



Soft retail prices and falling property prices

Decline in consumer prices

Strong export growth

HONG KONG ECONOMY

Following the recovery in economic activity in 1999, Hong Kong's economic revival gathered momentum in 2000, with GDP attaining a double-digit growth of 12.5% in real terms in the first nine-months of 2000. However, after the sharp rebound, and bearing in mind the expected slowdown in global economic activity, Hong Kong is expected to achieve to a more steady pace of economic growth. For 2000 as a whole, real GDP is forecast to grow by 10.0%.

However, underlying this impressive headline performance, was a less than robust internal economy. Private consumption was weak in nominal terms, with retail sales rising just 2% in value terms, and residential property prices falling 15% on average during the year. Unemployment drifted lower throughout the year to finish at 4.5%. However, this trend failed to stimulate domestic demand, partly because real interest rates remained stubbornly high, as interest rates increased through most of the year and deflation persisted. This situation allowed Hong Kong to become more price competitive, but it discouraged investment, which recorded a positive growth of 5.1% in the first half of 2000 over a year earlier, only slightly reversing the 17.3% decline in 1999. Also, most of the increase in investment was due to the start of several Government-run infrastructure projects such as the West Rail Link. Overall, the process of economic recovery did not broaden to the domestic sector in 2000.

This was reflected in consumer prices, which fell throughout the year. However, the decrease narrowed appreciably, from -5.3% in the beginning of the year to -1.8% in December in terms of the Composite Consumer Price Index. Labor costs and property rentals have shown signs of bottoming out in recent months, although in overall terms price pressure from domestic sources is still subdued. Intense competition has meant local retailers have continued to give large discounts to promote sales. Also, there was a continued freeze in government fees and in a number of public utility charges.

The global economic environment bolstered Hong Kong's exports of goods and services in 2000 – particularly in the early part of the year. In fact, the recovery in GDP 2000 was almost entirely export-led. On the back of continued brisk import demand both from within the region and in Hong Kong's traditional overseas markets, exports of goods surged by

16.6% in 2000. Exports of services also recorded an accelerated growth of 15.2% over the same period. But import of goods also staged a sharp rebound, rising 19% during the year, stimulated by retained imports to support the export demand and the pick-up in domestic demand. The combined visible and invisible trade account nevertheless remained in surplus, at HK\$34 billion for the year.

HONG KONG BANKING

In line with the rise in US interest rates, the Hong Kong dollar savings deposit rate and the Prime lending rate were raised by a total of 100 basis points in 2000, to 4.75% and 9.50%, respectively. Hong Kong dollar inter-bank interest rates had been on a rising trend since the beginning of the year, with 3-month interbank interest rate reaching around 7% in mid-May. They then started to ease as signs of a slowdown in the US economy alleviated concerns over a further tightening of monetary policy by the Federal Reserve.

Rising interest rates

As the domestic economy showed signs of recovery, domestic credit began to bottom out in the first half of the year. Total outstanding domestic Hong Kong dollar loans recorded a modest year-on-year rise of 2.8% over the year, after spending most of the year recording negative growth rates. This represented a significant moderation over the 10% decline at end-December 1999. However, with excess liquidity in the economy, and sluggish demand for loans, pricing competition intensified, pressuring the net interest income margins of banks. This was particularly so in the residential mortgage market, where competitive pressures lowered the price of a mortgage to below the Prime lending rate. This trend was alleviated by an improvement in the overall quality of the loan portfolio of banks in Hong Kong. For local banks the share of classified loans decreased from 9.8% in December 1999 to 7.7% as at 30 September 2000. The consolidated capital adequacy ratio of local banks was 18.7% at the end of September, the same as at the end of 1999.

Slow loan growth



The prospects for the Hong Kong economy beyond the short-term remain bright, benefiting from the sustained robust growth in China, fuelled by investment ahead of the mainland's accession into the World Trade Organization, as well as the further economic integration of Hong Kong into the Chinese economy. Recent cuts in interest rates will help to stimulate domestic demand in 2001, which should compensate for the expected weakness in Hong Kong's export performance. Trend GDP growth for the medium-term is forecast at 4%.

Bright prospects for 2001

8% GDP growth

Strong growth in industrial output and foreign trade



Revived consumer spending

Stable Renminbi

CHINA ECONOMY

China's economy grew by 8% in 2000, reversing the downward trend of the past several years. Rapid growth in the industrial, trade and service sectors spurred this growth.

China reported US\$284.6 billion in total industrial output for the entire year, an increase of 11.4% over the same period in 1999. This was led by increased trade activity. For the full year, exports surged 27.8% year-on-year to US\$249.2 billion. Imports grew by 35.8% to reach US\$225.1 billion, allowing China to enjoy a visible trade surplus of US\$24.1 billion.

Due to the government's active fiscal policy, fixed asset investment grew by 12.6% in the first 10 months of the year to reach US\$189.7 billion. Of that total, the state-owned sector contributed US\$106 billion, up 8.5%.

The economy's consumer market was quite active during the year with the Government engineering several incentives to boost consumption. Retail sales of consumer goods reached US\$410 billion during the period, an increase of 9.7% over the same period in 1999.

In 1999, the central government pursued a series of policies to enlarge demand, which resulted in prices falling more slowly. This produced results in 2000, as the Consumer Price Index edged up by 0.4% in the year, a sign of improvement following repeated falls in the past two years.

The surge in trade activity was matched by a rise in contractual foreign direct investment (FDI) in 2000, which amounted to US\$62.7 billion, 52% higher than the contracted FDI recorded in the same period in 1999. Actual FDI rose just 1% to US\$40.8 billion.

The Renminbi remained stable against the US dollar, and exchange reserves continued to rise, reaching US\$165.6 billion at the end of December, US\$10.9 billion more than at the end of the previous year. The authorities have allowed the Renminbi to appreciate slightly above its usual trading range in preparation for a widening of the band, possibly in 2001.

The Central government decided to enforce more vigorously an active financial policy, such as issuing a greater amount of treasury bonds, increasing investment and adjusting policies for income distribution, as

well as foreign trade and domestic taxation. All of these resulted in an effective expansion of demand, and stimulated economic growth.

Efforts were also made to bring a financial policy into play. Interest rates and bank required deposit reserves were lowered, allowing consumer credit and the central bank's loans to small- and medium-sized financial institutions to increase. At the end of December, the outstanding amount of all loans was RMB10,440 billion, up 12.1%. Money supply was also appropriately increased in a deflationary environment, with M2 rising 12.3% for the year. All these measures promoted domestic demand and economic growth, which is expected to continue into 2001. However, China's eventual accession into the World Trade Organization will bring a mixture of benefits and competitive pressures.

IBA ACTIVITIES

Against this encouraging but somewhat fragile economic background, International Bank of Asia achieved remarkably strong financial results for the year ending 31 December 2000. Profit attributable to shareholders increased 925% to HK\$244 million, powered by increases in net interest income and other operating income while specific provisions declined substantially. Outpacing the Hong Kong banking industry, IBA grew its loan portfolio by 29% compared to less than 3% for the industry as a whole, with advances to customers reaching HK\$17.4 billion. Total assets reached HK\$29 billion, up 22% over 1999. Customer deposits rose an equally impressive 24% to HK\$23.4 billion, and IBA's HK\$800 million certificate of deposit issue raised medium term funds to HK\$1.2 billion. Shareholders' funds climbed to HK\$3.42 billion, giving a capital adequacy ratio of 18.1%. Return on assets rose to 0.93% compared to 0.10% in 1999 while return on average equity surged to 7.3%, a ten fold increase over the previous year. Despite the downward trend in interest rates, IBA's net interest margin was essentially unchanged at 2.93%, one of the highest among Hong Kong banks. IBA declared a final dividend of 5 cents, for a full year total of 8 cents, up 60% over 1999.

Anticipating the upturn in the economy, IBA positioned itself at the beginning of the year to achieve growth through the introduction of new products, the opening of the first Superbranch, the expansion of the Investment Center network, increased advertising and promotional programs, and the exploitation of both technology and strategic partnerships with the Bank Consortium and Winterthur Insurance.

Net Profit rose 925%

Net interest margin - one of the highest in Hong Kong

Introduced new products and Superbranch



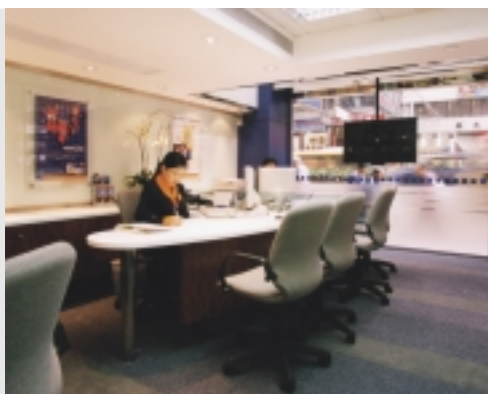
Strong loan growth across the board

Loan growth started in the second quarter and was achieved across the board, led by a 68% increase in high yield hire purchase loans and more than 30% increase in consumer loans including both credit card and personal loans. Corporate lending also grew by almost 30% through the expansion of the customer base. Residential mortgage loans also rose at a healthy double-digit rate.

Strong growth in high yield customer loans

IBA Credit, the bank's wholly-owned hire purchase and leasing subsidiary, achieved extraordinary growth in industrial equipment and motor vehicles. The subsidiary has expanded its range of products to include consumer finance and personal loans, which will make a major contribution to income in 2001. IBA's credit card operations continued to be an industry leader with the redesign of its successful myCard for women and the introduction of the Magiccard, which is linked to an exclusive website. IBA's residential loan portfolio is comprised of loans to families, with the average loan being approximately HK\$1.6 million at inception. The widely diversified portfolio is one of the keystones of the bank's business.

Making banking simple attracts deposits



The strong growth in customer deposits arose from targeted marketing through the branch network, and a focus on customer value. IBA believes the quality of service offered to customers is key to growth, and implemented a special service pledge in each of its 27 branches. Upgraded operating systems, specialized training and innovative monitoring has won the praise of customers throughout the system. IBA has promised to make banking simple for its customers, enabling them to enjoy more time with their family and friends while knowing their financial needs are in secure hands. The opening of the Causeway Bay Superbranch, created through the merger of the Percival Street and Causeway Bay branches, had a notable impact. Established clients reacted favorably to the larger and more friendly facilities, increasing their deposits, and the image of a well-established institution served to attract new customers. The result was an increase of more than one-third in deposits in a period of less than 6 months.

Oversubscribed HK\$800 million FRCD issued

After the revival of the FRCD market which had been dormant during the Asian financial crisis, IBA raised its largest ever pure Hong Kong dollar FRCD. Going to market for HK\$500 million, the bank enjoyed an overwhelming reception, with the oversubscription raising the total issue to HK\$800 million. Private placements during the year raised an additional HK\$350 million in medium term funds.

Liquidity remained high, averaging 43% for the year. As usual, IBA was a net lender in the interbank market throughout the year, consistently placing more than HK\$4 billion. Investments increased 18% to HK\$2.6 billion, consisting of Hong Kong Exchange Fund paper, bank FRCDs and highly rated corporate bonds. Despite the strong growth in loans, the loan-to-deposit ratio stood at 71% at year-end.

High liquidity

Interest income rose 10.5% to HK\$2.0 billion as a result of the expansion of the loan portfolio. The momentum accelerated in the second half, with interest income up 16% in the final six months of the year, reflecting the full benefit of bookings beginning in the second quarter. Interest expense rose 13% year-on-year to HK\$1.3 billion despite the 24% increase in customer deposits and 29% increase in medium term funding, reflecting IBA's traditional tight control over funding costs. Net interest income was up 6% to HK\$704 million. The net interest margin improved from 2.86% in the first half of 2000 to 2.96% in the second half reflecting better loan mix and favorable funding costs. The net interest margin for the full year was 2.93%, almost identical to 1999's 2.94%, which was impressive in the face of the strong downward pressure on mortgage yields.

Steady growth in interest income

Other operating income soared by 73% to HK\$205 million as a result of strong increases in loan fees, securities brokerage, credit card commissions and merchant fees, insurance commissions and trade finance fees. Other income continued to grow throughout the year, with second half fee income rising 45% over the figure for the first six months of 2000. Other operating income increased to 23% of total operating income in 2000, compared to 15% in 1999.

73% growth in non-interest income

IBA Securities, the brokerage arm of the bank, doubled turnover and brokerage fees. With Investment Centers operating in Mongkok, Yuen Long, Shatin and Causeway Bay, almost 60% of business volume is now transacted in these modern and convenient locations. IBA has also increased the range of investment services it offers customers, including a broad spectrum of life and general insurance products such as IBA Swiss Link, a unique long-term savings program developed by Winterthur Life Insurance specifically for IBA customers. As a member of Bank Consortium Trust, IBA has been able to offer Mandatory Provident Fund services to customers as well as increasing the number of payroll accounts for corporations. IBA has been an active participant in the expansion of the Consortium's activities, including club lending to large corporations and internet banking.

Two new investment centers



The growth in the number of credit card holders, achieved through the introduction of new cards, the redesign of the unique myCard, and an attractive range of benefits for cardholders, boosted fees. IBA's Credit Card Division also services thousands of merchants in Hong Kong, generating important handling fees. IBA recently added internet payment services for merchant clients as well.

Rising productivity

Operating income rose 16% year-on-year to HK\$909 million. The increase from the first half of the year to the second half was 22%. Operating expenses rose 13.5% to HK\$439 million. This reflected the resumption of broad scale advertising in line with economic recovery and the first salary increase in two years as well as further investment in technology. These investments in business expansion showed immediate payoffs as the cost income ratio actually declined year-on-year from 49.4% to 48.3%. IBA also expanded its staff to cope with business expansion and to upgrade customer service. Headcount stood at 583 as of year-end 2000, an 8% increase over the previous year. During 2000, assets per employee rose 3% to HK\$47 million, while profit per staff was up 887% to HK\$438 thousand. Staff productivity and measured investment in the future remain hallmarks of IBA, resulting in a 19% increase in operating profit before provisions, reaching HK\$470 million.

Sharp decline in provisions

Specific provisions declined by 58% to HK\$184 million as the Hong Kong portfolio remained stable and resolution of overdue PRC loans commenced. During the year final payments were received from a number of PRC borrowers, resulting in the release of excess provisions. Guangdong Enterprises signed a final agreement with its more than 200 bank creditors in the largest debt restructuring conducted in Hong Kong. The increase in total loans during 2000 caused an increase in general provisions by HK\$10 million in contrast to the reduced amount of total loans in 1999.

Profit before tax increased by 1,162% to HK\$276 million

Profit before tax rose more than 1,100% to HK\$276 million on the combined result of increased interest and fee income and lower provisions. After benefiting from the Hong Kong Government's general tax rebate in 1999, IBA paid additional tax in 2000 as a result of the ten-fold increase in profits. Net income after tax rose 925% to HK\$244 million. Second half net profit exceeded first half profit by 25%, reflecting the momentum that built during the year. Return on average assets jumped to 0.93% in 2000 compared to 0.10% in 1999. The return improved over the year from 0.88% during the first six months to 0.98% in the second half. Return on average equity improved ten-fold from

0.72% in 1999 to 7.30% in 2000. This ratio improved from 6.55% for the six months ending June 2000 to 7.94% for the six months ending December 2000. The weighted average earnings per share stood at 21 cents in 2000 compared to 2 cents in 1999.

In 1996 IBA received the Hong Kong banking industry's first full rating from Standard & Poor's. At that time, in the midst of Hong Kong's economic boom, IBA was granted an A-3 short-term and BBB long-term rating. It is a pleasure to report that those ratings have remained unchanged since 1996, and that after completing the annual review of IBA's business and portfolio in May, S&P reaffirmed the ratings once again.

S&P rating reaffirmed

IBA faces new challenges in 2001. The rapid slowing of the US economy, Hong Kong's second largest trading partner, threatens to limit growth, although the cuts in interest rates orchestrated by the Federal Reserve are mirrored in Hong Kong as a result of the link between the US dollar and the Hong Kong dollar. It is still unclear if this welcome relief in real interest rates will stimulate consumer spending and a recovery in the property market. These sectors are essential to lifting loan demand in Hong Kong.

New challenges

Hong Kong will carry out the final stage of interest rate deregulation in July 2001, which may cause some momentary disruption in the markets as banks become accustomed to free competition. IBA believes this is a positive step, which, along with the implementation of a deposit insurance program in the near future, will create a level playing field. While some observers opine that deregulation will put added pressure on smaller banks, in the end it is the level of service and the ability to understand market trends and manage funding costs that result in success.

Further deregulation

Further advances in technology and more widespread use of internet capabilities present both opportunity and challenge. Internet banking can reduce operating costs and increase customers in the long run, but in the initial period there is an extended learning process for both customers and banks. IBA is implementing a well-designed strategy which will deliver customer value within a framework of adequate control, ensuring that the bank maintains its strong position in the middle market. Expanded consumer products offered through the retail branches, credit card operations and consumer hire purchase will expand the customer base and increase net interest margins. The opening of

New banking channels

additional Superbranches and Investment Centers, including a New Territories Headquarters in Tsuen Wan, housed in a three-story building acquired especially for this purpose, will strengthen IBA's reputation. A new Small and Medium Enterprise lending unit to supplement the established position in the SME sector attained by IBA Credit will increase the corporate customer base.

IBA-DePaul program

People remain IBA's most valuable asset. In addition to a robust training program in technical skills, IBA completed the fourth year of its unique collaboration with DePaul University of Chicago, one of the leading institutions in mid-career education. The second group of IBA-DePaul MBA students, numbering 20, completed their 2-year program in December, while another 24 staff are in the final months of a Bachelor's Degree program. Both programs bring DePaul professors to Hong Kong to teach 6 week courses in a specially built lecture hall in the IBA Headquarters Building in Central.

Good prospects in 2001

IBA has identified market segments that are seeking quality banking services. Our principle, "Banking made simple", appeals to these segments, and this will be emphasized in a major corporate advertising campaign during the year. IBA intends to match the record of growth in assets and profit achieved during 2000 again in 2001.