MAJOR AUSTRALIAN BANKS

The Majors and their margins
Half Year 2022 Results Analysis

May 2022

Contents

Half Year 2022 Results Snapshot

REVENUE

Operating income increased by **0.8%** to

$39.9 billion

Net interest income increased by **0.2%** to

$32.0 billion

EARNINGS

Cash profit after tax **increased** by **5.1%** to

$14.4 billion

Average **net interest margin decreased** by **13.0 bps** to

175 bps

SHAREHOLDER RETURNS

Average return on equity[1] **increased** by **0.21% pts** to

10.6%

Average **dividend payout ratio increased** by **2.8% pts** to

66.0%

EXPENSES

Average **cost to income ratio decreased** by **0.7% pts** to

49.6%

Share of **risk and compliance of total investment spend decreased** by **1.9% pts** to

48.0%

ASSET QUALITY

Average credit impairment provisions (as % of GLA) **decreased** by **9 bps** to

0.70 %

Write-back of credit provisions of

$218 million

BALANCE SHEET

Average CET1 **capital ratio decreased by 90 bps** to

11.8%

Deposit to loan ratio increased 1.4% pts to

86.0%

Lending assets increased by 4.1% to

$2.9 trillion

*Comparisons are to the 2021 financial year, unless otherwise stated and adjusted for restatements as applicable

[1] Includes notable items

At a glance

	ANZ		CBA[1]		NAB		WBC	
	1H22	PCP[2]	1H22	PCP[2]	1H22	PCP[2]	1H22	PCP[2]
Ranking								
By profit before tax	2	4	1	1	3	3	4	2
By total assets	2	2	1	1	3	4	4	3
By total equity	3	3	1	1	4	4	2	2
By market capitalisation	4	4	1	1	2	3	3	2
By CET 1 capital ratio	3	3	2	1	1	2	4	3
Financial Performance – P/L (continuing operations)								
Operating Income – cash basis	8,948	8,423	12,205	11,961	8,828	8,439	9,959	10,799
Profit before tax ($ million) – statutory basis	5,035	4,376	6,646	5,362	5,001	4,520	4,718	5,061
Profit after tax ($ million) – statutory basis	3,535	2,951	4,741	3,759	3,571	3,230	3,284	3,445
Cash profit after tax ($ million)	3,113	2,990	4,746	3,868	3,480	3,343	3,095	3,537
Performance Measures – P/L (continuing operations)								
Net interest margin – cash basis (basis points)	158	163	192	206	163	174	185	209
Cost to income ratio – cash basis (%)	53.9	53.5	45.8	46.7	44.9	45.8	53.9	55.4
Basic earnings per share – statutory basis (cents)	125.9	104.0	272.5	212.3	109.7	97.8	90.5	94.5
Basic earnings per share – cash basis (cents)	110.8	105.3	272.8	218.5	106.9	101.6	85.4	97.1
Return on average equity (%) – cash basis	10.0	9.7	12.3	10.5	11.3	11.1	8.7	10.2
Credit Quality Measures								
Impairment charge/(benefit) ($ million) (statutory basis)	(284)	(491)	(75)	882	2	(128)	139	(372)
Impaired loans to total loans and advances to customers (%)	0.26	0.31	0.41	0.42	0.17	0.20	0.23	0.30
Collective provision to credit RWA (%)	1.08	1.22	1.30	1.39	1.31	1.35	1.16	1.17
Financial Position								
Total assets ($ million)	1,017,361	978,857	1,149,813	1,091,975	975,876	925,968	964,749	935,877
Total equity ($ million)	61,756	63,676	74,663	78,688	61,029	62,779	70,333	72,092
Capital Measures								
Capital Adequacy Ratios (%)								
- Total	16.6	18.4	18.0	19.8	18.6	18.9	17.7	18.9
- Tier 1	13.2	14.3	14.0	15.7	14.1	14.6	13.4	14.7
- Common Equity Tier 1	11.5	12.3	11.8	13.1	12.5	13.0	11.3	12.3
Market capitalisation ($ billion)[3]	77.0	79.4	172.2	177.0	103.9	91.2	84.9	95.4

[1] CBA reported as at 31 December 2021. All other Majors as at 31 March 2022.
[2] PCP data comprises of 1H21 for profit and loss (P/L) metrics and 2H21 for balance sheet (B/S) metrics, unless otherwise stated.
[3] Market capitalisation as at the reporting date of the Majors.

Executive summary

The 2022 half year results of the Australian major banks (the Majors) saw an increase in aggregate cash profit of 5.1 per cent. The results highlight the improved economic conditions and strong demand for credit. Underlying margin pressures continue to be the largest headwind impacting the Majors' performance.

Key Highlights

The Majors reported a combined **cash profit after tax** from continuing operations of $14.4 billion, up 5.1 per cent from the prior comparative period (PCP). This result reflects strong growth in lending activities and reductions in large one-off notables including remediation, regulatory and impairment expenses.

The **average net interest margin** (cash basis) compressed, decreasing 13 basis points from the first half of 2021 to 175 basis points. Declining margins were driven by fierce mortgage competition, strong demand for low margin fixed rate mortgages and higher holdings of low-yielding treasury assets.

Write-backs to **aggregate loan impairment expenses** of $218 million were driven by continued improvements in the economic environment and strengthened asset quality. These releases were offset in part by targeted provisioning to capture the potential downside emerging from interest rate increases and inflationary pressures.

Cost-to-income ratios decreased modestly from an average of 50.3 per cent in HY21 to 49.6 per cent. The Majors reported a decrease in operating costs of 1 per cent to $19.7 billion, reflecting reductions in notable items, offset by higher staffing expenses in response to increased lending volumes and increased investment in growth and productivity.

On average the Majors' **Common Equity Tier 1 (CET1) ratio** decreased by 90 basis points to 11.8 per cent as all of the Majors completed share buy-backs during 1H22 and lending growth has driven higher Credit Risk-Weighted Asset (CRWA) usage. The Majors' CET1 ratio still remains comfortably above APRA 'unquestionably strong' benchmark of 10.5 per cent.

Dividend pay-out ratios increased to 66.0 per cent from 63.2 per cent in the PCP. The return to higher dividends illustrates the Majors' confidence in the sustainability of their earnings.

Rebounded earnings have seen **returns on equity** (ROE) increase by 21 basis points from the PCP to 10.6 per cent, returning to the double-digit standards experienced prior to the pandemic. Maintaining shareholder returns in an inflationary environment will continue to challenge ROEs for the foreseeable future.

"The major banks have successfully used the recovery of the Australian economy and the strong housing market performance to deliver much improved financial results. With returns on equity in the sector now again restored to double digits but with uncertainty ahead, it will be interesting to see how they maintain their current momentum."

STEVE JACKSON,
KPMG AUSTRALIA'S HEAD OF BANKING AND CAPITAL MARKETS

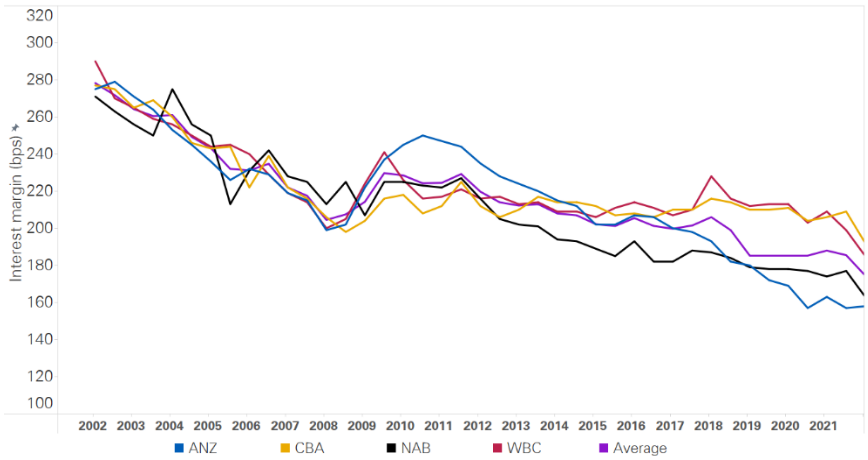
Key Observations

Under the hood of profitability

Following a period of earnings volatility, a level of stability has returned as the Majors benefited from strong demand for credit amidst the pandemic turmoil. The results continue to be affected by the downward pressure on interest margins, resulting from strong rate competition and a higher proportion of lower margin fixed rate mortgages, which has more than offset the benefits of lower funding costs. In addition, the Majors need to address APRA's expectation for ADIs to reduce their reliance on the sector-wide Committed Liquidity Facility (CLF), as it phases out in 2022.

Despite margin relief anticipated in a rising interest rate environment, these challenges are not expected to abate in the short-to-medium term as competition for market share will remain intense.

Diagram 1 **Net Interest Margins**



Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Stubborn costs

The 2022 half-year results illustrate the Majors face headwinds in their drive to reduce costs, as adjusted cost-to-income ratios (excluding notable items) remain effectively flat. The question is still out as to when it can be expected that the Majors' cost transformation initiatives will result in improved cost-to-income ratios, as emerging inflationary pressures have seen two of the Majors re-position their upcoming cost target commitments.

Capital turning point

The Majors reported decreases in their CET1 ratio which, whilst modest, appears to signal an inflection point has been reached in deepening the capital coffers. This follows recent periods where the Majors have been adding to their capital strength through a combination of divestments and lower dividend pay-outs over the course of the pandemic. It is entirely possible the capital positions have now peaked, as the Majors will need to continue utilising their capital to facilitate loan growth in a competitive, rising interest rate environment.

Re-pivoting provisioning

As customers and businesses learn to live with the pandemic, the significant COVID related provisions raised by the Majors in 2020 have been significantly unwound. Underlying credit quality of the Majors' lending portfolios has returned to pre-pandemic levels, with 90+ day delinquencies decreasing to 58 basis points of Gross Loans and Advances.

Increasing interest rates and rising inflation have introduced new uncertainties however, with three of the four Majors raising targeted provisioning in response to these emerging risks during the half.

" We may have reached an inflection point on balance sheet strength. This signals that the Majors have left the recent disruptions behind them, and are now charting a new course. They are starting to 'draw down' on the balance sheet 'deposits' they have been making since 2020."

MARIA TRINCI,
KPMG BANKING PARTNER

Outlook

Despite the Australian Economy's strong rebound from the height of the pandemic, the economic outlook remains uncertain amidst inflationary pressures and geopolitical unrest. Reversing an historic decade long trend, the RBA's recent announcement to increase the cash rate brought a renewed focus on the Majors and the role they will play as part of the monetary setting equation. All of the Majors responded quickly, confirming mortgage rates would see the full 25 basis point increase. Alongside the Federal Reserve's largest rate hike since 2000 of 50 basis points, economists are forecasting earlier and more frequent rate rises domestically.

Rate rises have become synonymous with mortgage distress and softening house prices given Australian household indebtedness. The RBA has pointed to improved resilience in households to withstand the effects of higher rates as supportive macroeconomic measures over the course of the pandemic has resulted in significant saving buffers. These buffers are expected to be tested over the next two years as a number of rate increases are anticipated.

Whilst the increasing interest rate environment will support a recovery in the Majors' net interest margins, this expectation should be tempered. A higher fixed rate back-book mix, steepening yield curves and the upcoming requirement (between September 2023 and June 2024) to refinance cheap Term Funding Facility (TFF) funding will dampen the benefit of rate increases. The Majors have become increasingly dependent on mortgage and business lending following the divestment of non-core business. Concurrently, their investments in building new banking business models are some way away from producing significant new revenue streams. The question is, where will the growth come from in the short-to-medium term as lending potentially slows as a result of higher interest rates.

" We expect to see the dual impacts of both net interest margin relief and higher levels of mortgage book stress, as RBA interest rates are expected to increase several times. However, these impacts will take their time to pull through as both margins and book quality have built up their momentum over a long period of low rates."

HESSEL VERBEEK,
KPMG'S BANKING STRATEGY LEAD

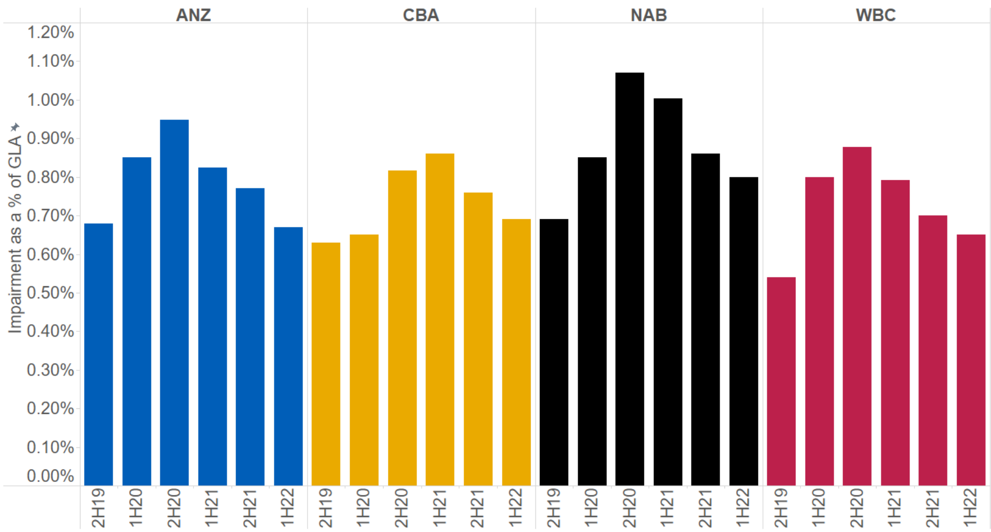
Asset quality

Based on a strong underlying economy, the Majors have further released loan impairment provisions of $218 million in 1H22, although there is uncertainty on the horizon from potential impacts of inflation and interest rate rises.

With the Australian economy's continued strong recovery, the Majors have an optimistic economic outlook compared with the last two years. The overall increase in GDP, including an historically high 3.4 per cent in the December 2021 quarter, and the decrease in unemployment have both evidenced and promoted optimism in the wider economy. Notwithstanding, there are raised uncertainties due to higher inflationary pressures and rate rises by the RBA expected to continue in the short to medium term.

The overall impact of these factors was positive in 1H22 with an increase in the Majors' total loan portfolio and a decrease in credit loss provisions, resulting in a reduced ratio of impaired loans to Gross Loans and Advances (GLA) by an average of 7 basis points compared to 2H21. However, the ratio remains 7 basis points higher than pre-COVID levels.

Diagram 2 **Provisions as % of GLA**



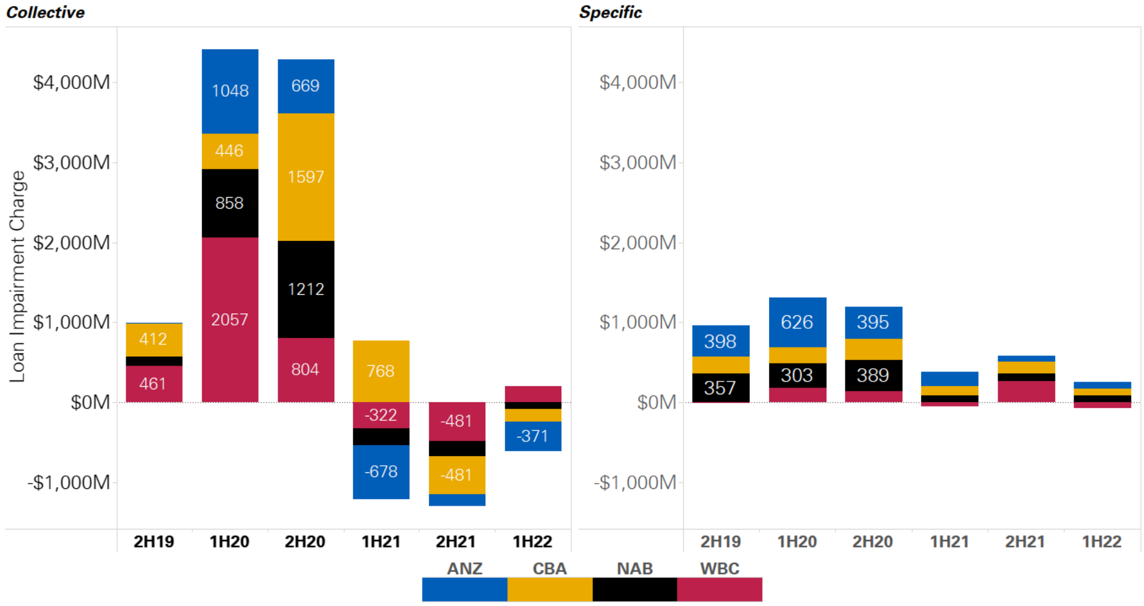
Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Loan Impairment

The Majors have released $405 million in collective impairment charges in 1H22. This has primarily been driven by improved economic conditions in Australia and increasing asset quality. Uncertainties in the economic outlook remain, in particular the geopolitical unrest between Ukraine and Russia and supply chain disruptions. The Majors have incorporated these uncertainties into their forward-looking assumptions of expected credit losses (ECLs).

Specific impairment charges of $187 million were taken during 1H22 compared to $335 million in 1H21. This reduction is a result of decreases in underlying delinquencies and impairment flows, as well as a return to normalised levels of impairment after the COVID-impacted comparative period.

Diagram 3 **Loan impairments charge**

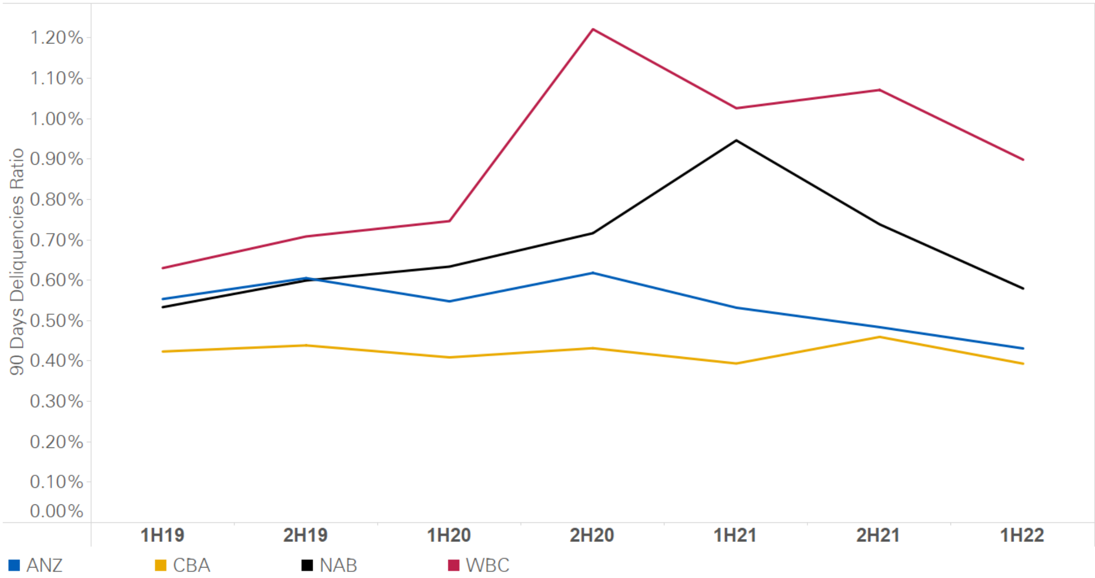


Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Delinquency

Delinquencies (90+ days past due) have seen a general reduction as a result of improving economic conditions, a strong property market and the effect of government support provided during the pandemic. Average delinquencies as a proportion of GLA across the Majors decreased by 11 basis points compared to 2H21.

Diagram 4 **90 Days Delinquency Ratio**



Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Capital

Strong balance sheets have positioned the Majors well for growth, with each of the Majors executing share buy-backs over the half.

Capital adequacy

The Majors are well capitalised as a result of capital management strategies through the pandemic, and capital positions continue to exceed the 'unquestionably strong' thresholds set by APRA.

The average CET1 ratio across the Majors decreased by 90 basis points to 11.78 per cent. This has mainly been driven by the completion of share buy-backs, payment of final FY21 dividends and higher total risk-weighted assets (RWA) due to growth of the lending portfolio and interest rate risk in the banking book. The Majors collectively completed $13.5 billion in share buy-backs during the period:

- ANZ completion of $1.5 billion on-market share buy-back in March 2022.
- CBA completion of $6.0 billion off-market share buy-back in October 2021.
- NAB completion of $2.5 billion on-market share buy-back in March 2022.
- WBC completion of $3.5 billion off-market share buy-back in February 2022.

	ANZ		CBA		NAB		WBC	
	1H22	PCP	1H22	PCP	1H22	PCP	1H22	PCP
Common Equity Tier 1 (%)	**11.5**	**12.3**	**11.8**	**13.1**	**12.5**	**13.0**	**11.3**	**12.3**
Tier 1 Capital (%)	13.2	14.3	14.0	15.7	14.1	14.6	13.4	14.7
Tier 2 Capital (%)	3.4	4.1	4.0	4.1	4.5	4.3	4.3	4.2
Total Regulatory Capital ratio (%)	**16.6**	**18.4**	**18.0**	**19.8**	**18.6**	**18.9**	**17.7**	**18.9**

The average leverage ratio across the Majors decreased by 43 basis points to 5.40 per cent. This remains well above APRA's minimum requirement of 3.50 per cent for internal ratings based ADIs. The movement was consistent across the Majors, driven primarily by off-market share buy-backs and net organic capital generation.

Liquidity

Across the Majors, liquidity ratios remain healthy, with the average liquidity coverage ratio (LCR) increasing by 375 basis points to 134.25 per cent, largely driven by an increased holding of High-Quality Liquid Assets (HQLA). This is despite APRA's announcement of a sector-wide phased reduction in the reliance on the Committed Liquidity Facility (CLF) and has resulted in an insignificant movement in LCR across the Majors. The RBA expects there will be sufficient HQLA for ADIs to meet their LCR requirements without the need to utilise the CLF by the end of 2022, subject to market conditions.

Net interest income

Margins continue to compress across the Majors, despite lower funding costs, due to an increase in the share of fixed rate lending driven by increased competition, as well as the impact of increases in lower yielding liquid assets.

Cash Basis	1H22	PCP	Movement
Net Interest Income ($million)			
ANZ	7,100	6,986	1.6%
CBA	9,748	9,600	1.5%
NAB	7,085	6,839	3.6%
WBC	8,028	8,469	-5.2%
Aggregate	**31,961**	**31,894**	**0.2%**
Net Interest Margin (basis points)			
ANZ	158	163	(5)
CBA	192	206	(14)
NAB	163	174	(11)
WBC	185	209	(24)
Average	**175**	**188**	**(13)**

Net interest margin

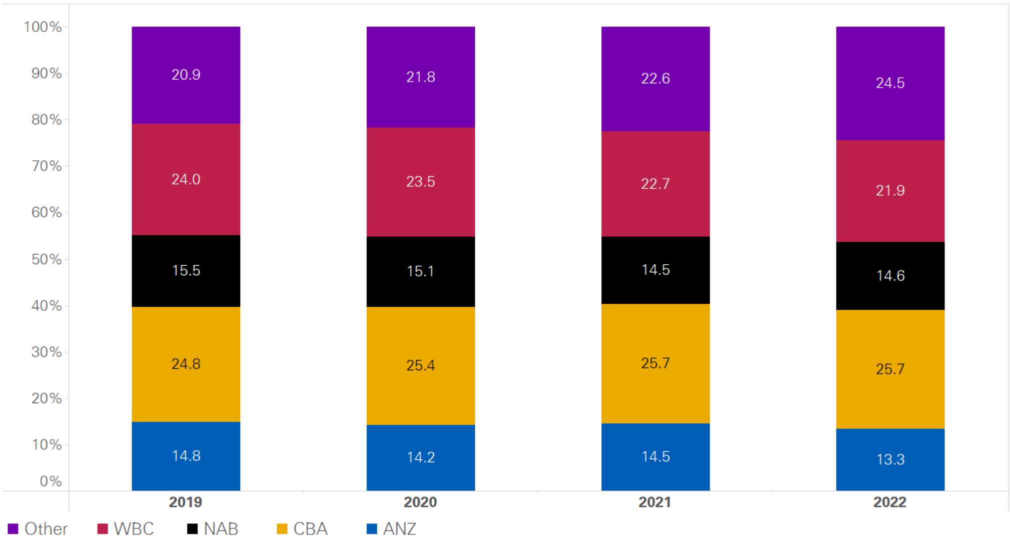
Net interest margin across the Majors continued to fall in 1H22 with an average decrease of 13 basis points. Thematically, the key drivers of margin pressure across the Majors were consistent and include:

- Increased competition both amongst the Majors and from challenger banks and non-bank lenders, particularly impacting household lending margins. The combined Majors' household lending market share has decreased from 79.1 per cent at the start of 2019 to 75.5 per cent today (see Diagram 5).
- Refinancing activity within mortgage lending as customers took advantage of lower margin fixed rate loans.
- Pressure on the household loan portfolio from the impact of increased swap rates on fixed rate loans.
- Continued deployment of excess liquidity generated by strong deposit inflows into lower yielding assets.

The downward pressures on the net interest margin have been partially offset by:

- Lower funding costs driven by net gains from deposit repricing in the market and
- The costs of wholesale funding have fallen, improving margins, although there is an increasing reliance on customer deposits.

Diagram 5 **Household Lending Market Share**



Source: APRA Monthly Banking Statistics

Interest earning assets

Average interest earning assets increased by 6 per cent from 2H21 to $3,652 billion with all four Majors reporting increases.

This was primarily driven by above system growth in both housing and business lending in the period.

Mortgage lending saw growth of 3 per cent across the Majors in 1H22 to $1,874 billion. The growth was predominantly driven by stronger demand for credit and overall system growth across the Australian market.

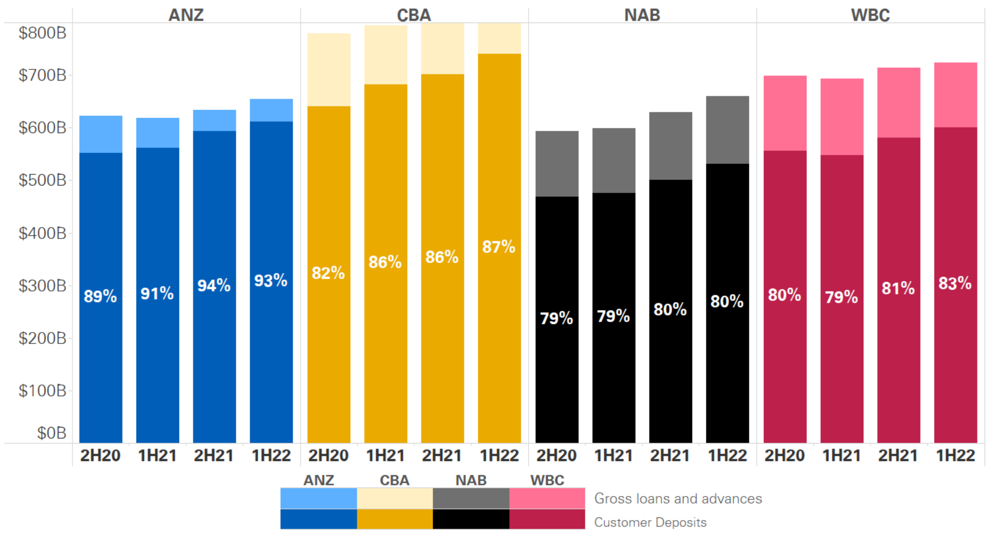
Aggregate other lending (including business lending) grew by 5 per cent from 2H21 to $1,015 billion, largely due to improving business confidence and lower rates stimulating increased demand.

Funding Mix

Customer deposits remain the primary source of funding for the Majors. The average proportion of customer deposits to total gross loans and advances across the Majors has increased, with three out of four Majors reporting an increase, by an average of 1 per cent in 1H22 to 86 per cent.

The rate of growth in customer deposits has moderately exceeded the ability of the Majors to grow their lending assets. In comparison, total gross loans and advances increased by 3 per cent during the period.

Diagram 6 **Customer deposits as a proportion of gross lending assets us**



Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Notable Items

Divestments continue to be a key feature across the Majors as well as customer remediation costs.

Divestments

The Majors have continued their simplification journey, with sustained divestment activity in 1H22 with three banks reporting asset sales. Key transactions during the period included:

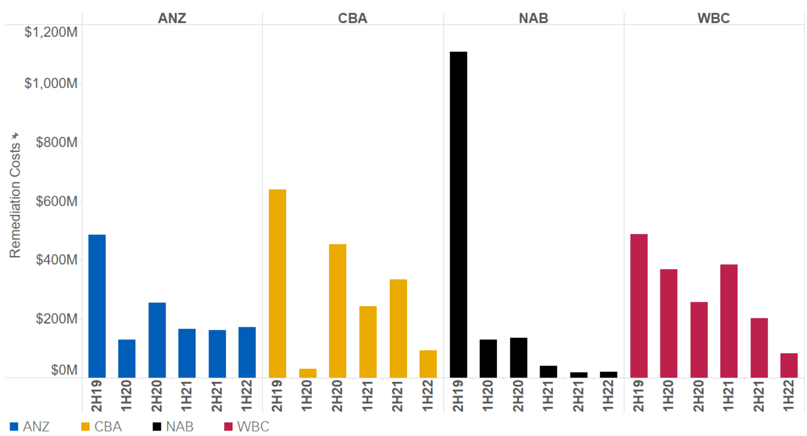
- ANZ completed its merchant acquiring partnership with Worldline AS, resulting in a pre-tax gain of $307 million. ANZ also completed the sale of its financial planning and advice business to Zurich Financial Services Australia Ltd recognising a $62 million loss.
- CBA completed its sale of a 55 per cent interest in Colonial First State resulting in a post-tax gain of $840 million. CBA also completed its sale of the Commonwealth Financial Planning business recognising a post-tax loss of $73 million.
- Westpac earned a pre-tax gain of $170 million on its sale of the Group's Motor vehicle dealer finance and novated leasing business. Westpac also completed its sale of Westpac Life-NZ-Limited, recognising a gain of $119 million.

Customer remediation

Customer remediation charges have remained a prominent, although declining, theme for the Majors in 1H22. Across the Majors, costs and reversals in revenue related to remediation totalled $497 million for the period.

Since the second half of 2019, the Majors have incurred $6,481 million in expenses and repayments to customers. While costs are well below the peak of 2019, it is expected remediation will continue to be a feature in future results.

Diagram 7 **Customer remediation costs**



Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Other notable items

Other notable items during the period included:

- ANZ recognised a $65 million loss to simplify the Group's legal entity structure by dissolving Minerva Holdings Limited and ANZ Asia Limited.
- Westpac recognised a loss of $154 million due to the write-down of goodwill and capitalised software associated with the Group's superannuation business.
- Westpac also recognised expenses of $65 million due to an increase in provisions for customer refunds, repayments, associated costs and litigation penalties.

Costs

The Majors have maintained their focus on simplification and process improvements, but with higher inflation and operational volumes their costs continue to be under pressure.

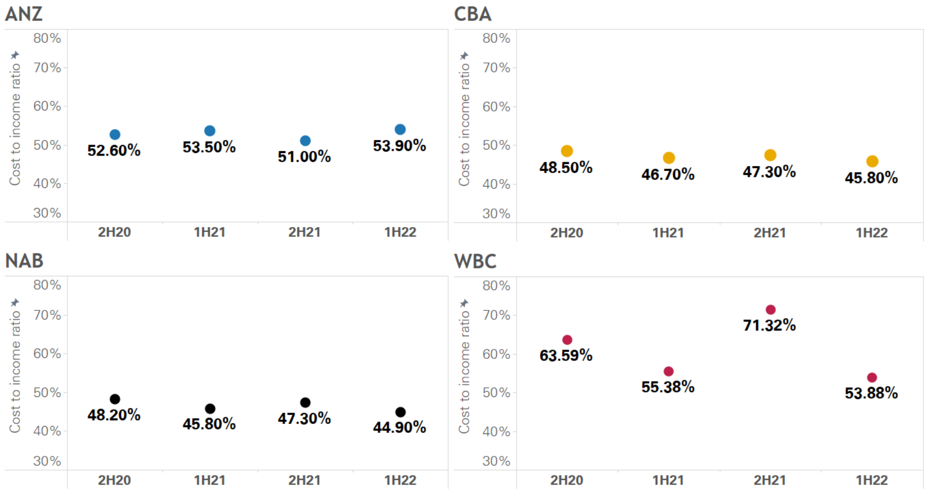
Operating expenses

Whilst operating expenses have decreased by 1 per cent from 1H21 to $19,708 million across the Majors, this has been driven by a marked reduction in non-recurring expenses compared to the PCP.

Excluding notable items, the key drivers contributing to an increase in underlying operating expenses were:

- Higher personnel costs in response to increased loan application processing and financial crime assessments, with inflation and the tight employment market also being key factors; and
- Increased investments in growth and productivity.

Diagram 8 **Cost to Income Ratio – cash basis**



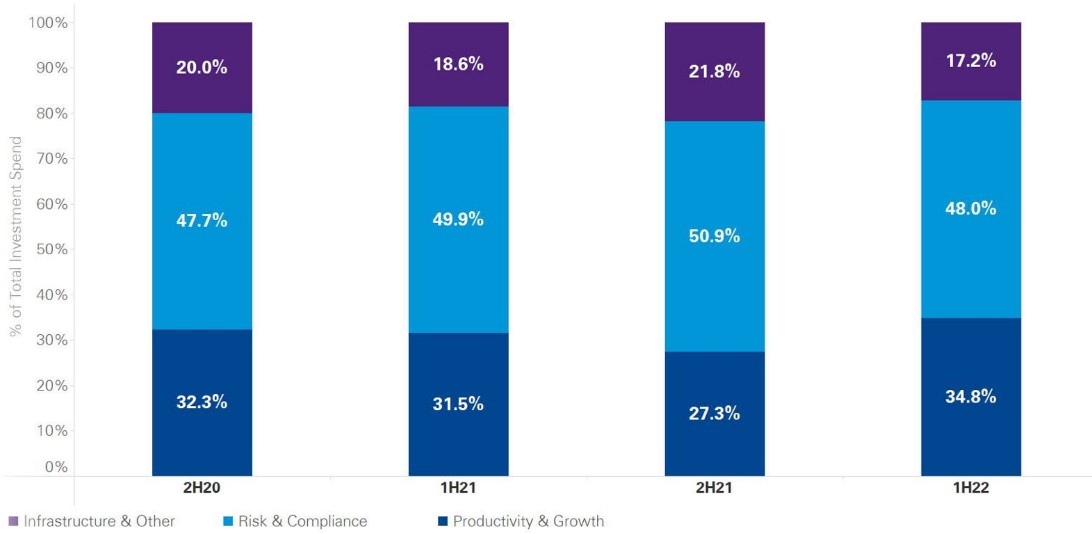
Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Investment spend

Aggregate investment spend across the Majors increased by $610 million to $3,584 million in 1H22. Risk and compliance costs continue to remain a focus, comprising 48 per cent of the aggregate investment spending, representing a decrease of 191 basis points from the prior comparative period. However, we have seen a shift across the Majors with a higher investment allocation into productivity and growth, representing 34.8 per cent.

Technology operating expenditure has decreased by $182 million to $3,658 million largely driven by lower amortisation charges, partly offset by higher IT infrastructure and maintenance costs including higher cloud computing, storage volumes and software licence costs.

Diagram 9 **Investment Spend**

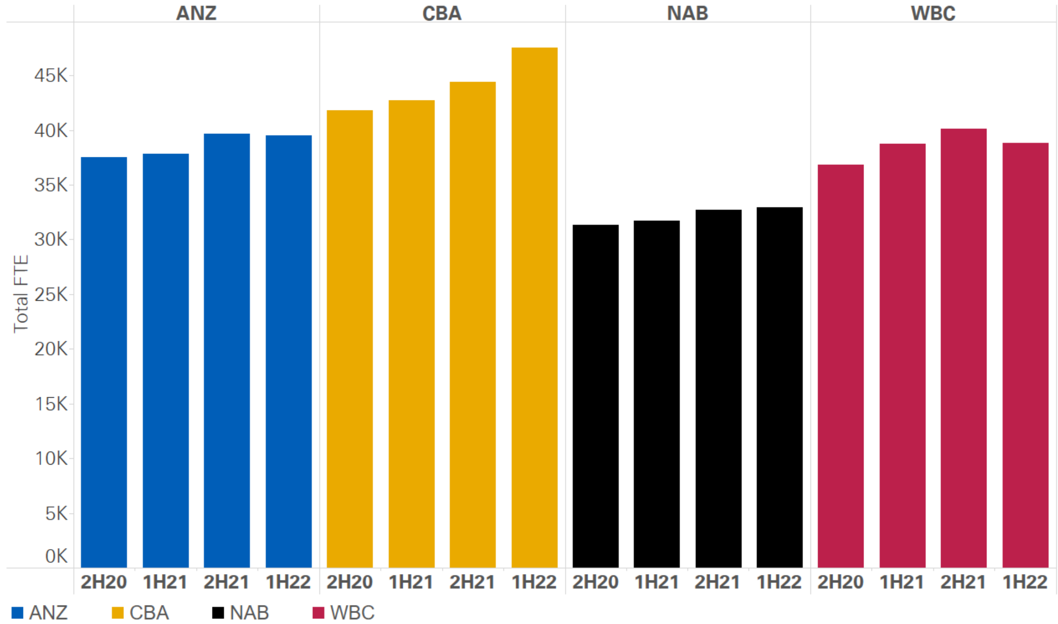


Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Personnel

The aggregate number of Full Time Equivalent (FTE) staff employed by the Majors has increased by 1,873 during 1H22. This was primarily driven by additional operational staff required in processing higher lending volumes and financial crime assessments, most notably at CBA which increased their FTE by 3,157 (7 per cent). Westpac reduced their FTE (down 1,320 or 3 per cent) as a result of businesses sold and a reduction in resources originally hired to manage COVID-19 activities.

Diagram 10 **Total FTE – Continuing Operations**



Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

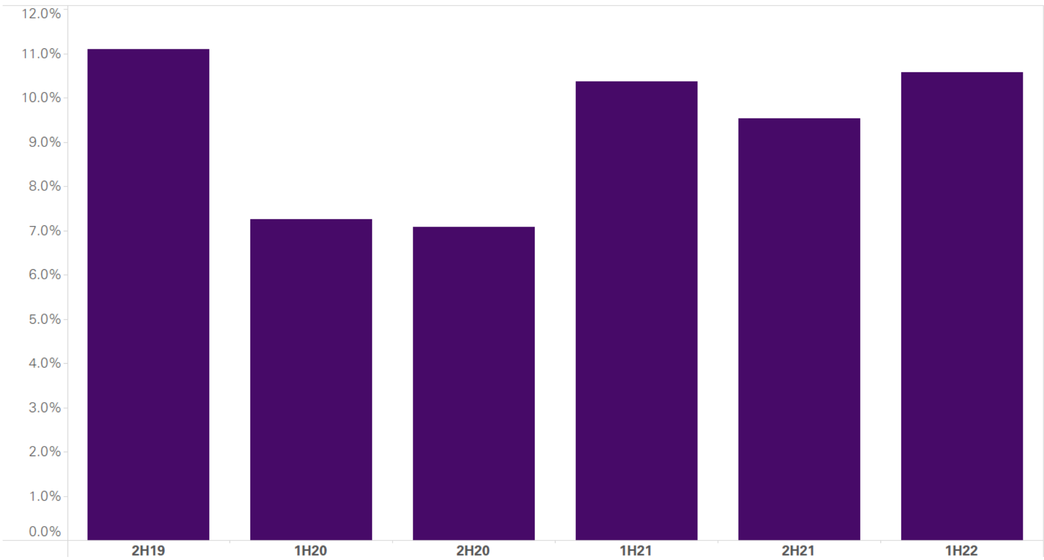
Shareholder returns

Stronger returns and an increase in dividends and payout ratios.

Return on Equity

ROE has continued on an upward trend in 1H22 across the Majors. Average ROE increased by 21 basis points compared with 1H21 to 10.6 per cent for 1H22, rising back towards pre-COVID-19 levels of double-digit ROE. This has been driven by the impact of higher cash profit and the share buy-backs completed by each of the Majors.

Diagram 11 **Average Return on Equity**

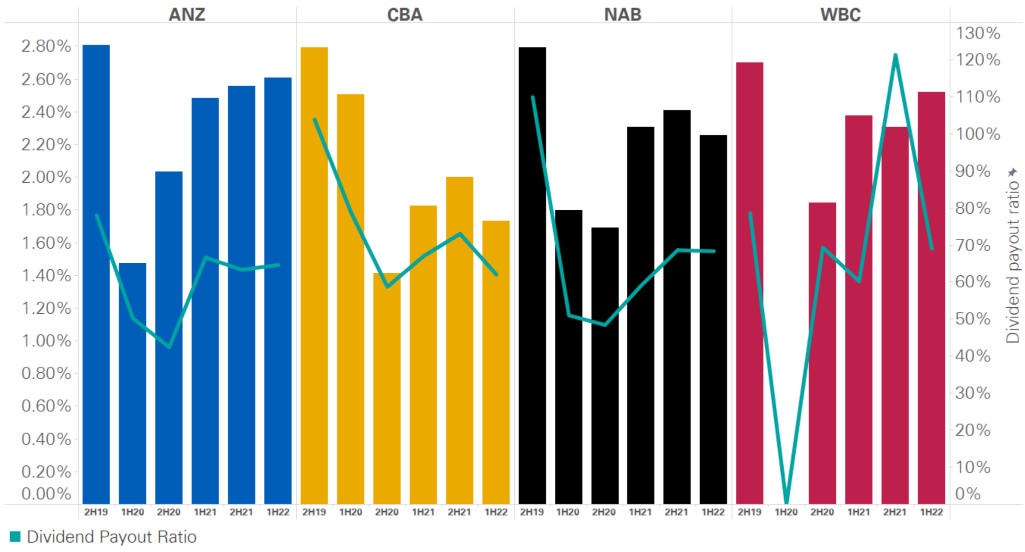


Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Dividends

After APRA's expectation that ADIs moderate dividend payout ratios in 2020, the Majors have maintained higher interim dividend payments in 1H22 with an increase in the average interim dividend per share of 12.7 per cent compared to 1H21. The increase of dividend payments has resulted in an increase of the average interim dividend payout ratio to 66.0 per cent from 63.2 per cent in 1H21. Dividends, in both quantum and pay-out ratios, are still below those experienced before the COVID-19 pandemic.

Diagram 12 **Dividend Yield vs Payout Ratio**



Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

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Hailey
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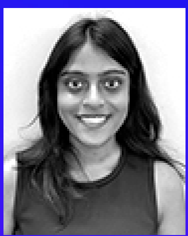

Christina
Fernandez

Jackie
Liu

Ben
Pollack

Susanna
Wong

Grace
Yang

Contact us

Hessel Verbeek
Partner, Banking, KPMG Strategy
+61 2 9458 1540
hverbeek@kpmg.com.au

Maria Trinci
Partner, Audit Assurance Risk
+61 3 9838 4038
mtrinci@kpmg.com.au

Steve Jackson
National Sector Leader, Banking
+61 2 9335 8051
sjackson2@kpmg.com.au

KPMG.com.au

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