

REVIEW AND PROSPECTS

The Hong Kong economy, which had been improving since the second half of last year, was still showing signs of lingering vigor at the beginning of this year. Both the government and the business community were then optimistic about the economic performance of the local economy for this year. However, good times did not last long because of rapidly changing external factors. First of all, the Japanese authorities have announced that Japan's gross domestic product has shrunk for months in a row and that its unemployment rate has hit record high since the Second World War, shifting the entire Japanese economy into recession. Moreover, we kept hearing a raft of bad news from the United States. Ever since the Bush administration came into power, the once thriving US economy has taken a sudden dive for the worse, bringing about an adjustment period that has a dragging effect on the global economy. The Federal Reserve has since the first half of this year successively reduced interest rates six times by a total of 2.75 percentage points. The frequency of the rate reductions is unprecedented. This in turn implies that the shattering effect of the economic slowdown is impending. Urgent actions are needed to hopefully stage an early turnaround in order to avoid being caught in a whirlpool of deep recession that would hamper the normal development of the global economy.

The economies of East Asia depend to an extremely large extent on that of the United States. Although the Hong Kong economy is among the stronger systems in the region, it still finds it difficult to set its own house in order in the light of the gloomy economic conditions. The local government estimated earlier this year that there might be a 4 percent increase in the territory's gross domestic product. However, various forecasts that have been published over the past few months tend to reduce the GDP growth estimate for 2001 by a large margin. Hang Seng Bank, for instance, reduced its estimate to 2 percent in the July 2001 issue of its monthly economic report, while HSBC even lowered its forecast to 1.8 percent. In addition to the repercussions of the sluggishness of America, Europe and Japan on a macro scale, the local economy is still hampered by problems inherited from the earlier financial turmoil. Such problems include asset devaluation, personal and corporate financial difficulties, long-standing high unemployment rate, sagging investor confidence, dwindling consumer spending, and deflationary pressure. Though a turnaround is not expected in the short term, it is hoped that, as many scholars and experts have analysed and predicted, the series of rate reductions brought about by the United States would help ease the predicaments and resuscitate the global economy.

The Bank's unaudited, consolidated results for the first half of 2001 declined somewhat compared with those for the previous corresponding period. Net interest income sank 11.53 percent to HK\$413.75 million. Operating profit before provisions dropped 21.48 percent to HK\$280.27 million. Provisions for bad and doubtful debts have been drastically reduced by 30.4 percent to HK\$51.3 million. Profit attributable to shareholders amounted to HK\$202.31 million, a drop of 13.93 percent. As of 30 June 2001, total customers' deposits increased 12.67 percent to HK\$32.597 billion against last year's corresponding figure. Total loans and advances to customers (after provisions for bad and doubtful debts) edged down slightly by 0.33 percent to HK\$17.909 billion. Total assets rose 9.78 percent to HK\$39.912 billion. As of 30 June 2001, unadjusted capital adequacy ratio of 22.27 percent exceeded last year's corresponding figure slightly by 0.32 percent, while average liquidity ratio for the first half of 2001 increased 11.33 percent to 59.33 percent.

Loan-to-deposit ratio, as of 30 June 2001, stood at 48.04 percent, a drop of 10.84 percent against last year's corresponding ratio. The above figures essentially show that the Bank is not only amply capitalized and substantively sound but also persistent in pursuing its prudent management policy. A major reason for the reduced profit is that interest rates have been slashed successively six times by a total of 275 basis points, reducing the prime lending rate from 9.5 percent to 6.75 percent. Besides, the stock market as well as the property market are still in the doldrums. And loan demand remains soft. The Bank has been hit most directly by existing borrowers' continual requests for interest rate reductions on the back of intense competition within the banking sector. On balance, interest income has been reduced.

We have joined forces with certain fellow bankers to form BC Reinsurance Limited and Hong Kong Life Insurance Limited. The two companies have opened for business one after another in the first half of this year. Considering their satisfactory performance thus far, it is expected that they will generate respectable non-interest income for the Bank in the future. Moreover, we have also teamed up with three of our fellow bankers and iMerchants Limited to form Net Alliance Co Limited which became operational on 24 July 2001. Net Alliance aims specifically at providing customers with a more comprehensive, as well as a more convenient, range of internet banking services which will include internet securities trading and corporate banking services towards the latter half of this year.

Mr Nam Lee Yick, an executive director, resigned on 18 July 2001 to join his family in Australia. Mr Ryoichi Kato, a non-executive director, resigned today following his return to Japan. The board, on the other hand, confirmed today the appointment of Mr Tatsuo Tanaka, the General Manager of the Hong Kong Branch of the Bank of Tokyo-Mitsubishi, as a non-executive director as well as the appointments of two veteran members of the Bank's staff – Mr Lau Wai Man and Mr Frank Shui Sang Jin, who are accountants by training – as executive directors. I, on behalf of my fellow directors, would like to sincerely thank the two gentlemen who have just retired from the board and warmly welcome the ones who have now joined us as new board members.

It is expected that, by the end of this year to early next year, the economy will have benefited from the effect of the interest rate reductions and become progressively robust. However, as far as the performance of the banking sector is concerned, the second half of this year will still be troubled by hidden worries. The economy as a whole will continue to flag. Besides, in the wake of the full deregulation of the interest rate rules in July this year, fierce competition among our fellow bankers for deposit and lending business has worsened the operating environment. However, it is hoped that the Hong Kong economy will be invigorated by the gradual stabilization of the US economy, not to mention the stimulating effect brought about by China's successful bid to host the 2008 Olympic Games and its imminent admission to the World Trade Organization. In order to strengthen the Bank's competitive niche in the market, we will continue to work hard for quality lending portfolios and devote ourselves to the development of new products as well as business activities to generate non-interest income.

By Order of the Board

Liu Lit Man

Chairman & Managing Director

16 August 2001