Annual Report 1998

Contents

Message from the Chairman of the Board of Directors

The Bank's consolidated financial performance during the year was disappointing and after-tax profit was HUF 1.91 billion compared to HUF 5.43 billion in 1997. This reflected continued competitive and market pressure on interest and fee income as well as an increase in operating costs at a faster rate than the rate of inflation whilst we continue to invest significant amounts in the infrastructure of the Bank. However, there was a 19% increase in loan volumes and 17% increase in customer deposits reflecting a continued strong sales activity. In line with the strategic direction of the Bank, the volume of small and medium sized commercial loans rose by 30%. The newly introduced consumer financing through retailers and for car purchase tripled over the year and the relaunched equipment leasing company increased its assets 3-fold to HUF 7.5 billion at the year end.

The most important GE initiatives in 1998 regard the unrelenting drive for 'Six Sigma' quality across the Bank Group. Under a new quality leader we now have over 30 full-time colleagues called 'Black Belts' who are dedicated to improve every process in the Bank that concerns our customers. The Customer Focus '98 Project radically improved the front office services of our branch network. This project has seen queueing time reduced in branches by 50% and has simplified all branch based procedures to make our customers' lives easier. The requirement to maintain exceptionally high standards of compliance, control and integrity to safeguard the assets of our customers is paramount. Programs have therefore been instigated to eradicate the risk of fraud, money laundering and extraordinary loss.

The success of the company is totally dependent on the quality, professionalism and dedication of the staff. I would like to take this opportunity to thank all of them for their immense efforts throughout the year to transform the Bank.

Jenne Britell
Chairman

The Chief Executive Officer's Foreword

Over the last year a number of significant changes have been undertaken at Budapest Bank by a new management team that is absolutely determined to realize a mission. The whole of the organization has now become totally customer focused.

Our target customer groups are small and medium sized enterprises, consumers, professionals and entrepreneurs. The key objective is to assist successful companies grow through expert advice, financial and operational services. We already have a large number of business customers throughout the country and they are beginning to feel the Bank's commitment to their success.

We also continue to focus on a number of key Hungarian corporations that are the engines of growth in this country and we value our relationship with them.

We are now positioned to provide a range of financial services to individuals throughout their life according to their changing needs.

Considerable resources are dedicated to the development of high quality, competitive and innovative products. In 1998 some good examples were rapid response finance and operating leases for equipment and vehicle finance, Phare subsidized environmental loans, personal loans and 'Família' savings accounts. There will also be some non-core product areas that we exit such as Institutional Custody services.

The design and layout of many branch offices have been radically improved to be modernized and customer friendly. Queuing time in Budapest Bank branches has been reduced by more than 50% in one year through simplification of processes and focus on the customer needs.

One centralized customer accounting system has been fully implemented with many benefits for customers. A modern call centre is now providing professional and consistent service and the key bank card and Business Terminal services are fully stabilized.

Quality is now a way of life at Budapest Bank and every employee is charged with making the customer feel the benefit. Finally, with the emphasis in 1999 on growth and productivity, the management is determined to improve the profitability of the Bank significantly and to sustain the improvement into the new century.

Richard Pelly
Chief Executive Officer

The Economic Environment in 1998

International market disturbances in the second half of the year put the brakes on the momentum of exports and the corporate demand for credit as well as on the intensity of capital inflow. Nevertheless, despite the less vigorous performance in the second half of the year, the economic growth rate increased to 5.1%, which is a promising result both in international comparison and in relation to earlier years. The primary factor in growth was the over 20% volume increase in exports. In addition, with real earnings rising for the second year running, household consumption and consequently also the domestic sales of industry began to grow.

Growth acceleration was accompanied by a minor increase in the debt burden. The current account deficit increased by USD 1.3 billion in 1998. There was no difficulty in financing the deficit, as the inflow of foreign direct investments and financial investments continued in the first half of the year.

The increase in the consumer price index was reduced by 8 percentage points in 1998. The unexpectedly favorable changes in energy and food prices played a significant role in this. The growing difficulties of agricultural exports also contributed to the latter in the second half of the year.

The growth of the balance sheet total of the domestic banking sector exceeded the increase in the consumer price index by 5 percentage points in 1998; its profitability, however, lagged behind the rates achieved in earlier years both with regard to the volume of pre-tax profits and their ratio to total assets.

The faster than expected decrease in the rate of inflation and the disturbances in international markets led to a considerable rise in the level of real interest rates in 1998. The nominal interest rate level sank by no more than 0.3 percentage point in the case of consumption loans, by 2 percentage points in the case of corporate credits and by 2.5 percentage points in the case of one-year government securities in the course of the last year.

Corporate Banking

Business undertaken with small, medium and large sized companies is a major contribution to the Bank's balance sheet and income statement. In 1998 our activity was particularly focused on increased loan volumes and business with middle market companies and equipment leasing by the rapidly growing Budapest Leasing Ltd, a subsidiary of the Bank. Over the last year we also maintained a traditional and close relationship with our major corporate clients through improved services, competitive pricing and participation in and the arrangement of club deals and syndications. Sales efforts incorporated in the services provided by our company car fleet subsidiary to this segment contributed to achieving our goals.

We refined our strategy regarding the small business sector and implemented the necessary organizational changes. Major actions were taken regarding the relocation of small business sales and marketing activity to meet the corporate business line. By achieving this we established a common and unified approach to our main market segment: small and medium sized companies. The ten corporate business centers around the country are responsible for this segment in close cooperation with the centralized Corporate Marketing Team.

We believe that local sales and customer services rendered to our wide customer base, including a full use of the branch network, are prerequisites to achieve our ever multiplying goals in the future. The centralized sales team for servicing large corporations will enable a more considerable focus on this important customer base which is facilitated by the use of local support from branches.

Small and Medium Sized Enterprises

65% of the income of Budapest Bank comes from corporate clients. We consider a broad range of financing products and operating services offered to small and medium sized businesses to be our major strength. The overall market share of Budapest Bank in this segment is close to 15%, which is one of the largest in the domestic banking sector.

Market research with this target market has given us the clear view that service quality and simplicity are the principal requirements. In light of the tightening interest margins, which are due to the decreasing inflation rate and other related factors, the most appropriate way for us to increase our earnings is to increase service commissions and fees. The Bank's strategy and the shareholders' profitability expectations compelled us to refocus on companies and products with a higher growth potential. A major initiative was launched to transform the Bank's sales practices from an 'all products, all market segments' approach to a highly focused sales and marketing activity with specific products sold to targeted market segments.

Leasing Services

In 1998 Budapest Leasing Ltd succeeded in further strengthening its market position and is now among the three most prominent representatives of the dynamically developing leasing market. With regard to our customers and our product development efforts, our main objective was to render quality services instead of price competition; a concept which was justified by the reaction of the market.

Today, customers associate quality and quick reaction with Budapest Leasing. We can now welcome Renault Truck Hungária and Volvo Truck Hungária as our new partners. Our market share has increased in the IT financing sector. Furthermore, we established well-working ties with several agricultural producers and distributors. We have concluded 550 contracts with 375 clients, representing HUF 5.9 billion in value.

In the past year one of the biggest challenges for us was to test and introduce a new integrated IT system. This task was performed in several phases throughout 1998. The introduction of new software facilitates the handling of the portfolio and the provision of management information. One of the most obvious advantages is the simplification of accounting activities and the tracking of payments.

Fleet Services

Budapest Bank Fleet Services Ltd was established with a HUF 50 million share capital. The fleet management company provides primarily large and medium market corporations with operating leasing and fleet management services necessary for them to establish and continuously manage their company car fleet, complemented with car repair services.

Factoring

Operated as a division within the Bank, Budapest Bank launched factoring activities in February 1998. With this service we offer an additional financing and liquidity management tool to our customers. By purchasing and providing advances against both domestic and export receivables, this service is designed to meet the working capital needs of our customers and to provide additional funds in the framework of a lasting co-operation, in addition to mitigating business risks, we offer this type of trade financing to both our existing and prospective clients. Subject to the status of our customers in specific commercial transactions (vendor, supplier to a large corporation, or to multinational companies or buyer), the agreements can be concluded under different terms and conditions.

During the period of introducing this business line we managed to achieve a HUF 2 billion turnover with a relatively low number of customers. We did not have doubtful receivables, or bad debts and the majority of our turnover was generated in export factoring. After the first year of operation our intention is to develop the factoring business line, as a type of asset based financing, and to make it a part of the Bank's strategic products in the coming period. As an affiliate of GE Capital, our factoring services can also be efficiently assisted by GE's decades-old experiences and a market leader know-how.

Consumer Banking

Budapest Bank's market share in retail loans and deposits has doubled in 1998. We launched our personal loan business last July throughout the entire branch network. This loan allows flexible use, an easy and fast application routine with the amounts and terms tailored to the needs of individual customers. In order to extend the variety of products offered to our customers, we developed our 'Família' savings facility last June. This savings scheme is unique due to its high flexibility in increasing the savings amount and withdrawing funds from the account. The product is very successful and is the most preferred savings scheme among the various deposit products of the Bank.

Sales Finance

The sales finance activity of the Bank was launched in 1997. 1998 was a very successful year, our market share increased to 15%, the outstanding payments at the end of the year amounted to HUF 2.1 billion. Professional risk management and collection helped reach the average GE Capital standards of the business. Due to the growing competition and new players in the market, the challenge for the year 1999 is to develop the professional sales force, acquire more key accounts and a large number of medium sized merchant partners.

Auto Finance

Budapest Auto Finance Ltd was established with a HUF 50 million share capital. This company extends loans and leases to finance the purchase of new and used cars for private individuals and entrepreneurs. Budapest Auto Finance concluded 5,486 contracts in 1998. The aggregate amount of financing provided by the company was HUF 7.4 billion. Due to this achievement the company holds the 6th ranking regarding car loan financing and is ranked 4th among brand-free firms. Budapest Auto Finance has contracts with 240 distributors and dealers, as a result of which we are able to approve a loan at the dealer within 1 hour. Payment delinquency is at a very acceptable level. The company has obtained the position of official financer for Peugeot and Mitsubishi. Budapest Auto Finance will further increase the number of dealers in 1999. The company endeavor to promote expanded banking services to dealers. Budapest Auto Finance will continue to test and introduce new products ie. car loans as well as permanent leases.

Fund Management

Budapest Fund Management Ltd is the fund manager of eight open ended investment funds and the asset manager of two pension funds (Budapest Mandatory and Voluntary Pension Fund). Budapest Fund Management could retain its market leader position, while the main competitor's market share increased and smaller fund managers were slightly losing their market share respectively. New entrants made a very modest debut. Our eight funds under management increased from HUF 86.6 billion to HUF 116 billion. At the end of 1998 the market share of Budapest Fund Management exceeded 36%. As far as the annual yields of the investment funds are concerned, the performance of Budapest II Fund was the best in the Hungarian market.

Securities

In 1998 Budapest Securities Ltd continued its specialization for retail customers. As the financial market became more volatile, Budapest Securities assigned primary importance to minimizing vulnerability of our clients' investments. The scope of activities was streamlined to develop a low risk product structure which meets the requirements of retail customers. Simultaneously, the gradual integration of functional areas began at Budapest Bank in order to increase operating effectiveness and reliability. The primary objective for 1999 is to pursue the branch network distribution of investment services, to increase unit volume and the returns on sales exclusively through branch network distribution and customer convenient sales channels ie. via telephone and the Internet.

Pension Fund

Enjoying the support of their parent company, the subsidiaries of the Bank and GE Lighting Tungsram were the first to join the Budapest Voluntary Pension Fund. Participation in the pension fund business as well as the provision of services both in Budapest Mandatory and in Budapest Voluntary Pension Fund started in 1998, making wide use of the co-operation with different organizational units of Budapest Bank. As a result of the marketing campaign and the acquisition activities of the branches and business centers, both private and corporate customers joined the funds. By the end of 1998, the total number of pension fund members exceeded 40,000. The good quality of administration services and the low level of costs for members have also contributed to the success of our customer acquisition efforts. Budapest Fund Management Ltd manages the investments. Due to their high standards of efficiency both pension funds attained an outstanding average yield on their investments for the whole year amounting to 23% for the voluntary and 22% for the mandatory pension fund.

Branch Network

The introduction of the new image of the Bank comprises several phases and a relatively long and expensive process. The development of the new profile includes the creation of an original architectural design and marketing approach as well as the introduction of a new logo. In the course of modernizing the branches, Budapest Bank focused on opening new branches in new areas and closed inefficient branch offices. Furthermore, we refurbished several branches to various degrees so that they can meet 21st century requirements. The main objective was to create an efficient, yet customer-friendly and attractive environment. The new interior design was introduced at a somewhat slower pace, changes in the Bank’s advertisements as well as the replacement of the old signs and notices in branch offices were accomplished within a year.

New branches opened in 1998:
Budapest, Csepel,
Budapest, Gazdagrét
Budapest, Királyhágó tér
Budaörs
Bük
Dunakeszi
Gyôr
Mosonmagyaróvár
Siófok

Branches refurbished in 1998:
Budapest, Budagyöngye
Jászberény

Customer service area improvements in 1998:
Budapest, Pestlôrinc
Budapest, Rákosszentmihály
Gödöllô
Vác
Veszprém

Community Spirit

In the course of the past year altogether 1195 employees took part in 441 various programs, thus spending some 3113 hours on developing community spirit. This follows a great tradition throughout the General Electric Company.

Our biggest nation-wide activity was April 22nd, Earth Day. On this occasion the employees of Budapest Bank organized community programs at 20 different venues around the country. Altogether 327 employees took part in these activities, the objective of which was to develop and improve the surroundings of the branches.

The most extensive program in Autumn was the painting of the entire Ferencváros Kindergarten Complex and Primary School, which was achieved on a voluntary basis by the staff of Budapest Bank and GE Lighting Tungsram. Furthermore, we donated computers to the school, thus enhancing the children's chances of continuing their studies and for their further success.

In 1998 as a result of the enthusiastic organizational work we were able to make hundreds of children happy at Santa Claus Day and Christmas as well as to take them on excursions. On a weekend in March we were able to invite the top 30 students of Gandhi High School to Budapest. Furthermore 450 handicapped children celebrated Christmas singing their favorite songs with Judit Halász.

In addition to this, employees donated blood as well as organized clothing donation campaigns and raised funds for flood victims.

Budapest Bank, as a good corporate citizen, also supports civil initiatives through its two foundations. The mission of the 'Budapest Bank for Budapest' Foundation is to contribute to the development of the intellectual and scientific life, education and culture of the capital city and to support the protection and the improvement of the natural and architectural treasures of Budapest, the care of historical monuments and the creation of a healthier Budapest.

The 'Budapest Bank for Education and Hungarian Financial Culture' Foundation encourages and supports Hungarian financial and economic research, education and culture.

Financial Overview

Shareholders' Information
Audited Consolidated Financial Statement

Shareholders' Information*

During the ten years of its operation Budapest Bank pursued, on the one hand, traditional commercial banking activities and also created a number of new subsidiaries that render specialized financial services. Budapest Bank has exclusive ownership of these companies. Budapest Bank assigns special emphasis to product development and the provision of services to special target markets with suitable products having a significant service and added value content. This is achieved using the technical skills available in Hungary, as well as the wide product range of GE Capital that has proved to be successful all over the world.

Ownership Structure
As of December 31, 1998 EBRD owned a 32.6% stake, General Electric Capital as the strategic shareholder had a 27.6% equity stake and the Hungarian Government in its capacity as owner of the State Privatization and Holding Ltd had 23.1% of the Bank's shares. Other domestic investors owned 7.3% and foreign investors held 6.5% of the shares. The Bank's own treasury shares represented 2.9% of the total shareholders' equity.

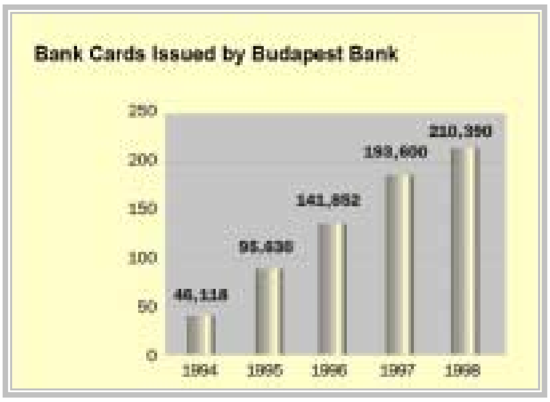
Share Capital
Pursuant to the provisions of the relevant Hungarian laws, the shareholders' capital is broken down as follows: On December 31, 1998 the share capital of Budapest Bank was HUF 19,906,470,000 which consisted of 19,034 preferential shares with a nominal value of HUF 1,000,000 each, 43,952 preferential shares with a nominal value of HUF 10,000 each and 350,680 preferential shares with a nominal value of HUF 1,000 each, as well as 8,227 preferential interest bearing shares with a nominal value of HUF 10,000 each. In accordance with the established international practice, KPMG includes ESOP shares in the aggregate amount of share capital and deducts the existing capital value of repurchased shares. In the past years HUF 579 million worth of shares were repurchased. The Bank allows the purchase of non-voting shares to be held by the company's employees, which represented HUF 16 million of the share capital at the end of 1998.

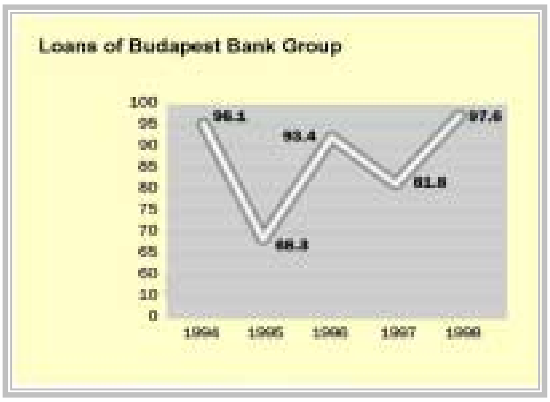
Shareholders' Equity of Budapest Bank Group

	1994	**1995**	**1996**	**1997**	**1998**
Shareholders' capital	17.1	19.7	19.4	19.4	19.3
Reserves	(0.8)	4.9	7.3	10.3	10.4
Total	**16.3**	**24.6**	**26.7**	**29.7**	**29.7**

Market Positions
The Balance Sheet Total Figure of the Budapest Bank Group was HUF 274 billion at the end of 1998, which marks a 7% increase as compared to the previous year. The Hungarian banking market is characterized by keen competition for customers and, in this situation, Budapest Bank managed to retain the 6th place among domestic banks. With the issue of more than 210,000 bank cards, Budapest Bank is the 3rd biggest card issuing bank. Budapest Auto Finance Ltd, a subsidiary founded in 1997, became one of the most important players in the auto finance market by the end of 1998, with the various credit lines and leasing products provided for the purchase of new and used cars. Budapest Bank Fleet Services Ltd was also created in October 1997, and the company offers car fleet financing and management schemes (Fleet Leasing).

Budapest Bank Fleet Services became the 2nd largest service provider in this market by the end of 1998. Budapest Fund Management Ltd, another member of the Budapest Bank Group, is a market leader in the management of investment funds. In 1998, assets managed by the company increased by 17%, up to nearly HUF 116 billion.





Assets

The 7% growth of total assets and the 16% increase in loan assets achieved by the Bank Group in 1998 were accompanied by an important portfolio restructuring activity, prudent lending and effective risk management. The portfolio risk was significantly reduced and our security position was strengthened.

Our dependence on a small number of large corporations is continuously decreasing. In accordance with our strategy, we strive to attract retail market customers (small businesses and individuals), as well as medium sized companies. There were spectacular results in the retail credit business. In 1998, the consumer credit and the private credit business grew by 2.5 times as compared to the 1997 year end balance.

In addition to intensifying our activities in the corporate and retail markets, we consistently maintained an active placement position on the financial market. We maintained a strong liquidity position. The financial market instruments, including deposits kept at the National Bank of Hungary and various financial institutions as well as the investments in commercial securities, represent low-risk assets in our portfolio. Nearly 80% of the total securities portfolio comprised government securities and Euro-bonds issued by the National Bank of Hungary. We maintained and refined our policy of risk management. The collateral evaluation regulations became more conservative, the rating scale of debtors was broadened, allowing a high degree of differentiation of credit risk.

Deposit Liabilities

Due to the volume of new term deposits made by businesses and individuals, the liabilities of the Bank Group increased by 21% over 1997. The structure did not change significantly in 1998. 75% of the liabilities of the Bank comprised the savings of businesses and individuals. These are fixed deposits with a maturity of up to 1 year. The ratio of domestic and foreign currency deposits is 3 to 1.

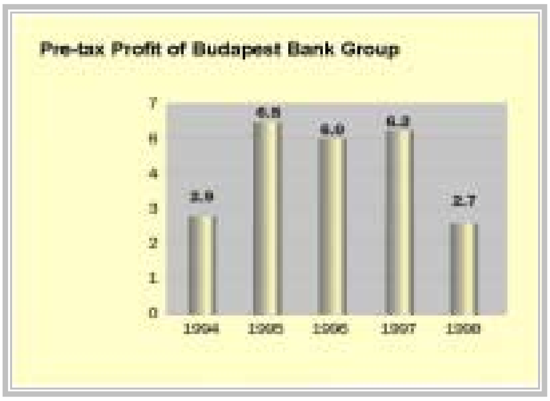
Capital Position

The Bank enjoys a sound capital position. In 1998, the total capital and reserves of the Bank amounted to HUF 29.7 billion. The capital adequacy ratio was 17.5%, which is much higher than the mandatory 8%. The guarantee capital provides a good basis for the safe execution of our planned development projects.

Profits

In 1998 the after-tax profit was 12% lower than in 1997. At the Bank Group level, the consolidated profit decreased more significantly, considering that the business growth achieved by subsidiaries could only produce a moderate profit increasing effect at this stage.

The reduction of interest margins, which was a consequence of the decrease in interest rates, had an unfavourable effect on the net interest differential. However, in spite of these negative market trends, we were able to improve our net interest contribution. The reduction of interest margins in the large corporate banking market, which is generally more sensitive to interest rates, was effectively offset by the portfolio growth achieved in the more profitable small and medium sized business area.



As a result of the transformation of the price structure of our products and the increase of the sales volume, our fee income grew significantly in comparison to the previous year. The increase in the payment turnover, the introduction of products generating other fee income and the increase in the net assets of the funds managed by Budapest Fund Management Ltd also contributed to this result.

Operating Expenses

In 1998, the operating expenses of the Bank Group grew to HUF 23.2 billion. The increase is largely attributable to the infrastructure development projects of the Bank Group. The Bank underwent a massive reorganization process. Retail and corporate banking divisions with professional marketing teams were set up, the marketing structure was reorganized, quality methods were applied in a wide range of areas in order to improve the processes.

The branch modernization and information technology projects that are currently under way are envisaged to achieve the maximum level of customer satisfaction. In 1998, a significant number of branches were modernized, including the introduction of a more customer-oriented approach and the improvement of efficiency. We successfully completed our preparation for the year 2000. In 1998 a significant part of the operating costs comprised the costs of high-priority projects, staff costs and depreciation.

Dividend

Based on the earnings in 1998, the Bank paid dividends amounting to 10% of the nominal value of ordinary shares and interest bearing shares and 8% of the nominal value of preference shares. The aggregate amount of dividends paid pursuant to the resolution of the Annual General Meeting was HUF 1.9 billion.

Audited Consolidated Financial Statements

Independent Auditor's Report

To the Shareholders of Budapest Bank Ltd

We have audited the accompanying consolidated balance sheet of Budapest Bank Ltd ('the Bank') and its subsidiaries as at December 31, 1998 and theconsolidated statements of profit and loss, cash flows and changes in shareholders' equity for the year then ended (collectively 'the consolidated financial statements'). The consolidated financial statements are the responsibility of management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Bank and its subsidiaries as at December 31, 1998 and the result of its operations and cash flows for the year then ended in accordance with International Accounting Standards.

April 14, 1999

Stephen B. M. Young
Partner, KPMG Hungária

Consolidated Statement of Profit and Loss for the year ended December 31, 1998

	Note	1998	1997
Interest income		34,463	30,335
Interest expense		(18,040)	(16,078)
Net interest income	4	16,423	14,257
Other income, net of expenses	5	10,549	15,245
Operating income		26,972	29,502
Operating expenses	6	(23,171)	(20,451)
Net operating income before credit and investment losses		3,801	9,051
Provision for credit and investment losses	7	(1,098)	(2,819)
Profit before taxation		2,703	6,232
Taxation	8	(794)	(802)
Net profit after taxation		**1,909**	**5,430**
Assets			
Cash		7,276	9,479
Deposits with the National Bank of Hungary	9	57,082	73,660
Deposits with other banks	10	33,373	26,776
Loans and advances	11	97,587	81,846
Prepayments and accrued interest receivable		4,939	6,190
Trading securities	12	18,114	17,005
Investment securities	13	22,326	15,984
Other assets		9,478	5,261
Premises and equipment	14	24,283	19,963
Total Assets		**274,458**	**256,164**
Liabilities			
Deposits and other customer accounts	15	208,490	175,628
Borrowings from the National Bank of Hungary	16	8,406	11,114
Deposits from other banks	17	7,747	14,916
Other government borrowings	18	676	3,173
Accruals and accrued interest payable		2,697	4,005
Other creditors	19	10,570	10,906
Provision for guarantees and other off balance sheet risks	7	2,298	2,855
		240,884	222,597
Subordinated debt	20	3,861	3,861
Total Liabilities		**244,745**	**226,458**
Shareholders' Funds			
Share capital	21	19,343	19,379
Legal reserves		4,891	5,150
Retained earnings		5,479	5,177
		29,713	29,706
Total Liabilities and Shareholders' Funds		274,458	256,164
Commitments and contingent liabilities	22		

	1998	1997
Cash Flows (Used in)/Provided by Operating Activities		
Net profit	2,703	5,430
Adjustments to determine net cash provided by operating activities:		
Depreciation	3,151	2,326
Release of provision for loss on investments	(553)	(1,163)
(Release)/charge in provision on trading securities	91	(201)
(Release) in provision for loans and other assets	(1,897)	(13,921)
(Release)/charge in provision for off balance sheet items	(557)	1,339
Change in minority interest	–	(1,006)
Net change in accrued income and other assets and accrued expense and other liabilities	(6,547)	2,368
Income taxes paid	(794)	(802)
Net loans and advances	(13,934)	640
Deposits net of withdrawals	25,693	38,874
Net purchase of trading portfolio	(1,200)	(3,865)
	6,156	30,019
Cash Flows (Used in)/Provided by Financing Activities		
Treasury Shares	36	(59)
Dividend paid	–	(2,308)
Net decrease in refinancing and other government borrowings	(5,205)	(6,074)
Repayment of bonds issued	–	(9,575)
	(5,169)	(18,016)
Cash Flows (Used in)/Provided by Investing Activities		
Net non liquid bank deposits	(5,603)	(2,642)
Net sale/purchase of investment securities	(5,789)	13,846
Net purchase of premises and equipment	(7,471)	(2,811)
	(18,863)	8,393
Net increase in cash and cash equivalents	(17,876)	20,396
Cash and cash equivalents at beginning of year	82,234	61,838
Cash and cash equivalents at year end	**64,358**	**82,234**
Cash	7,276	9,479
Liquid deposits with the National Bank of Hungary	57,082	72,755
Cash and cash equivalents at year end	**64,358**	**82,234**

	Share Capital	Legal Reserves			Retained earnings
		General Reserve	General Risk Reserve	Foreign Exchange Risk Reserve	
Balance at January 1, 1998	19,379	2,967	1,769	414	5,177
Treasury shares	(36)				30
Other	–	–			42
Transfer from General Risk Reserve	–	–	(26)	–	26
Transfer from Foreign Exchange Risk Reserve	–	–	–	(233)	233
Net profit for the year	–	–	–	–	1,909
Proposed Dividend	–	–	–	–	(1,938)
Balance at December 31, 1998	**19,343**	**2,967**	**1,743**	**181**	**5,479**

1. General information

Budapest Bank Ltd ('Budapest Bank' or 'the Bank') was formed in 1987 as a joint venture between the State, state-owned enterprises and co-operatives when the two-tier banking system was created in Hungary. At that time a proportion of the customers and business of the National Bank of Hungary (the 'NBH') were transferred to the Bank, together with the associated assets, liabilities, rights and obligations.

Following the privatization of the Bank in December 1995, the principal shareholders are the European Bank for Reconstruction and Development 32.6%, General Electric Capital Services 27.6% and the Hungarian State (first: Ministry of Finance, now the State Privatization and Holding Company) 23.1%. The remaining shares (16.7%) are owned by other shareholders.

These consolidated financial statements have been prepared in accordance with International Accounting Standards and under the historical cost convention. The Bank and its subsidiaries maintain their official accounting records and prepare their financial statements in accordance with the relevant Hungarian accounting regulations. The accompanying consolidated financial statements reflect certain adjustments not recorded in the local statutory records. All inter-company balances have been eliminated.

Certain items in the 1997 financial statements have been reclassified to conform with 1998 presentation.

2. Summary of significant accounting policies

(a) Principles of consolidation
The accounts have been consolidated in accordance with International Accounting Standard 27. They include the accounts of Budapest Bank and its subsidiaries except those subsidiaries where control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future. Subsidiary companies included in these consolidated accounts are shown in note 2 (d).

Control is presumed to exist when more than one half of a subsidiary's voting power is controlled by the parent company; or the parent company is able to govern the financial and operating policies of a subsidiary; or control the removal or appointment of the management or Board of Directors of a subsidiary.

(b) Fair value
The carrying values of financial assets and liabilities are substantially equivalent to their fair values and transactions have been effected at market rates, unless otherwise disclosed.

(c) Derivatives
Derivative products include options, spot and forward foreign exchange contracts. The scale and size of the trading transactions are not significant compared to the hedging transactions. Non-trading derivatives hedge one or more characteristics of the Bank's risk on a deposit, loan or security to meet the Bank's funding or investing strategies.

(d) Consolidated subsidiary companies
The Bank directly or through its subsidiaries, owns controlling interests in the following entities all of which are incorporated in Hungary, except Pater Bank which is incorporated in Romania.

Company	Ownership % 1998	Ownership % 1997	Business activity
Pater Credit Bank Ltd.	99.9%	99.9%	Banking
Budapest Ingatlanhasznosító Rt.	100%	100%	Non banking services
Budapest Értékpapír Rt.	100%	100%	Brokerage
Budapest Lízing Rt.	100%	100%	Leasing
Budapest Autófinanszírozási Rt.	100%	100%	Car leasing
Budapest Alapkezelô Rt.	100%	100%	Investment fund manager
2B Kft.	100%	100%	Trading company
Budapest Bank Autóparkkezelô Rt.	100%	100%	Fleet leasing
Budapest Pénztárszolgáltató Rt.	100%	100%	Pension fund manager

(e) Investment securities
Long-term investments are accounted for at cost less any provision for permanent impairment in value. Investments consist of minority shareholdings in Hungarian companies and government bonds.

(f) Trading securities
Trading securities include corporate bonds, government stock and investment units. These securities are not intended to be held to maturity and are carried at the lower of cost or market value.

(g) Loan losses
Loans and advances are stated net of loan loss provisions. Specific provision is made against loans and advances which are considered to be bad or doubtful.

(h) Premises and equipment
Premises and equipment are stated at cost less accumulated depreciation calculated on a straight-line basis over the estimated useful lives of the assets. The depreciation rates used are as follows:

Buildings	2% or 6%
Furniture, fittings and equipment	14.5% or 33%
Vehicles	20%

(i) Intangible assets
Intangible assets, which are included in other assets, are stated at cost less accumulated amortization calculated on a straight-line basis at 15% to 16% per year.

(j) Foreign currency translation
Foreign currency transactions are recorded in Forints at rates of exchange ruling at the value dates of the transactions. Assets and liabilities denominated in foreign currencies are translated at the rates of exchange ruling at the balance sheet date. The resulting gains or losses are included in the profit and loss account.

(k) Legal Reserves

General Reserve
In accordance with Section 75 of Hungarian Act No. CXII of 1996, a General Reserve equal to 10% of net income after tax, as calculated under Hungarian accounting and banking rules is required to be made. Increases in the General Reserve are treated as appropriations from retained earnings, under Hungarian accounting and banking rules and thus are not charged against income. The balance of the General Reserve was HUF 2,967 million as at December 31, 1998 and 1997. During the year the Bank obtained permission from the State Money and Capital Market Supervision ('Állami Pénz- és Tôkepiaci Felügyelet') not to further increase the reserve due to the Bank's satisfactory capital adequacy ratio.

General Risk Reserve
Under Section 87 of Hungarian Act No. CXII, a General Risk Reserve of 1.25% of the risk-weighted assets, as calculated under Hungarian accounting and banking rules must be set up over a period of up to 3 years from December 31, 1997. However, the full amount has been set aside as at December 31, 1998. Under Hungarian Law the amount of the General Risk Reserve is charged to the Profit and Loss Account and is a tax-deductible expense. This amount has been reversed from the Profit and Loss Account in these accounts and treated as an appropriation of retained earnings. As at December 31, 1998 the Bank carried a General Risk Reserve of HUF 1,743 million (1997: 1,769 million).

Foreign Exchange Risk Reserve
Under Section 13.7 of Government Decree No. 198/1996 a Foreign Exchange Risk Reserve must be set aside which is calculated based on the net open foreign currency position of the Bank as at the year end. As at December 31, 1998 the Foreign Exchange Risk Reserve amounted to HUF 33 million (1997: 414 million).

Foreign Exchange Loss Reserve
Under Section 13.8 of Government Decree No. 198/1996 a Foreign Exchange Loss Reserve must be set up based on the exchange difference, calculated for all foreign exchange assets and liabilities of the Bank resulting in exchange gain. As at December 31, 1998 the Bank provided for the possible future loss of these unrealized gains HUF 148 million (1997: nil).

3. Risk management policies

Budapest Bank's policies for managing interest rate, credit, foreign exchange and liquidity risk are reviewed regularly by the Asset and Liability Committee (ALCO). The policies can be summarized as follows:

Interest rate risk
Gaps in the value of assets and liabilities that mature or reprice in a given period generate interest rate risk. In managing the Bank's repricing structure, the ALCO considers macro and micro economic forecasts and the anticipated trends in interest rates.

Liquidity risk
The objective of prudential liquidity management is to ensure that the Bank has the ability to generate sufficient funds to meet all cash outflow obligations as they fall due. In managing its liquidity the Bank takes into account various legal requirements and limitations and the need to maintain market confidence. Limits are set accordingly and the liquidity situation is reviewed continuously by senior management.

Foreign exchange rate risk
Foreign exchange risk arises when a mismatch arises in the assets and liabilities denominated in foreign currencies. The Bank ensures that the foreign currency position, as far as practical, is minimized.

Credit risk
Credit risk is the risk of financial loss occurring as a result of default by a borrower or counterparty on their contractual obligation with the Bank. The Bank reviews the creditworthiness of customers applying for loans and establishes credit limits on the basis of the risk assessment. Customers are monitored quarterly and limits are adjusted if necessary. The limits also take into account various collateral types. Organizational units and committees independent from business units perform customer's qualification and limit reviews as well as quarterly portfolio review and provisioning.

4. Net interest income

	1998		1997	
	Income	**Expense**	**Income**	**Expense**
Corporations and consumers	15,618	(13,802)	11,757	(11,269)
Other financial institutions	9,205	(2,191)	2,755	(1,385)
National Bank of Hungary	9,640	(2,047)	15,823	(3,424)
	34,463	**(18,040)**	**30,335**	**(16,078)**

5. Other income/expenses net

		1998			1997	
	Income	**Expenses**	**Net**	**Income**	**Expenses**	**Net**
Portfolio investments	340	(205)	135	1,329	(1,486)	(157)
Foreign exchange trading	2,242	(102)	2,140	3,075	(515)	2,560
Fees and commissions	7,208	(1,903)	5,305	6,504	(1,322)	5,182
Income/(expenses) on disposals of investment					(122)	(122)
Other	11,333	(8,364)	2,969	13,092	(5,310)	7,782
	21,123	**10,574**	**10,549**	**24,000**	**(8,755)**	**15,245**

6. Operating expenses

Operating expenses comprise the following:	**1998**	**1997**
Staff	9,891	8,585
Office administration and related expenses	9,471	8,636
Non-recoverable VAT and other taxation	658	904
Depreciation	3,151	2,326
	23,171	**20,451**

7. Provision for credit and investment losses

Movements in provisions were as follows:

	1998							1997
	Loans	**Trade Debtor**	**Invest-ment**	**Secu-rities**	**Inter-bank**	**Off-B/S items**	**Total**	
Balance at the beginning of the year	4,728	983	565	0	89	2,855	9,220	23,166
Amounts written off net of recovery	(574)		(621)			(206)	(1,401)	(2,071)
Provision released on assets sold	(1,420)	(2)	(11)			(1,076)	(2,509)	(14,694)
Provision charge/(release)	187	105	79	91	(89)	725	1,098	2,819
Balance at year end	**2,921**	**1,086**	**12**	**91**	**0**	**2,298**	**6,408**	**9,220**

8. Taxation

The taxation charge for the year is based on the profit for the year according to the statutory accounts of individual companies within the group, adjusted in accordance with relevant taxation regulations. The tax rate, in Hungary for the year ended December 31, 1998 amounted to 18% (1997: 18%). No major differences exist between the tax and accounting basis and accordingly no allowance has been made in these accounts for certain timing differences which may reduce taxable profits in the future. Legal reserves as noted in Note 2 (k) are considered to be permanent differences, which will not reverse in subsequent periods.

9. Deposits with National Bank of Hungary (NBH)

Deposits with NBH consist of:	**1998**	**1997**
Restricted cash balance	12,898	9,117
Short-term deposit with NBH	44,184	63,638
Long-term deposit with NBH	–	905
	57,082	**73,660**

Regulations of the National Bank of Hungary require that banks maintain a specified level of monetary reserves in support of certain deposit balances. These reserves are maintained both in the form of cash and interest bearing deposits with the National Bank of Hungary and are not available for investment purposes.

10. Deposit with other banks

The amount of HUF 33,373 million primarily matures within one year.

11. Loans and advances

	1998	**1997**
Advances to customers	100,508	86,574
Less: provisions	(2,921)	(4,728)
	97,587	**81,846**

Loan concentration by industrial sectors is as follows:

	1998	**1997**
Sector	%	%
Infrastructure	31	42
Manufacturing industry	30	29
Agriculture	14	15
Energy, mining and construction	7	14
Other	6	–
Consumer finance	12	–
	100	**100**

Loans outstanding mature as follows:

Term to maturity	**1998**	**1997**
Within 1 year	60,022	58,836
2–5 years	34,329	23,729
Over 5 years	6,157	4,009
	100,508	**86,574**

Loans provided to:

	1998	**1997**
the management	203	156
the members of the Board of Directors	–	2
the members of the Supervisory Board	9	–
	212	**158**

12. Trading securities

	1998	**1997**
Cost:		
Corporate shares	17	58
Corporate bonds	834	948
State bonds	8	20
NBH Eurobonds	11,131	10,273
FX bonds	1,095	2,393
NBH Bonds	–	1,312
Discount treasury bills	3,776	584
Investment units	1,207	1,034
Other securities	137	383
	18,205	17,005
Less: provisions		
Corporate shares	10	–
FX bonds	66	–
Discount treasury bills	4	–
Other securities	11	–
	(91)	0
Net book value	**18,114**	**17,005**

The market value of trading securities closely approximates the carrying value of the securities.

13. Investment securities

	1998			**1997**
	Investment at cost	**Provision for losses**	**Net book value**	**Net book value**
Government Securities	21,161	–	21,161	14,730
Other investments	1,177	(12)	1,165	1,254
	22,338	(12)	22,326	15,984

Government Securities mature as follows:

	1998	**1997**
1998	–	97
1999	1,470	975
2000	1,666	1,579
2001	1,619	245
2013	8,049	7,963
2014	8,357	3,871
	21,161	14,730

The market value of investment securities closely approximates the carrying value of the securities.
Other investments consists shares in associates as follows:

	1998	**1997**
Aranypénz Rt.	10	10
Értéktár Kft.	5	5
Kulturinvest Bt.	9	9
Nemzetközi Bankárképzô Központ Rt.	29	29
Rent-Oil Kft.	117	117
Szuper Rádió Rt.	13	–
Other	–	783
	183	**953**

14. Premises and equipment

	Land and buildings	**Equipment**	**Construction in progress**	**Total**
Cost				
Opening at January 1, 1998	13,052	9,839	1,190	24,081
Additions	1,309	7,011	5,930	14,250
Disposals	(308)	(1,700)	(5,816)	(7,824)
Closing at December 31, 1998	**14,053**	**15,150**	**1,304**	**30,507**
Depreciation				
Opening at January 1, 1998	399	3,719	–	4,118
Additions	285	2,866	–	3,151
Disposals	(31)	(1,014)	–	(1,045)
Closing at December 31, 1998	**653**	**5,571**	**–**	**6,224**
Net book value at December 31, 1998	**13,400**	**9,579**	**1,304**	**24,283**
Net book value at December 31, 1997	**12,653**	**6,120**	**1,190**	**19,963**

15. Deposits and other customer accounts

	1998	**1997**
Current and demand accounts	102,275	92,546
Deposits and savings accounts	106,215	83,082
	208,490	**175,628**

Customer deposits primarily mature within one year.

16. Borrowings from the National Bank of Hungary

	1998	**1997**
Long-term borrowings	78	92
Refinancing credits	6,592	8,550
World Bank refinancing loans from NBH	1,736	2,472
	8,406	**11,114**

Refinancing credits mature from 1999 through 2012 and bear interest at rates ranging from 3% to 24% (1997: 3% to 24%) depending on the currency.

17. Deposits from other banks

The balance of HUF 7,747 million (1997: 14,916 million) consists of HUF 6,823 million (1997: 13,397 million) maturing within one year and HUF 924 million (1997: 1,519 million) maturing after more than one year.

18. Other government borrowings

Other government borrowings consist of amounts payable to the State for advances to customers on behalf of the State, for which the Bank is at risk should the customer default. Accordingly, these loans have been recorded as assets and are included in Loans and Advances, with an equal corresponding liability.

19. Other creditors

This balance contains dividends payable of HUF 1,938 million (1997: 2,308 million).

20. Subordinated debt

On December 20, 1994 the Bank issued to the State subordinated bonds in the amount of HUF 3,861 million maturing in 2014. The bonds bear interest at the rate equal to the average interest rate on discount treasury bills in the last 6 month period to the interest payment due date (at year end: 17.2%). This debt is subordinated to all other liabilities.

21. Share capital
Authorized and issued

		1998		1998	1997
Par value (in HUF)	**1,000**	**10,000**	**1,000,000**		
		Number		**Total**	**Total**
Ordinary shares		43,952	19,034	19,474	19,474
Employee shares				16	28
Non voting shares:					
Preference shares					
Cumulative		8,227		82	82
Non cumulative	105,200	24,548		350	350
Treasury shares	(5,252)	(6,652)	(507)	(579)	(555)
	99,948	**70,075**	**18,527**	**19,343**	**19,379**

22. Contingent liabilities and commitments
a) In the normal course of business the Bank enters into commitments for forward exchange contracts, guarantees, provision of credit and other engagements. These instruments involve various degrees and type of credit, interest rate, foreign exchange and liquidity risk.

Off Balance Sheet Items

	1998	**1997**
Commitments and contingent liabilities		
Guarantees of indebtedness	12,212	14,975
Letters of credit	2,725	840
Unused overdraft facilities/Nondisbursed approved loans	30,763	35,014
Options	3,088	806
Other commitments	29,127	3,114
	77,915	54,749
Forward transactions		
Forward – Securities	11,431	14,699
Forward – FX (notional, payable side)	–	1,550
	11,431	16,249
Spot transactions		
Spot FX transactions (notional, payable side)	2,045	4,218
Total Off Balance Sheet Items	**91,391**	**75,216**

b) Various legal claims exist against the Bank, all of which arise from the ordinary course of business. Management has reviewed all claims and have provided for anticipated losses, where loss is considered likely to occur. Management believes that, for the substantial majority of the claims on the Bank, either no loss will be incurred by the Bank or, if a loss is incurred, that the loss will be covered by the indemnification provisions of the Budapest Bank Share Purchase Agreement between GE Capital, EBRD and the Hungarian Government, dated December 15, 1995.

23. Foreign exchange exposure
The Bank's assets and liabilities, denominated in foreign currencies, are as follows:

	1998	**1997**
Assets		
Cash and deposits with the National Bank of Hungary	4,291	10,831
Customer loans and interbank	42,077	30,746
Trading securities	13,300	13,002
Other	1,956	1,316
	61,624	55,895
Liabilities		
Deposits	56,808	47,763
Interbank	3,899	12,596
Other	80	–
	60,787	60,359
Net foreign currency exposure, long/(short)	**837**	**(4,464)**

Foreign currency assets and liabilities are mostly denominated in USD and DEM.