KPMG

FIPS Quarterly

Financial Institutions Performance Survey

July 2010

FINANCIAL SERVICES

MARCH QUARTER

A steady quarter of results – back on the growth path

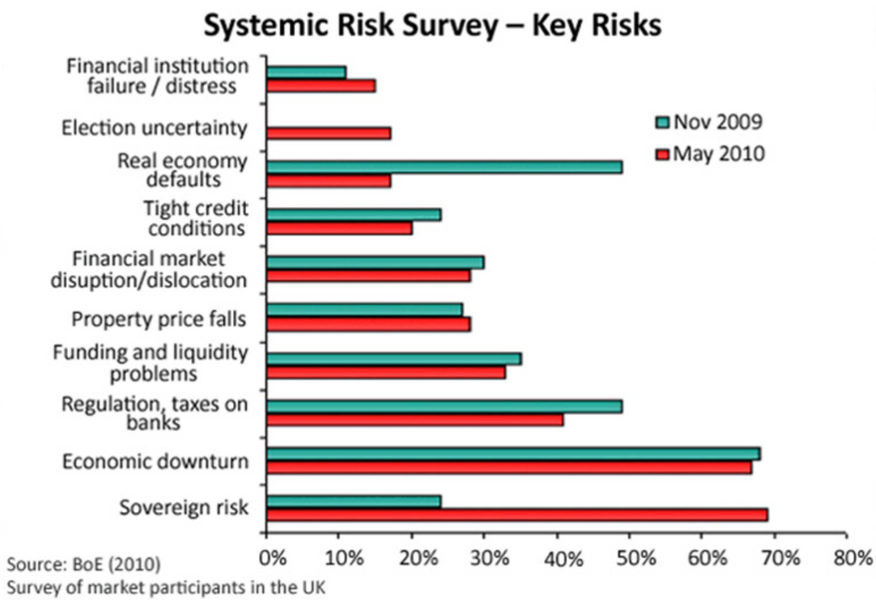
Results from the Major Banks
to 31 March 2010

Overview for the quarter

The results of the most recent quarter were steady, reflecting some encouraging signs that the worst of the recession is behind New Zealand and that conditions are starting to improve – albeit at a slower growth rate than many would have liked to see. While bottom line earnings were down on the previous quarter they were an improvement on the same quarter a year ago. For most of the banks margins had improved although the drive to lengthen the tenor of funding books has put pressure on funding costs for most. Impaired asset expense continued the trend of the previous three quarters and improved again (slightly).

The significant and noteworthy impacts over the quarter being:

- Margins compressed by 3 basis points over the quarter to 1.93% although this average was largely driven by Westpac BG who had an increase in funding costs over the quarter;
- The previously announced reductions in fees and charges, particularly on default type fees, is translating into lower fee income;
- Treasury and markets income over the March 2010 quarter was well below that experienced in the previous quarter – largely accounting for the lower net profit in the March quarter compared to the December quarter;
- Net bad debts continues to moderate, with an improvement in impaired asset expense reflecting the continued recovery in the economy and a perceived improvement in sentiment towards the rural sector as the milk payout ratio improves and droughts ease across the country.



Global

On a global banking perspective sovereign debt issues have continued to be prominent. As the Bank of England noted in its latest Financial Stability Report Sovereign Risk has leapt to the top of market participants list of key risks in 2010.

Further, the G20 has agreed to give banks more time to adopt the proposed tougher global rules in a concession that the body tasked with coordinating reforms said would both safeguard the recovery and ultimately lead to stronger banks. The Group of 20 endorsed a flexible timeline for building up higher levels of capital and liquidity and recommended that implementation of these new standards begins in 2012, with a transition horizon determined by the macroeconomic climate. The process for raising capital levels, so-called Basel III, toughens up the definition of core capital with a goal to strengthen banks ability to absorb market shocks without having to go cap in hand to taxpayers and central banks again.

Banks in the UK will be forced to pay more than two billion pounds in a new annual levy (which is the first of a series of taxes on large financial institutions in developed economies). The levy is pitched at 0.04 percent of targeted liabilities, rising to 0.07 percent in the following year. While Barak Obama announced a levy on big US institutions, the US tax has languished in the Senate and is yet to be effected.

New Zealand

In New Zealand, the Reserve Bank noted in its most recent Financial Stability Report (May 2010) that "the New Zealand banking sector has weathered the global financial crisis well, and the outlook for the sector is generally improving. The 'funding and liquidity' dimension... has continued to shift towards more normal levels... banks are now issuing greater quantities of debt at longer maturities without a government guarantee. However the costs of retail deposits have risen as banks vigorously compete for this additional source of stable funding."

They further state that "loan losses lag behind the improvement in economic activity. However, most of the key drivers of loan losses have been improving since the middle of 2009."

On 6 May 2010 Dr Bollard gave a pointer towards the Reserve Bank's view of the likely recovery in New Zealand. "Using a truck driver analogy, our foot is strongly on the accelerator. Over coming months we expect to reduce the pressure on this pedal, but in effect to keep some throttle going. Truck drivers know they must reduce acceleration long before the corner. We are not talking about tightening policy yet. We do not expect to have to touch the brake pedal for some time."

This translated into the first increase in the Official Cash Rate (OCR) by 25 basis points to 2.75 percent on 10 June 2010 reflecting a perception that the economy was moving into a growth phase.

The high proportion of borrowers having moved from fixed rate mortgages to floating over the last 6 to 12 months (with the low interest rate environment), has increased the effectiveness of the OCR in impacting economic recovery compared to the last time Dr Bollard moved rates back in April 2009.

Results for the quarter

Interest margin movements have been mixed over recent quarters, bouncing along between 1.9% and 2.0%. The most recent quarter continued this trend with an overall 3 basis point reduction to 1.93% on average. Although within the individual banks trends have been varied with ANZ, BNZ and CBA all experiencing a slight improvement in margins, while Westpac had a reduction in margin. For Westpac this appears to relate more to the December 09 quarterly margin being abnormally high rather than any systemic directional change in Westpac's margins. In fact ANZ, BNZ and Westpac have seen a convergence of their margins into a very narrow band of between 2.04% and 2.08%. CBA continues to track at a significantly lower level of 1.56%, and Kiwibank again reported an exceptionally low margin of 1.14%. For Kiwibank the competition for domestic deposits has reset margins at a level far below those experienced in previous years where Kiwibank was earning around 1.8%.

System growth has returned with loans and advances increasing 0.4% in the quarter across the surveyed banks, compared to system contraction in the prior quarter of 0.7%. The significant change across the group has been the slowing of growth at Kiwibank of only 3.2% over the quarter, down from the over 10% average quarterly growth experienced in the previous ten quarters. This would appear to reflect both the slower economic environment but also a more circumspect approach from Kiwibank.

Overall mortgage duration continues to shorten as borrowers appear to be attracted to the shorter end of the curve by the favourable rates. The proportion of mortgage duration two years or longer on bank balance sheets has fallen from 20% in May 2009 to only 10% in May 2010. These loans are essentially moving to floating rates.

As banks look to take advantage of the OCR rate rise – to increase mortgage rates (at the short end) but essentially hold deposit rates – we would expect to see some improvement in margins over the coming quarter/s.

Other income in the March 2010 quarter (primarily treasury and financial markets income) was softer than the previous quarter reflecting less volatility and the impact of the reductions in transaction fees across the major banks. The December 2009 quarter other income was a stronger quarters result than seen in the previous few quarters.

Operating expenses have reduced again in the March 2010 quarter, although with the lower level of operating income in the quarter, the cost to income ratio across the sector has increased.

Impaired asset expense improved on the December 2009 quarter with an impaired asset expense ratio to gross loans of 0.48% – well down on the high of March 2009 at 0.89%, or the 0.51% from the December 2009 quarter. This reflects a stabilisation in the level of new individual provisions being recorded, with a 5% reduction in individual provisions held being experienced over the quarter.

The quality of loan books has shown some deterioration with a 12% increase in gross impaired and past due loans. There has been a significant rise in impaired loans from $3.3 billion to $3.8 billion (a 15% increase), although past due loans remained largely static with a 3% lift over the quarter. This increase in the level of impaired loans would seem to point to a hardening of the banks stance with certain customers, and reflects the relatively poor market for development property and an almost stagnant market for rural land sales.

The industry increased collective provisions by approximately $90 million over the quarter lifting the ratio of total collective provisions to loans and advances to 0.71% (up from 0.68%).

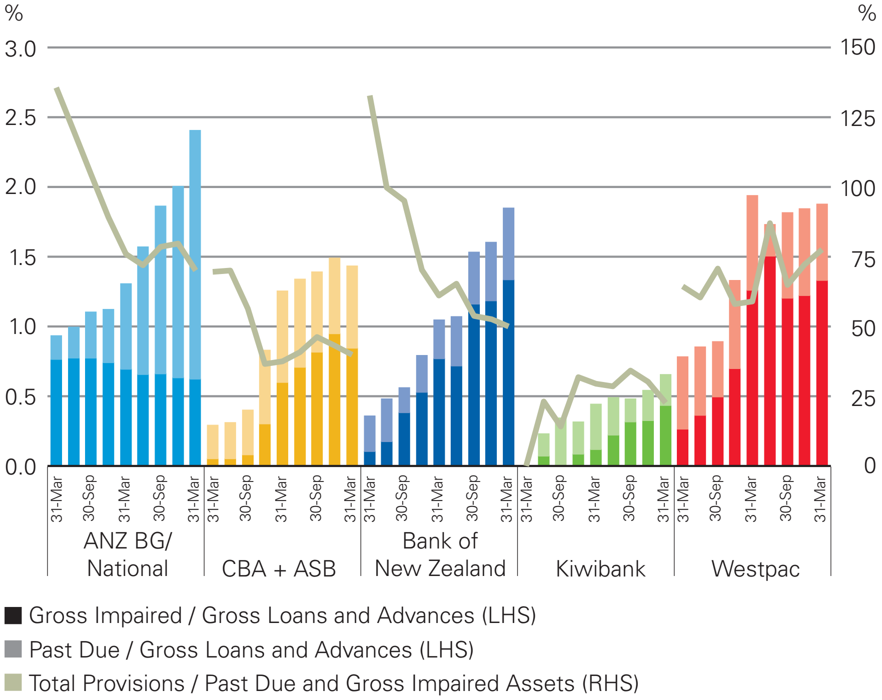
Overall profit levels have stabilised over the quarter although are still impacted by the higher level of impairment charges than experienced in prior years.

Regulatory developments

Global banking regulators and central banks have been active in recent months with a stress test of between 70 to 120 of the largest European banks. In Europe stress tests have recently been performed for the European Central Bank and the question now arises whether the results of these stress tests will be kept confidential or made public.

The new liquidity policies (core funding ratio, one week and one month mismatch ratios) are now effective for New Zealand banks from 1 April 2010. These ratios measure the fundamental structural liquidity mismatch across a bank. New Zealand is once again at the forefront of global regulation and is one of the first countries globally to impose such a policy.

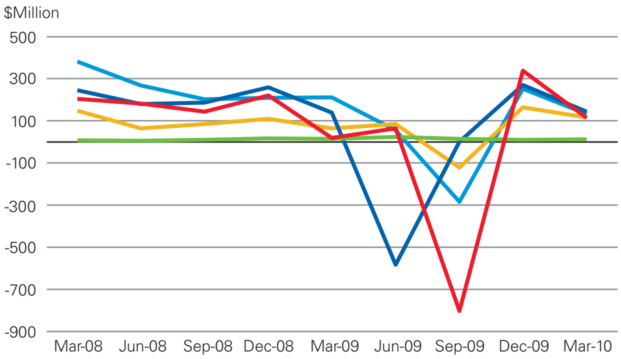
Major Banks: Past Due and Gross Impaired Assets vs Gross Loans and Advances



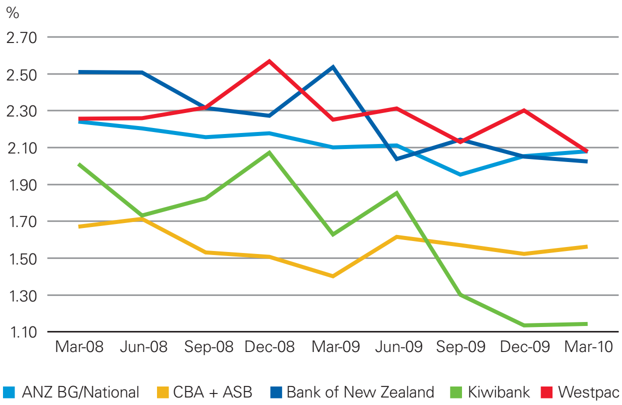
Retail banks – Quarterly analysis

Quarterly Analysis	Size & strength measures							
	30 Jun 08	30 Sep 08	31 Dec 08	31 Mar 09	30 Jun 09	30 Sep 09	31 Dec 09	31 Mar 10
	Total Assets							
ANZ Banking Group[(a)]	111,582	119,598	128,799	129,651	122,905	122,992	121,210	119,944
Bank of New Zealand	60,169	64,130	76,004	73,214	70,080	69,760	67,629	67,171
Commonwealth Bank of Australia[(a)]	66,048	69,522	72,263	72,524	71,662	71,062	70,161	70,309
Kiwibank Limited	7,183	8,146	9,370	9,700	10,328	10,743	11,974	12,030
Southland Building Society	n/a	8,146	2,562	2,538	2,562	2,609	2,658	2,625
TSB Bank Limited	3,281	3,403	3,650	3,831	3,924	4,055	4,299	4,404
Westpac Banking Corporation[(a)]	65,698	70,255	77,109	77,230	73,642	72,821	71,789	71,538
Total/Average	313,961	343,200	369,757	368,688	355,103	354,042	349,720	348,021
	Total risk weighted exposures							
ANZ Banking Group[(a)]	77,031	75,449	77,260	83,826	82,421	81,181	86,744	79,856
Bank of New Zealand	49,015	45,555	45,749	46,075	48,537	43,838	42,838	41,922
Commonwealth Bank of Australia[(a)]	42,829	43,893	44,892	45,177	42,829	44,626	43,234	43,428
Kiwibank Limited	3,378	3,815	4,341	4,639	4,966	5,241	5,607	5,858
Southland Building Society	n/a	3,815	1,667	1,654	1,664	1,687	1,699	1,710
TSB Bank Limited	1,472	1,494	1,562	1,689	1,766	1,900	1,984	2,053
Westpac Banking Corporation[(a)]	47,273	49,163	51,065	50,798	49,163	48,877	47,710	47,734
Total/Average	220,998	223,184	226,536	233,858	231,346	227,350	229,816	222,561
	Capital adequacy							
ANZ Banking Group[(a), (b)]	11.39	11.72	11.68	11.00	12.93	13.70	13.40	13.00
Bank of New Zealand	10.58	10.78	10.68	10.80	10.00	10.88	11.79	12.03
Commonwealth Bank of Australia[(a), (b)]	11.60	11.60	11.40	11.40	10.40	10.50	11.63	11.60
Kiwibank Limited	10.40	10.40	10.00	10.00	10.10	9.80	9.60	9.40
Southland Building Society	n/a	10.40	9.57	12.46	13.43	13.40	13.52	13.35
TSB Bank Limited	17.95	18.36	18.15	16.86	17.05	16.46	16.38	15.90
Westpac Banking Corporation[(a), (b)]	10.10	10.80	11.20	11.40	11.00	10.80	11.10	10.80
Average								
	Net profit							
ANZ Banking Group[(a)]	268	203	210	212	56	-284	253	133
Bank of New Zealand	181	188	260	140	-583	2	271	144
Commonwealth Bank of Australia[(a)]	65	86	109	66	84	-122	164	117
Kiwibank Limited	7	10	16	14	24	14	10	12
Southland Building Society	n/a	10	2	4	3	2	3	5
TSB Bank Limited	12	13	9	9	15	14	13	9
Westpac Banking Corporation[(a)]	183	144	220	19	66	-802	340	114
Total/Average	716	653	826	465	-335	-1,176	1,054	534

Major Banks: Net Profit After Tax



Major Banks: Interest Margins



Footnotes

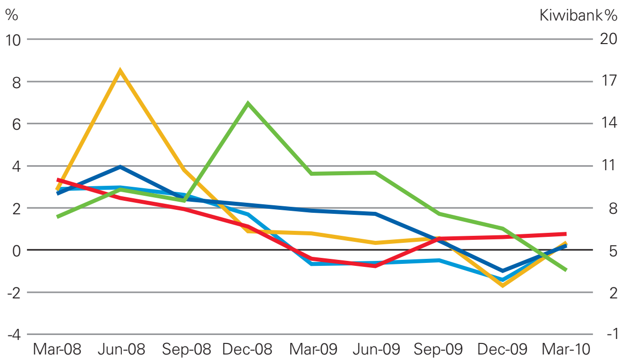
(a) The results for ANZ Banking Group (ANZ BG), Commonwealth Bank of Australia and Westpac Banking Corporation relates to the New Zealand banking group division of these entities.

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

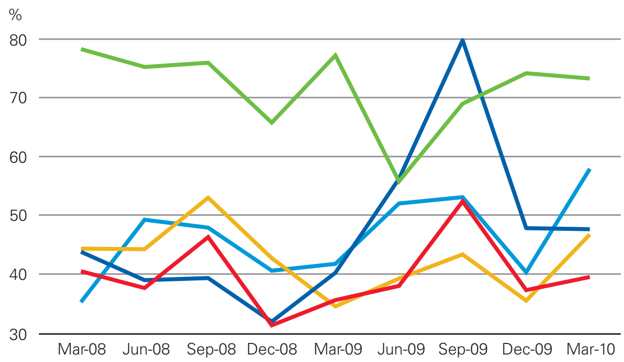
n/a = not available/applicable

Quarterly Analysis	Profitability							
	30 Jun 08	30 Sep 08	31 Dec 08	31 Mar 09	30 Jun 09	30 Sep 09	31 Dec 09	31 Mar 10
	Interest margins							
ANZ Banking Group[(a)]	2.20	2.16	2.18	2.10	2.11	1.95	2.05	2.08
Bank of New Zealand	2.31	2.27	2.54	2.04	2.14	2.05	2.02	2.04
Commonwealth Bank of Australia[(a)]	1.71	1.53	1.51	1.40	1.61	1.57	1.52	1.56
Kiwibank Limited	1.73	1.82	2.07	1.63	1.85	1.30	1.13	1.14
Southland Building Society	n/a	1.82	2.07	2.26	2.38	2.19	2.30	2.45
TSB Bank Limited	2.97	2.87	2.62	2.21	3.02	2.73	2.70	2.40
Westpac Banking Corporation[(a)]	2.26	2.32	2.57	2.25	2.31	2.13	2.30	2.08
Total/Average	2.12	2.11	2.19	1.96	2.06	1.91	1.96	1.93
	Non-interest Income / Total assets							
ANZ Banking Group[(a)]	0.63	0.94	1.06	0.84	0.32	0.62	1.16	0.22
Bank of New Zealand	0.99	1.13	1.20	0.68	0.12	-0.33	0.71	0.59
Commonwealth Bank of Australia[(a)]	0.46	0.40	0.82	1.03	0.60	0.67	0.98	0.44
Kiwibank Limited	1.79	1.60	2.02	1.14	1.88	1.90	1.34	1.37
Southland Building Society	n/a	1.60	0.12	1.86	0.78	0.62	0.76	0.76
TSB Bank Limited	0.26	0.57	0.13	0.74	0.31	0.50	0.29	0.28
Westpac Banking Corporation[(a)]	0.88	1.00	1.05	0.91	0.76	0.54	0.90	0.65
Total/Average	0.73	0.89	1.05	0.87	0.48	0.46	0.98	0.47
	Impaired asset expense/Average gross loans							
ANZ Banking Group[(a), (b)]	0.31	0.55	0.38	0.78	0.98	1.42	0.62	0.71
Bank of New Zealand	0.16	0.16	0.26	0.47	0.31	0.35	0.31	0.33
Commonwealth Bank of Australia[(a), (b)]	0.22	0.13	0.45	0.79	0.70	0.60	0.24	0.07
Kiwibank Limited	0.21	0.05	0.33	0.21	0.20	0.23	0.21	0.12
Southland Building Society	n/a	0.05	0.63	0.61	0.49	0.65	0.64	0.80
TSB Bank Limited	0.05	0.19	0.02	0.31	0.07	0.11	0.34	0.17
Westpac Banking Corporation[(a), (b)]	0.25	0.60	0.69	1.70	1.61	0.89	0.84	0.72
Average	0.24	0.39	0.43	0.89	0.88	0.88	0.51	0.48
	Operating expenses/Operating income							
ANZ Banking Group[(a)]	49.40	48.06	40.82	41.99	52.21	53.25	40.50	58.10
Bank of New Zealand	39.23	39.60	32.21	40.45	56.37	79.84	48.04	47.80
Commonwealth Bank of Australia[(a)]	44.48	53.14	42.96	34.75	39.48	43.56	35.73	46.92
Kiwibank Limited	75.36	76.03	65.87	77.25	55.91	69.05	74.29	73.33
Southland Building Society	n/a	76.03	63.96	61.69	55.00	61.11	55.00	47.62
TSB Bank Limited	33.66	33.81	44.76	50.44	31.25	34.38	41.94	37.93
Westpac Banking Corporation[(a)]	37.82	46.48	31.55	35.86	38.18	52.53	37.52	39.73
Total/Average	44.30	47.43	38.15	40.31	46.95	55.14	41.46	50.00

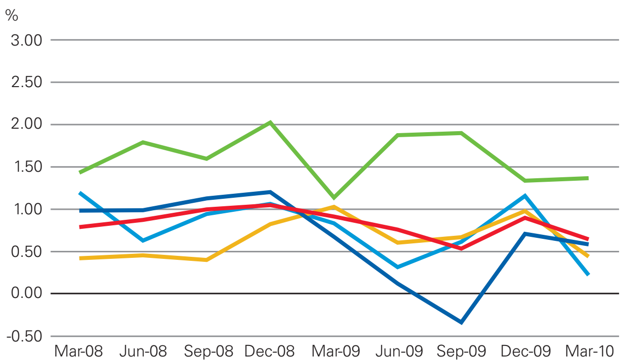
Major Banks: Quarterly Increase in Gross Loans and Advances



Major Banks: Operating Expenses vs Operating Income

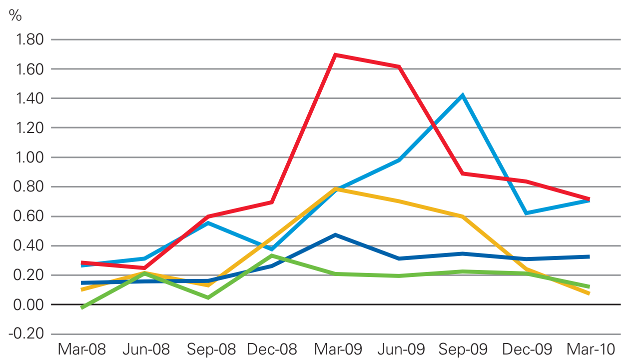


Major Banks: Non-interest Income vs Average Total Assets



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

Major Banks: Impaired Asset Expense vs Average Gross Loans and Advances



ANZ BG/National ■ CBA + ASB ■ Bank of New Zealand ■ Kiwibank ■ Westpac kpmg.com/nz

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