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Financial Institutions
Performance Survey

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JUNE QUARTER

New Zealand's banking sector remains profitable, however there continues to be the uncertainty regarding the global and domestic economic outlook.

Results of the Major Banks to June 2011

Executive summary

The overall theme for the first half of 2011 is one of continued profitability, however, there is still uncertainty regarding the economic outlook with the sovereign debt crisis in Europe and ongoing issues in the US.

- Quarterly profits have returned to December 2010 levels following an increase in provisions resulting from the Canterbury earthquakes last quarter
- The official cash rate has remained at 2.5%
- Whilst there are still uncertainties surrounding Christchurch the timing and extent of the rebuild, positive steps have been made with a number of planning consents being granted in recent months
- While deleveraging continues, there are increases in the household lending sector

Table 1	Interest margins			
	30 Jun 2011	Movement in the quarter	Movement for the 6 months	Movement for the 12 months
ANZ BG/National Bank [(a)]	2.41	0.05	0.02	0.16
Bank of New Zealand	2.24	0.05	0.09	0.12
Commonwealth Bank of Australia [(a)]	2.00	0.00	0.04	0.32
Kiwibank	1.45	(0.10)	(0.01)	0.32
Southland Building Society	2.34	0.04	(0.37)	0.10
TSB Bank	1.99	0.14	(0.20)	(0.17)
Westpac Banking Corporation [(a)]	2.43	0.33	0.28	0.18
Average	**2.25**	**0.09**	**0.08**	**0.19**

Table 2	Impaired asset expense/average gross loans			
	30 Jun 2011	Movement for the quarter	Movement for the 6 months	Movement for the 12 months
ANZ BG/National Bank [(a)]	0.19	(0.02)	0.06	(0.15)
Bank of New Zealand	0.13	(0.26)	(0.15)	(0.21)
Commonwealth Bank of Australia [(a)]	(0.06)	(0.46)	(0.25)	(0.08)
Kiwibank	0.77	0.37	(0.00)	0.57
Southland Building Society	0.46	0.06	(0.01)	(0.10)
TSB Bank	0.15	(0.25)	(0.00)	0.09
Westpac Banking Corporation [(a)]	0.48	0.08	0.08	0.43
Average	**0.21**	**0.38**	**(0.04)**	**0.00**

(a) The results for ANZ Banking Group (ANZ BG), Commonwealth Bank of Australia and Westpac Banking Corporation relates to the New Zealand banking group division of these entities.

Issues facing the banking sector

Global outlook

The sovereign debt issues in Europe together with the deceleration of growth in the US have been prominent headlines over the first six months. In its October Regional Economic Outlook the IMF commented that "Finding a durable solution to the euro area sovereign crisis has become more than overdue", and has warned that a recession in 2012 "can't be ruled out".

In the US economic growth for the first half of 2011 was 0.9%, the lowest level since the end of the global financial crisis, however, it has been reported that many economists do not expect another recession, albeit that they do not anticipate an acceleration in growth.

There was further gloom when Italy's Government bond ratings were downgraded from Aa2 to A2 by Moody's on the 5 October, and Germany's largest bank, Deutsche issued a profit's warning and announcing job losses. These stories arose in the same week as the French, Belgian and Luxembourg Governments announced plans to bail out Dexia SA, the second bailout the bank has received in four years.

At home, the ripple effect of the problems in Europe has also impacted New Zealand with the turmoil in Europe being cited as one of the reasons behind the recent deterioration in our exchange rate. More significantly, ratings agencies

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Fitch and Standard & Poor's downgraded New Zealand from an AA+ rating to AA on 30 September 2011, reasons cited are New Zealand's level of external debt, agricultural debt and an aging population. It is interesting to note that in September 2011's Monthly Economic indicators the Treasury reported that improvements to official statistics indicated that the level of net international indebtedness was less severe than had previously been thought, at its peak the net liability is thought to have been 85% of GDP rather than previous estimates of 95%, the reported to be 70%.

That said there are rays of hope as the Treasury announced that real GDP growth in the first half of the year was stronger than expected and some analysts are predicting a strong spring property market in New Zealand. Furthermore, despite the problems in the area Gerry Brownlee announced on 5th September that economic indicators show that the manufacturing and export sectors in Canterbury are continuing to perform well.

Nevertheless, the global economy will inevitably continue to focus on the developments in Europe and the US.

Christchurch re-build

To date the majority of construction activity in Christchurch has focussed on assessments and repair, however, in July earthquake related building consents totalled $36m with a further $20m in August. $20m of Augusts consents related to residential property (Source Statistics NZ).

In addition to the above it is expected that during October CERA will announce details of some 6,000 sections that will be made available, this will enable the region to move forward and provide further welcome stimulus to the region.

New entrants

Having been granted registered bank status on 31 March 2011 the Bank of India (New Zealand) Limited opened its first branch for business on 6 October in Auckland.

The bank has announced that it will offer its customers a full range of retail banking products and also provide corporate financing. Chairman and managing director, Alok Misra, has commented that with New Zealand-India trade increasing, it was the right time for the bank to establish a presence here. He also said the bank would also leverage its expertise in financing agriculture and small businesses for the benefit of its clientele in New Zealand.

Regulation

The Money Laundering and Countering Financing of Terrorism Act has had press coverage in the period, principally due to it resulting in further costs to sectors that have already seen significant levels of regulatory development in recent times. By 30 June 2013 New Zealand's banks, insurance companies and other financial institutions will need to have implemented the requirements of the Act. With less than two years to go until the legislation is introduced in New Zealand the impact on cost and manpower should not be underestimated; in 2009 the Ministry of Justice estimated that in aggregate firms in New Zealand impacted by the legislation will incur implementation costs of $111.8m and on-going annual costs of $42.5m.

At its simplest level the Act requires organisations to detect and guard against money laundering and terrorism financing. In practical terms this will require organisation wide changes as responsibility will no longer rest solely with the compliance officer for monitoring systems and organisations will need to prepare risk assessments, appoint a compliance officer to specifically oversee money laundering and put in place suspicious transaction reporting and auditing processes.

Australia has already adopted the Act and this will provide some help to New Zealand subsidiaries of Australian companies in their preparations. There is, however, still a lot to do to bring the appropriate systems and controls on-line by 2013.

Review of the June 2011 Results

Deleveraging

The deleveraging trend has continued into the second quarter of 2011. The balance sheets of the major banks disclose the following:

- Gross loans and advances have reduced $304m ($850m since the start of 2011)
- Deposits from customers have increased $887m in the quarter

That said, individual experience has varied with Kiwibank, Westpac and BNZ all reporting increases in lending. Table 4 also illustrates that the rise in household lending noted in the first quarter has continued with gross household lending increasing by $851m in the quarter ($1,707m in the six months to June).

Impaired loans

The impaired asset expense for the quarter improved with a charge of $152m for the sector compared to $274m in March. This improvement is consistent with the reduction in the level of gross impaired and past due loans.

Drilling into the data, whilst the impaired asset expense has improved for Kiwibank, CBA and BNZ following increases in the first quarter, Westpac has seen a minor increase in its quarterly expense, reporting $69m for the June quarter compared to $61m in March – principally through individually assessed provisions; the disclosure statement discloses a $57m release of collective provision in the 9 months to June.

Total assets

The sectors total assets increased by $1,571m to $355,752m in the quarter, a 4.4% increase.

The principal increases in total assets were at Westpac ($851) and BNZ ($784m). Westpac reported $494m increase in net loans and a $995m increase in amounts due from related parties, offset by a $632m reduction in cash and investments. At BNZ the

Table 3	Deposits from customers		
Movement for the quarter	**30 Jun 2011 $Million**	**31 Mar 2011 $Million**	**% increase**
ANZ BG/National Bank	62,745	62,812	-0.11
Bank of New Zealand	30,858	30,608	0.82
Commonwealth Bank of Australia	33,714	33,354	1.08
Kiwibank	7,902	7,799	1.33
Southland Building Society	241	240	0.26
TSB Bank	4,511	4,397	2.59
Westpac Banking Corporation	38,841	38,715	0.33
Total/Average	**178,812**	**177,925**	**0.50**
Movement for the 12 months	**30 Jun 2011 $Million**	**30 Jun 2010 $Million**	**% increase**
ANZ BG/National Bank	62,745	58,246	7.72
Bank of New Zealand	30,858	27,986	10.26
Commonwealth Bank of Australia	33,714	31,848	5.86
Kiwibank	7,902	6,912	14.33
Southland Building Society	241	217	10.88
TSB Bank	4,511	4,049	11.41
Westpac Banking Corporation	38,841	36,681	5.89
Total/Average	**178,812**	**165,939**	**7.76**

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disclosure statement reports a $444m increase in net loans and a $470m increase in derivatives.

Interest margins

Interest margins have recovered following minor falls in the 3 and 6 month periods to 31 March 2011. Whilst the trend is positive the overall movements in the past twelve months have been relatively minor with the Sector average increasing just 9 basis points to 2.25% in the quarter and 19% over the past 12 months. Kiwibank continues to report the lowest margin at 1.45, albeit it is 32 basis points higher than June 2010.

As can be seen in figure 1 there has been an increasing trend of customers coming off lower fixed term mortgages and moving to higher floating rates, however, the benefits to banks have not yet been felt as a result of March's drop in the official cash rate to 2.5% together with competition for deposits.

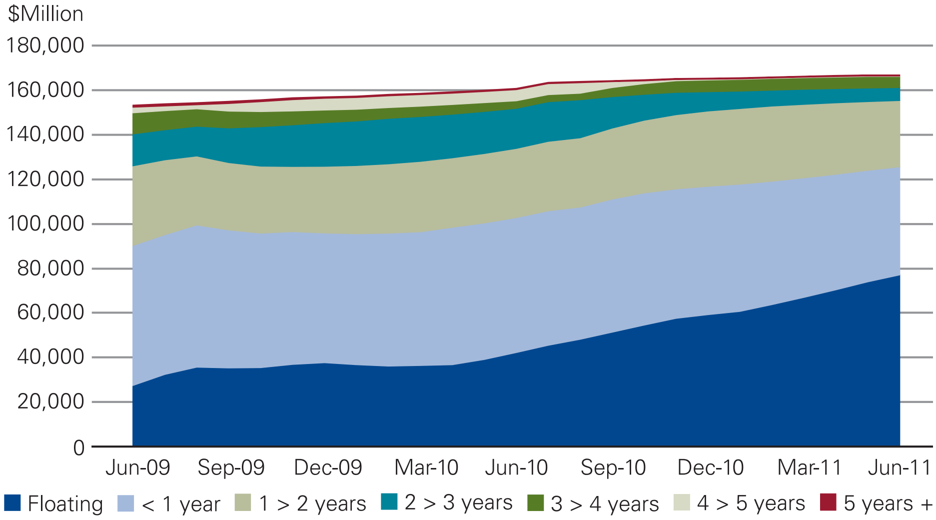
Net profit

Net profit for the sector has increased in the quarter and returned to levels achieved in the quarter to December 2010. In part this will be a consequence of the increase in provisioning during the first quarter of the year following the earthquakes in Canterbury.

Drilling into the data, factors impacting the individual results include the following:

- Aggregate quarterly impairment charge for the sector of $132m compared to $274m for the March 2011 quarter
- CBA had an interest expense charge for the quarter of $611m compared to $683 in the March quarter, however, as illustrated in figure 8 the ratio of operating expenses to operating income has increased from 42.3% in March to 47.5%
- Westpac has reported a reduction in the operating expenses to operating income from 45.8% to 38.4%, the lowest for the sector. In comparison to March 2011, interest income was $28m lower at $981m, whereas interest expense was $89m lower at $573m
- ANZ's operating expense ratio has improved over the quarter, contributing factors being lower spend on its move to a single banking technology platform, $6m in the quarter - $141m had been spent in the six months to March 2011.
- Overall Kiwibank continues to report the highest ratio of operating expenses to operating income.

Figure 1: Residential mortgage loans maturity profile (to June 2011)



Source: Reserve Bank of New Zealand Statistics

Figure 2: Major banks: Gross impaired vs Impaired asset expense

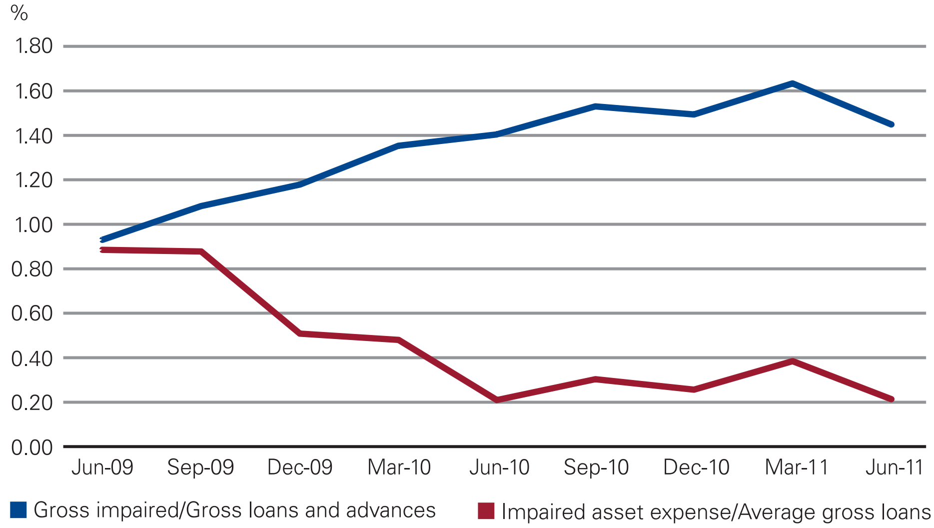


Table 4	Analysis of gross loans and advances		
	Gross loans and advances		
	30 Jun 2011 $Million	31 Mar 2011 $Million	31 Dec 2010 $Million
ANZ BG/National Bank	95,939	96,695	97,059
Bank of New Zealand	56,618	56,172	55,649
Commonwealth Bank of Australia	56,675	57,379 [a]	58,310 [a]
Kiwibank	11,582	11,252	10,978
Southland Building Society	2,575	2,609	2,624
TSB Bank	2,677	2,643	2,586
Westpac Banking Corporation	57,997	57,617	57,707
Total	**284,063**	**284,367**	**284,913**
	Household lending		
ANZ BG/National Bank	53,978	54,032	53,898
Bank of New Zealand	27,077	26,743	26,432
Commonwealth Bank of Australia	38,622	38,698	38,734
Kiwibank	10,631	10,325	10,081
Southland Building Society	1,804	1,813	1,820
TSB Bank	2,393	2,364	2,318
Westpac Banking Corporation	34,709	34,387	34,223
Total	**169,213**	**168,362**	**167,506**
	Household lending as a percentage of gross loans and advances		
ANZ BG/National Bank	56.26%	55.88%	55.53%
Bank of New Zealand	47.82%	47.61%	47.50%
Commonwealth Bank of Australia	68.15%	67.44%	66.43%
Kiwibank	91.79%	91.76%	91.83%
Southland Building Society	70.05%	69.50%	69.36%
TSB Bank	89.39%	89.44%	89.64%
Westpac Banking Corporation	59.85%	59.68%	59.30%
Total/Average	**59.57%**	**59.21%**	**58.79%**

(a) Figures estimated from information presented in the Disclosure statement.

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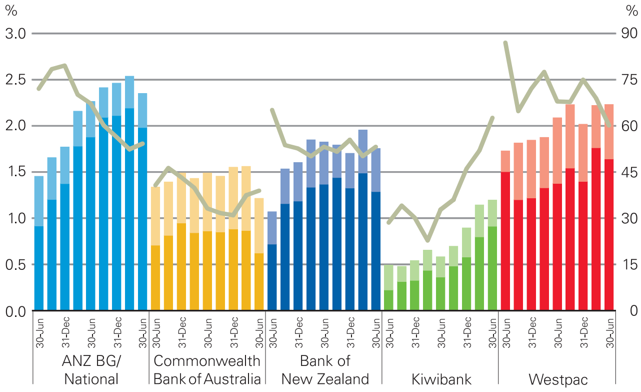
Retail banks – quarterly analysis

Quarterly analysis	Size & strength measures							
	30 Sep 09	31 Dec 09	31 Mar 10	30 Jun 10	30 Sep 10	31 Dec 10	31 Mar 11	30 Jun 11
	Total assets							
ANZ BG/National Bank [(a)]	122,992	121,210	119,944	118,797	123,484	121,012	121,530	121,774
Commonwealth Bank of Australia [(a)]	71,062	70,161	70,309	69,550	70,438	69,416	68,701	68,275
Bank of New Zealand	69,760	67,629	67,171	67,905	69,530	68,512	68,535	69,319
Kiwibank	10,743	11,974	12,030	12,190	12,594	12,921	13,796	13,827
Southland Building Society	2,609	2,658	2,625	2,578	2,569	2,823	2,811	2,836
TSB Bank	4,055	4,299	4,404	4,417	4,484	4,720	4,850	4,913
Westpac Banking Corporation [(a)]	72,821	71,789	71,538	70,705	72,168	72,218	73,958	74,809
Total	354,042	349,720	348,021	346,142	355,267	351,622	354,181	355,752
	Total risk weighted assets							
ANZ BG/National Bank [(a)]	81,181	86,744	79,856	79,461	79,775	79,461	80,444	79,520
Commonwealth Bank of Australia [(a)]	44,626	43,234	43,428	43,057	42,471	41,655	41,428	40,849
Bank of New Zealand	43,838	42,838	41,922	42,959	42,269	43,661	44,322	43,522 [(c)]
Kiwibank	5,241	5,607	5,858	5,997	5,990	6,220	6,942 [(c)]	6,720
Southland Building Society	1,687	1,699	1,710	1,701	1,714	1,822	1,822	1,789 [(c)]
TSB Bank	1,900	1,984	2,053	2,071	2,097	2,169	2,264	2,284
Westpac Banking Corporation [(a)]	48,877	47,710	47,734	47,524	44,874	44,740	48,530	50,272
Total	227,350	229,816	222,561	222,770	219,190	219,728	225,752	224,956
	Capital adequacy							
ANZ National Bank [(a), (b)]	13.70	13.40	13.00	12.60	11.90	11.90	12.10	11.80
Commonwealth Bank of Australia [(a), (b)]	10.50	11.63	11.60	11.50	11.30	11.50	N/A [(d)]	11.70
Bank of New Zealand	10.88	11.79	12.03	11.63	11.81	11.32	11.29	11.24
Kiwibank	9.80	9.60	9.40	11.70	11.90	11.40	10.50	10.50
Southland Building Society	13.40	13.52	13.35	13.45	13.66	13.97	13.60	13.89
TSB Bank	16.46	16.38	15.90	16.18	16.37	16.29	15.78	16.16
Westpac Banking Corporation [(a), (b)]	10.80	11.10	10.80	10.80	11.00	10.50	11.00	11.00
	Net profit							
ANZ BG/National Bank [(a)]	-284	253	133	234	247	260	218	257
Commonwealth Bank of Australia [(a)]	-122	164	117	132	169	144	114	155
Bank of New Zealand	2	271	144	161	26	150	105	131
Kiwibank	14	10	12	10	9	5	1	6
Southland Building Society	2	3	5	2	4	4	2	3
TSB Bank	14	13	9	9	10	11	10	12
Westpac Banking Corporation [(a)]	-802	340	114	190	116	143	134	166
Total	-1,176	1,054	534	737	582	717	584	729

Figure 3: **Major banks: Past due and gross impaired assets vs gross loans and advances**



■ Gross impaired/Gross loans and advances (LHS)
■ Past due/Gross loans and advances (LHS)
■ Total provisions/Past due and gross impaired assets (RHS)

Figure 4: **Major banks: Net profit after tax**

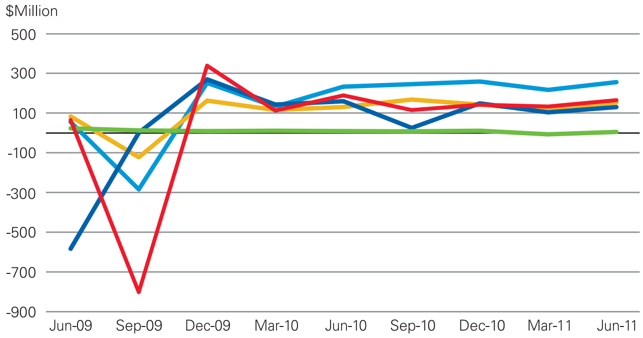
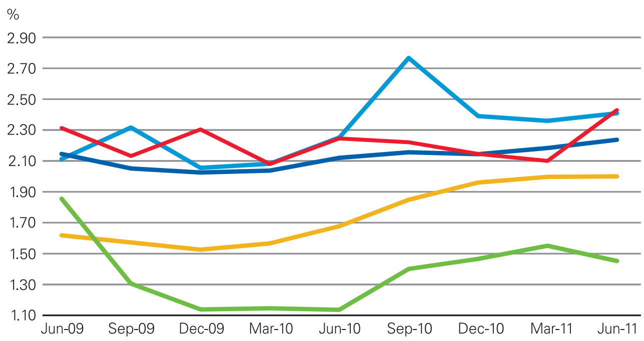


Figure 5: **Major banks: Interest margins**



■ ANZ BG/National ■ CBA + ASB ■ Bank of New Zealand ■ Kiwibank ■ Westpac

Footnotes

(a) The results for ANZ Banking Group (ANZ BG), Commonwealth Bank of Australia and Westpac Banking Corporation relates to the New Zealand banking group division of these entities.

(b) The capital adequacy ratio's reported are for the overseas banking group.

(c) Estimated using figures in the disclosure statement.

(d) December 2010 figure included in the March 2011 Disclosure statement.

n/a = not available/applicable

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Quarterly analysis	Profitability							
	30 Sep 09	31 Dec 09	31 Mar 10	30 Jun 10	30 Sep 10	31 Dec 10	31 Mar 11	30 Jun 11
	Interest margins							
ANZ BG/National Bank [(a)]	2.31	2.05	2.08	2.25	2.77	2.39	2.36	2.41
Commonwealth Bank of Australia [(a)]	1.57	1.52	1.56	1.67	1.85	1.96	1.99	2.00
Bank of New Zealand	2.05	2.02	2.04	2.12	2.15	2.14	2.18	2.24
Kiwibank	1.30	1.13	1.14	1.13	1.40	1.46	1.55	1.45
Southland Building Society	2.19	2.30	2.45	2.23	2.30	2.70	2.30	2.34
TSB Bank	2.73	2.70	2.40	2.16	2.01	2.19	1.85	1.99
Westpac Banking Corporation [(a)]	2.13	2.30	2.08	2.24	2.22	2.14	2.10	2.43
Average	2.04	1.96	1.93	2.06	2.28	2.17	2.16	2.25
	Non-interest income/total assets							
ANZ BG/National Bank [(a)]	0.30	1.16	0.49	0.82	-0.01	0.58	0.65	0.57
Commonwealth Bank of Australia [(a)]	0.67	0.98	0.44	0.61	0.63	0.54	0.52	0.55
Bank of New Zealand	-0.33	0.71	0.59	0.89	-0.06	0.67	0.29	0.32
Kiwibank	1.90	1.34	1.37	1.29	1.23	1.32	1.17	1.22
Southland Building Society	0.62	0.76	0.76	0.92	1.09	0.74	0.71	0.64
TSB Bank	0.50	0.29	0.28	0.34	0.30	0.26	0.25	0.31
Westpac Banking Corporation [(a)]	0.54	0.90	0.65	0.66	0.76	0.67	0.69	0.66
Average	0.35	0.98	0.56	0.77	0.32	0.63	0.58	0.56
	Impaired asset expense/average gross loans							
ANZ National Bank [(a), (b)]	1.42	0.62	0.71	0.34	0.20	0.14	0.21	0.19
Commonwealth Bank of Australia [(a), (b)]	0.60	0.24	0.07	0.02	-0.01	0.19	0.49	-0.06
Bank of New Zealand	0.35	0.31	0.33	0.34	0.37	0.28	0.40	0.13
Kiwibank	0.23	0.21	0.12	0.19	0.38	0.77	0.93	0.77
Southland Building Society	0.65	0.64	0.80	0.56	0.41	0.47	1.22	0.46
TSB Bank	0.11	0.34	0.17	0.06	0.10	0.16	0.15	0.15
Westpac Banking Corporation [(a), (b)]	0.89	0.84	0.72	0.05	0.73	0.40	0.42	0.48
Average	0.88	0.51	0.48	0.21	0.30	0.26	0.38	0.21
	Operating expenses/operating income							
ANZ BG/National Bank [(a)]	53.25	40.50	51.52	45.76	56.76	50.73	58.92	47.87
Commonwealth Bank of Australia [(a)]	43.56	35.73	46.92	48.19	41.05	43.33	42.34	47.51
Bank of New Zealand	79.84	48.04	47.80	41.89	66.36	43.56	47.69	48.77
Kiwibank	69.05	74.29	73.33	73.97	72.84	67.30	68.99	66.30
Southland Building Society	61.11	55.00	47.62	55.74	58.46	56.52	52.38	61.94
TSB Bank	34.38	41.94	37.93	33.19	42.61	39.29	44.00	37.90
Westpac Banking Corporation [(a)]	52.53	37.52	39.73	40.04	45.12	44.02	45.88	38.42
Average	55.14	41.46	48.00	45.02	52.85	47.17	51.34	46.54

Figure 6: **Major banks: Quarterly increase in gross loans and advances**

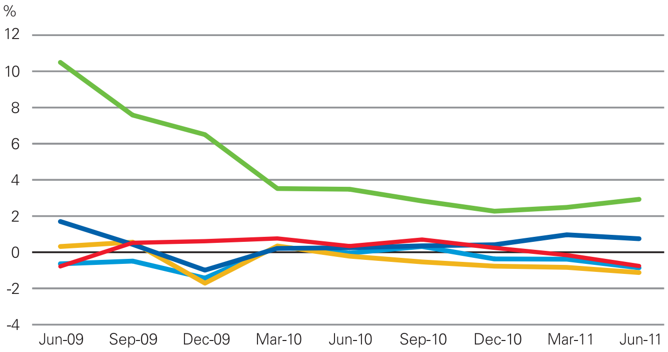


Figure 8: **Major banks: Operating expenses vs operating income**

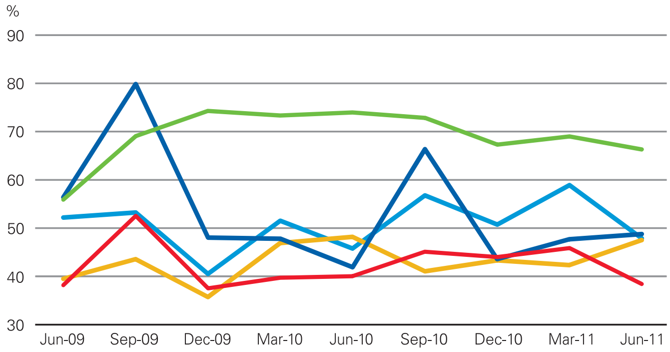


Figure 7: **Major banks: Non-interest income vs average total assets**

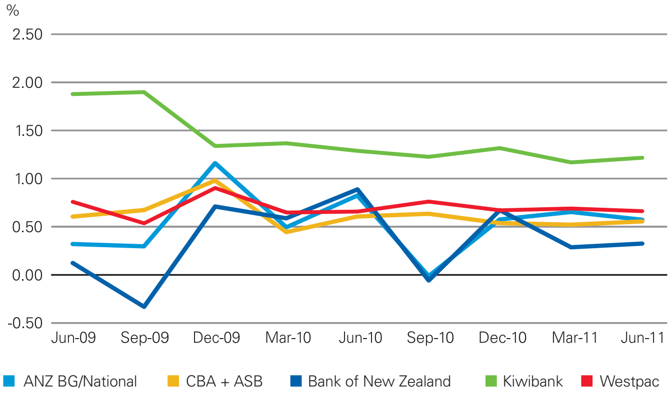
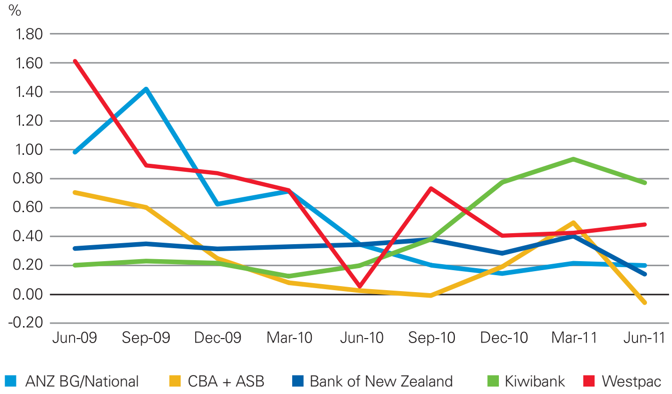


Figure 9: **Major banks: Impaired asset expense vs average gross loans and advances**



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