

Management Discussion and Analysis

Financial Review

Economic and Financial Environment

In the first half of 2019, global economic growth slowed and international trade and investment slumped. The pace of US economic recovery was slowing, the Eurozone's economy remained sluggish, while the Japanese economy witnessed a modest expansion. Emerging economies suffered from dwindling growth impetus.

International financial markets were roughly stable, although volatility increased in the second quarter. Regarding interest rates, there was a decrease in long-term Treasury bond yields, and some countries entered into a rate-cutting cycle. Regarding exchange rates, the USD Index fell after an initial increase, the Euro declined slightly, and the currencies of some emerging economies strengthened. The stock markets of major economies performed well, while the prices of commodities such as crude oil and gold rose amid fluctuations.

China's economic growth remained resilient and continued maintaining a trend of smooth and steady development, with key economic indicators operating within a reasonable range. Structural adjustment went ahead, and overall supply and demand were basically balanced. Consumption and investment grew steadily, trade surplus increased, and CPI and employment remained stable. However, internal and external uncertainties increased. In the first half of 2019, China's gross domestic product (GDP) grew by 6.3% year on

year and the consumer price index (CPI) rose by 2.2% year on year. Total retail sales of consumer goods (TRSCG) increased by 8.4% year on year, total fixed asset investments (TFAI) recorded a nominal increase of 5.8% year on year, and imports and exports grew by 3.9% year on year, with a trade surplus of RMB1.2 trillion.

The Chinese government continued to implement a sound monetary policy, made moderate, well-timed counter-cyclical adjustments, deepened financial supply-side structural reform, and strengthened support for the real economy. Money supply and all-system financing aggregates grew moderately, and RMB exchange rate remained stable as a whole. Financial market saw steady operation. The Scientific and Technological Innovation Board and the "Shanghai-London Stock Connect" programme was launched, and the two-way opening-up of the capital market has been advancing steadily. By the end of June 2019, the broad money supply (M2) was RMB192.1 trillion, an increase of 8.5% year on year. The balance of RMB loans reached RMB146.0 trillion, an increase of 13.0% year on year. The outstanding RMB deposits stood at RMB187.6 trillion, an increase of 8.4% year on year. The outstanding all-system financing aggregates was RMB213.3 trillion, an increase of 10.9% year on year. As at 30 June 2019, the central parity rate of RMB against USD was 6.8747, a depreciation of 0.17% compared with the prior year-end. The SSE Composite Index rose by 485 points compared with the prior year-end. The combined market capitalisation of the Shanghai and Shenzhen Stock Exchange stood at RMB44.3 trillion, an increase of 10.2% year on year.

Income Statement Analysis

In the first half of 2019, the Group achieved a profit for the period of RMB121.442 billion, an increase of 5.08% compared with the same period of the prior year. It realised a profit attributable to equity holders of the Bank of RMB114.048 billion, an increase of 4.55% compared with the same period of the prior year. Return on average total assets (ROA) was 1.12%, and return on average equity (ROE) was 14.56%.

The principal components and changes of the Group's consolidated income statement are set out below:

Unit: RMB million, except percentages

Items	For the six-month period ended 30 June 2019	For the six-month period ended 30 June 2018	Change	Change (%)
Net interest income	181,684	172,451	9,233	5.35%
Non-interest income	95,004	79,031	15,973	20.21%
Including: net fee and commission income	50,564	48,188	2,376	4.93%
Operating income	276,688	251,482	25,206	10.02%
Operating expenses	(91,130)	(82,132)	(8,998)	10.96%
Impairment losses on assets	(33,670)	(28,270)	(5,400)	19.10%
Operating profit	151,888	141,080	10,808	7.66%
Profit before income tax	152,558	141,961	10,597	7.46%
Income tax expense	(31,116)	(26,386)	(4,730)	17.93%
Profit for the period	121,442	115,575	5,867	5.08%
Profit attributable to equity holders of the Bank	114,048	109,088	4,960	4.55%

A detailed review of the Group's principal items in each quarter is summarised in the following table:

Unit: RMB million

Items	For the three-month period ended					
	30 June 2019	31 March 2019	31 December 2018	30 September 2018	30 June 2018	31 March 2018
Operating income	135,682	141,006	127,947	124,377	125,396	126,086
Profit attributable to equity holders of the Bank	63,083	50,965	26,812	44,186	60,087	49,001
Net cash flow from operating activities	144,262	(235,156)	91,303	211,986	(23,613)	382,682

Net Interest Income and Net Interest Margin

In the first half of 2019, the Group achieved a net interest income of RMB181.684 billion, an increase of RMB9.233 billion or 5.35% compared with the same period of the prior year. The average balances² and average interest rates of the major interest-earning assets and interest-bearing liabilities of the Group, as well as the impact on interest income/expense of variances in the volume factor and the interest rate factor³, are summarised in the following table:

Unit: RMB million, except percentages

Items	For the six-month period ended 30 June 2019			For the six-month period ended 30 June 2018			Analysis of changes in interest income/expense		
	Average balance	Interest income/ expense	Average interest rate	Average balance	Interest income/ expense	Average interest rate	Volume factor	Interest rate factor	Total
Interest-earning assets									
Loans	11,834,692	253,135	4.31%	10,864,310	224,817	4.17%	20,066	8,252	28,318
Investments	4,789,954	76,251	3.21%	4,393,348	69,379	3.18%	6,254	618	6,872
Balances with central banks and due from and placements with banks and other financial institutions	3,362,876	35,978	2.16%	3,245,424	36,013	2.24%	1,305	(1,340)	(35)
Total	19,987,522	365,364	3.69%	18,503,082	330,209	3.60%	27,625	7,530	35,155
Interest-bearing liabilities									
Due to customers	15,012,842	134,919	1.81%	13,859,827	110,411	1.61%	9,205	15,303	24,508
Due to and placements from banks and other financial institutions	2,968,579	34,365	2.33%	2,970,986	37,911	2.57%	(31)	(3,515)	(3,546)
Bonds issued	757,581	14,396	3.83%	515,867	9,436	3.69%	4,423	537	4,960
Total	18,739,002	183,680	1.98%	17,346,680	157,758	1.83%	13,597	12,325	25,922
Net interest income		181,684			172,451		14,028	(4,795)	9,233
Net interest margin			1.83%			1.88%			(5) Bps

Notes:

- Investments include debt securities at fair value through other comprehensive income, debt securities at amortised cost, investment trusts and asset management plans, etc.
- Balances with central banks and due from and placements with banks and other financial institutions include mandatory reserves, surplus reserves, other placements with central banks and due from and placements with banks and other financial institutions.
- Due to and placements from banks and other financial institutions include due to and placements from banks and other financial institutions, due to central banks and other funds.

² Average balances are average daily balances derived from the Group's management accounts (unreviewed).

³ The impact on interest income/expense of variances in the volume factor is calculated based on the changes in average balances of interest-earning assets and interest-bearing liabilities during the reporting period. The impact on interest income/expense of variances in interest rate factor is calculated based on the changes in the average interest rates of interest-earning assets and interest-bearing liabilities during the reporting period. The impact relating to the combined changes in both the volume factor and the interest rate factor has been classified as changes in interest rate factor.

The average balances and average interest rates of domestic loans and due to customers, classified by business type, are summarised in the following table:

Unit: RMB million, except percentages

Items	For the six-month period ended 30 June 2019		For the six-month period ended 30 June 2018		Change	
	Average balance	Average interest rate	Average balance	Average interest rate	Average balance	Average interest rate
Domestic RMB businesses						
Loans						
Corporate loans	5,041,073	4.50%	4,713,585	4.44%	327,488	6 Bps
Personal loans	3,785,264	4.80%	3,348,018	4.65%	437,246	15 Bps
Trade bills	245,828	3.52%	148,901	4.83%	96,927	(131) Bps
Total	9,072,165	4.60%	8,210,504	4.53%	861,661	7 Bps
Including:						
Medium and long-term loans	6,521,215	4.78%	5,727,133	4.73%	794,082	5 Bps
Short-term loans within 1 year and others	2,550,950	4.12%	2,483,371	4.08%	67,579	4 Bps
Due to customers						
Corporate demand deposits	3,138,872	0.68%	3,057,703	0.64%	81,169	4 Bps
Corporate time deposits	2,402,044	2.83%	2,241,171	2.76%	160,873	7 Bps
Personal demand deposits	2,354,160	1.14%	1,910,825	0.64%	443,335	50 Bps
Personal time deposits	2,656,736	2.84%	2,593,768	2.69%	62,968	15 Bps
Other	655,167	3.95%	511,545	4.29%	143,622	(34) Bps
Total	11,206,979	1.94%	10,315,012	1.80%	891,967	14 Bps
Domestic foreign currency businesses						
						Unit: USD million, except percentages
Loans	38,469	3.41%	53,906	2.87%	(15,437)	54 Bps
Due to customers						
Corporate demand deposits	45,442	0.77%	45,607	0.44%	(165)	33 Bps
Corporate time deposits	28,856	2.72%	31,897	1.67%	(3,041)	105 Bps
Personal demand deposits	25,418	0.05%	27,889	0.05%	(2,471)	–
Personal time deposits	18,004	0.69%	19,619	0.63%	(1,615)	6 Bps
Other	1,678	2.16%	2,169	2.23%	(491)	(7) Bps
Total	119,398	1.09%	127,181	0.72%	(7,783)	37 Bps

Note: "Due to customers — Other" includes structured deposits.

In the first half of 2019, the Group's net interest margin was 1.83%, a decrease of 5 basis points compared with the same period of the prior year. This was mainly due to an increase in deposit costs. To mitigate the impact of this cost increase, the Bank continuously optimised its assets and liabilities structure, proactively adjusting and optimising its existing assets and liabilities and efficiently allocating their increments. In the first half of 2019, the proportion of the average balance of the Group's domestic RMB medium and long-term loans within its domestic RMB loan business increased by 2.13 percentage points compared with the same period of the prior year.

Non-interest Income

In the first half of 2019, the Group reported a non-interest income of RMB95.004 billion, an increase of RMB15.973 billion or 20.21% compared with the same period of the prior year. Non-interest income represented 34.34% of operating income.

Net Fee and Commission Income

The Group earned a net fee and commission income of RMB50.564 billion, an increase of RMB2.376 billion or 4.93% compared with the same period of the prior year. Net fee and commission income represented 18.27% of operating income. This was mainly due to the Bank actively seizing the opportunities arising from the rapid development of consumer finance and the recovery of the insurance market and expanding its business in credit cards, internet payment and agency

insurance. As a result, the Bank's fee and commission income from bank cards business, settlement and clearing business and insurance agency business grew well. Please refer to Note III.2 to the Condensed Consolidated Interim Financial Information.

Other Non-interest Income

The Group realised other non-interest income of RMB44.440 billion, an increase of RMB13.597 billion or 44.08% compared with the same period of the prior year. This was primarily attributable to an increase in net gains from foreign exchange derivatives trading compared with the same period of the prior year, affected by market price fluctuations. Please refer to Notes III.3, 4, 5 to the Condensed Consolidated Interim Financial Information.

Operating Expenses

In the first half of 2019, the Group recorded operating expenses of RMB91.130 billion, an increase of RMB8.998 billion or 10.96% compared with the same period of the prior year. The Group's cost to income ratio (calculated under domestic regulations) was 24.63%. The Bank continued to operate its business in a prudent manner. It optimised its cost structure, increased investment in technological innovation, allocated greater resources to key products, areas and regions, and made greater efforts to support mobile finance, RMB internationalisation, and the construction of intelligent outlets. Please refer to Notes III.6, 7 to the Condensed Consolidated Interim Financial Information.

Impairment Losses on Assets

In the first half of 2019, the Group's impairment losses on assets amounted to RMB33.670 billion, an increase of RMB5.400 billion or 19.10% compared with the same period of the prior year. Specifically, the Group's impairment losses on loans and advances amounted to RMB35.721 billion, an increase of RMB3.864 billion or 12.13% compared with the same period of the prior year. The Bank continued to improve its comprehensive risk management system and adopted a proactive and forward-looking approach to risk management, ensuring a relatively stable credit asset quality. It stringently implemented a prudent and solid risk provisioning policy and maintained adequate capacity

for risk mitigation. Please refer to the section "Risk Management — Credit Risk Management" and Notes III.8, 16 and Note IV.1 to the Condensed Consolidated Interim Financial Information for more information on loan quality and allowance for loan impairment losses.

Financial Position Analysis

As at 30 June 2019, the Group's total assets amounted to RMB22,266.024 billion, an increase of RMB998.749 billion or 4.70% compared with the prior year-end. The Group's total liabilities amounted to RMB20,358.572 billion, an increase of RMB816.694 billion or 4.18% compared with the prior year-end.

The principal components of the Group's consolidated statement of financial position are set out below:

Unit: RMB million, except percentages

Items	As at 30 June 2019		As at 31 December 2018	
	Amount	% of total	Amount	% of total
Assets				
Loans and advances to customers, net	12,257,784	55.05%	11,515,764	54.15%
Investments	5,361,318	24.08%	5,054,551	23.77%
Balances with central banks	2,069,564	9.29%	2,331,053	10.96%
Due from and placements with banks and other financial institutions	1,577,492	7.08%	1,405,534	6.61%
Other assets	999,866	4.50%	960,373	4.51%
Total assets	22,266,024	100.00%	21,267,275	100.00%
Liabilities				
Due to customers	15,644,634	76.85%	14,883,596	76.16%
Due to and placements from banks and other financial institutions and due to central banks	3,227,068	15.85%	3,250,997	16.64%
Other borrowed funds	857,279	4.21%	814,888	4.17%
Other liabilities	629,591	3.09%	592,397	3.03%
Total liabilities	20,358,572	100.00%	19,541,878	100.00%

Note: "Other borrowed funds" includes bonds issued and other borrowings.

Loans and Advances to Customers

Centring on the financial demands of the real economy, the Bank implemented national macroeconomic policies, rationally allocated credit extension and expanded its lending scale at a stable and moderate pace. The Bank continuously improved its credit structure and proactively supported the credit needs of key areas and industries. The Bank strictly controlled credit facilities granted to industries characterised by high pollution, high energy consumption and overcapacity. It also continued to implement a differentiated residential mortgage loan policy and steadily expanded its personal loan business. As at 30 June 2019, the Group's loans and advances to customers amounted to RMB12,569.734 billion, an increase of RMB750.462 billion or 6.35% compared with the prior year-end. Specifically, the Group's RMB loans and advances to customers totalled RMB9,736.098

billion, an increase of RMB640.536 billion or 7.04% compared with the prior year-end, while its foreign currency loans amounted to USD412.183 billion, an increase of USD15.326 billion or 3.86% compared with the prior year-end.

The Bank continuously improved its risk management system, paid close attention to changes in the macroeconomic situation, strengthened risk identification and management in key areas and made greater efforts in the disposal of non-performing loans, thus maintaining a relatively stable asset quality. As at 30 June 2019, the balance of the Group's allowance for loan impairment losses amounted to RMB312.254 billion, an increase of RMB8.473 billion compared with the prior year-end. The balance of the Group's restructured loans amounted to RMB12.721 billion, an increase of RMB2.719 billion compared with the prior year-end.

Unit: RMB million, except percentages

Items	As at 30 June 2019		As at 31 December 2018	
	Amount	% of total	Amount	% of total
Corporate Loans	7,781,599	61.90%	7,347,598	62.17%
Personal Loans	4,753,381	37.82%	4,440,085	37.57%
Accrued Interest	34,754	0.28%	31,589	0.26%
Total Loans	12,569,734	100.00%	11,819,272	100.00%

Investments

The Bank closely monitored financial market dynamics, increased its bond investments and continuously improved its investment structure. As at 30 June 2019, the Group held investments of RMB5,361.318 billion, an increase of RMB306.767 billion or 6.07% compared

with the prior year-end. Specifically, the Group's RMB investments totalled RMB4,114.027 billion, an increase of RMB135.391 billion or 3.40% compared with the prior year-end, while its foreign currency investments totalled USD181.432 billion, an increase of USD24.666 billion or 15.73% compared with the prior year-end.

The classification of the Group's investment portfolio is shown below:

Unit: RMB million, except percentages

Items	As at 30 June 2019		As at 31 December 2018	
	Amount	% of total	Amount	% of total
Financial assets at fair value through profit or loss	443,792	8.28%	370,491	7.33%
Financial assets at fair value through other comprehensive income	2,084,968	38.89%	1,879,759	37.19%
Financial assets at amortised cost	2,832,558	52.83%	2,804,301	55.48%
Total	5,361,318	100.00%	5,054,551	100.00%

Investments by Currency

Unit: RMB million, except percentages

Items	As at 30 June 2019		As at 31 December 2018	
	Amount	% of total	Amount	% of total
RMB	4,114,027	76.74%	3,978,636	78.71%
USD	768,731	14.34%	740,206	14.64%
HKD	229,114	4.27%	192,853	3.82%
Other	249,446	4.65%	142,856	2.83%
Total	5,361,318	100.00%	5,054,551	100.00%

Top Ten Financial Bonds by Value Held by the Group

Unit: RMB million, except percentages

Bond Name	Par Value	Annual Rate	Maturity Date	Impairment Allowance
Bond issued by policy banks in 2017	16,074	3.88%	2020-04-19	–
Bond issued by policy banks in 2016	15,050	2.65%	2019-10-20	–
Bond issued by policy banks in 2018	13,880	4.98%	2025-01-12	–
Bond issued by policy banks in 2017	11,150	4.39%	2027-09-08	–
Bond issued by policy banks in 2017	9,740	3.98%	2020-04-19	–
Bond issued by policy banks in 2017	9,490	3.54%	2020-01-06	–
Bond issued by policy banks in 2018	9,430	4.73%	2025-04-02	–
Bond issued by policy banks in 2018	8,730	4.99%	2023-01-24	–
Bond issued by commercial banks in 2019	8,000	4.28%	2029-03-19	–
Bond issued by commercial banks in 2018	7,600	4.86%	2028-09-25	–

Note: Financial bonds refer to debt securities issued by financial institutions in the bond market, including the bonds issued by policy banks, other banks and non-bank financial institutions, but excluding restructured bonds and PBOC bills.

Due to Customers

The Bank aligned itself with interest rate liberalisation trends, accelerated product and service innovation and thus enhanced its financial services offering. As a result, its liability business grew steadily. It further improved salary payment agency, payment collection and other basic services, optimised the functions of personal certificates of deposit (CDs), steadily expanded its administrative institution customer base, and solidified its relationships

with basic settlement and cash management customers. As a result, it steadily grew its customer deposits.

As at 30 June 2019, the Group's due to customers amounted to RMB15,644.634 billion, an increase of RMB761.038 billion or 5.11% compared with the prior year-end. Specifically, the Group's RMB due to customers totalled RMB11,892.454 billion, an increase of RMB636.000 billion or 5.65% compared with the prior year-end, while its foreign currency due to customers stood at USD545.795 billion, an increase of USD17.304 billion or 3.27% compared with the prior year-end.

Equity

As at 30 June 2019, the Group's total equity was RMB1,907.452 billion, an increase of RMB182.055 billion or 10.55% compared with the prior year-end. This was primarily attributable to the following reasons: (1) In the first half of 2019, the Group realised a profit for the period of RMB121.442 billion, of which profit attributable to equity holders of the Bank amounted to RMB114.048 billion. (2) The Bank pushed forward its external capital supplement project in a proactive and prudent manner, successfully issuing RMB40.0 billion of undated capital bonds and RMB73.0 billion of preference shares in the domestic market. (3) As per the 2018 profit distribution plan approved at the Annual General Meeting, a cash dividend of RMB54.167 billion was paid out on ordinary shares. (4) The Bank paid a dividend on its preference shares of RMB1.540 billion. Please refer to the "Condensed Consolidated Statement of Changes in Equity" in the Condensed Consolidated Interim Financial Information.

Cash Flow Analysis

As at 30 June 2019, the balance of the Group's cash and cash equivalents was RMB1,519.866 billion, a

decrease of RMB168.734 billion compared with the prior year-end.

In the first half of 2019, net cash flow from operating activities was an outflow of RMB90.894 billion, whereas it was an inflow of RMB359.069 billion in the same period of the prior year. This was mainly attributable to the increase of net increase in loans to customers and placements with and loans to banks and other financial institutions, and the decrease of net increase in due to banks and other financial institutions compared with the same period of the prior year.

Net cash flow from investing activities was an outflow of RMB156.224 billion, an increase of RMB27.351 billion compared with the same period of the prior year. This was mainly attributable to the increase of purchase of financial investments compared with the same period of the prior year.

Net cash flow from financing activities was an inflow of RMB75.058 billion, an increase of RMB43.255 billion compared with the same period of the prior year. This was primarily attributable to the increase of proceeds from issuance of other equity instruments compared with the same period of the prior year.

Fair Value Measurement

Movement of Financial Instruments Measured at Fair Value

Unit: RMB million

Items	As at 30 June 2019	As at 31 December 2018	Change	Impact on profit for the period
Financial assets at fair value through profit or loss				
Debt securities	315,516	273,447	42,069	
Equity instruments	59,700	47,061	12,639	6,770
Fund investments and other	68,576	49,983	18,593	
Loans and advances to customers at fair value	280,485	227,643	52,842	66
Financial assets at fair value through other comprehensive income				
Debt securities	2,065,534	1,862,232	203,302	(251)
Equity instruments and other	19,434	17,527	1,907	
Derivative financial assets	86,982	124,126	(37,144)	(4,566)
Derivative financial liabilities	(82,861)	(99,254)	16,393	
Due to and placements from banks and other financial institutions at fair value	(6,016)	(876)	(5,140)	(2)
Due to customers at fair value	(19,354)	(24,141)	4,787	–
Bonds issued at fair value	(25,879)	(20,517)	(5,362)	(40)
Short position in debt securities	(18,273)	(14,327)	(3,946)	(58)

The Bank has put in place a sound internal control mechanism for fair value measurement. In accordance with the *Guidelines on Market Risk Management in Commercial Banks*, *Regulatory Guidelines on Valuation of Financial Instruments in Commercial Banks*, CAS and IFRS, with reference to the New Basel Capital Accord, and drawing on the best practices of international banks regarding valuations, the Bank formulated the *Valuation Policy of Financial Instrument Fair Values of Bank of China Limited* to standardise the fair value measurement of financial instruments and enable timely and accurate financial information disclosure. Please refer to Note IV.4 to the Condensed Consolidated

Interim Financial Information for more detailed information related to the fair value measurement.

Other Financial Information

There are no differences between the equity and profit for the period of the Group prepared in accordance with IFRS and those prepared in accordance with CAS. Please refer to Supplementary Information I to the Interim Financial Information for detailed information.

The operating performance and financial position of the Group's geographical and business segments are set forth in Note III.30 to the Condensed Consolidated Interim Financial Information.