

Management Discussion and Analysis

Financial Review

Economic and Financial Environment

In the first half of 2020, the shock of the COVID-19 pandemic sent the world economy into recession, disrupted global industrial and supply chains, caused a sharp contraction in international trade and investment, and resulted in rising geopolitical risks. The growth rate of the US economy dropped significantly, the Eurozone economy sank into a continued recession, and Japan's economy recorded negative growth for three consecutive quarters. Many emerging market economies stood on the verge of a debt crisis.

Global financial markets were highly volatile, witnessing a notable increase in various uncertainties and destabilising factors including rising debt default risk. Major economies vigorously promoted ultra-accommodative monetary policies, with low or even negative interest rates becoming normalised around the world. The USD Index fell after an initial increase, while the currencies of some emerging market economies depreciated substantially. The stock markets of major economies rallied moderately after a sharp decline, while the prices of commodities, including crude oil, picked up following an initial plunge. The gold price rose significantly.

Facing the shock of the COVID-19 pandemic, the Chinese economy showed great resilience. As policies for controlling COVID-19 and promoting economic and social development were introduced and implemented, daily life and work began to recover at a faster pace, major economic indicators gradually rebounded and market expectations improved on the whole, indicating

China's overall economic fundamentals of stable growth and solid long-term momentum remaining intact. In the first half of 2020, China's gross domestic product (GDP) fell by 1.6% compared with the same period of last year, of which grew by 3.2% year-on-year in the second quarter. The consumer price index (CPI) rose by 3.8% year-on-year. Meanwhile, the employment situation was generally stable and the imports and exports were better than expected.

China's sound monetary policy was more flexible and appropriate. The PBOC used a variety of tools such as required reserve ratio cuts, interest rate cuts and central bank lending, developed new monetary policy instruments that directly stimulated the real economy, provided stronger targeted support to inclusive micro and small-sized enterprises, and guided broad money supply and aggregate financing to reasonable growth, so as to lower the financing costs of enterprises in a stable manner. As at 30 June 2020, the outstanding broad money supply (M2) was RMB213.5 trillion, an increase of 11.1% year-on-year. Outstanding all-system financing aggregates stood at RMB271.8 trillion, an increase of 12.8% year-on-year. The balance of RMB loans reached RMB165.2 trillion, an increase of 13.2% year-on-year. The RMB exchange rate was kept generally stable at an adaptive and equilibrium level. At 30 June 2020, the central parity rate of the RMB against the USD was 7.0795, a depreciation of 1.46% compared with the prior year-end. China's financial markets were stable overall and opened further wider. The SSE Composite Index fell by 65.45 points compared with the prior year-end. The combined market capitalisation of the Shanghai and Shenzhen Stock Exchanges stood at RMB52.06 trillion, an increase of 17.49% year-on-year.

Income Statement Analysis

In the first half of 2020, the Group achieved a profit for the period of RMB107.812 billion, a decrease of 11.22% compared with the same period of the prior year. It realised a profit attributable to equity holders of the Bank of RMB100.917 billion, a decrease of 11.51% compared with the same period of the prior year. Return on average total assets (ROA) was 0.92%, and return on average equity (ROE) was 11.10%.

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

Unit: RMB million, except percentages

Items	For the six-month period ended 30 June 2020	For the six-month period ended 30 June 2019	Change	Change (%)
Net interest income	196,895	181,684	15,211	8.37%
Non-interest income	90,088	95,004	(4,916)	(5.17%)
Including: net fee and commission income	50,342	50,564	(222)	(0.44%)
Operating income	286,983	276,688	10,295	3.72%
Operating expenses	(90,946)	(91,130)	184	(0.20%)
Impairment losses on assets	(66,484)	(33,670)	(32,814)	97.46%
Operating profit	129,553	151,888	(22,335)	(14.70%)
Profit before income tax	129,616	152,558	(22,942)	(15.04%)
Income tax expense	(21,804)	(31,116)	9,312	(29.93%)
Profit for the period	107,812	121,442	(13,630)	(11.22%)
Profit attributable to equity holders of the Bank	100,917	114,048	(13,131)	(11.51%)

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 2020	31 March 2020	31 December 2019	30 September 2019	30 June 2019	31 March 2019
Operating income	138,440	148,543	133,153	140,169	135,682	141,006
Profit attributable to equity holders of the Bank	48,334	52,583	27,826	45,531	63,083	50,965
Net cash flow from operating activities	(296,989)	434,346	76,461	(469,833)	144,262	(235,156)

Net Interest Income and Net Interest Margin

In the first half of 2020, the Group achieved a net interest income of RMB196.895 billion, an increase of RMB15.211 billion or 8.37% 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 2020			For the six-month period ended 30 June 2019			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	13,300,149	268,880	4.07%	11,834,692	253,135	4.31%	31,408	(15,663)	15,745
Investments	4,839,648	76,475	3.18%	4,789,954	76,251	3.21%	793	(569)	224
Balances with central banks and due from and placements with banks and other financial institutions	3,617,373	30,575	1.70%	3,362,876	35,978	2.16%	2,734	(8,137)	(5,403)
Total	21,757,170	375,930	3.47%	19,987,522	365,364	3.69%	34,935	(24,369)	10,566
Interest-bearing liabilities									
Due to customers	16,050,374	132,966	1.67%	15,012,842	134,919	1.81%	9,338	(11,291)	(1,953)
Due to and placements from banks and other financial institutions	3,286,675	28,950	1.77%	2,968,579	34,365	2.33%	3,686	(9,101)	(5,415)
Bonds issued	1,046,030	17,119	3.29%	757,581	14,396	3.83%	5,494	(2,771)	2,723
Total	20,383,079	179,035	1.77%	18,739,002	183,680	1.98%	18,518	(23,163)	(4,645)
Net interest income		196,895			181,684		16,417	(1,206)	15,211
Net interest margin			1.82%			1.83%			(1) Bp

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 the 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 loans and due to customers in the Chinese mainland, classified by business type, are summarised in the following table:

Unit: RMB million, except percentages

Items	For the six-month period ended 30 June 2020		For the six-month period ended 30 June 2019		Change	
	Average balance	Average interest rate	Average balance	Average interest rate	Average balance	Average interest rate
RMB businesses						
in the Chinese mainland						
Loans						
Corporate loans	5,522,044	4.36%	5,041,073	4.50%	480,971	(14) Bps
Personal loans	4,246,013	4.89%	3,785,264	4.80%	460,749	9 Bps
Trade bills	341,490	2.67%	245,828	3.52%	95,662	(85) Bps
Total	10,109,547	4.52%	9,072,165	4.60%	1,037,382	(8) Bps
Including:						
Medium and long-term loans	7,401,153	4.85%	6,521,215	4.78%	879,938	7 Bps
Short-term loans within 1 year and others	2,708,394	3.63%	2,550,950	4.12%	157,444	(49) Bps
Due to customers						
Corporate demand deposits	3,353,501	0.72%	3,138,872	0.68%	214,629	4 Bps
Corporate time deposits	2,395,923	2.82%	2,402,044	2.83%	(6,121)	(1) Bp
Personal demand deposits	2,248,516	0.42%	2,354,160	1.14%	(105,644)	(72) Bps
Personal time deposits	2,966,302	3.01%	2,656,736	2.84%	309,566	17 Bps
Other	913,483	3.49%	655,167	3.95%	258,316	(46) Bps
Total	11,877,725	1.87%	11,206,979	1.94%	670,746	(7) Bps
Foreign currency businesses						
in the Chinese mainland						
Unit: USD million, except percentages						
Loans						
	40,545	2.09%	38,469	3.41%	2,076	(132) Bps
Due to customers						
Corporate demand deposits	42,265	0.51%	45,442	0.77%	(3,177)	(26) Bps
Corporate time deposits	35,964	2.09%	28,856	2.72%	7,108	(63) Bps
Personal demand deposits	25,068	0.03%	25,418	0.05%	(350)	(2) Bps
Personal time deposits	17,518	0.78%	18,004	0.69%	(486)	9 Bps
Other	1,699	2.25%	1,678	2.16%	21	9 Bps
Total	122,514	0.94%	119,398	1.09%	3,116	(15) Bps

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

In the first half of 2020, the Group's net interest margin was 1.82%, a decrease of 1 basis point compared with the same period of the prior year. This was mainly due to a decrease in asset yields caused by a lowering in the loan prime rate (LPR) and US dollar interest rate cuts. To mitigate the downward pressure on net interest margin, the Bank maintained the balance between the quantity and the price, strengthened the control over debt cost, actively reduced high cost deposits, and promoted the steady decline of interest payment rate.

Non-interest Income

In the first half of 2020, the Group reported a non-interest income of RMB90.088 billion, a decrease of RMB4.916 billion or 5.17% compared with the same period of the prior year. Non-interest income represented 31.39% of operating income.

Net Fee and Commission Income

The Group earned a net fee and commission income of RMB50.342 billion, a decrease of RMB0.222 billion or 0.44% compared with the same period of the prior year. Net fee and commission income represented 17.54% of operating income. Focusing on customers' demands, the Bank seized market opportunities and increased marketing and business development. As a result, it realised robust growth in income from its fund distribution and custody businesses. In contrast, the Bank saw a decrease in income from its foreign

exchange and settlement businesses. 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 RMB39.746 billion, a decrease of RMB4.694 billion or 10.56% compared with the same period of the prior year. This was primarily attributable to a year-on-year decrease in net trading gains. Please refer to Notes III.3, 4, 5 to the Condensed Consolidated Interim Financial Information.

Operating Expenses

In the first half of 2020, the Group recorded operating expenses of RMB90.946 billion, a decrease of RMB0.184 billion or 0.20% compared with the same period of the prior year. The Group's cost to income ratio (calculated under regulations in the Chinese mainland) was 23.41%, down by 1.22 percentage points compared with the same period of the prior year. The Bank continued to operate its business in a prudent manner. It proactively optimised its cost structure, increased investment in technological innovation, allocated greater resources to key products, areas and regions, made greater efforts to support scenario construction, mobile finance, etc., and continuously improved input and output efficiency. Please refer to Notes III.6, 7 to the Condensed Consolidated Interim Financial Information.

Impairment Losses on Assets

In the first half of 2020, the Group's impairment losses on assets amounted to RMB66.484 billion, an increase of RMB32.814 billion or 97.46% compared with the same period of the prior year. Specifically, the Group's impairment losses on loans and advances amounted to RMB60.728 billion, an increase of RMB25.007 billion or 70.01% compared with the same period of the prior year. The Bank continued to improve its enterprise risk management (ERM) system and adopted a proactive and forward-looking approach to risk management, ensuring relatively stable credit asset quality. It stringently implemented a prudent and solid risk provisioning policy, comprehensively and truly reflected the asset quality, made full and timely allowances,

and laid a solid foundation for development. 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 2020, the Group's total assets amounted to RMB24,152.855 billion, an increase of RMB1,383.111 billion or 6.07% compared with the prior year-end. The Group's total liabilities amounted to RMB22,064.242 billion, an increase of RMB1,271.194 billion or 6.11% 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 2020		As at 31 December 2019	
	Amount	% of total	Amount	% of total
Assets				
Loans and advances to customers, net	13,670,820	56.60%	12,743,425	55.97%
Investments	5,374,301	22.25%	5,514,062	24.22%
Balances with central banks	2,109,854	8.74%	2,078,809	9.13%
Due from and placements with banks and other financial institutions	1,895,462	7.85%	1,399,519	6.15%
Other assets	1,102,418	4.56%	1,033,929	4.53%
Total assets	24,152,855	100.00%	22,769,744	100.00%
Liabilities				
Due to customers	17,090,217	77.46%	15,817,548	76.07%
Due to and placements from banks and other financial institutions and due to central banks	3,037,976	13.77%	3,153,998	15.17%
Other borrowed funds	1,118,228	5.07%	1,124,098	5.41%
Other liabilities	817,821	3.70%	697,404	3.35%
Total liabilities	22,064,242	100.00%	20,793,048	100.00%

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

Loans and Advances to Customers

The Bank decisively implemented national macroeconomic policies, increased support for the real economy and expanded its lending scale at a stable and moderate pace. It continuously improved its credit structure and proactively supported the credit needs of key areas and weak links in the domestic economy. It also further increased credit support for inclusive finance, private enterprises and manufacturing. As at 30 June 2020, the Group's loans and advances to customers amounted to RMB14,040.165 billion, an increase of RMB971.380 billion or 7.43% compared with the prior year-end. Specifically, the Group's RMB loans and advances to customers totalled RMB10,782.953 billion, an increase of RMB633.608 billion or 6.24% compared with the prior year-end,

while its foreign currency loans amounted to USD460.091 billion, an increase of USD41.605 billion or 9.94% compared with the prior year-end.

The Bank continuously enhanced its risk management, paid close attention to changes in the macroeconomic situation, strengthened risk management in key areas and made greater efforts in the disposal of non-performing loans, thus maintaining relatively stable asset quality. As at 30 June 2020, the balance of the Group's allowance for loan impairment losses amounted to RMB369.912 billion, an increase of RMB43.989 billion compared with the prior year-end. The balance of the Group's restructured loans amounted to RMB15.251 billion, an increase of RMB2.873 billion compared with the prior year-end.

Unit: RMB million, except percentages

Items	As at 30 June 2020		As at 31 December 2019	
	Amount	% of total	Amount	% of total
Corporate Loans	8,656,247	61.65%	7,986,380	61.11%
Personal Loans	5,344,510	38.07%	5,047,809	38.62%
Accrued Interest	39,408	0.28%	34,596	0.27%
Total Loans	14,040,165	100.00%	13,068,785	100.00%

Investments

The Bank closely tracked financial market dynamics, maintained bond investment activity at a reasonable pace and continually improved its investment structure. As at 30 June 2020, the Group held investments of RMB5,374.301 billion, a decrease of RMB139.761 billion

or 2.53% compared with the prior year-end. Specifically, the Group's RMB investments totalled RMB4,072.001 billion, a decrease of RMB154.383 billion or 3.65% compared with the prior year-end, while its foreign currency investments totalled USD183.954 billion, a decrease of USD0.628 billion or 0.34% 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 2020		As at 31 December 2019	
	Amount	% of total	Amount	% of total
Financial assets at fair value through profit or loss	450,655	8.39%	518,250	9.40%
Financial assets at fair value through other comprehensive income	2,054,786	38.23%	2,218,129	40.23%
Financial assets at amortised cost	2,868,860	53.38%	2,777,683	50.37%
Total	5,374,301	100.00%	5,514,062	100.00%

Investments by Currency

Unit: RMB million, except percentages

Items	As at 30 June 2020		As at 31 December 2019	
	Amount	% of total	Amount	% of total
RMB	4,072,001	75.77%	4,226,384	76.65%
USD	794,632	14.79%	787,775	14.29%
HKD	254,614	4.74%	237,004	4.30%
Other	253,054	4.70%	262,899	4.76%
Total	5,374,301	100.00%	5,514,062	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 2018	12,980	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 2018	9,770	4.73%	2025-04-02	—
Bond issued by financial institutions in 2019	7,400	4.28%	2029-03-19	—
Bond issued by policy banks in 2017	7,200	4.30%	2024-08-21	—
Bond issued by policy banks in 2017	6,940	4.11%	2022-07-10	—
Bond issued by financial institutions in 2018	6,450	4.86%	2028-09-25	—
Bond issued by policy banks in 2018	6,450	4.99%	2023-01-24	—
Bond issued by policy banks in 2017	6,152	4.24%	2027-08-24	—
Bond issued by policy banks in 2018	6,049	4.88%	2028-02-09	—

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

Due to Customers

Seizing the opportunity presented by ample market liquidity, the Bank focused on AUM to increase the effort in developing the deposit business and accelerate product and service innovation. As a result, its deposit business grew steadily. It further improved salary payment agency business, payment collection and other basic services, actively expanded its basic settlement and cash management customer base, undertook vigorous marketing efforts to attract administrative institution customers, and increased deposits from

the source, leading to continuous improvement in the development quality of its deposit business. As at 30 June 2020, the Group's due to customers amounted to RMB17,090.217 billion, an increase of RMB1,272.669 billion or 8.05% compared with the prior year-end. Specifically, the Group's RMB due to customers totalled RMB12,922.471 billion, an increase of RMB996.548 billion or 8.36% compared with the prior year-end, while its foreign currency due to customers stood at USD588.706 billion, an increase of USD30.863 billion or 5.53% compared with the prior year-end.

Equity

As at 30 June 2020, the Group's total equity was RMB2,088.613 billion, an increase of RMB111.917 billion or 5.66% compared with the prior year-end. This was primarily attributable to the following reasons: (1) In the first half of 2020, the Group realised a profit for the period of RMB107.812 billion, of which profit attributable to equity holders of the Bank amounted to RMB100.917 billion. (2) The Bank pushed forward its external capital replenishment project in a proactive and prudent manner by successfully issuing RMB40.0 billion of undated capital bonds and USD2.82 billion of offshore preference shares. (3) As per the 2019 profit distribution plan approved at the Annual General Meeting, a cash dividend of RMB56.228 billion was paid out on ordinary shares. (4) The Bank paid a cash dividend on its preference shares of RMB5.9995 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 2020, the balance of the Group's cash and cash equivalents was RMB1,719.769 billion, an

increase of RMB373.877 billion compared with the prior year-end.

In the first half of 2020, net cash flow from operating activities was an inflow of RMB137.357 billion, whereas it was an outflow of RMB90.894 billion in the same period of the prior year. This was mainly attributable to the increase of net increase in due to customers compared with the same period of the prior year.

Net cash flow from investing activities was an inflow of RMB208.188 billion, whereas it was an outflow of RMB156.224 billion in the same period of the prior year. This was mainly attributable to the increase in proceeds from financial investments compared with the same period of the prior year.

Net cash flow from financing activities was an inflow of RMB19.099 billion, a decrease of RMB55.959 billion compared with the same period of the prior year. This was primarily attributable to the increase in repayments of debts issued 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 2020	As at 31 December 2019	Change	Impact on profit for the period
Financial assets at fair value through profit or loss				
Debt securities	298,325	371,232	(72,907)	
Equity instruments	89,659	79,456	10,203	2,906
Fund investments and other	62,671	67,562	(4,891)	
Loans and advances to customers at fair value	389,055	339,687	49,368	172
Financial assets at fair value through other comprehensive income				
Debt securities	2,031,876	2,196,352	(164,476)	(4,255)
Equity instruments and other	22,910	21,777	1,133	
Derivative financial assets	114,856	93,335	21,521	(888)
Derivative financial liabilities	(123,271)	(90,060)	(33,211)	
Due to and placements from banks and other financial institutions at fair value	(7,859)	(14,767)	6,908	(20)
Due to customers at fair value	(31,341)	(17,969)	(13,372)	–
Bonds issued at fair value	(10,271)	(26,113)	15,842	(76)
Short position in debt securities	(12,510)	(19,475)	6,965	(159)

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*, the *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 shareholders' equity and profit for the period prepared by the Group 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.31 to the Condensed Consolidated Interim Financial Information.