Major Australian Banks

Strong results, but for how long?

Half Year 2023 Results Analysis

May 2023

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Half Year 2023 Results Snapshot

REVENUE

Operating income increased by 13.5% to
$45.7 billion

Net interest income increased by 17.1% to
$37.7 billion

EARNINGS

Cash profit after tax **increased** by 16.6% to
$17 billion

Average **net interest margin increased** by 13.5 bps to
189.5 bps

SHAREHOLDER RETURNS

Average return on equity[1] **increased** by 1.9% pts to
13%

Average **dividend payout ratio decreased** by 0.8% pts to
65.2%

EXPENSES

Average **cost to income ratio decreased** by 5% pts to
44.3%

Technology expenses **increased** by 2.8% to
$3.761 billion

ASSET QUALITY

Average credit impairment provisions (as % of GLA) **decreased** by 2.6 bps to
0.67%

Total **impaired loans decreased** by 13% to
$6.6 billion

BALANCE SHEET

Average CET1 **capital ratio increased by** 49.5 bps to
12.3%

Deposit to loan ratio increased 0.6% pts to
86.6%

Lending assets increased by 6% to
$3.1 trillion

*Comparisons are to the 2022 financial year, unless otherwise stated and adjusted for restatements as applicable

[1] Includes notable items

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At a glance

	ANZ		CBA[1]		NAB		WBC	
	1H23	PCP	1H23	PCP	1H23	PCP	1H23	PCP
Ranking								
By profit before tax	4	2	1	1	3	3	2	4
By total assets	2	2	1	1	3	3	4	4
By total equity	3	3	2	1	4	4	1	2
By market capitalisation	4	4	1	1	2	2	3	3
By CET 1 capital ratio	1	1	4	3	3	2	2	4
Financial Performance – P/L (continuing operations)								
Total operating income – cash	10,528	8,948	13,593	12,205	10,529	8,828	11,003	10,230
Profit before tax ($ million) – statutory basis	5,009	5,035	7,445	6,646	5,584	5,001	5,625	4,718
Profit after tax from continuing operations ($ million) – statutory basis	3,561	3,535	5,216	4,741	3,982	3,571	4,055	3,284
Cash profit after tax ($ million)	3,821	3,113	5,153	4,746	4,070	3,480	4,005	3,284
Performance Measures – P/L (continuing operations)								
Net interest margin – cash basis (basis points)[3]	175	158	210	192	177	163	196	191
Cost to income ratio – cash basis (%)[3]	47.5	53.9	42.5	45.8	42.0	44.9	45.3	52.5
Basic earnings per share – statutory basis (cents)	118.5	124.6	307.8	72.5	126.3	109.7	114	90.5
Basic earnings per share – cash basis (cents)[3]	127.6	109.9	304.1	272.8	129.5	106.9	Refer to footnote 3	
Return on average equity (%) – cash basis[3]	11.4	10.0	14.1	12.3	13.7	11.3	11.3	9.3
Credit Quality Measures								
Impairment charge / (benefit) ($ million) (statutory basis)	133	(284)	511	(75)	393	2	390	139
Impaired loans to loans and advances to customers (%) – B/S	0.12	0.21	0.33	0.33	0.17	0.15	0.2	0.2
Collective provision to credit RWA (%) – B/S	1.2	1.1	1.2	1.2	1.6	1.3	1.3	1.2
Financial Position								
Total assets ($ million)	1,111,200	1,085,600	1,232,436	1,215,260	1,048,288	1,055,126	1,019,108	1,014,198
Total equity ($ million)	69,609	66,400	72,543	72,838	61,415	59,032	72,668	70,452
Capital Measures								
Capital Adequacy Ratios (%) –								
Total	20.6	18.2	17.8	17.6	19.8	18.2	19.8	18.4
Tier 1	15.1	14.0	13.3	13.6	13.9	13.1	14.5	13.4
– Common Equity Tier 1	13.2	12.3	11.4	11.5	12.2	11.5	12.3	11.3
Market capitalisation ($ billion)[2]	68.8	68.1	173.1	153.6	86.8	90.8	76	72.3

[1] CBA reported as at 31 December 2022. All other majors reported as at 31 March 2023.
[2] Market capitalisation as at the respective reporting date of each Major bank.
[3] During the reporting period Westpac did not present cash basis results. For certain cash basis results on this page we have used Westpac's statutory basis results.

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Key Insights

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Credit quality

Credit quality remains strong but increasing arrears and provisions signal potential stress ahead.

Credit quality remains sound, with household and business savings buffers and high employment continuing to insulate the Majors' loan books from any significant stress. However, given the expectation for economic softening, banks should continue to focus on leading credit indicators and early warning signals to identify customers at increasing risk of default.

Where banks have invested in analytics and data capabilities, they may be more aware of the extent of customers' financial difficulty than the customers themselves. Proactive management and support for customers will be beneficial for the bank and the customer.

- Savings buffers built up through Covid and high employment rates are insulating customers against the impact of interest rate rises and may be delaying mortgage arrears.
- However, savings buffers are being eroded for many customers and will be exacerbated by the volume of fixed rate mortgages converting to variable.
- Impairment provisions are forward-looking and have increased. Impairment charges have risen by $1,645m from 1H22 and collective provisions to credit RWA have increased to 1.29%
- Arrears rates have started to increase and are being led by unsecured products which act as leading indicators of emerging credit stress.
- There are early signs of mortgage arrears trending upwards.

"We expect that arrears and impairments will start to accelerate over the second half of the year with mortgage arrears following the lead of unsecured products."

Paul Lichtenstein

Partner, Credit Risk Management

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Cost

Bank costs continue to rise, despite heavy investment in digital capabilities.

While cost to income ratios have trended down, actual costs continue to rise caused by higher levels of inflation; higher numbers of staff (and the increasing cost of those staff); and the ongoing cost of risk/regulatory, technology and growth investment.

- The Majors are working hard to reduce their cost bases, but are pressured on several fronts.
- FTE continues to be the largest cost bucket for the majors:
  - FTE numbers have remained relatively steady. Salary levels have increased due to the need for more complex and niche roles such as data scientists over high-volume operational staff.
  - For the Majors, measuring and understanding productivity drivers across a number of high-FTE areas (bankers, business development, risk professionals) continues to be a challenge.
  - Any structural cost improvements achieved to date are being countered by the strong forces of new customer, regulatory and emerging risk drivers increasing FTE and costs in these areas.
- Banks continue to respond primarily by increasing headcount, and are yet to find ways to leverage digital and technology investments to perform activities at scale in a more efficient way.
- The continuation of significant risk and regulatory programs have also increased costs in the short term, and banks are now facing the challenge of how to transition these heavily resourced program activities into BAU without creating persistently elevated costs.
- Digital investments are not yet producing the customer and operational changes anticipated. Digital customer channels continue to create ‘shadow costs’ without truly decreasing the human-to-human needs of customers.
- In addition, where banks are beginning to better apply new technologies (e.g. payments and transaction screening) these are still in their early stages of development and continue to require significant headcount while they mature.
- Traditional cost reduction levers, such as renegotiating contracts with vendors, are less effective in the current market. Vendors are also experiencing the impact of inflation in the form of higher costs, meaning the Majors have less ability to manage these down.
- The cost of data and technology capabilities continues to rise due to both unit costs and volume increases (e.g. data storage costs). Lower-cost offshore alternatives continue to be an avenue for the Majors to explore for a source of cost advantage.
- Delivering much needed change programs also continues to layer in costs as the Majors look to innovate and evolve. Much is being ‘added in’ with less being ‘taken away/stopped’.

“Banks that make considered strategic decisions to actively reduce costs within their control and minimise ongoing business impost will be best positioned to maintain margins in a retracting economy.”

Ben Kilpatrick

Partner, Customer Advisory

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Success or failure for the Majors?

Banks must now master how to effectively serve and support their customers through a challenging economic environment, whilst continuing to invest in digital transformation to tackle structural cost issues.

These issues are not separate, but fundamentally intertwined. Understanding this and responding to them together is a key way to extract value.

- Banks need highly capable frontline staff, equipped with timely data, insight and customer knowledge to effectively support their customers' needs. This is a challenge to the cost base.
- The instinct is to look for costs to cut, but banks who seek to tackle costs in isolation, and in a tactical way by reducing or removing activities, may struggle to support customers effectively and set their platforms up for growth over the medium to long term.
- Banks are at different stages in their digital transformation journeys as they look to automation to improve customer experiences and break the direct link to costs. Those that continue to invest in the right areas, throughout a more challenging economic cycle, will be best placed to capitalise on the opportunities the future presents.
- Banks must now tackle modernisation of the full value chain, whilst recognising their customer bases are not homogenous.
- Taking a modular approach to each step (e.g. for lending – onboarding through to settlement) will be a new skill for many banks to master. This is different to pursuing straight-through processing for the simplest parts of the portfolio.
- SME is the new battleground for growth and improved returns, a segment with very specific value proposition requirements which are not easy for many banks to deliver on.
- SME customers can be complex in nature and require an insight-led touch and experienced servicing. They often require bankers with sector expertise and specific skill sets in customer knowledge and service. The margin available for those who can deliver on this is attractive but doing this effectively, and not through an increase in the cost to serve, is key.
- The ultimate goal for banking remains the orchestration of a true ecosystem of services for their customers, with banking services at its heart. Those banks who have already begun their journey to this goal will have a significant advantage.

"We expect to see divergence in the fortunes of Australian banks as the economy is further challenged. Those who have been courageous in their efforts to tackle these challenges and continue to invest, will have the advantage. The defining factor of success will be how well the banks can tackle these challenges in combination with a long-term, growth mindset versus tactically and focused only on today."

Theo Efthymiou
Partner, Financial Services
KPMG Australia

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