

ECONOMIC REVIEW

The global economy faced significant uncertainties following the events of September 11, 2001 and this impacted the performance of the Hong Kong economy early in 2002. However, there have been signs recently of a revival in business activity, particularly in the trade sector, which offers some degree of optimism for the performance of the economy in 2003. However, Hong Kong's open economy will be subjected again to global economic forces and the impact of China's accelerated development since its accession to the World Trade Organisation.

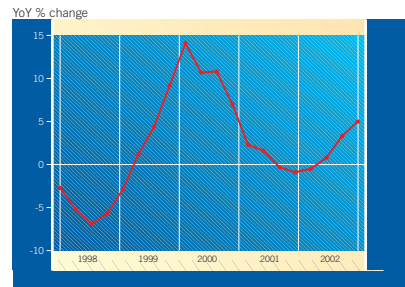
The shape of the revival in economic activity in the course of 2002 was similar in nature to the performance of 2000, only the extent of the recovery was much more shallow. Trade dominated the better than expected recovery, allowing the Hong Kong government to revise its full year GDP forecast higher on two occasions during the year.

Unfortunately, domestic consumption remained subdued, with rising unemployment culminating in a record high unemployment rate of 7.8% dampening private consumption, as reflected in the 4.1% decline in retail sales. Hong Kong entered its fifth year of deflation, with prices in 2002 falling 3.0%, due to lower wages and rentals and weak consumer confidence. Import prices were soft, amidst persistent deflation in the major supplier economies. The greater propensity of individuals to seek creditor protection by filing for bankruptcy accelerated in 2002, with the number of bankruptcy orders rising 177% to 25,328 in the year. Generally, consumer confidence ebbed to a new low in the year, with sentiment only picking up slightly at the end of the year. Even an 18% increase in tourist arrivals, mostly from mainland China, failed to lift overall consumer spending.

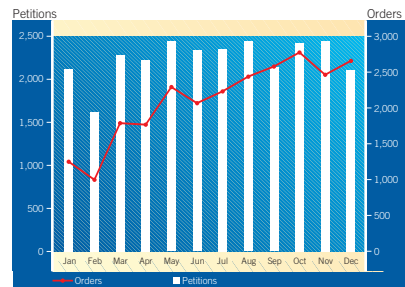
Mass residential property prices fell approximately 10% during the year. Property market transactions fell 5% to 85,921 with most of the decline attributed to slack in the secondary market. Grade A office was impacted by new supply and weak demand due to downsizing and rationalisation by the corporate sector. The Government's nine-point housing property measures program was formally announced in November, providing hope for a stabilisation of property prices. According to the Hong Kong Monetary Authority, the amount of mortgage loans in negative equity was 24% at the end of the year, affecting 76,686 households. Local banks are offering mortgage insurance schemes to alleviate the pressure on homeowners in negative equity.

Gradual revival of the economy...

GDP Growth

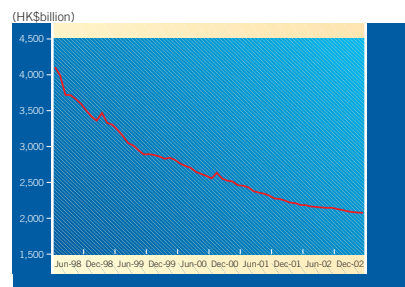


Statistics of Bankruptcy Petitions and Orders in 2002



...but continuing domestic weakness

Hong Kong Loan Outstandings





Externally, trade improved as the year progressed, with total trade in 2002 rising 5%. This acceleration was because Hong Kong's peak shipping season was later than usual in 2002. Within the total exports of goods, re-exports rose 7.7%, but domestic exports fell 15%, with this weakness reflecting a structural shift away from domestic exports to re-exports and offshore trade. The accelerated pace of growth in re-exports and a larger replenishment of inventory lifted the import of goods by 3.3% in 2002.

Against this backdrop of variable strengths and weaknesses in the local economy, IBA's strategy for 2002 focused on the basics of banking: know your customers, assess risks stringently, lower funding costs, manage expenses and achieve acceptable returns for shareholders.

IBA PERFORMANCE

Net interest income for 2002 was HK\$728 million compared to HK\$758 million in 2001. The decline in market rates (one-month HIBOR averaged 1.82% in 2002 versus 3.71% in 2001) along with lower loan outstandings reduced interest income by 34%. Interest expense declined 58% to HK\$402 million as a result of the successful promotion of low cost deposits. The Bank's flagship deposit product, the Magic Money Manager, drew more than HK\$2.6 billion in balances, helping raise low cost deposits to almost 20% of total customer deposits. Interest expense reductions were also a result of the successful callable certificate of deposit programs placed with retail customers, raising HK\$810 million in low cost medium term funds.

Other operating income (excluding gains on the securities portfolio reported separately below) recorded strong growth, with commissions on the sale of investment products rising sharply. Credit card commissions and loan fees also performed well, contributing to the 7% increase in total fees to HK\$151 million.

Operating expenses were reduced for the second consecutive year, down 6% to HK\$457 million. Streamlining of operational procedures and intensified training including Six Sigma methodology for reducing cycle time and errors increased productivity and capped staff compensation. The Bank was also judicious in its promotional expenditures in the face of reduced economic activity. As a result, operating income reached HK\$423 million, 2.4% higher than 2001.

*Magic Money Manager
attracts more low-cost
deposits*

*Strong performance in fee
income*

*Increased productivity,
reduced expenses*

Directors' Statement (continued)

The sharp rise in bankruptcy petitions submitted to the Official Receiver's Office affected all banks, and IBA was not immune from this phenomenon. While corporate credit quality continued to improve, as evidenced by the decline in non-performing loans to 1.7% (compared to 5.0% in December 2001), the lowest level in five years, provisions for individual delinquencies caused total provisions for bad and doubtful debts charged to the income statement to rise to HK\$339 million, an increase of 46%. This figure was affected by a one-time charge resulting from a change in the timing for provisions on bankruptcies, accelerating the charge to income. New risk management procedures implemented in the second half of 2002 have contributed to a decline of specific provisions, a hopeful sign for the future.

Despite the fact that the interest rate environment was not as favourable as 2001 for crystallizing gains on the securities investments, the bond portfolio produced HK\$170 million in profits for the year, compared to HK\$132 million in 2001. This resulted from the upgraded capabilities of the Treasury Division and the meticulous application of portfolio management tools.

Profit attributable to shareholders declined from HK\$295 million in 2001 to HK\$225 million in 2002, reflecting the poor economic conditions and decline in loan demand.

Total assets rose from HK\$28.2 billion at the end of 2001 to HK\$32.3 billion as of December 31, 2002. The balance sheet was highly liquid, with short-term funds jumping 133% to HK\$12 billion. Loans declined by HK\$1.4 billion to HK\$15 billion, mirroring the statistics for the banking system as a whole. As the year neared an end, the duration of the investment portfolio was shortened in anticipation of a reversal of interest rate trends.

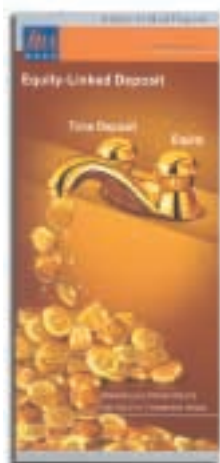
Reflecting the high liquidity of the balance sheet, the liquidity ratio averaged 49.8% for 2002 compared with 43.7% in 2001, well above the statutory requirement of 25%. The Bank's strong capital base was reflected in capital adequacy of 21.4% at the end of 2002, compared with 19.7% in 2001. These healthy ratios contributed to Standard & Poor's reaffirmation of IBA's A-3 short-term, BBB long-term, credit ratings during the year.

IBA was one of the first local banks to issue retail callable certificates of deposit, in May 2002. This innovative product introduced hundreds of new customers to the Bank. IBA has recently rolled out more deposit products, such as a foreign currency-linked deposit and equity-linked

\$170 million in investment gains

Assets rose by HK\$4 billion

High liquidity and capital adequacy



IBA launches innovative deposit products

deposits, to further broaden the Bank's appeal to depositors. Total customer deposits rose by 2.9% to HK\$22.9 billion despite the fact Hong Kong consumers continued to look for higher yields on investment products, which contributed to the sharp rise in IBA's non-interest income. IBA will be introducing more treasury-related products during the course of 2003, to match an ever-increasingly sophisticated customer.

As noted, there was a significant shift into lower cost deposits, helping protect IBA's lending margins. IBA was designated a Market Maker by the Hong Kong Monetary Authority in June 2002. As an active participant in both the primary and secondary markets in Exchange Fund, Hong Kong Mortgage Corporation and Mass Transit Railway Corporation paper, the bank has a position which appears in the short term funds, investments and short position in Exchange Fund Bills account.

IBA's business continued to diversify in 2002 with the introduction of new products, expanded Treasury capabilities and new delivery channels. The wealth management centre concept was further enhanced through the opening of mini-wealth management centres at selected retail bank branches, while another full wealth management centre will be opened in North Point shortly, bringing the number to eight. Enhanced information technology systems, including the installation of a data warehouse and a customer relationship management system have also enhanced the Bank's ability to serve its customers.

Corporate governance has always been a priority at IBA and this function was further enhanced through the active participation in matters relating to transparency and access of the IBA Corporate Governance and Compliance Officer.

Mike M. Murad

Vice Chairman, Managing Director and Chief Executive Officer

Hong Kong, 25 February 2003