legal regime for secured transactions and the rules relating to corporate governance are well developed. However, improvements are still needed in some areas crucial to the business environment and to foreign investment, in particular in the fields of insolvency and concessions. In its effort to enhance insolvency laws, Hungary improved the framework for the ranking of claims and related regimes, and coherently regulated the right of third parties to challenge an agreement during the insolvency procedure. In addition, the surveys of legal effectiveness conducted by the EBRD indicate that commercial laws may at times suffer from inadequate administrative and judicial support.

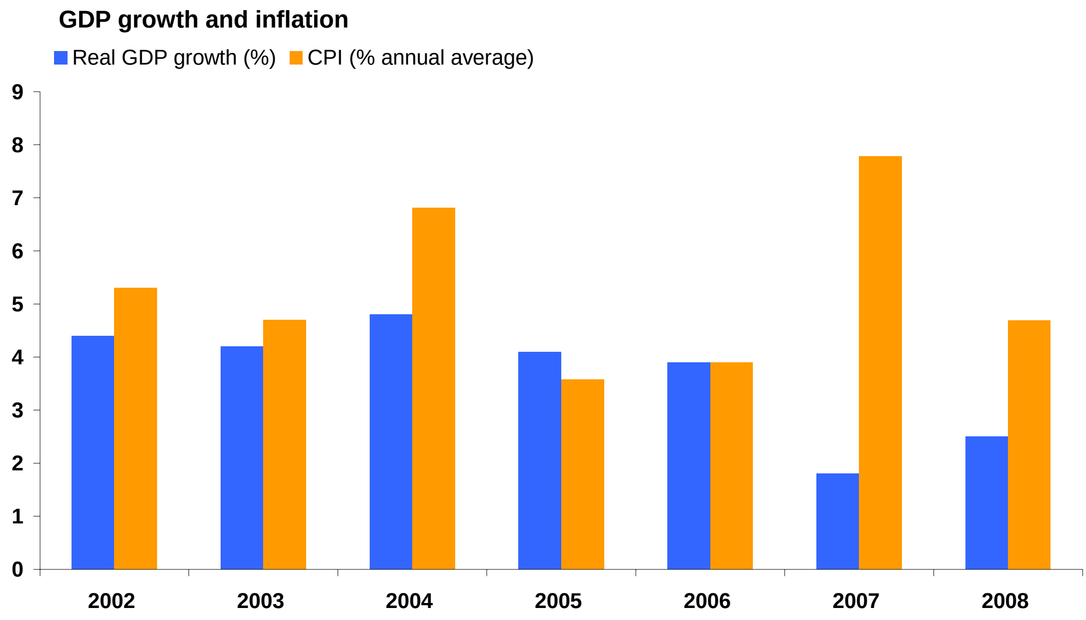
2.2. Progress in transition and the economy's response

2.2.1. Macroeconomic conditions for the Bank's operations

The general government deficit reached 7.8 per cent of GDP in 2005 and the situation worsened in the first half of 2006. A collapse of public finances was prevented by the introduction of stringent fiscal austerity measures and tax increases. As a result, the full-year fiscal deficit closed at an estimated 9.2 per cent of GDP in 2006 and fell to about 5.7 per cent in 2007. Deep structural reforms need to be implemented in order to cut government expenditure and cement the increased revenue base. To this end, the Government has adopted a reform proposal to improve fiscal governance, which includes the introduction of multi-annual budgeting and new fiscal rules, and the foundation of a new budgetary institution. The medium-term fiscal strategy envisages reducing the deficit to around 4 per cent of GDP in 2008 and to 3.2 per cent of GDP by 2009. On the expenditure side, the fiscal strategy includes a reduction in administrative and social security expenditures, cuts in subsidies for prescription medicines, and a tightening of eligibility criteria for disability benefits.

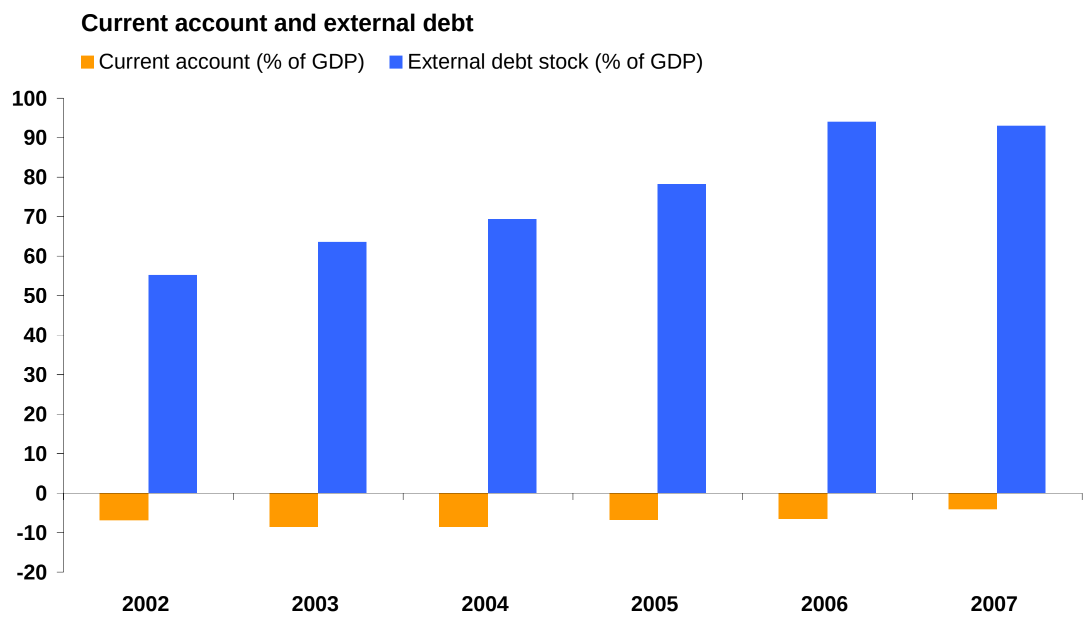


Real GDP growth in 2006 reached an estimated 3.9 per cent, which is lower than that of neighbouring countries. Consumer spending fell in the first half of 2007 due to higher expenditure taxes, tight monetary policy and hikes in utility bills implemented in the summer of 2006. GDP growth slowed down to about 0.9 per cent in the third quarter of 2007. The slowdown was also driven by weak corporate investments in the face of the government's stabilisation measures. On the other hand, industrial production was boosted by rising demand in the euro zone and expanded by about 8.2 per cent year-on-year in the first eleven months of 2007. As a result, net exports remained the main driver of economic growth. After a relatively weak growth at around 1.8 per cent in 2007, the government expects economic expansion to accelerate to around 3 per cent in 2008.



Inflation accelerated to 9 percent in March 2007, driven by tax increases and price hikes. It fell to 6.4 per cent in September before increasing back to 7.4 per cent in December on the back of growing food and oil prices. Inflationary pressures motivated the Hungarian National Bank to increase the reference rate to 8 per cent in October 2006, up from 6.25 per cent in June 2006. Following weakening inflationary pressures, the reference rate was cut to 7.5 per cent in two steps in June and September 2007. Further cuts were prevented by increase in consumer prices in the last quarter of the year.

The current account deficit was around 6.8 per cent of GDP in 2005. It narrowed to an estimated 6.5 per cent of GDP in 2006, mainly on the basis of shrinking trade deficit. In 2006, exports grew by 18 per cent while imports rose by only 12.6 per cent. This trend continued in 2007, leading to a surplus in trade of goods and services in the first three quarters of the year. Net foreign direct investment reached around 2.7 per cent of GDP in 2006. External debt grew substantially in 2006 and 2007, partly due to outflow of portfolio investments. It is now estimated at above 90 per cent of GDP.



Hungary's GDP per capita in purchasing power standards stood at 65 per cent of the average of the enlarged EU (EU-25) in 2006, which was below the levels in Estonia (66 per cent), the Czech Republic (77 per cent) and Slovenia (85 per cent) but above all other transition economies that joined the EU on 1 May 2004. In terms of regional differences, the 2004 GDP per capita in the capital region Közép-Magyarország was at 101.6 per cent of the EU-25 average, while GDP per capita in the poorest Észak-Alföld region stood only at about 41.9 per cent of the EU-25 average, making it the sixth poorest region in the EU at that time.

2.2.2. Transition successes and challenges

Despite substantial progress since the early 1990s, a number of transition challenges remain in Hungary.

Enterprise sector

Focus on services and new technologies: *Despite good overall competitiveness of the enterprise sector, further transition towards services and new technology is needed to reach the standards of developed market economies*

Hungary's enterprise sector is one of the most competitive in the EU-10. Early privatisation and substantial foreign investments helped the country transform from an inefficient centrally planned economy to a market-based export-oriented model which allows Hungary to respond to the changing environment with a substantial degree of flexibility. However, Hungary still needs to move more vigorously towards a service-driven economy and refocus its industrial base on higher value-added products and new technologies. These steps are necessary to ensure long-term competitiveness and sustainable growth in modern Europe.

Tailored finance for SMEs: *There are still gaps in the availability of finance for SMEs where tailor- made financial instruments may be needed.*

Small and medium enterprises (SME) form the backbone of the Hungarian economy and are crucial providers of employment and services, particularly in the poorer areas of the country. Due to their size and business models, SMEs experience the greatest difficulties in accessing external finance. Nevertheless, most commercial banks now have dedicated SME departments. Hitelgarancia, a credit guarantee agency, jointly owned by commercial banks and the State, has been successfully assisting the expansion of SME lending by commercial banks and bank credit to enterprises, and is steadily growing. Several highly subsidised microfinance programmes are in place, making it difficult to establish commercially-based microfinance, although some loans/leases are being extended under IFI-supported credit lines. Shortage of finance for SMEs occurs mostly in niche products or in areas still underserved by commercial credit providers, e.g. venture capital and other high risk products.

Financial sector

Banking sector: *The financial sector is sound, albeit it has yet to develop its regulatory framework and use more sophisticated financial instruments.*

The privatisation of the banking sector is almost complete, with state-owned banks having no significant asset share. The ratio of domestic credit to the private sector to the country's GDP is high by regional standards. The basic regulatory framework is in place. The number of banks is stable and the majority is foreign-owned, whilst the largest bank, OTP has expanded to play a regional role without a strategic investor. Although loans to corporate clients form the largest part of banks' portfolios, the share of loans to households is growing rapidly. Most of the new households' loans are mortgages, usually denominated in foreign currencies. Among corporate loans, there is an increasing shift in focus towards smaller enterprises and foreign-currency denominated lending.

Substantial sector liquidity and the availability of funding from parent institutions have not yet warranted the development of innovative financial instruments commonly used in developed markets to refinance existing exposures. In particular, interest in securitisations has picked up only in recent months and more sophisticated hedging instruments and credit derivatives are yet to be developed on a meaningful scale. The introduction of new financial products and instruments should be accompanied by the further development of an appropriate regulatory and supervisory framework to enable the financial sector to deal with the challenges that such innovations are likely to pose.

Non-banking financial institutions: *The insurance and pension sectors are growing but their portfolios are tilted toward government bonds.*

Although the financial sector is still dominated by commercial banks, the share of non-banking financial institutions in total assets is growing steadily. Most of the Hungarian non-bank financial enterprises are involved in financing households' car purchases and car leasing. The growth in the non-life insurance sector is partially fuelled by consumer and housing loans and the accompanied insurance demand. Private pension funds are gaining importance as they continue to accumulate an increasing portion of the retirement savings of the Hungarian population.

Nevertheless, the composition of the investment portfolio of insurance companies and pension funds continues to be conservative in comparison to their counterparts in the EU, being heavily tilted toward government bonds and other fixed income assets. This is at least partly driven by a conservative investment culture of asset managers and a lack of alternative investment instruments. The pension system also appears to be in need of some fine-tuning to improve its efficiency and enhance the process of collecting contributions, allocating investment and managing future benefit payouts.

Equity markets: *Despite progress, the availability of external equity capital is still scarce.*

Although the Hungarian capital markets have grown in recent years, they still remain underdeveloped by EU standards. The Budapest Stock Exchange is still not an attractive option for Hungarian companies. In 2006 six companies left the exchange, partly as a result of buy-outs, while only 3, relatively low capitalised, stocks were newly listed.

Hungary has one of the most developed private equity fund sectors among transition economies. Private equity investment as a percentage of GDP in Hungary is comparable to that of Austria and exceeds that of Greece. The importance of domestic investors is increasing, though they are still dominated by government agencies and banks (mainly the Hungarian Development Bank).

Infrastructure and environmental sector

Energy: *Energy security and energy efficiency are increasing priorities, although there is still room for increasing competition.*

The legacy of the centrally planned economic system, the historical reliance on undiversified supply routes, as well as the changing geopolitical situation mean that energy security issues are increasingly on governments' agendas in Central Europe. In Hungary, steps are being taken to increase the security of supply of natural resources by constructing adequate storage facilities and possibly diversifying supply routes. These steps are viewed as an essential component of market reforms that provide a safe supply for competitively operating private companies.

Increasing pressure on competitiveness and energy security translates into the need to promote energy efficiency improvements and decrease energy intensity of the Hungarian economy. The ESCO market is reasonably developed, with some commercial and residential energy efficiency projects. Hungary has ratified the Kyoto protocol and as a new EU member is part of the Emissions Trading System (ETS). However, government agencies have been slow in considering and approving renewable energy projects and the conditions of many approvals fell short of investors' expectations. Furthermore, more can be done to stimulate energy efficiency improvements among households and small enterprises, which often lack awareness of the issues and financing options.

In the electricity sector, there is substantial private sector participation in the distribution and generation thanks to early privatisation to strategic investors. However, there is substantial demand for new generation capacity to come into operation after 2010, as most of the current capacity will reach the end of its useful life in the next 5 years. The liberalisation of the electricity market started in 2003 with the launch of regular biannual auctions for electricity trading companies and commercial users. The process of liberalisation, however, is hindered by technical difficulties, rigid legislation, and insufficient competition among energy suppliers and producers. In particular, MVM, which controls an important part of Hungary's generation capacity, appears to limit the amounts of unused domestic generation capacity put for auctions.

Transport: *Increasing budgetary pressures may lead to larger private sector involvement.*

Although Hungarian authorities have been more forthcoming to private involvement in road construction than most governments in Central Europe, PPP structures have been extended only to a handful of projects, including the M1/M15 and the more successful M5 and M6 Phase I motorways. Meanwhile, most of the investments are to be implemented by the State Motorway Operator Company (AAK). Increasing fiscal pressures may lead to further transition in the way roads are constructed and maintained in Hungary. The existing contracts are under pressure to be refinanced under more favourable conditions reflecting the improving risk profile of the country. Furthermore, there are prospects for further PPPs and perhaps even private involvement in AAK.

The railway sector is a clear laggard in the overall reform process but is likely to be catching up in 2008. Operating and policy setting functions have been separated and core railway functions have been divided into individual business units within MAV, the national railways. MAV Start, the passenger operator commenced its new life as a separate company on 1 July 2007 but as yet without a public service contract signed with the state. Access to the track is legally available but not fully working in practice. There is limited private participation in the sector, albeit the privatisation of MAV Cargo has been launched and is expected to be completed in 2007. MAV plans to involve the private sector in its real estate management and railway station refurbishment activities.

The privatisation of Budapest Airport Ltd, the airport operator in Budapest, was completed in 2005 and the sale of MALEV, the national airline, in spring 2007. Restructuring and new investments are the imminent tasks of the new private owners. Regional airports are slowly being developed, with selective government support and limited private involvement, for charter and low-cost flights as well as air cargo.

Municipal and environmental infrastructure: *There is significant scope for private involvement in the delivery of public services and in EU financed projects.*

The municipal sector in Hungary remains fragmented, and is often suffering from poor administrative capacity. With more than 3,000 municipalities, only a few large cities can access external financing on reasonable terms. There is noteworthy private sector participation in water and to a lesser extent in district heating, but little in public transport, waste water and solid waste management. The institutional framework for municipal finance is in place and tariffs have been mostly adjusted to reflect costs, but experience of revenue-based financing is very limited.

With substantial fiscal pressures on municipal finances, there is an increasing scope for private involvement in enhancing efficiency in the delivery of public services. There are first signs of private involvement in managing healthcare facilities. Possible involvement of private companies in managing other facilities, like public transport, waste water treatment and education, could lead to further efficiency gains and cost reductions. When co-financing of EU projects is not available from the central budget, there is an additional scope for private sector involvement through PPPs but there is little experience, both at central government and local levels, in implementing municipal PPP projects. Furthermore, many investments will go beyond one municipality and there is a dire need for regional cooperation that goes beyond the current possibility of forming multi-purpose associations.

3. Strategic orientations

3.1. Bank's Priorities for the Strategy Period

3.1.1. The Bank's Priorities for the Strategy Period

In response to the analysis of Hungary's remaining transition challenges, the Bank's main focus during the strategy period will be to

- Support private-sector involvement in the provision of public services, including through public-private partnerships in the infrastructure area and also in cooperation with Cohesion/Structural Funds.

- Promote investments in the diversification of energy supply, in energy efficiency and renewable energy to enhance energy security, reduce energy intensity and meet environmental targets.

- Provide higher-risk products such as equity and structured debt for local corporations to fund their growth. Particular attention will be paid to local companies' investments in the context of cross-border expansion.

- Participate in the introduction of new capital market products by financial institutions and support innovative products/financial institutions that provide financing for SMEs.

- Actively manage the Bank's portfolio to maintain its high quality.

This Strategy will be implemented in accordance with the strategic outline for the years 2006-2010 agreed upon in CRR3 with respect to graduation.

3.2. Sectoral Challenges and Bank Objectives

3.2.1. Enterprise Sector

Transition Goals

Based on the analysis in section 2.2.2, the following Transition Goals are relevant for the Enterprise Sector:

- Development of higher value-added activities through support of local entrepreneurs, foreign investors and cross-border cooperation, particularly in the less developed regions of the country.
- Development of complimentary financial instruments for SMEs.

Operational Priorities

- Provide higher-risk products such as equity and mezzanine financing to the private sector for local operations as well as cross-border expansion targeting countries of East and South East Europe.

3.2.2. Financial Sector

Transition Goals
Based on the analysis in section 2.2.2, the following Transition Goals are relevant for the Financial Sector:

- Assist in the strengthening of the non-banking financial sector and in the introduction of innovative financial products.
- Broaden the access by the local corporate sector, particularly medium size companies, to equity, quasi-equity and structured finance.

Operational Priorities

- Selectively commit financing to new equity funds, targeting medium sized companies, and non-bank financial institutions with a focus on SMEs.
- Continue the policy dialogue on securitisation legislation and work on new transactions with capital market products.

3.2.3. Infrastructure and Environmental Sector

Transition Goals
Based on the analysis in section 2.2.2, the following Transition Goals are relevant for the Infrastructure and Environmental Sector:

- Reform and improved efficiency of the railway sector.
- Diversification of sources of energy supply to ensure competition on markets for primary fuels and energy.
- Full unbundling and further liberalisation of electricity markets.
- Development of energy efficiency and renewable energy sectors.
- Commercialisation of municipal service companies and expansion of private sector involvement in the provision of public services.
- Involvement of the private sector in the design and implementation of municipal projects with EU funding.

Operational Priorities

- Support of private sector participation in financing of at least two major infrastructure or municipal services projects.
- Support at least one major project aimed at diversifying energy supply and/or mitigating disruption risks to energy markets.
- Develop an energy efficiency credit line for the residential, SME and municipal sectors.
- Support at least one renewable energy or co-generation project, if possible with the use of carbon credits.

3.3. Portfolio management challenges

The Bank will structure its portfolio management in such a way that it is able to maintain the current high quality of the portfolio and project monitoring.

4. Other IFI's and the European Union

Hungary was allocated EU structural and cohesion funds close to EUR 25 billion for 2007-2013.

OP title	Fund	EU co-financing	National contribution	Co-financing rate	Total allocation to the OP	Share of in tota NSRI allocati
OP for Social Renewal	ESF	3,482,518,044	614,562,008	85%	4,097,080,052	13.
OP for State Reform	ESF	146,570,507	25,865,384	85%	172,435,891	0.
OP for Economic Development	ERDF	2,495,769,115	440,429,844	85%	2,936,198,959	10.
OP for Environment and Energy	ERDF + CF	4,178,846,341	737,443,472	85%	4,916,289,813	16.
OP for West Pannon	ERDF	463,752,893	81,838,746	85%	545,591,639	1.
OP for South Great Plain	ERDF	748,714,608	132,126,107	85%	880,840,715	3.
OP for Central Transdanubia	ERDF	507,919,836	89,632,912	85%	597,552,748	2.
OP for North Hungary	ERDF	903,723,589	159,480,633	85%	1,063,204,222	3.
OP for Transport	ERDF + CF	6,223,429,149	1,098,252,203	85%	7,321,681,352	24.
OP for Social Infrastructure	ERDF	1,948,922,941	343,927,578	85%	2,292,850,519	7.
OP for North Great Plain	ERDF	975,070,186	172,071,209	85%	1,147,141,395	3.
OP for Implementation	CF	315,132,937	55,611,695	85%	370,744,632	1.
OP for South Transdanubia	ERDF	705,136,988	124,435,939	85%	829,572,927	2.
OP for Electronic Public Administration	ERDF	358,445,113	63,255,020	85%	421,700,133	1.
OP for Central Hungary	ERDF	1,467,196,353	258,917,003	85%	1,726,113,356	5.
Total NSRF 2007-2013	**All Funds**	**24,921,148,600**	**4,397,849,753**	**85%**	**29,318,998,353**	**100.**

Figures in EUR (current price)

4.1. European Investment Bank (EIB)

Since 1990 the EIB has lent in excess of EUR 6.3 billion in Hungary. The most recent projects include loans for the construction of bypass roads around two large East-Hungarian cities; participation in refinancing the M6 Phase I concession motorway project; loans to co-finance the Hungarian government's contribution to projects benefiting from EU grant support under the Cohesion Fund 2007-13; the long term credit line to the Hungarian Development Bank to finance environmental and infrastructure projects of municipalities and SMEs; a loan to Magyar Telekom to upgrade and develop broadband telecommunication services and global loans extended to local commercial banks for SME and municipal projects.

4.2. International Monetary Fund (IMF)

Hungary has been a member of the IMF since 1982. The last stand-by agreement with the IMF expired in 1998. The IMF undertakes annual consultation visits to Hungary. Its latest assessment of the Hungarian economy (Article IV consultations) was published in June 2007.

4.3. World Bank

Hungary has been a member of the World Bank since 1982. The aggregate World Bank's commitments to Hungary exceed US$ 4 billion for around 40 operations. There was one new project signed in 2005-2007 for USD 12.5 million, financing nutrient reduction to the Danube. Hungary "graduated" from the World Bank in April 2007.

4.4. International Finance Corporation (IFC)

Hungary has been a member of the IFC since 1985. IFC invested in 28 projects involving around US$ 372 million from its own account and US$ 21 million in syndications from other banks. In 2005-2007 IFC signed a USD 125 million local currency, 50% risk sharing facility to the largest local commercial bank, OTP, to support energy efficiency upgrades at schools under a modernization program launched by the Hungarian government.

ANNEX 1: COMMITTED PROJECTS PER YEAR

Year	Op Name	Direct/Regional	Total Project Value	EBRD Finance	Debt	Equity	Operation Stage
1991	Petofi Nyomda Rt.	Direct	5.1	5.1	5.1	0.0	Completed
1991	**1**		**5.1**	**5.1**	**5.1**	**0.0**	
1992	Hungarian Telecommunications Project	Direct	215.5	33.6	33.6	0.0	Completed
1992	Westel Radiotelefon KFT	Direct	8.2	8.2	8.2	0.0	Completed
1992	Fusion Inv. Co. Fast Food Restaurant Chain	Direct	20.7	3.0	0.0	3.0	Completed
1992	General Motors	Direct	82.1	30.7	30.7	0.0	Completed
1992	Budapest Orbital Motorway (MO) Project	Direct	108.8	21.0	21.0	0.0	Completed
1992	TVK/Columbian Tiszai Koromgyarto KFT	Direct	46.0	7.4	7.4	0.0	Completed
1992	**6**		**481.2**	**103.9**	**100.9**	**3.0**	
1993	Kner Nyomda RT	Direct	5.5	1.5	1.5	0.0	Completed
1993	Eurocorp	Direct	2.6	0.1	0.0	0.1	Completed
1993	New Europe East Investment Fund	Regional	23.0	4.9	0.0	4.9	Repaying
1993	PCA-Budafok (Kartongyar) KFT	Direct	13.4	3.3	3.3	0.0	Completed
1993	HungarianForeign Trade Bank (MKB) - Bond Issue	Direct	33.2	7.7	7.7	0.0	Completed
1993	Magyar Hotec (Formulae 1 Hotel), under RZB ag line	Direct	1.7	0.9	0.9	0.0	Completed
1993	Dun & Bradstreet	Regional	0.3	0.3	0.0	0.3	Completed
1993	ARP - Budapest Bank RT	Direct	6.6	6.6	6.6	0.0	Completed
1993	ARP - Kereskedelmi (Credit and Commercial Bank)	Direct	33.6	33.6	33.6	0.0	Completed
1993	ARP - OTP (National Savings Bank)	Direct	17.7	17.7	17.7	0.0	Completed
1993	Budapest Public Transport Rehabilitation Project	Direct	85.4	45.4	45.4	0.0	Completed
1993	Goldsun	Direct	4.1	4.1	4.1	0.0	Completed
1993	Hungarian Telecommunications Equity Investment	Direct	272.9	50.9	0.0	50.9	Completed
1993	Pannonia	Direct	48.8	6.3	0.0	6.3	Completed
1993	EGIS Pharmaceuticals - Partial Privatisation	Direct	37.8	37.8	0.0	37.8	Completed
1993	M1-M15 Motorway Project	Direct	249.7	72.2	68.2	4.0	Completed
1993	**17**		**836.4**	**293.2**	**188.9**	**104.3**	
1994	Budapest Wholesale Market	Direct	19.7	4.4	4.4	0.0	Completed
1994	Framochem - Borsod Chem/SNPE	Direct	5.1	0.6	0.6	0.0	Completed
1994	ARP - Magyar Hitel Bank (Hungarian Credit Bank)	Direct	9.2	9.2	9.2	0.0	Completed
1994	Hungarian Foreign Trade Bank (MKB) - Privatisation	Direct	31.4	17.5	0.0	17.5	Completed
1994	Advent Private Equity Fund - Central Europe LP	Regional	21.7	5.8	0.0	5.8	Repaying
1994	OTP Bank	Direct	10.7	10.7	10.7	0.0	Completed
1994	Central Business Center	Direct	18.5	5.9	4.9	1.0	Completed
1994	MOL Rt: Zsana Gas Container Project	Direct	70.0	20.6	20.6	0.0	Completed
1994	**8**		**186.3**	**74.6**	**50.2**	**24.3**	
1995	Hungarian Capital Fund	Direct	19.0	9.4	0.0	9.4	Completed
1995	Cofinec SA (Kner)	Direct	10.1	4.2	0.0	4.2	Completed
1995	MBA Loan Project (guarantee)	Regional	1.2	0.4	0.4	0.0	Repaying
1995	Graboplast Capital Increase	Direct	5.4	2.4	0.0	2.4	Completed
1995	East European Food Fund	Regional	37.9	7.8	0.0	7.8	Disbursing
1995	Investel Syndicated Loan Facility	Direct	764.1	13.2	13.2	0.0	Completed
1995	ARP - Budapest Bank Rt- Extension	Direct	0.4	0.4	0.4	0.0	Completed
1995	M5 Concession Motorway B.O.T.	Direct	310.7	61.0	61.0	0.0	Completed

1995	Budapest Bank Privatisation (equity)	Direct	36.6	36.6	0.0	36.6	Completed
1995	Prometheus ESCO Financing	Direct	3.8	3.8	3.8	0.0	Completed
1995	Deltav Rt. - Hungary Regional Telecommunications	Direct	153.6	23.5	21.6	1.9	Completed
1995	**11**		**1,342.9**	**162.8**	**100.4**	**62.4**	
1996	ARP - Kereskedelmi (Bank Extension)	Direct	30.9	30.9	30.9	0.0	Completed
1996	Borsod Chem Rt Privatization	Direct	14.8	14.8	0.0	14.8	Completed
1996	Digitel 2002 Rt	Direct	95.1	15.3	13.9	1.4	Completed
1996	Szikra Lapnyomda Rt.	Direct	10.9	6.1	4.1	2.0	Repaying
1996	New Europe Insurance Ventures	Regional	3.2	0.9	0.0	0.9	Repaying
1996	OTP Subordinated Loan	Direct	41.2	41.2	41.2	0.0	Disbursing
1996	Budapest Bank Credit Line for Environment and Energy	Direct	26.8	9.3	9.3	0.0	Repaying
1996	**7**		**222.9**	**118.4**	**99.4**	**19.1**	
1997	Winterthur MPF/CS L&P Penztarszolgaltato (equity)	Direct	8.5	4.5	0.0	4.5	Disbursing
1997	Hungarian Equity Partners	Direct	19.7	9.3	0.0	9.3	Repaying
1997	Raba Rt.	Direct	69.2	9.6	0.0	9.6	Disbursing
1997	DBG Osteuropa Holding GmbH	Regional	7.1	2.6	0.0	2.6	Repaying
1997	Prometheus II	Direct	28.9	16.1	9.6	6.5	Repaying
1997	Hungarian Foreign Trade Bank (MKB) Capital Increase	Direct	65.4	11.5	0.0	11.5	Completed
1997	Kereskedelmi es Hitelbank Rt	Direct	26.2	26.2	0.0	26.2	Completed
1997	Baring Communications Equity	Regional	12.7	2.5	0.0	2.5	Repaying
1997	Hungarian Commercial Television	Direct	52.4	12.2	12.2	0.0	Completed
1997	Advent Central & Eastern Europe II - Regional Fund	Regional	16.5	5.8	0.0	5.8	Repaying
1997	SRP - Hungarian SRP - Ganz Gipgyar Holding Kft	Direct	4.0	4.0	0.0	4.0	Completed
1997	Environmental Investment Fund	Regional	2.2	0.5	0.0	0.5	Disbursing
1997	**12**		**313.0**	**104.9**	**21.8**	**83.1**	
1998	Winterthur MPF/CS L&P Biztosito (equity)	Direct	10.1	4.9	0.0	4.9	Disbursing
1998	MAV - Railcar Modernisation and Marketing Project	Direct	220.0	40.0	40.0	0.0	Repaying
1998	Innova/98 LP	Regional	9.8	2.0	0.0	2.0	Repaying
1998	MBA Loan Project II (guarantee)	Regional	0.2	0.0	0.0	0.0	Completed
1998	Budapest Waste Water Services Privatisation	Direct	38.3	11.9	11.9	0.0	Disbursing
1998	CGE MPF Budapest Wastewater Service Privatisation	Direct	38.3	11.9	11.9	0.0	Disbursing
1998	**6**		**316.8**	**70.6**	**63.7**	**6.9**	
1999	Info. and Comm. Tech & Industrial Electronic Fund Ltd.	Regional	11.3	2.5	0.0	2.5	Disbursing
1999	AIG New Europe Fund	Regional	40.5	7.1	0.0	7.1	Repaying
1999	M1-M15 Motorway Restructured Project	Direct	204.8	65.8	65.8	0.0	Repaying
1999	L&G ESCO Hungary	Direct	3.5	1.2	0.9	0.3	Completed
1999	OTP Equity Investment	Direct	21.5	21.5	0.0	21.5	Repaying
1999	Ozdi Acelmuvek Kft Minimill Project	Direct	19.9	10.2	10.2	0.0	Repaying
1999	Honeywell ESCO Hungary	Direct	10.6	0.4	0.0	0.4	Disbursing
1999	Regional/Private Equity Fund Facility - Trigranit	Regional	37.5	6.8	0.0	6.8	Completed
1999	Energy Efficiency and Emissions Reduction Fund	Regional	10.7	3.0	0.0	3.0	Disbursing
1999	Emerging Europe Capital Investors LDC	Regional	20.4	5.5	0.0	5.5	Disbursing
1999	Budapest Intermodal Logistics Centre - Basic Infrastructure	Direct	18.1	4.7	4.7	0.0	Repaying
1999	**11**		**398.8**	**128.8**	**81.6**	**47.1**	
2000	Argus Capital Partners	Regional	48.7	11.7	0.0	11.7	Repaying
2000	Heitman Central Europe Property Partners Fund	Regional	37.8	9.3	0.0	9.3	Repaying
2000	Winterthur MPF/CS L&P Biztosito - 1st Capital Increase	Direct	6.0	2.1	0.0	2.1	Disbursing
2000	Winterthur MPF/CS L&P Penztarszolgaltato - Capital In	Direct	4.2	1.5	0.0	1.5	Disbursing
2000	**4**		**96.7**	**24.6**	**0.0**	**24.6**	

2001	Regional/Private Equity Fund Facility - Trigranit II	Regional	2.3	0.8	0.0	0.8	Repaying
2001	EU/EBRD Phase I - Euroventures Danube BV	Regional	15.0	3.0	0.0	3.0	Disbursing
2001	DVI, Inc. (debt)	Regional	4.3	1.1	1.1	0.0	Completed
2001	Innova/3	Regional	37.7	4.5	0.0	4.5	Repaying
2001	Winterthur MPF/CS L&P Biztosito - 2nd Capital Increase	Direct	9.6	3.3	0.0	3.3	Disbursing
2001	Raiffeisen EU Enlargement Fund	Regional	9.2	4.7	0.0	4.7	Repaying
2001	Viking River Cruises	Regional	5.8	5.8	5.8	0.0	Repaying
2001	Invitel	Direct	268.2	47.4	47.4	0.0	Completed
2001	Tecnicredito Hungary (syn loan)	Direct	25.0	10.0	10.0	0.0	Repaying
2001	EU/EBRD Phase II ext - Volksbank Hungary	Direct	10.2	10.2	10.2	0.0	Disbursing
2001	**10**		**387.1**	**90.8**	**74.5**	**16.3**	
2002	Accession Mezzanine Capital LP	Regional	16.6	7.8	0.0	7.8	Repaying
2002	Winterthur MPF/CS L&P Biztosito - 3rd Capital Increase	Direct	7.8	2.5	0.0	2.5	Disbursing
2002	Parmalat MPF - Hungary	Direct	27.7	9.0	0.0	9.0	Disbursing
2002	Heitman Central Europe Property Partners Fund II	Regional	28.7	8.8	0.0	8.8	Repaying
2002	**4**		**80.8**	**28.1**	**0.0**	**28.1**	
2003	DBG Osteuropa Holding II	Regional	21.8	6.6	0.0	6.6	Disbursing
2003	ORCO APARTHOTELS	Regional	16.3	1.7	0.0	1.7	Disbursing
2003	MOL - Duna WWTP Outsourcing Project	Direct	39.0	12.3	12.3	0.0	Completed
2003	Dalkia Prometheus III	Direct	3.0	0.6	0.0	0.6	Disbursing
2003	Winterthur MPF/CS L&P Biztosito - 4th Capital Increase	Direct	5.4	1.9	0.0	1.9	Disbursing
2003	Winterthur MPF/CS L&P Penztarszolgaltato - 2nd Cap. Incr.	Direct	2.4	0.8	0.0	0.8	Disbursing
2003	Internet Framework - Laserbit	Direct	5.9	1.7	0.0	1.7	Completed
2003	EU/EBRD Phase II ext. - MKB Euroleasing	Direct	9.8	9.8	9.8	0.0	Disbursing
2003	MOL Environmental Loan	Direct	750.0	150.0	150.0	0.0	Disbursing
2003	Volksbank FW - Volksbank Hungary Sub Debt	Direct	10.0	10.0	10.0	0.0	Disbursing
2003	Cora - Hungary	Direct	274.0	55.0	55.0	0.0	Repaying
2003	EU/EBRD Extension 4 - Volksbank Hungary II	Direct	5.0	5.0	5.0	0.0	Disbursing
2003	Euroventures Hungary III	Direct	46.0	10.0	0.0	10.0	Disbursing
2003	TUI advance payments	Regional	2.0	2.0	2.0	0.0	Completed
2003	EU/EBRD Extension 3 - Budapest Leasing	Direct	20.0	20.0	20.0	0.0	Disbursing
2003	**15**		**1,210.6**	**287.4**	**264.2**	**23.3**	
2004	Polish Enterprise Fund V	Regional	1.4	1.4	0.0	1.4	Repaying
2004	EU/EBRD Extension 4 - CIB Leasing	Direct	10.0	10.0	10.0	0.0	Disbursing
2004	Accession Fund	Regional	60.0	15.0	0.0	15.0	Disbursing
2004	Hungary M5 Refinancing	Direct	221.3	67.5	67.5	0.0	Completed
2004	TriGranit III	Regional	45.5	10.0	0.0	10.0	Repaying
2004	Advent Central & Eastern Europe Successor Fund	Regional	33.0	5.0	0.0	5.0	Disbursing
2004	Prometheus IV	Direct	15.0	3.0	0.0	3.0	Disbursing
2004	M5 Phase II	Direct	750.0	100.0	100.0	0.0	Repaying
2004	Europolis II	Regional	15.0	3.8	2.8	1.0	Disbursing
2004	UNIQA Biztosito Rt. (Hungary)	Direct	11.0	11.0	0.0	11.0	Disbursing
2004	EU/EBRD Extension 5 - SG Equipment Finance, Hungary	Direct	10.0	10.0	10.0	0.0	Disbursing
2004	EU/EBRD Extension 5 - HVB Leasing Hungary	Direct	10.0	10.0	10.0	0.0	Disbursing
2004	**12**		**1,182.2**	**246.7**	**200.3**	**46.4**	
2005	EU/EBRD Extension 4 - Merkantil	Direct	10.0	10.0	10.0	0.0	Signed
2005	EU/EBRD Extension 6 - CIB Leasing II	Direct	3.0	3.0	3.0	0.0	Signed
2005	Winterthur MPF/CSL&P Penztarszolgaltato - 3rd Capital Incr.	Direct	3.7	1.3	0.0	1.3	Disbursing
2005	EU/EBRD Extension 6 - Budapest Leasing II	Direct	5.0	5.0	5.0	0.0	Signed
2005	Eurventures III	Direct	46.0	5.0	0.0	5.0	Signed

2005	M6 Motorway	Direct	410.9	32.0	32.0	0.0	Disbursing
2005	Emerging Europe Convergence Fund II	Regional	60.0	3.6	0.0	3.6	Disbursing
2005	EU/EBRD Deutsche Leasing	Direct	10.0	10.0	10.0	0.0	Disbursing
2005	Orco Aparthotels	Regional	133.2	0.5	0.0	0.5	Disrbusing
2005	Southeast Europea Equity Fund II	Regional	20.0	4.2	0.0	4.2	Disbursing
2005	Argus Capital Partners	Regional	20.0	6.0	0.0	6.0	Disbursing
2005	Connex Equity Investment	Regional	196..3	17.8	0.0	17.8	Disbursing
2005	SG AM Eastern Europe	Regional	54.0	3.0	0.0	3.0	Disbursing
2005	**14**		**972.1**	**101.4**	**60.0**	**41.4**	
2006	M6 Motorway Refinancing	Direct	483.0	32.0	32.0	0.0	Disbursing
2006	EU/EBRD Budapest Leasing - Rural	Direct	5.0	5.0	5.0	0.0	Disbursing
2006	GED Eastern Fund II	Regional	20.0	2.0	0.0	2.0	Disbursing
2006	Alpha CEE II	Regional	50.0	7.5	0.0	7.5	Disbursing
2006	AIG New Europe Fund II	Regional	50.0	4.0	0.0	4.0	Disbursing
2006	**5**		**608.0**	**50.5**	**37.0**	**13.5**	
2007	EU/EBRD SG Equipment Finance - Rural	Direct	5.0	5.0	5.0	0.0	Disbursing
2007	Hospinvest	Direct	4.0	4.0	0.0	4.0	Disbursing
2007	Veolia Voda Equity Investment	Regional	105.0	8.4	0.0	8.4	Disbursing
2007	Royalton Partners II	Regional	50.0	5.0	0.0	5.0	Disbursing
2007	AIG New Europe Fund II	Regional	50.0	1.0	0.0	1.0	Disbursing
2007	Syntaxis Mezzanine Fund	Regional	26.0	2.5	0.0	2.5	Disbursing
2007	Accession Mezzanine Capital II	Regional	200.0	6.0	0.0	6.0	Disbursing
2007	Wintherthur/AXA MPF	Direct	4.3	4.3	0.0	4.3	Disbursing
31/10/2007	**8**		**444..3**	**36..2**	**5.0**	**31..2**	

ANNEX 2: NET CUMULATIVE BUSINESS BY INDUSTRY[1]

Sector Business group (SIC)	Sector Team (SIC)	EBRD Finance	Share of Commitments
Energy		**170.0**	**9%**
	Power	3.0	0%
	Natural Resources	167.0	9%
Financial Institutions		**580.0**	**32%**
	Bank Equity	114.0	6%
	Bank Lending	176.0	10%
	Equity Funds	144.0	8%
	Non Bank Financial Institutions	147.0	8%
Infrastructure		**616.0**	**33%**
	Municipal & Env Inf	124.0	7%
	Transport	491.0	27%
Corporate		**475.0**	**26%**
	Agribusiness	68.0	4%
	General Industry	142.0	8%
	Property & Tourism	63.0	3%
	Telecoms Informatics & Media	203	11%
HUNGARY TOTAL		**1,841**	**100%**

[1] As of 31 October 2007

ANNEX 3: PIPELINE STOCK

(in EUR million as of 31 October 2007)

	Final Review	Board Approval	Pipeline*	Number of Operations
HUNGARY	0.0	17.0	391.5	7.0*
DEBT	0.0	17.0	366.3	6.0
EQUITY	0.0	0.0	25.2	1.0
PRIVATE	0.0	17.0	391.5	7.0
STATE	0.0	0.0	0.0	0.0
Non-Sovereign	0.0	17.0	391.5	7.0
Sovereign	0.0	0.0	0.0	0.0
Natural Resources	0.0	0.0	159.5	2.0
Power and Energy	0.0	0.0	40.0	1.0
Energy	0.0	0.0	199.5	3.0
Bank Lending	0.0	0.0	100.0	1.0**
Bank Equity	0.0	0.0	0.0	0.0
Equity Funds	0.0	0.0	0.0	0.0
Non Bank Financial Institutions	0.0	17.0	17.0	1.0
Financial Institutions	0.0	17.0	117.0	2.0
Municipal & Env Inf	0.0	0.0	0.0	0.0
Transport	0.0	0.0	50.0	1.0
Infrastructure	0.0	0.0	50.0	1.0
Agribusiness	0.0	0.0	0.0	0.0
General Industry	0.0	0.0	0.0	0.0
Property and Tourism	0.0	0.0	0.0	0.0
Telecoms Informatics & Media	0.0	0.0	0.0	0.0
Specialised Industries	0.0	0.0	0.0	0.0

*Includes projects passed Concept Review stage

**A framework facility for energy efficiency credit lines/risk-sharing.

ANNEX 4: SELECTED ECONOMIC INDICATORS

Hungary

	2001	2002	2003	2004	2005	2006	2007	2008
							Projection	*Projection*
Output and expenditure	*(Percentage change in real terms)*							
GDP	4.1	4.4	4.2	4.8	4.1	3.9	1.8	2.7
Private consumption	5.7	9.8	7.8	3.2	3.8	1.2	-2.7	1.0
Public consumption	1.6	5.5	5.3	0.0	0.2	-5.5	-3.6	0.4
Gross fixed capital formation	5.1	10.1	2.1	7.7	5.6	-1.8	1.0	5.8
Exports of goods and services	8.1	3.9	6.2	15.7	11.6	18.0	13.6	9.8
Imports of goods and services	5.3	6.8	9.3	14.1	6.8	12.6	12.2	9.0
Industrial gross output	0.4	1.8	5.9	3.9	4.3	8.6	8.6	5.6
Agricultural gross output	16.5	-9.8	-0.7	54.4	-2.4	-6.1	na	na
Employment	*(Percentage change)*							
Labour force (annual average)	-0.4	0.2	1.4	0.1	1.3	1.1	na	na
Employment (annual average)[1]	0.3	0.1	1.3	-0.6	0.0	0.7	na	na
	(In per cent of labour force)							
Unemployment (end-year)	5.7	5.8	5.9	6.3	7.3	7.5	7.1	7.0
Prices and wages	*(Percentage change)*							
Consumer prices (annual average)	9.2	5.3	4.7	6.8	3.6	3.9	8.0	5.0
Consumer prices (end-year)	6.8	4.8	5.7	5.5	3.3	6.6	7.4	4.0
Producer prices (annual average)	5.2	-1.8	2.4	3.5	4.3	6.5	0.8	4.0
Producer prices (end-year)	-0.4	-1.3	6.2	1.6	4.5	4.5	0.5	na
Gross average monthly earnings in economy (annual average)	18.2	18.3	12.0	6.0	8.8	8.1	7.7	na
Government sector	*(In per cent of GDP)*							
General government balance[2]	-3.5	-8.2	-7.2	-6.4	-7.8	-9.2	-5.7	-4.1
General government expenditure	47.4	51.2	49.1	48.9	50.0	53.0	na	na
General government debt	50.7	54.0	58.0	59.4	61.7	66.0	na	na
Monetary sector	*(Percentage change)*							
Broad money (M2, end-year)	16.8	13.8	13.6	9.9	13.0	11.9	5.8	na
Domestic credit (end-year)	4.7	15.3	19.8	11.9	23.4	15.9	8.8	na
	(In per cent of GDP)							
Broad money (M2, end-year)	43.4	43.9	45.3	45.5	48.4	50.6	49.9	na
Interest and exchange rates	*(In per cent per annum, end-year)*							
Refinance rate	9.8	8.5	12.5	9.5	6.0	8.0	7.5	na
Interbank interest rate (up to 30-day maturity)	10.0	8.9	12.2	9.7	6.1	8.1	7.5	na
Deposit rate weighted average (fixed for less than 1 year)	9.4	7.4	8.7	9.1	5.2	7.4	na	na
Lending rate weighted average (maturing within 1 year)	12.0	9.7	11.2	11.0	7.4	9.2	na	na
	(Forints per US dollar)							
Exchange rate (end-year)	279.0	225.2	207.9	180.3	213.6	191.6	172.6	na
Exchange rate (annual average)	286.5	257.9	224.3	202.7	199.6	210.4	183.8	na
External sector								
	(In millions of US dollars)							
Current account[3]	-3,201.1	-4,643.2	-7,205.2	-8,767.4	-8,128.1	-6,527.63	-7,380.0	-5,800.0
Trade balance[3]	-2,233.7	-2,075.6	-3,271.2	-3,081.5	-1,960.9	-524.11	1,100.0	2,000.0
Merchandise exports[3]	31,054.4	34,684.1	43,324.6	56,720.3	63,071.4	73,374.36	na	na
Merchandise imports[3]	33,288.1	36,759.7	46,595.8	59,801.8	65,032.3	73,898.47	na	na
Foreign direct investment, net[3]	3,573.0	2,721.8	478.8	3,541.9	5,412.1	3054.54	3,000.0	na
Gross reserves, excluding gold (end-year)	10,738.2	10,359.0	12,748.7	15,920.0	18,552.3	21,528	23,968.0	na
External debt stock	33,951.4	36,883.2	53,767.5	70,871.9	86,400.8	105,384.65	135,000.0	na
	(In months of imports of goods and services)							
Gross reserves, excluding gold (end-year)	3.3	2.9	2.7	2.7	2.9	3.0	na	na
	(In per cent of exports of goods and services)							
Debt service[4]	14.5	13.7	14.2	15.1	16.0	13.0	na	na
Memorandum items	*(Denominations as indicated)*							
Population (end-year, million)	10.2	10.1	10.1	10.1	10.1	10.1	10.1	na
GDP (in billions of forints)	15,274.9	17,203.7	18,935.7	20,712.3	22,026.8	23,561.5	25,272.0	25,540.0
GDP per capita (in US dollars)	5,238.0	6,577.6	8,344.3	10,116.8	10,948.9	11,127.8	14,390.0	na
Share of industry in GDP (in per cent)	26.6	26.1	26.7	26.5	26.6	23.0	na	na
Share of agriculture in GDP (in per cent)	5.0	4.4	4.2	6.1	5.8	5.4	na	na
Current account/GDP (in per cent)	-6.0	-7.0	-8.5	-8.6	-6.8	-6.5	-5.2	-4.0
External debt - reserves (in US$ million)	23,213.2	26,524.1	41,018.7	54,951.8	67,848.5	83,856.3	111,032.0	na
External debt/GDP (in per cent)	63.7	55.3	63.7	69.4	78.3	94.1	96.0	na
External debt/exports of goods and services (in per cent)	89.1	87.7	103.1	104.8	114.3	121.4	na	na

1 Data from labour force surveys.

2 From 1999 data are based on Eurostat methodology (ESA95), excluding part of the cost of pension reform. Earlier data are based on local statistics and estimates.

3 Data from balance of payments.

4 Excluding inter-company loans.

ANNEX 5: RATINGS FROM THE 2005 ASSESSMENT OF TRANSITION CHALLENGES

HUNGARY	Structure	Institutions	Conduct	Comments
Agribusiness	*Small*	*Small*	*Small*	Poorly functioning land market. Agro-processors still need to improve efficiency and standards. Improvements to distribution and traceability are necessary. An appropriate financial system for agriculture is developing slowly (incl. warehouse receipt and insurance schemes).
Banking	*Negligible*	*Small*	*Negligible*	Regulatory framework in place. Number of banks is stable and majority foreign owned. Domestic credit to private sector (as % of GDP) is high for the region. Banking system that intermediates efficiently.
Energy Efficiency	*Small*	*Medium*	*Small*	The energy service (ESCO) market is one of the most developed in the region. The legal framework is set out in the energy efficiency law. Hungary has ratified the Kyoto and is part of the EU ETS.
General Industry	*Negligible*	*Negligible*	*Small*	The country is a regional leader in industry reforms. Improvements needed to increase labour market participation and lower state interference in the economy, but similar problems in other market economies. Completion of enterprise restructuring and expansion of local enterprises are remaining challenges.
MEI	*Small*	*Medium*	*Small*	There is noteworthy private sector participation in water and to a lesser extent in district heating, but very little in public transport. The institutional framework for municipal finance is in place and tariffs have been adjusted to reflect costs, but experience of revenue-based financing is limited.
MSMEs	*Medium*	*Small*	*Medium*	Starting a business is costly. A credit registry exists. Collateral and bankruptcy legislation are supportive of MSME lending. The cost of registering collateral is moderate. Most commercial banks now have dedicated SME departments and bank credit to enterprises is growing. Several highly subsidised microfinance programmes are in place making it virtually impossible to establish commercially based microfinance.
Natural Resources	*Small*	*Small*	*Small*	MOL has developed into an international quality oil and gas company. Remains vertically integrated but has divested non-core assets. Some further environmental improvements required to upgrade facilities. Otherwise tariff reform, governance and legislation sound.
NBFIs	*Negligible*	*Small*	*Small*	Securities and insurance markets legislation/regulation almost meet IOSCO/ IAIS standards. Capital markets are relatively developed with respect to the range of financial instruments available although stock market capitalisation has been declining over years. Insurance penetration is relatively small. There are mandatory and voluntary privately managed pension funds. Thriving leasing and consumer finance.
Power	*Small*	*Small*	*Small*	Sector not fully unbundled but substantial PSP in distribution and generation through early privatisation to strategic investors. Competition is hindered by presence of long term power purchase agreements. There is a strong independent regulator. Tariffs are cost oriented and tariff rebalancing has been largely completed.

Private Equity Funds	*Small*	*Small*	*Small*	One of the most developed sectors in region. Private equity investment % of GDP is comparable to that in Austria. The importance of domestic investors is increasing, though they are still dominated by government agencies and banks. The equity funds are yet to offer a broader range of products and become more visible providers of finance to enterprises. Small pool of experienced fund managers.
Property + Tourism	*Small*	*Small*	*Negligible*	Full tradability of land except foreigners. Sector is developing fast, including new types of property and financing instruments. The main issue is the subsidisation of residential housing by the government.
Telecoms	*Negligible*	*Small*	*Small*	Sector regarded as one of the most advanced of the region. The dominant fixed line incumbent has been fully privatised. The Government was committed to the introduction of competition, as highlighted by the ending of the monopoly of the incumbent a year earlier than had been originally envisaged.
Transport	*Medium*	*Small*	*Small*	In railways, operating and policy setting functions separated. Core railway functions separated into individual business units while ancillary services divested. Limited PSP. Infrastructure access granted legally but not fully working in practice. In roads, have been a number of PPP projects, but experience mixed (e.g. M1/M15). Road construction/maintenance contracted out to private sector. Sector finance in line with EU.

ANNEX 6: COMPARATIVE STRUCTURAL CHANGE INDICATORS

	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Slovakia	Slovenia
Liberalisation								
Share of administered prices in CPI (in per cent)	20.7	23.3	15.1	14.0*	13.5	1.0*	23.4*	17.4*
Number of goods with administered prices in EBRD-15 basket	2.0	2.0	1.0	2.0*	1.0	1.0*	2.0*	1.0*
Share of trade with non-transition countries (in per cent)	75.8*	78.3*	75.2*	53.6*	52.1*	78*	61.5*	74.5*
Share of trade in GDP (in per cent)	126.9	133.1	129.6	84.8	100.0	90.4	163.1	121.9
Tariff revenues (in per cent of imports)	0.2*	0.3*	0.1*	0.3*	0.4*	0.4*	0.1*	0.3*
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.0
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Privatisation								
Privatisation revenues (cumulative, in per cent of GDP)	25.3*	7.3*	35.3*	5.3*	13.7*	14.0*	35.2*	5.0*
Private sector share in GDP (in per cent)	80.0	80.0	80.0	70.0	75.0	75.0	80.0	70.0
Private sector share in employment (in per cent)	70.0	74.3*	79.3*	76.0	na	73.2*	75.0*	70.0
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	4.0	4.0	4.0	3.7	4.0	3.3	4.0	3.0
Enterprise and markets								
Budgetary subsidies and current transfers (in per cent of GDP)	na	1.4*	na	na	0.8*	0.8*	1.4*	3.7*
Share of industry in total employment (in per cent)	40*	25.9*	31.9*	18*	19.7*	31.1*	29*	29.5*
Change in labour productivity in industry (in per cent)	8.3*	15*	10.2*	-1.2*	10.4*	1.5*	7.2*	9.4*
Investment/GDP (in per cent)	25.6	38.2*	21.9*	38*	28*	20.6*	26.0	27.7
EBRD index of enterprise reform	3.3	3.7	3.7	3.0	3.0	3.7	3.7	3.0
EBRD index of competition policy	3.0	3.7	3.3	3.0	3.3	3.3	3.3	2.7
Infrastructure								
Fixed-line (mobile) penetration rate (per 100 inhabitants) *	31.5 (119.0)	40.9 (125.2)	33.3 (99.0)	28.6 (95.1)	23.2 (138.1)	29.8 (95.5)	21.6 (90.6)	42.6 (92.6)
Internet users (per 100 inhabitants)*	34.7	57.4	34.8	46.7	31.7	28.6	41.8	63.6
Railway labour productivity (1989=100) *	97.3	333.7	177.5	106.7	83.0	102.4	71.1	175.8
Residential electricity tariffs (USc kWh)	15.3	10.7	na	8.9	12.0	10.8*	14.0	14.0
EBRD index of infrastructure reform	3.3	3.3	3.7	3.0	3.0	3.3	3.0	3.0
Electric power	3.3	3.3	4.0	3.3	3.3	3.3	4.0	3.0
Railways	3.0	4.0	3.7	3.7	2.3	4.0	3.0	3.0
Roads	3.0	2.3	3.7	2.3	2.3	3.0	2.3	3.0
Telecommunications	4.3	4.0	4.0	3.0	3.7	4.0	3.7	3.0
Water and waste water	4.0	4.0	4.0	3.3	3.3	3.3	3.3	3.3
Financial sector								
Number of banks (foreign-owned)*	37 (28)	14 (12)	40 (28)	24 (12)	11 (6)	64 (53)	24 (16)	25 (10)
Asset share of state-owned banks (in per cent)*	2.2	0.0	7.4	4.4	0.0	21.1	1.1	12.6
Non-performing loans (in per cent of total loans)*	3.8	0.2	3.0	0.5	1.0	8.3	na	5.6
Domestic credit to private sector (in per cent of GDP)*	39.9	78.4	54.6	77.9	47.7	33.4	39.2	67.1
Stock market capitalisation (in per cent of GDP)*	31.5	34.6	34.1	12.8	32.6	41.0	8.9	49.9
EBRD index of banking sector reform	4.0	4.0	4.0	4.0	3.7	3.7	3.7	3.3
EBRD index of reform of non-bank financial institutions	3.7	3.7	4.0	3.0	3.3	3.7	3.0	2.7

* Data for 2005 or 2006

ANNEX 7: POLITICAL AND SOCIAL ASSESSMENT

Hungary is committed to, and applying, the principles of multiparty democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement establishing the Bank.

Political issues

Hungary was one of the first post-communist countries to start transition to a market economy and democracy. Almost twenty years after, its political system is mature and stable. The five democratic general elections since 1990 brought an alternation between centre-right and centre-left governments. The political system was put to a serious test during the riots of autumn 2006. The protests were triggered by unpopular austerity measures announced by the new Government soon after it was established in the spring of 2006 and descended into violence after the leaked revelations of Prime Minister Ferenc Gyurcsány of the ruling Hungarian Socialist Party (MSZP) that the MSZP leadership had not fully disclosed the state of affairs in the country's economy prior to the 2006 elections. The above-mentioned events undermined popular support to the current government's reform programme and cost the ruling party (and, to some extent, the entire political establishment) a drop in ratings, but the government and the political system in general proved stable in the face of extraordinary pressure.

The current government, established after the April 2006 elections, is a coalition led by the centre-left MSZP and comprising, as a junior partner, the Alliance of Free Democrats (SZDSZ), a liberal party with long-standing roots in anti-Communist dissidence. This coalition is a reincarnation of the one that already had been in power in Hungary in 1994-1998. It won two more consequent mandates, in 2002 and 2006. Despite the above-mentioned mass riots, the outcome of the October 2006 local elections, which MSZP lost to the main opposition political party, Fidesz, the overall shift in the balance of forces (the opposition has had a convincing lead in all opinion polls for quite some time now), and recurring divisions within the governing coalition itself, the ruling MSZP is keen to continue until the end of its mandate in 2010.

The balance of forces will be demonstrated during the elections to the European Parliament, due in 2009. The Government may also face the test of a spring 2008 nation-wide referendum, which has been initiated by the opposition in 2007 on issues related to the government's key reform areas, including healthcare and education. The main opposition party, Fidesz, seeks to capitalize on its current sweeping popular support. It insists that the government will have to resign should it lose the referendum. Although the negative result of the referendum is plausible (majority of citizens, according to the polls currently intend to say 'no' to the essentially populist questions, as formulated by the opposition: whether they wish to pay fees for education and hospital treatment), the government maintains that such a result could hamper the reforms, but will not halt them. At the same time, even though the government would not be legally bound to resign in case of defeat at the referendum, such an outcome would make further reforms more difficult.

Rule of Law and Human Rights

The legal system, which has undergone comprehensive reforms, an independent judiciary, and human rights ombudspersons provide an effective framework safeguarding fundamental rights and freedoms.

Elections

The Hungarian electoral system is fairly sophisticated and envisages a 3-tiered, mixed election process. Importantly, it adequately facilitates the free succession of power among political parties and provides the basis for a transparent, accountable, fair and equal process. All previous elections were assessed by international observers (ODIHR OSCE stopped monitoring Hungarian elections after the 2002 parliamentary elections) as conducted in a manner consistent with international standards and commitments for democratic elections. Although the number of candidates and parties competing in the election has steadily declined with each of the five successive elections, they remain highly competitive due to the duel between the two main political parties, centre-left MSZP and centre-right Fidesz.

Integrity issues

Hungary is one of the States with the lowest levels of corruption among the EBRD countries of operation. It was ranked 39 out of 179 countries in the latest Corruption Perceptions Index by Transparency International, the third best result among all countries of operation. However, some serious corruption issues remain. While the recent Life in Transition Survey, conducted by EBRD in cooperation with the World Bank, revealed that ‘irregular payments’ to public officials are fairly infrequent, some public officials, such as police or customs officers, are reported and caught on fraud charges. Some politicians and mayors have also been reported for illegal and corrupt deals. The debate about corruption is heavily politicised and mutual accusations of corruption form part of the political struggle between government and the opposition. In 2007, PM Gyurcsány launched a seven-point plan “Cleaner public life”, whose main points include, inter alia, a more stringent control over political campaigns funding, making asset-declaration investigations systematic and mandatory for senior civil servants, making MPs’ revenues more transparent and preventing them from holding other offices in parallel.[2] Transparency International still considers essential the adoption of a comprehensive strategic approach to fight corruption that would guarantee implementation beyond the life of any government.

Media

Freedom of speech is respected, and independent media operate freely in Hungary. The wide selection prevents any control over access to information. Foreign ownership of Hungarian media is extensive. The successful introduction of private Hungarian television stations has challenged the argument that state-supported media are necessary for balanced coverage. Nevertheless, the remaining state TV and radio stations (often arena for political infighting) are unlikely to be privatized.

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[2] In 2007, the Hungarian Government, collaborating with the American Chamber of Commerce in Hungary and the ambassadors of nine countries (Austria, the United States, France, Italy, the Netherlands, Japan, Canada, the United Kingdom and Germany) set up a "Transparency Working Group," which is focused on improving Hungary's transparency and public administration. Also, the Government set up an Anti-Corruption Co-ordination Board to elaborate an anti-corruption strategy and related action plan by January 2008.

Religious freedoms

While the Constitution guarantees religious freedom and adherents of all religions are free to worship in their own manner, the State provides financial support and tax breaks to four traditional groups, or “historical churches”: the Roman Catholic Church, the Calvinist Church, the Lutheran Church, and the Alliance of Hungarian Jewish Communities.

Human trafficking

Hungary is primarily a transit, and, to a lesser extent, a source and destination country for women from Slovakia, Romania, Ukraine, Moldova, Poland, and the Western Balkans, trafficked for the purpose of commercial sexual exploitation to Western Europe. Hungarian women are trafficked primarily to Western and Northern Europe and to North America.

The authorities comply with the minimum international standards for the elimination of trafficking. The progress achieved of late by the Hungarian authorities in fighting trafficking has been reflected, inter alia, in the upgrade of the country’s rank in the regular reports issued by the US State Department on the state of affairs in fighting human trafficking world-wide. The authorities have significantly improved their law enforcement efforts and victim assistance and prevention efforts, including establishing sound partnership with NGOs and providing appropriate funding for anti-trafficking education programmes.

Ethnic minorities

Hungary has an advanced system for minority protection, and a number of mechanisms have been developed to ensure that ethnic minorities enjoy cultural and political rights. There are 13 recognized ethnic minorities and they account for about 8 per cent of the population. Roma represent the largest minority population and at the same time the most vulnerable one. While most of Hungary’s other ethnic minorities have been integrated into the mainstream of public life, the Roma remain relatively marginalized: their living conditions are worse than those of the general population, they are less well educated, have below-average income, their unemployment rate is much higher than average. Considerable efforts are being made by the government to promote faster Roma integration. The National and Ethnic Minorities Ombudsman plays an active role in the examination of allegations of discrimination against the Roma community. Since July 2007 this position has been held by Ernő Kállai, the first ethnic Roma nominated to the post. Education is available to varying degrees in most minority languages. The Law on Equal Treatment was passed by Parliament in December 2003.

External relations

Hungary’s top foreign policy priority is further integration into EU and Euro-Atlantic institutions. Hungary became a member of NATO in 1999. It joined the EU on 1 January 2004.

Hungary, which borders seven countries of Central and Eastern Europe, generally has good relations with its neighbors. Successive Hungarian governments have sought to balance the need for furthering bilateral relations with neighbours with the wish to provide greater support for the sizeable ethnic Hungarian minorities in those countries. In 2001, Parliament adopted the Status Law, which granted special health and educational benefits to ethnic Hungarians residing outside the country and caused concern in some neighbouring countries. Later on, Hungary modified the application of the law to address these concerns, as well as those of the EU. In December 2004, a referendum was held on extending citizenship to ethnic Hungarians abroad. Though a majority voted in favour, turnout was insufficient for the referendum to pass.

Social conditions

Population

At the end of July 2007, Hungary's population was 10,054,000, according to an estimate by the Central Statistical Office. This represented a decline from the February 2001 Population Census figure of 10,198,315. The population has been falling since 1981, when the death rate began to exceed the birth rate. The birth rate stood at 9.9 per 1,000 inhabitants in 2006, compared with 12.3 per 1,000 in 1990. The death rate declined from 14 per 1,000 inhabitants in 1990 to 13.1 per 1,000 in 2006 but still exceeds the birth rate. The ageing population has placed an increasing strain on the relatively generous pensions and early retirement system. In 1998 a public-private three-pillar pension system was implemented, creating a more sustainable long-term pension structure but putting a strain on the system in the short term by reducing revenue in the state-run pay-as-you-go (PAYG) system. As part of fiscal consolidation reforms, the government has recently tightened eligibility criteria for early retirement.

Poverty

Despite years of strong economic growth, according to Eurostat an estimated 13 per cent of the population was at risk of poverty in 2005. In terms of absolute poverty measures, according to the World Bank, the poverty headcount ratio at $2 a day (PPP) stood at 2 per cent in 2005 of the population. The elderly, large families and the Roma are the groups most affected by poverty. Living standards in the North Eastern region of the country still fall below the EU average. The GDP of the country's poorest Észak-Alföld region was only about 41.9 per cent of the EU-25 average in 2004, making it the sixth poorest region in the EU at that time. Income inequality has increased slightly in recent years. According to Eurostat, the Gini coefficient increased from 0.26 to 0.27 between 2000 and 2003. In 2005, it stood at 0.28, indicating increased polarisation (Note that Eurostat data for 2005 is not fully comparable with previous years, though).

Education

Hungary's high standard of general education has played an important role in attracting foreign investment – especially in new-technology sectors. However, annual state spending on education as a percentage of GDP dropped slightly from 5.8 per cent in 1990 to around 5.5 per cent in 2005. In the 1998-2002 period, the number of university graduates grew each year by almost 30 per cent, but without any major rise in overall spending on education. In broad terms, the structure of the educational system has changed little from Communist times. Schooling is compulsory for children between six and sixteen. University students primarily come from grammar schools ('gymnasium'). Since 1989, enrolment in vocational schools (secondary schools training skilled workers) has declined. In 2005, the private sector's share in primary and secondary school enrolment stood at 6.4 per cent and 9.8 per cent respectively.

University and college education expanded rapidly in the 1990s. By 2002/03 the number of university students was three times higher than a decade earlier. According to the World Bank, the gross tertiary enrolment ratio stood at 14.4 per cent in 1990. By the year 2000, it had increased to 36.7 per cent and by 2005, to more than 60 per cent. As part of fiscal consolidation reforms, the government introduced university tuition fees in 2006. This measure formed part of an overarching reform aiming at decreasing the costs of the Hungarian education system through the consolidation of existing educational institutions and an increase in the student teacher ratio.

Health

The health of the Hungarian population is relatively poor by international standards. According to Eurostat, life expectancy at birth stood at 68.69 years for men and at 77.17 years for women in 2005. This is about 3 and 2.5 years longer than a decade earlier. For both men and women, life expectancy in 2005 was the fourth lowest among the current 27 EU Member States. Infant mortality declined from 10.7 deaths per 1,000 live births in 1995 to 6.2 in 2005. This was lower than in all new EU Member States, except for the Czech Republic (3.4) and Slovenia (4.1).

The health sector accounts for around 7.8 per cent of Hungarian GDP. Public funding alone accounts for 75 per cent of health spending, of which 66 per cent is spent in public hospitals compared to 30-40 per cent in advanced market economies. At 786.2 per 100,000 inhabitants in 2005, the number of hospital beds in Hungary was one of the highest in the EU and significantly above the EU-15 average of 570.7. This is associated with inefficiencies in management of hospital capacity, underutilised large hospitals, relative shortage of long-term case facilities and low hospital occupancy rates (75 per cent on average). The share of one-day surgeries is less than 5 per cent compared to about 50 per cent in advanced market economies. Downsizing, consolidation and even closure of some facilities are essential to rationalize the public health system and limit the drain on scarce public resources. There is also strong need to re-orient the sector from institutional care towards care at the primary level. A reduction in the number of hospital beds and the rationalisation of service provision through co-payment by healthcare users have been some of the main objectives of the recent healthcare reforms introduced by the government in 2006 as part of the larger fiscal consolidation package.

Labour issues

Hungary's unemployment rate remains relatively stable, at about 7.3 per cent in August 2007. It is slightly higher than the EU average of 6.9 per cent but below the unemployment rate in Slovakia (11.1 per cent) or Poland (9.1 per cent). The employment rate, at 57.3 per cent in 2006, is the third lowest in the EU and significantly below the EU average of around 64.4 per cent, as internal labour mobility remains low and the existing benefit system offers few incentives to enter the labour force. Only 63.8 per cent of men and 51.1 per cent of women in the 15-64 age bracket were employed in 2006 (against the EU average of 71.6 per cent for men and 57.2 per cent for women). Reported average weekly working hours stood at 40.7 in 2006, slightly above the EU average of 40.5 hours but below the levels in most new EU Member States.

There are visible regional disparities in unemployment, with the highest unemployment registered in Northern Hungary and Northern Great Plain (12.0 and 10.3 per cent in the second quarter of 2007) and the lowest in Central Hungary and Central Transdanubia (4.3 and 4.8 per cent in the second quarter of 2007).

The Labour Code recognises the right of unions to organise and allows trade union pluralism. There are six trade union federations, each roughly targeting a different sector of the economy. The largest trade union body is the Trade Unions' Co-Operation Forum (SzEF), the independent successor to the former monolithic Communist Union, with approximately 300,000 members. The overall rate of unionisation is low at just over 10 per cent in private sector firms.

ANNEX 8: OVERVIEW OF THE EBRD TC FUND AND OFFICIAL CO-FINANCING

Hungary – 1991/2005
Overview of the EBRD TC Fund and Official Co-financing

1. Aggregate TC Funds Commitment and Official co-financing signed projects;
2. Future scenario.

Appendix 1: Breakdown of TC Projects
Appendix 2: Breakdown of Official Co-financing (signed) projects

1. *Aggregate TC Funds Commitment and Official co-financing signed projects;*

- Since 1991, the Bank has been actively cooperating with multi and bilateral donors in the framework of both TC projects (for which the aggregate commitments value for the period 1991 - 09/2007 reached the value of € 9.1 million) and Official co-financing initiatives (€ 736.4 million is the total amount of the signed projects at the end of September 2007).

- TC Fund: four Donors (EU: €3.2 million, Japan: €2.7 million, UK; €0.7 million and Germany: €0.6 million) account for 80% of the total aggregate commitments. Three are the sectors having more benefited from the EBRD TC Fund. Finance & Business (€ 3.7 million), Transport (€ 2.3 million) and manufacturing (€ 1.4 million). Other sectors having benefited for the TC Support have been Telecommunications, Energy, Agro-business and Commerce. In 2006, Spain supported the implementation of a legal transition project aimed at providing legal assistance for a PPP initiative.

- Official Co-financing: three IFIs are the largest official co-financer and, with a total contribution of € 460 million, are covering the 65% of the total. The IFC is the largest co-financier with € 208 million followed by KfW with 156 million and the EIB with €100 million. Other co-financers are the JIC, the EC and the Hungarian development bank with more than 115 million. Transport and telecom have been the key sectors of official co-financing.

TC FUNDS and Donors
Aggregate Commitments (1991- 09/2007): € 9.1 million

DONOR	EUR Committed
European Commission	3,184,403
Japan	2,718,543
UK	755,495
Germany	612,545
France	425,280
Taipei China	386,949
Luxembourg	354,379
Spain	347,953
Switzerland	131,280
Finland	97,824
Italy	75,509
Austria	60,463
The Netherlands	9,976
Greece	5,680
Denmark	5,534

Official Co-financing and Donors
Signed projects - Signing years: 1993-2005)
€ 736.4 million

DONOR	Million EUR Committed
IFC	208.7
KfW	152.8
HDB	115.0
EIB	100.0
JIC	80.0
European Commission	51.4
EIF	15.0
Caisse Depot et Consignations	5.9
DEG	4.2
JAIDO	2.9

Future scenario

2. *Future scenario;*

Over the period 2005-2007 there has been a confirmation of a trend showing a considerable reduced interest by donors for funding initiatives in Hungary.

For the period 2005 – 2006 there has only been one assignment donor-funded in the amount of €210,000

However, Hungary will have access to the already allocated EU Structural and Cohesion Funds. For the 2007-2013 programming period, Hungary has been allocated an amount of € 25.3 billion. The Hungarian contribution will reach an amount of € 4.4 billion. The main objectives of the Hungarian National Strategic Reference Framework (NSRF) are to increase employment and sustain long-term growth. Sustained growth is to be achieved through the specific objectives of: (a) improving competitiveness including strengthening the knowledge economy, (b) widening the economic basis and (c) developing the business environment. The objectives of the NSRF are translated into six thematic and territorial priorities: economic development, transport development, social renewal, environment and energy, regional development and state reform. The relevant operational programmes could allow the identification of synergies with EBRD.

Appendix 1: Breakdown of TC Projects

Fund Name	Commitment Name	Euro Committed	Fund Code	Fund Approved Date	Commit. Stage Name	Sector Type Name
Austrian Technical Assistance Co-operation Fund	Prefeasibility study - Telecommunications	25,609	USD	01/07/91	Closed	Telecommunications
Austrian Technical Assistance Co-operation Fund	Culture-based tourism study	34,854	USD	30/05/94	Closed	Commerce, Tourism
Danish Technical Assistance Co-operation Fund	TurnAround Management Programme - Transelektro II	4,524	EUR	15/08/97	Closed	Manufacturing
EBRD-ICEX Technical Co-operation	Foreign trade financing	137,953	EUR	12/08/94	Closed	Finance, Business
EU-EBRD Cooperation Agreement, Bangkok Facility (PHARE programme)	Danube River Basin Development Programme - environmental management in the chemical industry	237,180	EUR	10/08/92	Closed	Finance, Business
EU-EBRD Cooperation Agreement, Bangkok Facility (PHARE programme)	Danube River Basin Development Programme - project financing and investment	155,336	EUR	15/09/92	Closed	Finance, Business
EU-EBRD Cooperation Agreement, Bangkok Facility (PHARE programme)	Budapest wholsale market project expansion - rationalisation of market operations/establishment of Market Information System	323,750	EUR	17/12/93	Closed	Manufacturing
EU-EBRD Cooperation Agreement, Bangkok Facility (PHARE programme)	M1-M15 monitoring study	165,765	EUR	15/11/95	Closed	Construction
EU-EBRD Cooperation Agreement, Bangkok Facility (PHARE programme)	Special restructuring programme - fund enterprise portfolio - Investment Development and Implementation Team (IDIT)	1,024,683	EUR	02/01/96	Closed	Finance, Business
EU-EBRD Cooperation Agreement, Bangkok Facility (PHARE programme)	Special Restructuring Programme framework contract - pre-investment enterprise support - Team I	326,941	EUR	02/01/96	Closed	Finance, Business
EU-EBRD Cooperation Agreement, Bangkok Facility (PHARE programme)	Special Restructuring Programme framework contract - pre-investment enterprise support - Team II	173,727	EUR	02/01/96	Closed	Finance, Business
EU-EBRD Cooperation Agreement, Bangkok Facility (PHARE programme)	MAV Hungarian Railways - passenger rail services study	345,948	EUR	10/02/97	Closed	Transport, Storage
EU-EBRD Cooperation Agreement, Bangkok Facility (PHARE programme)	Environment project preparation	106,369	EUR	13/02/97	Closed	Finance, Business
EU-EBRD Cooperation Agreement, Bangkok Facility (PHARE programme)	Environment project preparation	174,704	EUR	13/02/97	Closed	Finance, Business
EU-EBRD Cooperation Agreement, Bangkok Facility (PHARE programme)	MAV Passenger Railway Services Study, Phase II	150,000	EUR	08/02/00	Closed	Transport, Storage
Finnish Technical Cooperation Fund	National Labour Centre	46,870	EUR	02/12/92	Closed	Community/Social Services
Finnish Technical Cooperation Fund	Danube river basin development - pulp and paper assessment	50,954	EUR	20/01/93	Closed	Finance, Business
Finnish Technical Cooperation Fund	National Labour Centre - project start-up	32,528	EUR	22/10/93	Closed	Finance, Business

France Technical Cooperation - Foreign Affairs	Budapest wholesale market	20,305	EUR	13/07/92	Closed	Manufacturing
France Technical Cooperation - Foreign Affairs	Municipal development - Hungarian Communal Bank	28,597	EUR	28/05/93	Closed	Transport, Storage
France Technical Cooperation - Foreign Affairs	Budapest public transport - fares system restructuring study	85,797	EUR	09/07/93	Closed	Transport, Storage
France Technical Cooperation - Foreign Affairs	Meat processing industry restructuring	185,795	EUR	10/12/93	Closed	Manufacturing
France Technical Cooperation - Foreign Affairs	Energy efficiency project development - financing through energy service companies	104,786	EUR	17/07/95	Closed	Energy
German Technical Assistance Cooperation Agreement	Tiszai Vegyi Kombinat Rt - investment preparation	69,791	EUR	16/03/94	Closed	Energy
German Technical Assistance Cooperation Agreement	Combined transport feasibility	52,774	EUR	24/10/94	Closed	Transport, Storage
German Technical Assistance Cooperation Agreement	Hungary Special Restructuring Programme - feasibility study	170,423	EUR	03/11/94	Closed	Finance, Business
German Technical Assistance Cooperation Agreement	Hungary Special Restructuring Programme Feasibility study - extension	12,194	EUR	24/10/95	Closed	Finance, Business
Germany, KfW-EBRD Technical Cooperation Agreement	Magyar Hiltel Bank - due diligence	307,363	EUR	01/05/96	Closed	Finance, Business
Hellenic Technical Cooperation	Secured Transactions: Institution Building in Hungary	5,680	EUR	05/09/01	Closed	Community/Social Services
Italian Technical Co-operation	Budapest wholesale market	75,509	EUR	01/07/92	Closed	Manufacturing
Japan-Europe Co-operation Fund	GIRO Bankcard	79,962	JPY	01/08/91	Closed	Finance, Business
Japan-Europe Co-operation Fund	Budapest urban infrastructure	545,261	JPY	01/01/92	Closed	Construction
Japan-Europe Co-operation Fund	M1-M15 motorway concession	462,064	JPY	01/01/92	Closed	Transport, Storage
Japan-Europe Co-operation Fund	Export credit guarantee	21,490	JPY	01/02/92	Closed	Finance, Business
Japan-Europe Co-operation Fund	Agricultural restructuring	209,998	JPY	01/10/92	Closed	Agriculture, Forestry, Fishing
Japan-Europe Co-operation Fund	Clearing and depository centre for Budapest Stock Exchange	176,702	JPY	01/01/93	Closed	Finance, Business
Japan-Europe Co-operation Fund	Establishment of National Guarantee Scheme for SME's	4,181	JPY	01/07/93	Closed	Finance, Business
Japan-Europe Co-operation Fund	Environmental training for bankers	99,000	JPY	01/08/93	Closed	Finance, Business
Japan-Europe Co-operation Fund	Budapest public transport rehabilitation project - parking control scheme	125,000	JPY	01/08/93	Closed	Transport, Storage
Japan-Europe Co-operation Fund	Budapest public transport rehabilitation project - commercialisation study	246,987	JPY	01/08/93	Closed	Transport, Storage
Japan-Europe Co-operation Fund	TurnAround Management Programme - Ajka	27,822	JPY	01/09/93	Closed	Manufacturing
Japan-Europe Co-operation Fund	TurnAround Management Programme - Caola	4,198	JPY	01/09/93	Closed	Manufacturing
Japan-Europe Co-operation Fund	Agricultural restructuring project - advisory assistance to four banks	239,437	JPY	17/11/93	Closed	Finance, Business
Japan-Europe Co-operation Fund	Agricultural restructuring project - training assistance to four banks	207,818	JPY	17/11/93	Closed	Finance, Business
Japan-Europe Co-operation Fund	Budapest wholesale market expansion project - project design, tender preparation and supervision	167,908	JPY	01/12/93	Closed	Manufacturing
Japan-Europe Co-operation Fund	TurnAround Management Programme - Tanselektro	49,748	JPY	01/05/95	Closed	Manufacturing
Japan-Europe Co-operation Fund	TurnAround Management Programme - Eger East-West Limited	25,624	JPY	01/05/95	Closed	Manufacturing
Japan-Europe Co-operation Fund	TurnAround Management Programme - Transelektro II	10,815	JPY	15/08/97	Closed	Manufacturing
Luxembourg - European Bank Technical Co-operation	TAM Programme in central, eastern & southern Europe	58,951	EUR	13/09/00	Closed	Manufacturing

Luxembourg - European Bank Technical Co-operation	Femfeldogozo	54,398	EUR	12/05/03	Closed	Manufacturing
Luxembourg - European Bank Technical Co-operation	TAM - Matrametal	60,000	EUR	09/09/03	Committed	Manufacturing
Luxembourg - European Bank Technical Co-operation	TAM - Aranypok Handels	60,000	EUR	31/03/04	Committed	Manufacturing
Luxembourg - European Bank Technical Co-operation	TAM - Ajka Electronical Ltd	60,000	EUR	16/06/04	Committed	Manufacturing
Luxembourg - European Bank Technical Co-operation	TAM - Emika Elektromechanikai	60,000	EUR	13/10/04	Committed	Manufacturing
Luxembourg - European Bank Technical Co-operation	TAM - Emika Elektromechanikai	1,430	EUR	17/03/06	Closed	Manufacturing
Netherlands Technical Assistance Co-operation	Establishment of national guarantee scheme for SME	9,970	EUR	01/11/92	Closed	Finance, Business
Swiss Technical Co-operation	Combined transport feasibility	131,280	CHF	17/10/94	Closed	Transport, Storage
Spain TC Fund	Hungary: Legal Assistance Regarding PPP Issues	210,000	EUR	31/07/06	Disbursing	Community/Social Services
Taipei China-European Bank Cooperation	Hungary Telecommunications Company	52,281	USD	01/04/92	Closed	Telecommunications
Taipei China-European Bank Cooperation	Study of Hungarian Telecommunications Company - due diligence	198,772	USD	01/01/93	Closed	Telecommunications
Taipei China-European Bank Cooperation	TAM Programme - Malyi Brick	46,262	USD	15/01/02	Closed	Manufacturing
Taipei China-European Bank Cooperation	TAM Programme - Salgotarjan Konfekcioipari	44,932	USD	15/01/02	Closed	Manufacturing
Taipei China-European Bank Cooperation	Felina	44,699	USD	11/03/03	Disbursing	Manufacturing
UK-EBRD Technical Cooperation Fund (Central and South-Eastern Europe)	Regional - close-out netting legislation	50,000	GBP	08/11/99	Closed	Finance, Business
UK-EBRD Technical Cooperation Fund (Central and South-Eastern Europe)	Hungarian Financial Supervision (HFSA) - Supervision Assistance	100,000	GBP	19/01/01	Closed	Community/Social Services
UK-EBRD Technical Cooperation Fund (Central and South-Eastern Europe)	Legal Advisory Services to Hungary in connection with drafting a New Comprehensive Securities Act	49,684	GBP	20/03/01	Closed	Community/Social Services
UK-EBRD Technical Cooperation Fund (Central and South-Eastern Europe)	Secured Transactions: Institution Building Project	149,915	GBP	03/05/01	Disbursing	Community/Social Services
UK-Know How Technical Co-operation Agreement (Central and Eastern Europe)	Budapest public transport rehabilitation project - commercialisation study	17,000	GBP	01/05/94	Closed	Transport, Storage
UK-Know How Technical Co-operation Agreement (Central and Eastern Europe)	Transelektro group - environmental audit	3,378	GBP	01/09/94	Closed	Energy
UK-Know How Technical Co-operation Agreement (Central and Eastern Europe)	Transelektro group - technical study	88,693	GBP	07/09/94	Closed	Energy
UK-Know How Technical Co-operation Agreement (Central and	Assistance in developing a register for charges over movable assets	49,793	GBP	12/12/95	Closed	Community/Social Services

Eastern Europe)						
UK-Know How Technical Co-operation Agreement (Central and Eastern Europe)	Technical update on the gas distribution sector	18,480	GBP	25/09/96	Closed	Energy
UK-Know How Technical Co-operation Agreement (Central and Eastern Europe)	Assistance in implementing registration under new law for charges over moveable assets	200,389	GBP	29/01/97	Closed	Community/Social Services
UK-Know How Technical Co-operation Agreement (Central and Eastern Europe)	TurnAround Management Programme - Transelektro II	28,163	GBP	15/08/97	Closed	Manufacturing
t						
Hungary: Legal Assistance Regarding PPP Issues						
	Report Total Euro Amount:	**9,189,194**				
	No of Commitments: 74					

Appendix 2: Breakdown of Official Co-financing Projects

Operation Name	Signing Date	Status	Organisation Name	Country Name	Finance Type	EUR Amount	CYY Amount	CCY
Hungarian Telecommunications Equity Investment	31/12/93	Signed	International Finance Corporation	UNITED STATES	IFI Equity	26,033,341	26,033,341	EUR
Hungarian Telecommunications Project	25/04/93	Signed	Japan Bank for International Cooperation	JAPAN	Parallel Loan	43,459,810	85,000,000	DEM
Hungarian Telecommunications Project	31/12/93	Signed	Japan Bank for International Cooperation	JAPAN	Parallel Loan	36,652,665	44,500,000	USD
Central Business Center	31/12/94	Signed	JAIDO	JAPAN	Parallel Loan	2,980,832	5,830,000	DEM
M1-M15 Motorway Project	23/12/93	Signed	Kreditanstalt fur Wiederaufbau (KfW)	GERMANY	Participation	3,567,362	6,977,154	DEM
M1-M15 Motorway Project	23/12/93	Signed	Kreditanstalt fur Wiederaufbau (KfW)	GERMANY	Participation	9,399,462	11,411,887	USD
M1-M15 Motorway Project	23/12/93	Signed	Kreditanstalt fur Wiederaufbau (KfW)	GERMANY	Participation	10,001,043	19,560,340	DEM
M5 Concession Motorway B.O.T.	11/12/95	Signed	Kreditanstalt fur Wiederaufbau (KfW)	GERMANY	Participation	4,269,436	28,005,664	FRF
M5 Concession Motorway B.O.T.	11/12/95	Signed	Kreditanstalt fur Wiederaufbau (KfW)	GERMANY	Participation	28,278,734	185,496,336	FRF
MAV - Railcar Modernisation and Marketing Project	31/12/98	Signed	European Investment Bank	LUXEMBOURG	IFI Loan	100,000,000	100,000,000	EUR
MAV - Railcar Modernisation and Marketing Project	31/12/98	Signed	European Commission	BELGIUM	Grant	40,000,000	40,000,000	EUR
Investel Syndicated Loan Facility	31/12/95	Signed	International Finance Corporation	UNITED STATES	IFI Loan	182,690,112	182,690,112	EUR
Budapest Bank Credit Line for Environment and Energy	31/12/96	Signed	European Commission	BELGIUM	Parallel Loan	7,500,000	7,500,000	EUR
Hungarian Foreign Trade Bank (MKB) Capital Increase	31/12/97	Signed	DEG	GERMANY	Equity	4,200,000	4,200,000	EUR
Budapest Intermodal Logistics Centre - Basic Infrastructure	31/12/99	Signed	European Commission	BELGIUM	Grant	3,900,000	3,900,000	EUR
M1-M15 Motorway Restructured Project	23/12/93	Signed	Caisse des Dépôts et Consignations	FRANCE	Participation	5,979,033	5,979,033	EUR
M1-M15 Motorway Restructured Project	23/12/93	Signed	Kreditanstalt fur Wiederaufbau (KfW)	GERMANY	Participation	21,793,879	21,793,879	EUR
Euroventures Hungary III	17/12/03	Signed	European Investment Fund	LUXEMBOURG	IFI Equity	15,000,000	15,000,000	EUR
M5 Phase II	21/09/04	Signed	Hungarian Development Bank	HUNGARY	Parallel Loan	100,000,000	100,000,000	EUR

M5 Phase II	17/12/04	Signed	KFW Bankengruppe	GERMANY	Participation	3,439,394	3,439,394	EUR
M5 Phase II	09/12/04	Signed	KFW Bankengruppe	GERMANY	Parallel Loan	16,834,928	16,834,928	EUR
M6 Motorway	18/07/05	Signed	Hungarian Development Bank	HUNGARY	Parallel Loan	15,237,500	15,237,500	EUR
M6 Motorway	18/07/05	Signed	KFW Bankengruppe	GERMANY	Parallel Loan	55,296,053	55,296,053	EUR
						736,513,583		

ANNEX 9: ASSESSMENT OF HUNGARY'S COMMERCIAL LAWS

EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws "on the books" (also referred to as "extensiveness") and the actual implementation of such laws (also referred to as "effectiveness"). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for Hungary, accompanied by critical comments of the Bank's legal experts who have conducted the assessments.

Capital Markets

The basic legislation on the securities market is comprised by Act CXX of 2001 on the Capital Market and Act CXXIV of 1996 on Government Control of Financial Institutions (both last amended in July 2007). Act CXX of 2001 was adopted to ensure transparency and to improve regulations on actors of capital markets, investors protection and the efficiency of market supervision. Act CXXIV of 1996 regulates the legal status and powers and authorizations of the Hungarian Financial Supervisory Authority ("HFSA"), the securities market regulator.

The securities market legal framework is still expected to change substantially after the adoption and implementation of the EU Markets in Financial Instruments Directive ("MiFID"). According to the Ministry of Finance, a new law implementing MiFID should enter into force at the beginning of 2008.

The HFSA is in charge of the supervision of credit institutions and financial enterprises, insurance institutions, voluntary mutual insurance funds, venture capital enterprises, venture capital funds and individual specialised credit institutions. There is one stock exchange in Hungary, the Budapest Stock Exchange ("BSE") and there is a well developed OTC Market. In July 2007, the capitalisation of the market was close to EUR 19.68 billion, with 40 listed companies.

The 2007 EBRD Securities Markets Legislation Assessment, found Hungary in "high compliance" with the Objectives and Principles of Securities Regulation published by the International Organization of Securities Commissions (IOSCO) showing only minor weaknesses in the legislation on the regulator.

In order to understand how securities market legislation works in practice, EBRD recently concluded the 2007 Legal Indicator Survey. Respondents from leading law firms in the region were asked to comment on a hypothetical case study, advising an investor who lost his savings after buying shares through a bank, misled by erroneous information in the prospectus. In particular, respondents were asked to advise on the effectiveness of prospectus disclosure requirements, private and public enforcement mechanisms and the authority of the market regulator. The findings show a relatively effective framework. Disclosure and financial reporting practices are sound and investors can count on a good institutional support to their court actions. Overall the capacity of the courts, the regulator and the prosecution authority seems to be adequate.

Company Law and Corporate Governance

The primary legislation dealing with corporate governance is contained in Act IV of 2006 on Business Associations (the "Companies Act"). The Companies Act provides the basic regulation concerning limited liability companies and joint stock companies, which are the two most widely used corporate forms in Hungary. In addition to the Act, the Budapest Stock Exchange published in 2004 voluntary (non-binding) corporate-governance guidelines for listed companies, which provide guidance and recommendations on the role of the board of directors, supervisory board and other executive management, and the need to introduce better internal controls. They also address the rights of minority shareholders. In addition the BSE has required since 2005 large firms listed in the 'A' category of the BSE to publish an annual corporate-governance report, and since 2006 smaller firms in the 'B' category.

Generally speaking, Hungarian law is in line with the OECD Principles of Corporate Governance. However, when tested on its practical robustness, it appears that minority shareholders would have difficulties bringing a legal action to obtain disclosure and redress from companies, as procedures can be long and complex.

The institutional environment is deemed sound but the legal framework on related party transactions is weak and is reported to be easy for the defendant to delay the action. Enforceability is generally good but can vary substantially depending on the type of action pursued.

Concessions

Concessions legislation in Hungary is multiple: arrangements are governed by a combination of a general concessions law and sector specific legislation. There exists a government policy framework for improving the legal environment and promoting the concept of the Public Private Partnership ("PPP") pursuant to which a PPP task force was set up by the Ministry of Economy and Transport in 2003.

The 1991 Concessions Act, as amended (the "Concessions Act") is a general framework law and contains references to various sector-specific legislation. The Concessions Act provides an apparently exhaustive list of the activities/sectors where concessions arrangements are applicable. Sector specific concessions legislation further defines concessions arrangements applicable to particular sectors and contains cross references to the Concessions Act.

The Concessions Act contains rules on contracting arrangements, concession granting procedures and provides for the possibility of international arbitration for dispute settlement. It regulates the tendering process and also refers to a special tender law and to the relevant provisions of the Civil Code that are also applicable to a concession contract.

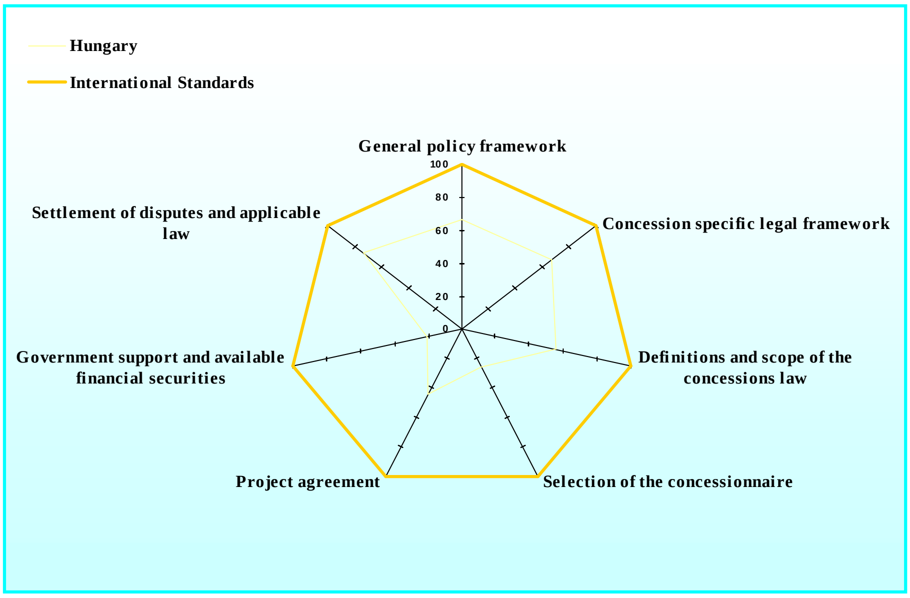
The Concessions Act appears somewhat superficial and inflexible. For example, assignment of concession rights to a third party is restricted. Other deficiencies include the absence of a stability clause, the lack of clarity of the concession definition and the application of a fair compensation mechanism. It contains very few provisions regarding project agreements (in particular, insufficient termination/compensation provisions). The Concessions Act needs serious improvement especially in the areas of concessionaire selection, government support and the availability of financial instruments and security assignability, in particular, the introduction of a pre-qualification procedure, a detailed procedure for requesting proposals and the regulation of unsolicited proposals.

A certain number of positive elements are worth noting: a possibility for the sector-specific act to apply subject to the Concessions Act and the requirements to publish concession award notices and maintain records accessible to public.

Thus, even though Hungary does have concessions on its records, the actual Concessions Act appears to be somewhat outdated and unclear in many respects. The multiple nature of legislation is not ideal either and the government's plans to reform the regime are welcome. In the context of EU accession and legal harmonisation and the adoption of the new Public Procurement Law in 2004, a new PPP enabling law, based on modern internationally accepted standards, would contribute to the development of PPP in Hungary.

In 2006 EBRD launched a technical assistance project to help the Government with the drafting of a new Concessions Law and with the preparation of a clear and detailed PPP Policy paper.

Quality of concession legislation –Hungary (2007)



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.

Source: EBRD Concessions Sector Assessment 2005

EBRD's 2005 Assessment of Concessions Laws undertaken to evaluate applicable regimes throughout the Bank's 27 countries of operations (the laws on the books only rather than how they work in practice), revealed that Hungarian concessions laws had "low compliance" with internationally accepted standards in this sector. As can be seen from the above spider graph, while concession related rules generally as well as rules covering settlement of disputes, for instance, are regulated fairly extensively, most other areas, as discussed earlier, need to be dramatically improved in order to meet the requirements of a modern legal framework facilitating private sector participation. The new law, sponsored by EBRD, aims to take into account the above in order to improve concessions legal framework.

Insolvency

Bankruptcy and insolvency in Hungary are governed by the Bankruptcy Proceedings, Liquidation Proceedings and Member's Voluntary Dissolution Act (as amended) (the "Bankruptcy Act"). This law was amended in 2006 with amendments coming into force between 1 July 2006 and 1 January 2007. The government has reportedly been working on a more comprehensive series of amendments; however these have not yet been introduced.

The recent amendments are too recent to have been fully analysed and their impact is, as yet, undetermined.

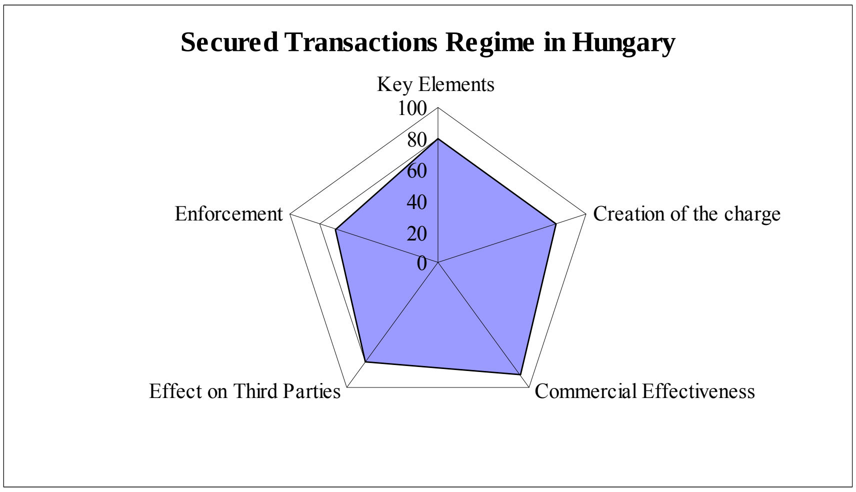
The Bankruptcy Act was most recently assessed in 2004 as part of the 2004 Insolvency Sector Assessment which examined the extensiveness of the law's compliance with international standards. The 2004 assessment had revealed a number of problems with that version of the law. Key amongst these were an unclear definition of 'insolvency', a commencement procedure which allowed the court up to 60 days to hear an initial insolvency application and the treatment of secured creditors in a manner inconsistent with international standards, since only half of the proceeds of the sale of a secured asset minus the cost of administration could be used to settle the secured claim. It was further noted that the reorganisation process was weak with no provision for 'DIP' financing and a requirement for an unrealistically high level of creditor support to approve a restructuring plan.

The recent amendments appear to address only one of these problems, the treatment of secured creditors. According to the new law, all of the proceeds of the sale less the cost of administering the assets will be used to satisfy the secured claim, and the amount which can be recovered by the liquidator for administering the asset has been capped at 50% of the sale price. This improvement should enable secured creditors to recover a higher percentage of the value of their claims.

The recent amendments make it easier for creditors to commence bankruptcy proceedings against debtors by allowing proceedings to be opened 15 days after the submission of an invoice which the debtor does not dispute but has failed to pay.

It is not yet clear how the new reform will impact the effectiveness of the system, but it remains clear that major problems continue to exist within the insolvency law and implementation regime. The government is encouraged to bring forward proposals for more comprehensive amendments including: a more rapid process for the commencement of proceedings; a new reorganisation procedure; provisions for financing during a restructuring; additional management powers for creditors including the ability to replace management and the ability to sell parts of a business as going concerns; and rules on bankruptcy proceedings for company-groups. It is also recommended that Hungary adopt the provisions of the UNCITRAL Model Law on Cross Border Insolvency which would work in parallel with the Council Regulation (EC) 1346/2000 on Insolvency Proceedings, providing clearer rules on cross-border insolvencies involving countries outside of the European Union.

Secured Transactions



***Source*:** EBRD Regional Survey on Secured Transactions, 2005
Note: *Scoring is done on a scale of 1 to 100, with 100 representing the most advanced legal regime.*

The fuller the 'web,' the more advanced the country's secured transactions legal system is.

As already stated in previous strategies, and as is clear from the graph above, Hungarian law provides a comprehensive, flexible and modern system for charging all kinds of assets. Registered charges over movable (tangible) assets are registered in the centralised electronic Charges Registry, which has been operated since May 1997 by the Hungarian National Chamber of Public Notaries. In recent years, substantial improvements have been brought to the law. The range of collateral that can be taken has increased; charges over pools of fluctuating assets are now possible. Foreclosure rules have been substantially simplified, and out-of-court enforcement (for example by the creditor selling the collateral directly to get repaid) is now possible and is reported to work well. Finally, the treatment of secured creditors in the case of the debtor's insolvency has been significantly improved (see above).
The need in Hungary now is for an economic and market analysis of how more use could be made of charges and greater benefit derived from the regime that exists. Such a 'fine-tuning' exercise would deal with practical problems and aim at increasing efficiency for secured credit operations, and would undoubtedly indicate some specific amendments that might be made. However, the on-going reform of the Civil Code has led to the creation of a working group led by the Ministry of Justice, which has undertaken a complete review of secured transactions provisions. We believe that such rewrite of the law is not necessary – on the contrary, it may cause confusion, introduce complexity and reduce public confidence in the secured credit sector.

Charges over immovable property (mortgages) are also working efficiently but there are serious bottlenecks to the system, in particular:

- the time required to register a mortgage, which is unduly long
- the costs associated with the creation of a mortgage, again comparatively high for the region; and
- the inefficiency of the enforcement process, due to the enforcement costs (again, very high) and the fact that the property is rarely sold at market value.

Telecommunications

The communications sector in the Hungary is currently regulated by the Nemzeti Hírközlési Hatóság, the national communications authority ("NHH") and is governed by the Electronic Communications Law 2003 (the '2003 Communications Law') and related regulations. The 2003 Communications Law and the subsequent secondary legislation finalised Hungary's transposition of the EU 2002 regulatory framework in accordance with the country's formal obligations as a an EU member state. The Ministry for Economy and Transport took over as the communications sector policymaker in 2006 following the dissolution of the Ministry of informatics and Communication in a government restructuring.

In addition to the transposition of the 2002 EU regulatory framework, the 2003 Communications Law sought to provide a framework for market analysis and re-structured the National Regulatory Authority. The 2003 Communications Law replaced the existing regulator, Hungarian Telecommunications Authority with NHH, enhancing the status and independence of the regulator. NHH's executive powers were further reinforced in 2006 in an effort to address a perceived deficiency in its ability to enforce decisions and impose fines against errant operators. NHH's role includes registration of service providers, market supervision, market surveillance and frequency management. In addition, NHH approves of reference offers, accounting separation models and provides dispute resolution services.

Hungary is widely regarded as having been one of the more advanced of the transition economies in aligning its communications legislation with the EU framework, with national policies being heavily influenced early on by the EU strategy for liberalising markets. The regulation of the communications sector has been relatively clear and consistent from the outset and Hungary was early to liberalise this sector beginning in 1992 and continuing over the following decade. The 1998 EU liberalisation framework and full market liberalisation were formally introduced in 2001-2002. Similarly, Hungary was one of the earliest of the central European countries to embrace communications sector privatisation, beginning in 1993. All operators are now understood to be privately owned, though the state retains a golden share in the former incumbent.

Hungary has made significant progress in development of the communications sector in recent times. Although the country was an early adopter of communications sector liberalisation and privatisation, there had been some concerns over the speed of implementation of the necessary EU regulatory framework. The authorities, in particular NHH, appear to have dispelled many of these concerns, advancing well through the required market analyses. With the formal framework now well entrenched, the most immediate challenges are to ensure that full implementation of the framework is sustained.