CHAIRMAN'S STATEMENT

It gives me much pleasure to report that despite a challenging interest rate environment, the Group's total operating profit for the six months ended 30 June 2005 reached HK$6,984 million, up 5.88% over the same period in 2004. Profit attributable to the equity holders of the Company was HK$6,522 million, up 16.86% from the same period last year. This substantial growth was due mainly to a 6.39% increase in net interest income, an investment property revaluation gain of HK$918 million, a write-back of HK$327 million impairment allowances on advances as a result of the adoption of new accounting standards and strong recovery of loans previously written-off. Earnings per share were HK$0.6169, up from HK$0.5279 a year ago. The Board has declared an interim dividend of HK$0.328 per share (2004 interim dividend: HK$0.32 per share).

The Hong Kong economy continued to flourish in the first two quarters of 2005, giving rise to a better operating environment for the business sector. Domestically, GDP growth was sustained by strong consumption demand, an improving job market and a vibrant property market. Externally, exports grew strongly due to increasing trade flows originating from the Mainland and a relatively weaker USD in the early months of the year. Investment demand increased as the business outlook in general was looking positive. On the other hand, the banking sector was impacted by consistently low interest rates in the first quarter followed by surging rates in the second quarter.

Riding on the economic upturn that has given rise to a stronger demand for credit and banking services, the Group has continued to pursue growth and excellence through a proactive business strategy that stresses higher yield and higher asset quality. I believe that the further strengthening of our management structure, the various corporate reforms carried out last year, the enhancement of corporate governance and risk management as well as the concerted effort of the staff are also crucial contributing factors to the Group's good performance so far this year.

In the first six months of 2005, the Group's corporate and retail banking businesses registered remarkable growth in loans and advances, especially in terms of trade finance, corporate loans, residential mortgages and credit card receivables. The expansion of our local SME business has made good progress since last year whereas our Mainland business continued to record phenomenal growth in the period under review.

As a result of proactive efforts in managing our interest rates amidst contracting margins during the first quarter, we successfully improved our net interest margin for the six months ended 30 June 2005 compared to the same period last year and achieved a satisfactory improvement in net interest income.

The improvement of asset quality has remained a top priority for the Group. The upturn of the economy and our persistent effort in de-risking our corporate loan portfolio have resulted in considerable progress made by us in this area in the first half of 2005. The Group's classified loan ratio dropped significantly year-on-year.

In view of improved market conditions and the Group's business performance in 2004, the Board approved an increase of staff salary with effect from April this year.

Looking ahead, we believe the fundamentals of the Hong Kong domestic economy have become even stronger than a year ago and the current upturn should be sustainable, to be driven mainly by inbound tourism especially with the opening of the Hong Kong

Disneyland later this year. However, we must remain alert to external uncertainties that have become increasingly apparent. Most significantly, the escalation of oil prices and the rise of trade-related issues between the Mainland and the US and EU, if unresolved, will likely affect Hong Kong's overall trade outlook in the second half of 2005. The current trend of interest rate hike may also slow down the local property market and make it more challenging to grow the wealth management business.

In contrast, the recent reform of the RMB exchange rate regime and the possibility of a further expansion of the scope of RMB banking services in Hong Kong, hopefully in the not too distant future, will almost certainly improve, albeit in small measures initially, the operating environment of the banking sector. Our strengths in the RMB business have already been firmly established. We believe we are now in a highly advantageous position to benefit further from the gradual and orderly relaxation of the RMB currency control in the Mainland.

Despite the challenges we are going to face, our business strategy in the second half of 2005 will continue to focus on delivering higher profitability. We will continue to drive the growth of segments that promise higher yield and ensure higher asset quality so as to improve our pre-provisioning operating profit.

The corporate reforms carried out in the past year or so and the new management team have greatly strengthened the Group's position as one of the leading banking groups in Hong Kong, which ensures that we can continue to maximise our value for shareholders and customers. As a dynamic organisation, we will keep in constant review the results of the reforms, with a view to making adjustment or initiating new reforms as and when necessary in anticipation of market needs.

I wish to thank the Board of Directors and the Senior Adviser for their wise counsel. I also wish to thank all our staff for their dedication and hard work.

XIAO Gang
Chairman

Hong Kong, 18 August 2005