CHIEF EXECUTIVE'S REPORT

The growth momentum of the Hong Kong economy extended into the first half of 2005, thus creating a more favourable operating environment for most businesses. Against this backdrop and through the effective implementation of its business strategies to improve net interest income, income structure and cost-efficiency while accelerating product development and market expansion, the Group was able to deliver an increase in operating profit as well as a substantial growth in profit attributable to shareholders.

We wish to emphasise that the business growth and positive developments recorded in this report should be seen as the direct consequence of the effective implementation of an enhanced development strategy, business model, corporate governance and corporate culture in the last couple of years. Our effort in those areas, especially after the reinforcement of our management structure last year through an open and competitive recruitment, have already begun to bear fruits, as reflected in our growth momentum and the higher value we have created for shareholders. Through our commitment and effort, the Group has firmly landed on the growth track and is moving forward in the right direction.

The Group's financial results for the first half of 2005 have been prepared in compliance with Hong Kong's new financial reporting standards that came into effect on 1 January 2005. The impact of the change on the Group's financial results is explained and analysed, where appropriate, in the Management's Discussion and Analysis section of this Interim Report.

Performance Highlights

For the six months to 30 June 2005, the Group recorded a profit attributable to shareholders of HK$6,522 million, up 16.9% from the same period last year. This growth was attributable mainly to higher operating profit, a substantial loan impairment allowance write-back as well as a property revaluation gain of HK$918 million. Earnings per share were HK$0.6169, up 16.9% from HK$0.5279 a year ago.

We are glad to see that total operating profit before impairment increased by 3.6% to HK$5,549 million, reversing a downward trend since 2001. Net interest income increased by 6.4% to HK$5,861 million on account of the rise in interest rates, the growth of loans and advances and our proactive management of the cost of funds. Non-interest income dropped by 6% during the interim period as a result of the fall in net fees and commission income.

There was a robust growth in loans, spanning through the corporate, personal, and overseas sectors. Advances to customers rose by HK$24,428 million or 7.8% in the first half of the year, higher than industry average. Loan-to-deposit ratio increased by 3.77 percentage points to 53.38% from end-2004.

With positive market conditions as well as effective risk management, the Group's asset quality continued to improve. Classified impaired loans dropped significantly by HK$2,876 million or 31% from end-2004. Classified impaired loan ratio down to 1.89% at 30 June 2005, compared to 4.12% one year ago.

Operating expenses rose marginally by 0.3%. The cost to income ratio dropped to 32.53% as compared with 33.24% of a year ago.

The return on average total assets increased by 0.13 percentage point to 1.61% and the return on average shareholders' funds was up 0.20 percentage point to 18.39%.

On 19 April 2005, Standard & Poor's upgraded BOCHK's BBB+ long-term credit ratings outlook to "stable".

Business Review

The Group's business focus in the first half of 2005 was on delivering higher growth, higher return and higher asset quality. We achieved these goals.

Retail Banking

The Group's retail banking business operated under a mixed environment where improved market conditions and household income drove the growth of residential mortgage and card business but the rise in deposit interest rates inevitably brought new challenges to the wealth management business.

The good performance of our mortgage business was sustained in a relatively buoyant residential property market through effective sales and marketing. The mortgage loan balance increased by 8.2% in the first six months of 2005, outperforming the market average. More importantly, we adjusted our pricing strategy and reducing cash rebates in respect of new mortgage loans since the second quarter, which should help improve the yield.

Fees and commission income derived from the distribution of wealth management products decreased as higher deposit rates attracted part of customers' personal investment to time deposits. However, the customer base and asset base of our wealth management business strengthened further with the introduction of Wealth Management VIP service in January and Wealth Management Prime service earlier. In the first six months of 2005, the number of Wealth Management customers and the amount of assets under management grew by 30% and 23% respectively. The Group's agency business relating to stocks, insurance and funds as well as personal wealth management also kept on developing. This, aside from being conducive to the improvement of the Group's income structure, would also help accelerate the transformation of the Group's service model.

Our card business also benefited from the economic upturn and consumers' higher propensity to spend. Card spending volume and merchant acquiring volume grew strongly by 20.4% and 21.5% respectively year-on-year.

Corporate Banking

With a stronger management, the Group's corporate banking business resumed its pace of growth and development under the new customer-centric business model and customer relationship building platform introduced last year. Capitalising on the economic upturn, we achieved an increase of 8.9% in our corporate advances and others in the first half of 2005. The quality of loans also improved through effective collection, write-off and risk management.

We have maintained our position as a leader in corporate and institutional banking and in arranging syndicated loans. We have also made much progress in growing our SME business and trade financing, which are our strategic priorities, through service enhancement and customisation. Loans to SMEs grew by 9.1% in the first six months of the year, while trade finance increased by 20.9%.

Significant progress was made in developing the cash management business with an increase in the number of key customers and business generated.

Mainland and RMB Business

Since the inception of an enhanced China-related business model early this year, our Mainland branches have been working more closely with the Group's Corporate Banking and Retail Banking Departments in its Hong Kong headquarters to bring about a higher degree of synergy and business growth. Loans and advances rose by 40.0% while operating profit before impairment grew by 94.5%. We also made considerable progress in expanding the scope of services of our Mainland branches and launching new products in the interim period.

We have remained the local market leader in personal RMB banking services. Personal RMB deposits recorded a hefty increase of 63.8% in the first six months of the year. We also maintained our leading position in the issuance of RMB credit cards. The total number of RMB cards issued increased 23.3% by end-June. Since the launch of the China UnionPay Card in early 2004, we have enjoyed a leading position by a large margin in the market.

Treasury

Following the move by the US Federal Reserve to raise interest rates, the Group's Treasury effectively reallocated and diversified its investment portfolio for better gains.

The turnover of the Group's customer-driven business was affected by a relatively quiet local equity market and foreign exchange market at the beginning of the year. However, we succeeded in developing retail structured deposits that would become a platform for offering other structured products in the future.

Channels and Technology

The Group's ongoing project to renovate and upgrade branches to align with its business strategies proceeded smoothly. As at end-June 2005, the number of branches in Hong Kong was 285, compared to 283 six months ago.

Since 2002, the Group has been implementing the IT Blueprint for the purpose of enhancing its core banking system, customer relationship management, management control systems and IT infrastructure development. To keep abreast of technological advancement and ensure that the Group's IT infrastructure can support various units in upgrading their capability and productivity for growing businesses and developing new services, our Chief Information Officer and IT team have been actively updating and adjusting the IT Blueprint in the past few months. The IT Department itself was restructured so that it can perform its diverse and important roles more proactively and effectively. This is a major transformation process involving projects that would span the next three years or more. We firmly believe that the resources to be invested in it will prove to be well justified for uplifting the Group's service quality and competitive edge in the long run.

Prospects and Strategies

While we are basically optimistic that market sentiments and business prospects would still be favourable in the second half of 2005, we are also aware of the need to manage the challenges that may arise in order to sustain growth and, above all, deliver higher profitability. Notwithstanding the external environment, we will strive to grow our business and increase our operating profit under our newly-refined business models and strategies, which have proven to be effective under the Group's enhanced management structure, corporate governance, risk management and corporate culture.

One of the crucial factors affecting business growth is that local interest rates are expected to further increase to keep up with USD interest rates. This would have both positive and negative impact on the banking industry. The obvious upside is mortgage interest would stay at a more reasonable level, which is a plus factor for growing interest income. Secondly, it should create more leeway for the tier pricing of deposits, though the benefits of which would be offset to some extent by deposit migration to the higher-yield end. At the same time, it would probably be more challenging to grow loans and wealth management products. We are also mindful that increased uncertainty with regard to interest rates, yield curve and exchange rates might bring volatility to the treasury business.

For the Group, we believe that top-line growth in the foreseeable future would come mainly from the improvement of interest spread, higher demand for lending, increase in income from high-margin products and services. In this regard, we will continue to make the best use of our extensive branch network and customer relationship building platform. In spite of the challenges we would face with regard to wealth management caused by higher deposit rates, it is still our policy to further upgrade our customer base and asset base for longer-term gains.

The relatively high growth recorded by the Group in corporate and personal loans should lay a solid foundation for the increase in net interest income in the second half of this year. It is also a key factor for us to further improve our profitability going forward, with emphasis placed on optimising the structure of our loan portfolio and enhancing loan yields. Of course, we are very much aware that prudent management of deposit rates in view of the rise in interest rates is another crucial factor for higher profitability.

To explore the vast potential in the Mainland market, we will continue to leverage the effective business model to grow our China-related business and offer quality cross-border services to customers. We are also confident that our expertise and experience in RMB services will give us unique advantages for the further extension of the RMB banking business in the foreseeable future.

Last but not least, in anticipation that operating costs may rise with the return of inflation, we will focus on maintaining optimal cost-efficiency in the remainder of the year and beyond.

Vote of Thanks

Finally, I wish to thank the Board of Directors for their guidance and advice. I also wish to thank all my colleagues for their loyalty and wholehearted support. I know I can continue to count on them for realising the Group's vision to be customer's premier bank and creating superior value for shareholders.

HE Guangbei
Vice Chairman & Chief Executive

Hong Kong, 18 August 2005