

The trading transactions include positions arising from the execution of trade orders from customers and transactions taken to hedge these positions. No significant proprietary positions are maintained by the Group. The hedging contracts are used to hedge the Group's own exposure to market risks as part of its asset and liability management.

The replacement costs and credit risk-weighted amounts of the off-balance sheet exposures disclosed in parts (a) and (b) of this note do not take into account the effects of bilateral netting arrangements. They are assessed in accordance with the HKMA's guidelines which implement the Basle agreement on capital adequacy. Replacement cost represents the cost of replacing all contracts which have a positive value when marked to market. The credit risk-weighted amount refers to the amount as computed in accordance with the Third Schedule to the Hong Kong Banking Ordinance on capital adequacy and depends on the status of the counterparty and the maturity characteristics. The credit risk-weightings used range from 0% to 100% for contingent liabilities and commitments, and from 0% to 50% for exchange rate and interest rate contracts.

11. Foreign exchange exposures

The net positions or net structural positions in foreign currencies are disclosed as follows:

	2004					Total
	US Dollars	New Zealand Dollars	Australian Dollars	Others		
<i>Equivalent in HK\$ Million</i>						
Spot assets	10,713	23	367	1,446	1,423	13,972
Spot liabilities	(10,005)	(206)	(352)	(1,416)	(1,055)	(13,034)
Forward purchases	2,078	369	8	381	838	3,674
Forward sales	(2,781)	(187)	(21)	(393)	(1,206)	(4,588)
Net option position	0	0	0	0	0	0
Net long/(short) position	5	(1)	2	18	0	24

	2003					Total
	US Dollars	New Zealand Dollars	Australian Dollars	Others		
<i>Equivalent in HK\$ Million</i>						
Spot assets	5,467	914	547	1,290	947	9,165
Spot liabilities	(7,008)	(606)	(447)	(1,199)	(809)	(10,069)
Forward purchases	6,050	1,640	42	677	1,011	9,420
Forward sales	(4,579)	(1,951)	(132)	(737)	(1,149)	(8,548)
Net option position	0	0	0	0	0	0
Net long/(short) position	(70)	(3)	10	31	0	(32)

12. Cross-border claims

The information of cross-border claims discloses exposures to foreign counterparties on which the ultimate risk lies, and is derived according to the location of the counterparties after taking into account any transfer of risk. In general, such transfer of risk takes place if the claims are guaranteed by a party in a country which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another country.

2004 Figures in HK\$ Million	Banks and other financial institutions		Public sector entities	Others	Total
Asia Pacific excluding Hong Kong					
- Australia		297	0	332	629
- Singapore		2,314	0	53	2,367
- Others		647	4	381	1,032
North America					
- Canada		7	0	5	12
- United States		430	1,172	53	1,655
Caribbean					
- Cayman Islands		0	0	428	428
- Others		0	0	131	131
Western Europe					
- Belgium		127	0	0	127
- France		261	0	0	261
- Germany		320	0	0	320
- Italy		97	156	0	253
- Luxembourg		18	0	19	37
- Switzerland		527	0	0	527
- United Kingdom		1,967	0	1	1,968
- Others		1	0	5	6
		7,013	1,332	1,408	9,753

2003 Figures in HK\$ Million	Banks and other financial institutions		Public sector entities	Others	Total
Asia Pacific excluding Hong Kong					
- Australia		562	0	211	773
- Singapore		1,478	0	45	1,523
- Japan		15	0	0	15
- Others		3	0	71	74
North America					
- Canada		107	0	1	108
- United States		200	1,632	34	1,866
Caribbean					
- Bermuda		0	0	12	12
- Cayman Islands		0	0	81	81
- Others		0	0	80	80
Middle East - Bahrain		233	0	0	233
Western Europe					
- Belgium		15	0	0	15
- Germany		11	0	0	11
- Italy		2	156	0	158
- Luxembourg		41	0	19	60
- Netherlands		458	0	0	458
- Switzerland		227	0	0	227
- United Kingdom		1,237	0	7	1,244
- Others		5	0	0	5
		4,594	1,788	561	6,943

13. Capital adequacy and liquidity ratios

	2004	2003
Unadjusted capital adequacy ratio at year end	18.46	19.79
Adjusted capital adequacy ratio at year end incorporating market risk	18.22	19.72
Average liquidity ratio for December	50.06	57.89
Average liquidity ratio for the year ended 31 December	63.28	59.37

The unadjusted capital adequacy ratio is computed on a consolidated basis as required by the HKMA for its regulatory purposes, and is in accordance with the Third Schedule of the Hong Kong Banking Ordinance. The adjusted capital adequacy ratio incorporating market risk is computed on the same consolidated basis, and is in accordance with the Guideline "Maintenance of Adequate Capital Against Market Risks" issued by the HKMA.

The average liquidity ratio for the year is computed as the simple average of each calendar month's average ratio, as reported in Part I (2) of the banking return "Return of Liquidity Position of an Authorised Institution" (MA(BS)1E) calculated in accordance with the Fourth Schedule of the Hong Kong Banking Ordinance.

14. The components of the total capital base after deductions as reported under Part I of the banking return "Capital Adequacy Return" (MA(BS)3) calculated in accordance with the Third Schedule of the Hong Kong Banking Ordinance are as follows:

	2004 HK\$ '000	2003 HK\$ '000
Core capital		
Paid up ordinary share capital	1,172,160	1,172,160
Reserves (including retained earnings)	1,670,086	1,774,178
Share premium	749,778	749,778
Eligible supplementary capital		
Reserves on revaluation of land and interests in land	36,868	36,868
Reserves on revaluation of holdings of securities not held for trading purposes	(4,350)	1,917
General reserves for doubtful debts	145,919	126,239
Total capital base before deductions	3,770,461	3,861,140
Deductions from total capital base	(67,930)	(69,821)
Total capital base after deductions	3,702,531	3,791,319

15. Segment reporting

Segment information is presented in respect of the Group's business and geographical segments. Business segment information is chosen as the primary reporting format because substantially all of the Group's business is attributable to a single geographical segment, Hong Kong.

The Bank and its subsidiaries are principally engaged in the provision of banking and related financial services.

Retail Banking comprises the Consumer Banking and the Retail Distribution Network businesses. Consumer Banking comprises credit card merchant acquiring, provision of credit card advances, insurance and unit trust businesses. Retail Distribution Network business mainly comprises private banking, deposit account services, residential mortgage and other consumer lending.

Wholesale Banking comprises the Small and Medium Enterprise businesses and the Corporate Banking Business. Small and Medium Enterprise businesses includes both personal and corporate equipment financing, commercial lending to small and medium enterprises, automobile and other consumer leasing contracts and lending activities. Corporate Banking business covers trade financing, syndicated loans and other corporate lending.

Financial Market mainly provides securities brokerage, foreign exchange services and centralised cash management for deposit taking and lending, management of trading securities, execution of management's investment strategies in money market investment instruments and the overall funding of the Group.

Real Estate is responsible for the management and orderly realisation of the Group's repossessed properties and properties acquired under lending agreements.

Unallocated items mainly comprise the central management unit, management of investments in securities, premises and property management and other activities which cannot be reasonably allocated to specific business segments.

In 2004, there was reorganisation of business segments for internal reporting purpose. As a consequence, the former Retail Banking segment has been expanded to include a majority of the business of the former Consumer Banking segment, private banking, insurance and unit trust businesses. A new Wholesale Banking segment was established to include the Small and Medium Enterprise business and the Corporate Banking business. In addition, private banking, insurance and unit trust businesses of the previous Investment Banking were allocated to the Retail Banking. The directors consider that the reclassification of the business segments with reference to the Group's organisation and internal reporting structure provides a better segmental analysis.

The comparative figures have been restated accordingly to conform with the new business segments classification.

2004	Retail Banking	Wholesale Banking	Financial Market	Real Estate	Unallocated	Inter-segment elimination	Consolidated
	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000
Interest income from external customers	372,740	237,559	353,696	0	7,788	0	971,783
Interest expense to external customers	(273,240)	(31,469)	(55,516)	0	(1,377)	0	(361,602)
Inter-segment income	364,444	0	0	0	0	(364,444)	0
Inter-segment expense	0	(16,460)	(251,890)	(6,521)	(89,573)	364,444	0
Net interest income	463,944	189,630	46,290	(6,521)	(83,162)	0	610,181
Other operating revenue from external customers	121,287	22,567	75,269	6,361	13,025	0	238,599
Inter-segment revenue	0	0	0	0	31,866	(31,866)	0
Fees and commission expenses	(9,679)	3,860	(5,829)	0	(964)	0	(13,412)
Other operating income	111,608	25,627	69,440	6,361	43,927	0	225,997
Operating income	575,552	215,257	115,730	(160)	(39,235)	0	835,278
Operating expenses	(385,878)	(82,726)	(42,342)	0	(171,093)	0	(602,039)
Inter-segment expenses	(28,045)	(3,004)	(817)	0	31,866	0	0

2004	Retail Banking	Wholesale Banking	Financial Market	Real Estate	Unallocated	Inter-segment elimination	Consolidated
	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000
Operating profit/(loss) before provisions and gains	241,629	129,527	72,571	(160)	(210,328)	0	233,239
Charge for bad and doubtful debts	(44,372)	(39,616)	0	32,159	656	0	(51,173)
Reversal of/(provision for) assets acquired under lending agreements	0	0	0	44,390	2,313	0	46,703
Gains less losses from disposal of non-trading securities	0	0	100,511	0	(7,255)	0	93,256
Profit on disposal of own property	0	0	0	0	16,324	0	16,324
Profit/(loss) before taxation	197,257	89,911	173,082	76,389	(198,290)	0	338,349
Income tax	0	0	0	0	(37,961)	0	(37,961)
Profit/(loss) attributable to shareholders	197,257	89,911	173,082	76,389	(236,251)	0	300,388
Operating expenses - depreciation	(18,439)	(1,562)	(2,516)	0	(37,673)	0	(60,190)
Segment assets	11,181,573	7,741,945	25,737,855	182,980			44,844,353
Unallocated assets ¹							916,428
Total assets							45,760,781
Segment liabilities	27,557,385	4,004,058	10,258,039	0			41,819,482
Unallocated liabilities ²							238,527
Total liabilities							42,058,009
Capital expenditure incurred during the year	13,063	9,045	30,068	0			52,176

2003	Retail Banking	Wholesale Banking	Financial Market	Real Estate	Unallocated	Inter-segment elimination	Consolidated
	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000
Interest income from external customers	409,395	256,675	273,122	0	8,594	0	947,786
Interest expense to external customers	(274,561)	(28,696)	(38,848)	0	(1,767)	0	(343,872)
Inter-segment income	287,790	0	0	0	0	(287,790)	0
Inter-segment expense	0	(51,271)	(199,875)	(13,437)	(23,207)	287,790	0
Net interest income	422,624	176,708	34,399	(13,437)	(16,380)	0	603,914
Other operating revenue from external customers	106,506	20,472	64,028	12,293	7,507	0	210,806
Inter-segment revenue	0	0	0	0	35,153	(35,153)	0
Fees and commission expenses	(242)	(1,780)	(6,327)	0	(530)	0	(8,879)
Other operating income	106,264	18,692	57,701	12,293	42,130	0	201,927
Operating income	528,888	195,400	92,100	(1,144)	25,750	0	805,841
Operating expenses	(273,479)	(77,393)	(34,262)	0	(103,710)	0	(488,844)
Inter-segment expenses	(31,153)	(3,337)	(663)	0	35,153	0	0
Operating profit/(loss) before provisions and gains	224,256	114,670	57,175	(1,144)	(77,960)	0	316,997
Charge for bad and doubtful debts	(151,023)	(34,874)	0	0	(816)	0	(186,713)
Reversal of/(provision for) assets acquired under lending agreements	0	0	0	(71,463)	0	0	(71,463)
Gains less losses from disposal of non-trading securities	0	0	90,896	0	0	0	90,896
Profit on disposal of own property	0	0	0	0	0	0	0
Profit/(loss) before taxation	73,233	79,796	148,071	(72,607)	(78,776)	0	149,717
Income tax	0	0	0	0	(11,579)	0	(11,579)
Profit/(loss) attributable to shareholders	73,233	79,796	148,071	(72,607)	(90,355)	0	138,138
Operating expenses - depreciation	(16,981)	(1,306)	(1,682)	0	(34,950)	0	(54,919)
Segment assets	10,358,296	6,160,071	19,898,424	557,792			36,974,583
Unallocated assets ¹							914,225
Total assets							37,888,808
Segment liabilities	26,516,028	3,575,259	3,893,297	0			33,984,584
Unallocated liabilities ²							120,053
Total liabilities							34,104,637
Capital expenditure incurred during the year	6,489	3,858	12,464	0			22,811

¹ Unallocated items mainly comprise interest income derived from shareholders' funds not used by the business segments, staff housing loans and the related interest income and funding costs, staff deposits and the related interest expenses and the head office premises, furniture, fixtures and equipment and the related depreciation.

² The loss for the year ended 31 December 2003 incurred by Real Estate was mainly caused by the decline in value of the properties acquired under lending agreements during the year.

Geographical segments

The geographical segmental analysis is based on the locations of the principal operations of the subsidiaries or on the location of the branches of the Bank responsible for reporting the results or booking the assets, the location of customers and the location of the assets. For the year ended 31 December 2004 and 2003, all of the Group's operating income and profit before taxation were generated by assets booked by the principal operations of the branches and subsidiaries of the Bank located in Hong Kong. More than 90% of assets were either located in Hong Kong or were extended to companies and individuals domiciled in Hong Kong. The balance of the assets were extended to companies and individuals domiciled outside Hong Kong, mainly in China.

HONG KONG AND CHINA ECONOMIC REVIEW

During the year 2004, Hong Kong achieved strong economic growth after six years of economic hardship. GDP for the full year 2004 expanded by an estimated 7.5%, driven by strong performance in external trade, solid improvement in domestic demand, a revived property market and a surge in tourist arrivals, especially from China. Indeed, China's strong growth along with the benefits of the Closer Economic Partnership Arrangement ("CEPA") and liberalization of travel between China and Hong Kong were major factors in Hong Kong's rebound. In addition, Hong Kong saw its first rise in the Composite Consumer Price Index in July 2004 after five and one half years of falling prices. Both personal bankruptcy petitions and mortgages in negative equity have