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News release

Banking profits lift even though net interest income comes under pressure

New Zealand's five major banks (ANZ, ASB, BNZ, Kiwibank and Westpac) have continued to show strong profits and lending growth in the first quarter of the 2015 calendar year (being 1 January 2015 to 31 March 2015, 1Q2015) however lending margins are beginning to contract due to stiff competition.

Net profit before tax increased by $94 million or 5.9% to $1.69 billion for the first quarter of 2015, compared to $1.59 billion earned during the fourth quarter of 2014. The $94 million increase in profit before tax is attributable to an increase in other operating income of $75 million (10.5%) and a decrease in operating expenses of $33 million (3.0%), offset by a decrease in net interest income of $3 million (0.1%) and an increase in impairment losses on loans of $11 million (12.4%).

All in all, this is another strong result reported by New Zealand's major banks behind the back-drop of escalating house prices, predominantly in the Auckland property market. While there have been numerous views on what is driving Auckland property prices, the Reserve Bank has continued to take action to elevate the concerns that a rapid house price correction in Auckland property market would have on New Zealand's overall financial stability. Time will tell what the full impact of these initiatives will be, but at least the Reserve Bank won't be accused of not taking active steps to lessen the risk of financial instability from a sharp correction in house prices.

Lost within the headlines of continued record profits by the banks is the decrease in net interest income. While total gross loans have increased by $6 billion or 1.9% during 1Q2015 to $327.3 billion, interest income has decreased across the same period by $40 million to $5.3 billion. Interest income to average interest earning assets have decreased from 5.95% in 4Q2014 to 5.78% in 1Q2015 reflecting the very competitive lending market during the first quarter of 2015, with the banks keen to attract new customers or retain existing customers through low interest rates which have eaten into their lending margins.

Interest expense has decreased by $37 million since 4Q2014 to $3.2 billion despite funding growth during 1Q2015 of $6.8 billion to $448.4 billion. This decrease in funding costs is due to significant falls in wholesale interest rates (especially in the medium to long terms). Interest expense to average interest bearing liabilities have decreased from 4.10% at 4Q2014 to 4.02% at 1Q2015. As a result, the banks' net interest margin has decreased from 2.31% at 4Q2014 to 2.26% at 1Q2015.

The increase experienced in other operating income was due to volatility in the gains/losses on financial instruments recognised at fair value in the current quarter.

Total operating expenses were down in 1Q2015 by $33 million when compared to 4Q2014. A slight decrease in operating expenses has been experienced by four of the five major New Zealand banks during 1Q2015 compared to 4Q2014 which reflects the continuation of cost control by the major New Zealand banks.

Impaired asset expenses or bad debt expenses have increased by $11 million to $100 million in 1Q2015 compared to $89 million in 4Q2014. Given the level of problematic loans being managed by the banks have not changed and the economic climate at that time, the impaired asset charges are not surprising.

Total lending growth for the first quarter was 1.90%, up from the previous quarter of 1.47%. Total lending sat at $327.3 billion at the end of the quarter, compared to $321.2 billion three months earlier. In examining this total increase in lending, it was observed that corporate lending growth for the quarter was 2.18%, up from 2.12% in the previous quarter, reflecting the continued positive economic conditions and the low interest environment. Total corporate lending was $120.1 billion at the end of 1Q2015.

Mortgage lending growth for the quarter was 1.72%, up from the previous period's mortgage lending growth of 1.26%. Consistent with 4Q2014, mortgage lending growth was lower than that generated in corporate lending. Total mortgage lending stood at $193.7 billion at the end of 1Q2015 ($190.5 billion at 4Q2014). Mortgage lending growth is higher than 1Q2014 taking into account seasonality, with more housing sales expected during the summer months. 1Q2015 is also higher than any quarter during 2014, which reflects the continued heated housing market particularly in Auckland and the current low interest rates offered by the banks. Other retail lending remained largely static at $13 billion.

The percentage of mortgages with an LVR in excess of 80% has continued to reduce and now represents 14% of total mortgage lending in 1Q2015, compared to 15% of total mortgage lending in 4Q2014. This supports the continued influence the LVR restrictions have had on New Zealand's mortgage market with a net reduction in mortgages with an LVR in excess of 80% to total mortgages.

Mortgage holders on floating interest rates make up 27% of the mortgage market at 1Q2015 (42% at 4Q2013, 63% at 1Q2012) and slightly down from 4Q2014. However, the mix of mortgage funding continues to increase in the medium to long-term of fixed interest rates with approximately 46% of mortgage lending fixed for longer than one year compared to 43% at 4Q2014 (26% at 4Q2013, 15% 1Q2012). This is predominantly due to the banks offering low mortgage interest rates to customers during 1Q2015 in the medium to long terms to drive volume growth.

Total credit provisioning has increased by $42 million since 4Q2014 to $1.9 billion at 1Q2015. However a net $49 million of this increase is due to a one-off adjustment for the impact of one bank changing their basis for providing for credit losses as a result of early adopting an accounting standard change.

Overall, credit quality remains steady in line with 4Q2014 with impaired assets continuing to be at $1.6 billion. 90 day past due assets (not impaired) have slightly increased by $55 million to $682 million at 1Q2015, due to seasonality as result of the holiday spending and is down on 1Q2014 of $747 million.

The funding mix for 1Q2015 has remained fairly consistent with the previous quarter. Retail funding represents approximately 63% of the banks' total liabilities and highlights the continuation of the improving funding composition of our major banks.

Capital levels continue to remain strong, with average total capital ratio hovering at 12.5%, well ahead of minimum requirements and an increase by 0.2% since 4Q2014. It will be interesting to see the impact on capital ratios as a result of the Reserve Bank's new asset class treatment for residential property investors which is expected to come into effect from 1 October 2015.

Basic leverage ratio (eligible capital to total assets) increased from 6.96% at 4Q2014 to 7.14% at 1Q2015 which reflects the increasing eligible capital generated by the banks offsetting the credit growth experienced in the first quarter of 2015.

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Notes to editors:

This analysis was prepared by PwC Partner and Banking & Capital Markets Leader Sam Shuttleworth and looks at the recent results of the four major Australian-owned banks that operate in New Zealand – Westpac (including Westpac New Zealand Limited), CBA (including ASB Bank), ANZ (including ANZ Bank New Zealand) and BNZ – as well as Kiwibank. Kiwibank is smaller than the four major banks but included in this analysis because it has a high-profile impact on the local market. This data is the reported results for the first quarter of the 2015 calendar year. The analysis is based on publicly available information.

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