KPMG

FIPS

Financial Institutions Performance Survey
Review of 2018

MASSEY UNIVERSITY
TE KUNENGA KI PŪREHUROA
UNIVERSITY OF NEW ZEALAND

1

11.21%
growth in NPAT

2

3.61%
escalation in operating expenses

3

7.35%
rise in net interest income

4

4 bps
increase in net interest margins

5

6.03%
increase in gross lending

6

13 bps
drop in average funding costs

7

18.19%
rise in gross impaired assets

8

2.56%
decrease in provisions

Contents

KPMG's Financial Services team provides focused and practical audit, tax and advisory services to the insurance, retail banking, corporate and investment banking, and investment management sectors.

Our professionals have an in-depth understanding of the key issues facing financial institutions.

Our team is led by senior partners with a wealth of client experience and relationships with many of the market players, regulators and leading industry bodies.

The Survey

KPMG's Financial Institutions Performance Survey (FIPS) report of 2018 represents the 32nd year that KPMG has provided in-depth insights into New Zealand's banking sector. In this 32nd edition, we will be presenting industry commentary and analysis on the performance of the New Zealand registered banks, together with a range of topical articles from other key stakeholders such as industry experts, regulators and our own business leaders.

The survey covers registered bank entities with balance dates between 1 October 2017 and 30 September 2018. As a result, registered banks with the balance date of 31 December will have their 31 December 2017 financial results included in this year's survey as their most recent results. Those affected include Bank of China, China Construction Bank, Citibank, Industrial and Commercial Bank of China, JPMorgan Chase Bank, Kookmin Bank, Rabobank and The Hongkong and Shanghai Banking Corporation.

TABLE 1: ENTITY MOVEMENTS

	Who's out	Who's in
Banks: 24	— Nil	— Nil

In late 2018, we published and launched our Non-bank Financial Institutions Performance Survey (Non-bank FIPS). The Non-bank FIPS document can be downloaded from KPMG's website and can be located at the following link: https://home.kpmg/nz/en/home/insights/2018/12/fips-non-banks-2018.html

There have been no changes to the bank participants this year, except for the name change of MUFG Bank, Ltd., formerly known as The Bank of Tokyo-Mitsubishi UFJ, Ltd. However, in December 2017, the Reserve Bank of New Zealand (RBNZ) registered China Construction Bank Corporation to operate in New Zealand as a branch in addition to the subsidiary (dual licenced), and in March 2018, the RBNZ also registered the Bank of China Limited to operate as a branch with a dual licence. China Construction Bank and the Bank of China have 31 December balance dates, their first year end of dual results will be included in next year's survey.

As with all previous FIPS Surveys, the information used in compiling our analysis is extracted from publicly available annual reports and disclosure statements for each organisation, with the exception of certain information provided by the survey participants.

We wish to thank the survey participants for their valued contribution, both for the additional information provided and for the time made available to meet and discuss the industry issues with us.

Massey University continues to be a partner and key contributor to the compilation of this publication, assisting with the data collection, as well as drafting the banks' profit forecasting section of this survey. We thank them for their continued contribution.

External contributors continue to play a vital role in our publication, providing insight on key issues and developments that we might not otherwise have. We would like acknowledge the contributors from the RBNZ, the Financial Markets Authority (FMA) and New Zealand Bankers' Association (NZBA) for their exceptional contributions toward the compilation of this publication.

We have supplemented their external thought leadership commentary with some of KPMG's own business line thought leadership. We trust you find the content of this survey of interest.

A KPMG view from the editor

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Head of Banking and Finance
KPMG

JOHN'S BIO

Following on from 2017, 2018 has turned out to be another record year for the banking sector's profits, which should bring much confidence and buoyancy to the sector and the economy generally. However, a big question hovering like a black cloud over the sector is whether the banking industry is at somewhat of a crossroads and facing some of the most challenging times it ever has.

In early November 2018, the FMA and RBNZ released their joint review on the state of conduct and culture in the New Zealand banking industry (the Review report). This was followed by an RBNZ capital consultation released in early December, and last week, the Royal Commission into Financial Services in Australia released its final report. Many participants believe it is the impact of these three, together with the normal business as usual challenges, that puts the banks and the economy at a crossroads.

While the joint regulators found that the issues that were uncovered by the Royal Commission in Australia were not prevalent to anywhere near the same extent in New Zealand's banking industry, they did however issue some clear messages to the banks as to what was expected going forward. The Review report has made it very clear that it is no longer adequate to simply say "we are different". Banks have been put on notice by the regulators that, by March 2019, they want to see both how they are going to ensure that the customer is put first in all their dealings going forward and also how they can prove it. Each bank by now will have received a specific letter outlining areas the two regulators want them to address.

While an appropriate focus, one of the difficulties with putting customers at the centre of everything an industry/entity does is that customer expectations, both individually and as a society, are constantly changing. When this is married to the instant impact of social media and a much more socially aware and active society, it is a difficult goal to achieve. The situation is further compounded by the fact that there is no industry that puts its customers first in all its interactions that can be used as a blue print. In addition, good customer outcomes, as they are often referred to, are quite different from a good customer experience – one requires measurement over a continuum while the other at a point in time. Banking industry participants have until March 2019 to provide a plan that addresses governance at the top all the way down to specific controls and procedures, and the way customer outcomes will be measured.

Good customer outcomes being at the forefront of everything is a concept that no one has any difficulty with. The good customer outcomes mantra is something many industry groups have become more aware of and are now striving to achieve. The difficulty for the banking sector is that it is the first cab off the rank in terms of creating it and then trying to measure it, and there is no existing industry or business model to follow, and the regulators have not set any specific guidelines or targets to meet.

In a very real sense, the banking sector is faced with creating good customer outcomes and the models they will use to monitor and measure them from scratch, whilst at the same time having to run their business as usual operations.

If all this was not difficult enough, there are still further issues on the regulatory horizon. There is the overhaul of the Financial Advice Laws which is awaiting a third reading, a relationship charter proposed by the RBNZ, and a number of pieces of legislation already underway in the form of the Financial Services Legislation Amendment Bill, Insurance Contract Law and the Credit Contracts and Consumer Finance Act. If this was not enough, they also have to continue to deal with the demand from customers to constantly innovate and bring new products and new channels to the market, or risk disrupters taking a slice of their business, while at the same time keeping their channels safe from cyber threats.

All of this considered together would make for a combination of the normal business as usual challenges plus a significant overlay from a conduct perspective but wait, there is more.

Just prior to Christmas, on 5 December 2018, the RBNZ issued its consultation on changes to a capital structure of banks. Many in the market were caught by surprise, perhaps expecting this to be more of a form of fine tuning around the way capital was calculated, bringing some of the New Zealand calculations more in line with offshore methods, some tweaking to the different models available to banks to calculate capital, and potentially a small increase in the amount of capital required to be held.

Most survey participants, and indeed commentators, were completely surprised at the final announcement when it was promulgated that the minimum levels of capital required to be held by the banks will need to almost double. The RBNZ Governor, Adrian Orr, stated that this could be achieved by retaining 70% of dividends for a period of up to five years, the proposed transition period, and many felt this seemed to imply this would be relatively easy to achieve.

In simple terms, the RBNZ is saying that they want a banking sector that is secure against a 1 in 200-year shock. Reading between the lines, it could also be saying if you are dominant in the market and make commensurate returns, then your balance sheet needs to be able to withstand a significant downturn should it occur.

This consultation paper on capital is probably the most worrying of all the challenges that the banks face, not only because it overlays the existing challenges but also for its potential downstream effects. In meeting with survey participants, we identified a range of potential impacts from the increase in capital required to be held.

— Firstly, a doubling of the capital will half the returns to shareholders, which without any further action by the banks will make them less attractive as investments.

  This will not only cause parent banks to re-assess their portfolio, but if returns are not restored will see a fall in value impacting both the sharemarket and fund values, such as KiwiSaver that hold these securities.

— Secondly, it is not as simple as the parent companies or the banks themselves (in the case in New Zealand owned entities) simply raising more capital. The sheer amount required will not be easily obtained from the Australian and New Zealand markets, and foreign parents might be unwilling to invest significant amounts of capital into a dilutive investment.

  In some cases, the parent entity may not be permitted to invest the required amount, and some of our locally incorporated banks will have unique challenges of their own around raising capital.

— Thirdly, we could see parent banks either unwilling or unable to contribute or raise all of the required capital the subsidiary banks need. As such, they will have to take one of a number of other steps.

  By far the most severe would be any step that leads to any form of credit rationing, as New Zealand is a young country that does not have huge pools of private wealth and is very reliant on borrowing to do business. A number of industries/sectors, in particular dairy, construction and small to medium-sized businesses, will be those where lending would be the first to be rationed, for reasons around the current levels of exposure, the current returns earned and the security provided.

New Zealand is also a country of small to medium-sized businesses. Many of these are the very ones that need a loan to assist them in their start-up phase. Many small businesses have grown out of the proprietor branching out from their previous employer and setting up a business. Many of these businesses are funded based on cash flows rather than security and as such consume a greater percentage of capital. In addition, any security that is provided or could be provided commonly includes the family home, thus putting further stress on the residential real estate market and loan-to-value ratios (LVRs).

Some participants pointed to the fact that the larger Australian-owned banks might be required to push some of their lending back to the parent, and have the parent lend direct from their balance sheet, with the loan attracting an approved issuer levy as opposed to withholding tax.

— Fourthly, one of the impacts of banks attempting to increase their return on equity will be that profitability has to improve. This could result in deposit rates being reduced, which will have a significant impact for those that live off fixed interest investments across the market, and will also likely see lending rates increase. This will not be welcome news for any borrower, and the unknown components of both the level of increase and its timing will be worrying.

  In effect, what could occur is an actual live stress test on certain parts of the economy if the banks are forced to raise lending rates.

— Lastly, with the recent changes to the overseas investment rules, many buyers who may have purchased a business or asset are now no longer permitted to so do, thus removing the exit strategy for many older New Zealand business owners.

All these things point to a likely slowing of the economy.

Many in the industry have asked us whether the RBNZ's initial releases around the consultation is positioning, or whether the RBNZ is serious about the doubling of the capital requirements.

A lot of water will flow under the bridge between now and when the consultation period ends in May 2019, and again to the point of implementation of any final legislation. The banks have shown in the past that they are very adept at adapting to changes in the market but right now the sector as a whole is faced with a significant number of challenges. One commentator noted that this may inadvertently play into the hands of the foreign registered banks, but also reminded us that we have seen what happens when the going gets tough for them both onshore and offshore. A number have asked whether the RBNZ has considered all the impacts that could potentially occur.

Two comments that the RBNZ have made are that this is a consultation, and that they are interested in hearing from everyone, and part of what they are doing is reviewing the credit risk appetite of the community. In addition, they do not necessarily see this as doubling capital, but more so converting some of the other forms of capital to stronger types of capital.

There is no doubt that this will be a very exciting time, both in the short term in the lead up to the end of the consultation period and the announcement of the final policy, and also in long term as to how the banks will choose to adapt to the new rules.


volume
Days
62
60
58
56
54
52
50
Jan
Mar
Range
May
Jul
Sep
Avg
Nov
Jan
mb
2,800
2,750
2,700
2,650
2,600
2,550
2,500

Industry overview

A number of key themes were continually brought up and discussed in the conversations we had with survey participants. These themes, as well as other relevant observations impacting the sector, are discussed in detail below. The major themes coming out of these discussions could be summarised as the '3 C's' – Conduct/Culture, Capital and Confidence.

Conduct and culture

In November 2018, the RBNZ and FMA released the results from their review of New Zealand registered banks in respect of their conduct and culture (the Review). The Review was a flow on impact from the Australian Royal Commission (ARC) into *Misconduct in the Banking, Superannuation and Financial Services Industry*, given the four largest banks in New Zealand have Australian parent banks.

While the Review concluded "conduct and culture issues do not appear to be widespread in banks in New Zealand at this point in time", there have been various areas for improvement identified. These include greater ownership and accountabilities, focusing on identifying issues and timely responses, strengthening processes and controls, firming staff reporting channels, having clear whistle-blower processes, and removing any incentives linked to sales measures for the frontline staff and through all of management[1].

FOOTNOTE 1

The risk to customers of not receiving the most suited products for their needs was amplified by sales-based performance incentives for staff. In response to this, ASB, ANZ, BNZ, and Westpac have all axed sale targets and sale target bonuses for all frontline staff[2]. However, this is only the first of many changes the industry needs to make, as banking culture tends to be driven by the 'tone at the top' – well away from the frontline staff. In fact, one of the findings of the review was that front line staff tended to do the right thing by customers.

FOOTNOTE 2

The banks have been challenged with improving their governance, processes and controls, and the measurement and reporting of them, to ensure that customer needs are put at the forefront and continue to be re-assessed throughout the life of any transaction.

While the Review did not name and shame in the same manner that the ARC has, the FMA CEO, Rob Everett, has made it clear they will use that tactic if banks do not shape up by March 2019[3]. By this date the banks are expected to have developed a plan and commenced implementation as they move toward a new paradigm of putting the customer first in all interactions.

FOOTNOTE 3

The difficulty with this lofty goal is that individual customer and societal expectations are constantly changing, such that what is considered okay today may not be tomorrow, the impact of social media makes issues far more obvious to the public, and there is no industry to follow that has a model where the client is put first in all interactions.

For further information on conduct and how providers of financial services can excel in this new environment, please read the article included in this publication on page 42 which has been written by Kate Stewart, a KPMG Senior Manager specialising in conduct and regulation.

An example of the issues faced across the ditch was highlighted in the Australian Securities and Investments Commission (ASIC) report on credit card lending in Australia issued in July 2018, which revealed 18.5% of consumers with credit cards fulfilled at least one of the problematic debt indicators, being:

- severe delinquency – the account has been written off or is in the worst possible state;
- serious delinquency – 60+ days of overdue credit within the previous period;
- persistent debt – the average card balance is at 90% over the period and interest has been charged; and/or
- repeated low repayments – eight plus payments have been below 3% of the credit limit and interest has been charged over the previous period.

In light of this, ASIC has identified that credit card providers should be taking more proactive action to address problematic credit card debt, ensuring products are appropriate for consumers, and are expecting improvements in credit providers' practices to address these issues[4].

FOOTNOTE 4

In New Zealand high credit card rates have not been targeted by a specific report. The Review does touch on credit cards, identifying incorrect interest rates applied and loyalty points being awarded incorrectly amongst issues that are being remediated[5].

FOOTNOTE 5

However, when The Co-operative Bank launched its credit card in 2016, with annual interest of 12.95% for both purchases and cash advances, the Bank's then-CEO Bruce McLachlan said credit card interest rates and fees "have been ridiculously high for too long.[6]"

FOOTNOTE 6

While The Co-operative Bank has kept its rate at 12.95% since launching[7], the weighted average interest rate on interest bearing advances sits at 17.9% and of the $6.77 billion of advances outstanding, $4.13 billion is interest bearing[8], suggesting that a number of Kiwis may not have the most appropriate credit card for their spending habits. With the RBNZ asking New Zealand banks to *prove* that they are different from their Australian parents[9], there is an opportunity for the banks to improve credit cards for customers with problematic debt. This could be done by proactively following up with customers who are failing to repay their credit cards to ensure they are on lower rate credit cards, or even offering to put their debt onto their mortgage where possible.

FOOTNOTE 7

FOOTNOTE 8

FOOTNOTE 9

While banks are unlikely to reduce interest rates, with the Commerce Commission seemingly content to let interest rates be constrained by the competitive market[10], it is an area where they earn a lot of interest income.

FOOTNOTE 10

However, as Jeff Bezos famously said "your margin is my opportunity[11]", meaning disruption is to likely hit higher profit industries or products first. We may already be starting to see this, with the impact of 'buy now, pay later' schemes, where customers are purchasing products using these services. Customers are also using different methods of payment, such as POLi[12], which allows them to purchase online without a credit card and allows them to avoid a transaction fee[13], with more likely to come with application programming interfaces (APIs) and open banking. One of the concerns expressed by many participants was that these new entities are not regulated nor subject to some of the regulatory requirements of existing players (e.g. responsible lending – on the basis they are not lending). Another concern is that many people are using their credit card to pay off their buy now pay later debt.

FOOTNOTE 11

FOOTNOTE 12

FOOTNOTE 13

Higher capital

In December 2018, the RBNZ released their consultation paper on a proposal to raise the amount of capital that banks must hold. This proposal was a culmination of almost two years of detailed work and review by the RBNZ[14].

FOOTNOTE 14

With the RBNZ stating that "adequate capital is the first and most powerful defence for a bank to survive an unwanted shock"[15], and the significant impact that the failure of one of the major banks would have on the economy, the intention of the proposed increase in capital would further safeguard both the registered banks and the financial system as a whole to future adverse events.

FOOTNOTE 15

In the consultation paper, the RBNZ proposes two main changes:

- an increase to the minimum capital levels of the banks; and
- restrictions on the benefits that can be gained from using the Internal Risk Based (IRB) approach to calculating minimum capital levels.

In respect of the increase in minimum capital levels, there are significant increases proposed compared to the current levels of capital that needs to be held (see Figure 1 from the consultation paper). This increases a flat Tier One capital requirement (including buffers) of 8.5% to a new requirement of 16% for Domestically Systematically Important banks and 15% for all other banks. The RBNZ estimates that this will require the banks to hold between 20% and 60% more capital, which they believe represents about 70% of the banking sectors expected profits over the proposed five-year transition period.

VIEW FIGURE 1

These new capital requirements are significantly higher than most other countries, leading to many noting that the proposed requirements are highly conservative, reinforced by a report released by the Investment bank UBS, stating that the new levels would make the capital requirements for banks the highest in the developed world[16]. However, the RBNZ has set these levels to create a banking system that can cope with a 1 in 200-year event that would otherwise cause a bank (or the banking sector) to have difficulty and potentially require the Government (taxpayer) to step in and bail them out.

FOOTNOTE 16

In respect of the restrictions on benefits from using the Basel II internal ratings-based (IRB) approach, the banks that currently using the IRB approach to calculate their capital requirements (the big four) currently get an outcome that is approximately 76% of the outcome that the standardised approach would calculate (which all other banks use)[17]. This means that the largest banks are required to hold significantly less capital for the same exposure than the other banks. The consultation proposed to set a 'floor' to the difference between the IRB and standardised approach, effectively that the IRB approach can be no less than 90% of what would be calculated under the standardised approach. This is expected to raise the risk-weighted assets of the big four banks by $36 billion (16%), requiring even further increases to capital for the big four banks.

FOOTNOTE 17

The RBNZ themselves recognise that there will be trade-offs from these new capital levels. While "higher capital levels lower the probability and impact of bank failure … higher capital levels may increase banks' average funding costs, lowering the quantity of credit availability to the economy at a given price"[18].

FOOTNOTE 18

These higher capital levels are also expected to result in higher lending rates, reduced interest rates on deposits, and reduced Gross Domestic Product (GDP) for New Zealand[19]. The same UBS report referenced above also noted that they would expect banks to "increase mortgage rates by 80 basis points (bps), to generate a 12% group return on equity, and 125 bps to maintain current ROE of around 14.4%".

FOOTNOTE 19

What remains to be seen is to what degree the above impacts would eventuate, and the flow on effects that these could have on the banks, their customers and shareholders, and the economy overall:

— Lower rates on deposits will mean that people who rely on this income, especially retirees, will have less to live on. It could also induce a flight to yield in higher risk deposit taking entities, such as finance companies. This will lead to the finance companies needing to lend out more money, and thus possibly accepting deals that would previously not met the banks' lending criteria – remember this is a situation we last saw prior to the finance company collapses in 1988.

— Higher interest rates on lending could result in lower asset prices (such as housing) or less discretionary spending resulting in people spending less and saving more, dampening economic growth and inflation. Some early estimates are that mortgage rates could go up by 80 to 125 bps, a significant increase considering some will currently only be paying 400 bps on short fixed term mortgages[20]. One additional impact in this area could be that the impact of the increased capital could create a real live stress test of the lending market.

FOOTNOTE 20

— Lowering the quantity of available credit could mean that some people can no longer borrow from the bank, or at best borrow less, at higher rates, and may be pushed to a non-bank lender with even higher interest rates if credit rationing occurs. The amount of the credit flowing over to the non-bank lenders may be relatively small in percentage terms from a banking sector perspective, but it would be a huge amount for the non-bank sector, and begs the question if the non-bank sector in turn has enough capital available to meet this increase in demand. A reduction in available credit across the sector could have a significant impact for many unsecured borrowers or areas where returns are low – with those areas being the first to feel a credit squeeze. This could impact the very heart of the New Zealand economy – small to medium sized entities and new small business owners. Other industries identified as ones that would suffer rationing were Dairy and Construction.

The overall impact on the economy has also been discussed by several banks from the perspective of what impact this would have on the RBNZ's Official Cash Rate (OCR), with one suggesting the OCR may need to drop to 1% next year, and another suggesting that it would merely slow the increases in future years. This again demonstrates the uncertainty of the impact attached to such significant changes to the banking sector.

On the other side of the argument, as a prudent regulator the RBNZ will want to do as much as it can to protect the sector, particularly at a time when another market shock might be seen as due soon. In addition, there is an element of the Australian banks being told implicitly, if you want to continue to make strong returns in our market then in return you better be capitalised in a way that you do not cause any market disruption in a downturn.

At the end of the day it is about levels of capital that are required to cover levels of risk, what is too little and what is too much, and from what perspective you look at it from.

With the submission date of May 2019 and an expected commencement date not long after that, we will not have too long to wait to see the results of the consultation, and how much impact submissions have on the current proposal. The RBNZ were quite open about this being a consultation and wanted to hear from all interested parties.

Confidence

Consistent with the theme raised by non-bank participants in our 2018 Non-bank Financial Institutions Performance Survey, there is stark difference between the lack of business confidence being reported in the economy compared to the actual performance of the economy.

New Zealand continues to report low unemployment rates[21], low inflation and interest rates[22], strong GDP[23] and strong prices for key export commodities, such as milk[24], yet business confidence levels remain low[25].

FOOTNOTE 21

FOOTNOTE 22

FOOTNOTE 23

FOOTNOTE 24

FOOTNOTE 25

One reason suggested for this difference is due to things being so good for the last five years or so, and at the moment people feel that things cannot get much better. As such, there is a general expectation that this good run will start to come to an end. Another reason is that the change in government could be impacting confidence, as it can take businesses a period of time to adjust to a different style of government after being under National for nine years. Another reason is that global events could be causing uncertainty about the future, especially with Brexit looming, and the trade disputes continuing between China and the USA.

While the level of confidence has improved from the previous quarter, in general it is still not positive. Businesses are feeling more demand, with more optimism for expansion, but businesses have also felt increasing cost pressures, which have been difficult to pass onto consumers, and thus decreasing both profitability[26] and confidence.

FOOTNOTE 26

One local confidence factor mentioned is that farmers may be concerned about the future, in respect of new sustainability/environmental requirements under the new Coalition Government.

VIEW FIGURE 2

Rural borrowers are currently indebted to New Zealand banks for $60.4 billion, of which two thirds is lent to dairy farms. While many agri-sectors at the heart of the New Zealand economy continue to perform well, such as wine, fruit, forestry and red meats, one that has struggled more recently is the dairy sector. With milk prices down from the highs seen a few years ago and the farmgate milk price hovering around $6.00 per kgMS, which is near break-even for many dairy farms, this debt is a clear area of focus for the banks[27].

FOOTNOTE 27

VIEW FIGURE 3

On top of this, the Coalition Government has been threatening to impose far stricter environmental rules which will force farm owners to face additional costs regarding water regulations, climate change and industrial relations. These costs will only further increase the farmgate milk price needed to breakeven.

To ensure that there isn't a collapse of the dairy sector that will be a contagion for the rest of the economy, this will require clear early signalling from the Coalition Government to allow a smooth orderly transition over a reasonable period of time.

Housing market

The housing market finished 2018 on a two paced note. Median prices in Auckland were $862,000 in December 2018, up 0.2% on December 2017, showing the market in Auckland appears to have peaked, and has managed to hold on to prices even with significant drops in volume. On the other hand, median prices in New Zealand excluding Auckland were $480,000, up 6.4% on December 2017[28].

FOOTNOTE 28

Many economists have said that the house prices in New Zealand often tend to mirror those in Australia, reflecting a similar demand and supply factor. However, there tends to be a six-month lag between the trends in the Australian market before making their way across the Tasman and affecting New Zealand. The Australian housing market is currently suffering from a weak housing market, with house prices in Sydney dropping 9.5% and Melbourne's taking a 5.8% hit. Given this, many are worried that it is only a matter of time before the market in New Zealand, namely Auckland, makes a similar movement[29].

FOOTNOTE 29

Some commentators claim that there are local factors specific to New Zealand that will limit this flow on impact from Australia, being a lack of supply of houses that looks to only increase with time required to build new houses and the high net immigration, and continued record low interest rates.

However, this logic implies the current market price is 'rational', based only on underlying economic factors, whereas 'asset bubbles' tend to be defined by their 'irrational' factors, such as 'fear of missing out'. With the restrictions on overseas buyers implemented in October 2018 and house prices struggling in Australia, 2019 is likely to be the 'litmus test' on the resilience of house prices.

Loan-to-value ratio (LVR)

Another factor that may help support house prices is the slight relaxing of LVR restrictions. In the RBNZ's *Financial Stability Report* issued in November 2018, they announced a slight loosening of LVR restrictions in place for mortgage lending. This allows more lending (up from a maximum of 15% of total lending to 20%) to low deposit (more than 80% LVR) owner occupiers, and a slight reduction in what is considered low deposit lending to investors (70% LVR, up from 65%).

In doing this, the RBNZ recognised that while New Zealand households have high levels of debt to income ratios, and this leaves New Zealand vulnerable to global risks, house price inflation and household lending growth appear to have moderated, allowing them to slightly ease these restrictions[30]. This is in line with these measures being a prudential tool that need to be tweaked based on the macroeconomic factors, rather than being a natural countercyclical prudential tool (such as a debt to income ratio limit) that would be held fairly constant.

FOOTNOTE 30

However, this is unlikely to have a significant immediate impact given the banks already lend well within their existing LVR volume limits and have historically shown little inclination to push up against limits. On top of this, with the probable extra capital requirements for these higher LVR loans and the probable need for significantly more capital, the banks may decide it is not worth undertaking these type of loans.

Immigration and the housing crisis

Since the National Government changed immigration rules in 2013, which made it easier for international students to work[31], New Zealand's net migration soared to record highs until they introduced remuneration thresholds for Skilled Migrant applicants and tweaked temporary work visa conditions in mid-2017[32].

FOOTNOTE 31

FOOTNOTE 32

One of these changes included a stand-down period for lower-skilled workers when their visa ended, requiring them to leave New Zealand for a 12-month period. This has seemed to have reversed the trend in the number of departures since coming into effect (see Figure 4).

VIEW FIGURE 4

Net migration for the year ended October 2018 was 61,800, down 8,900 from the year ended October 2017[33], attributable to both a decrease in arrivals (down 3,500) and increase in departures (up 5,400).

FOOTNOTE 33

However, this is still significantly higher than the Labour Party's pre-election immigration policy goal (net migration of 20,000–30,000)[34], with Labour estimating that if the net immigration goal was not achieved then up to 10,000 more houses would be needed.

FOOTNOTE 34

However, these actual immigration figures may be lower than initially thought, with Statistics New Zealand adopting a new method to track immigration after the removal of departure cards in New Zealand airports.

The new method shows net migration of 43,400 for the 12 months ended November, and 45,200 for October, with Statistics New Zealand claiming the new method is more reliable[35]. Regardless, whilst more building consents have been issued, rising 5.3% for the year ended November 2018, to 32,783[36], this has not eased the housing crisis, but it has slowed the demand for the number of dwellings needed for the year. The estimated annual housing shortfall for the year in Auckland has dropped significantly; however, the cumulative shortfall will still take more time to clear[37], as demonstrated by the fact that welfare payments for emergency housing rose by almost 200% over the last year[38].

FOOTNOTE 35

FOOTNOTE 36

FOOTNOTE 37

FOOTNOTE 38

KiwiBuild has promised to have 100,000 affordable homes built by the end of 2028 for first home buyers. However, in the five months to 30 November 2018, only 33 homes have been built with 77 in progress[39], showing it might be a while yet until KiwiBuild starts to have a real impact on the housing crisis. All of the major banks have already agreed that they would be willing to lend on KiwiBuild homes, with Kiwibank and ASB both offering cash incentives to borrowers to borrow with them, with most of the major banks lowering the deposit threshold to between 5–10%[40].

FOOTNOTE 39

FOOTNOTE 40

According to Statistics New Zealand, overseas buyers account for about 3% of total home transfers in New Zealand and in the June 2018 quarter, one in five central Auckland homes were transferred to overseas people, showing how concentrated overseas buyers were towards Auckland[41].

FOOTNOTE 41

While 3% is only a small percentage of the housing market, in the midst of a 'housing crisis', there is concern that international buyers are affecting house prices and making it harder for Kiwis to purchase homes. To give New Zealanders a better chance of buying a house in a market, not influenced by international pricing pressures, the Coalition Government has implemented the Overseas Investment Amendment Act (the Act). The Act aims to stop foreign buyers not intending to live in New Zealand from buying property, with the exception of new apartments in large developments[42].

FOOTNOTE 42

Non-residents are no longer allowed to buy existing homes either, excluding Australians and Singaporeans who are instead subjected to screening by the Overseas Investment Office.

It appears that the ban is already impacting the housing market, perhaps more than expected. December 2018 saw the lowest number of residential property sales across New Zealand in the last seven years, decreasing by 12.9% (787 houses), although this decrease was also partly driven by listings being down 13.3%. The decrease in the sale of houses for New Zealand excluding Auckland was only 8.2%, whereas the Auckland region seems to be feeling the effect of the ban most, with a much larger drop of 24.3%. It will be interesting to see if the effects of the ban, combined with increased consents for housing and KiwiBuild, will finally burst the 'housing bubble'.

Some market participants noted that this policy change had made New Zealand look 'anti-foreigner' and hoped that this would not affect trade and other relations.

Climate change

On top of all the economic risks that banks have to be mindful of, another emerging risk is climate risk.

Throughout the year, the RBNZ has been working on developing a climate change strategy. As a regulator the RBNZ has to ensure that financial institutions are adequately managing the risks presented by climate change.

The physical impacts of climate change involve the risks of potential damage to property and the subsequent change in property values. Banks will need to be prudent in their lending decisions to account for these climate risks[43].

FOOTNOTE 43

RBNZ has warned that the impact of climate change could render some properties uninsurable due to climate change, which in turn may raise the costs of insurance and decrease the value of properties exponentially. Given banks require insurance on properties pledged as security to lending, to protect the value of this security, the lack of affordable insurance on these properties may mean some houses cannot be bought with credit – which will significant decrease the value of these properties[44].

FOOTNOTE 44

This is an area that will require careful navigation and a cohesive multi-industry approach, given the significant impact on people in particularly exposed areas in New Zealand who may find their house suddenly become both uninsurable and worthless.

Fintech

From the survey of bank executives, there was a general feeling of surprise that disruption had not really occurred in the banking industry to the level expected yet, but there was a resignation that it was just a matter of time. One of the reasons posed for this delay could be that New Zealand's banking system is already near the forefront of technology compared to many of its global peers, which continue to act as a traditional bank. China appears to be a clear exception to this and sits in a league of its own.

Alipay (55%) and WeChat (38%) processed 93% of China's $US15 trillion of mobile payments in 2017[45]. This is a significantly high number of transactions which are traditionally captured by the banking and card industry in other countries.

FOOTNOTE 45

Alipay is the largest mobile payment platform in the world, with over 520 million users and currently has the ability to process an extraordinary number of transactions, as witnessed in November, where Alipay processed 90% of Alibaba's $25.3 billion sales for Singles Day 2018[46]. In March 2018, Smartpay signed an agreement with Alipay to enable Chinese customers to pay conveniently by using Alipay while in Australia and New Zealand[47]. This payment option will be available for the 25,000 merchants who use Smartpay terminals, and Smartpay's share price subsequently rose 29%, to 22 cents after the announcement[48].

FOOTNOTE 46

FOOTNOTE 47

FOOTNOTE 48

However, as Alipay currently appears to be focused on the Chinese customer base, there are other digital wallet options for customers outside of China, such as Apple Pay and Google Pay. As banking has become more tied to our phone, so has our payment methods. Google Pay and Apple Pay offer peer-to-peer payments and enable customers to pay merchants by taping their device to the payment terminal. These services also have an additional layer of security that you do not get with a regular payWave transaction, and work towards a cashless society. Although in New Zealand, ANZ and BNZ are the only banks currently to offer Google Pay[49] and Apple Pay[50], meanwhile ASB offers its customers Apple Pay[51] and Fitbit Pay[52], which is a similar service.

FOOTNOTE 49

FOOTNOTE 50

FOOTNOTE 51

FOOTNOTE 52

In the UK, Monzo is a different kind of bank that is based on your smartphone with no physical banks involved, allowing them to offer lower priced products that gives them a competitive advantage; and it is currently preparing to launch in the US[53]. Monzo offers traditional online banking services alongside its inbuilt budgeting tool, financial breakdowns and summaries, and data insights based on spending[54]. As people tend to be more cautious with their money and data privacy, this style of banking could be slow to be adopted in New Zealand, but using these tools to see more clearly what their financial life looks like and better understand their spending habits could be fantastic for consumers who struggle with budgeting. It will be interesting to see which of the behaviours drive the uptake – conservative /security based concerns or the desire for new products.

FOOTNOTE 53

FOOTNOTE 54

On a smaller scale, New Zealand banks continue to develop technology to improve the customer experience, and thus 'disrupt' themselves before they become disrupted by others.

The latest innovation making our banking life easier is the ability of facial biometrics allowing us to open a bank account without needing to physically go to a branch to set it up. The facial biometrics allow banks to confirm a customers' identity by comparing a picture of their driver's licence/ passport and a selfie video that they create while applying for the account.

Three banks currently have a format which allows customers to perform the above in one way or another, with The Co-operative Bank being the first to the market, closely followed by BNZ and ASB. All of the banks have slightly different variations of the process. ASB appears to have the least friction with the account opening automatically 15 minutes after the application, and transactions allowed on the same day, whereas The Co-operative Bank and BNZ require a confirmation call from the respective bank, and in some cases cannot transact until the next day. Westpac are said to be in the process of developing similar technology.

This process significantly reduces 'friction' in the customer experience with a bank, especially at the important stage of 'getting' a new customer. This also reduces the barriers of switching banks, making customers less sticky to their bank and likely to be more price sensitive.

Naturally, there would be concerns about the ability to get around systems and processes which are automated with no human involvement. However, the speed and process of the new system will not come at the expense of security. In fact, the use of the video will be more secure and make defrauding harder as the method works by using facial biometrics to compare the photo ID with the selfie, ensuring that they match[55].

FOOTNOTE 55

The facial biometric developments are not the only technological launch during the year, with ANZ releasing their digital assistant 'Jamie'. Jamie is available on the ANZ website and is able to answer any banking questions that customers may have. Jamie is much like Apple's 'Siri' in that customers are able to speak to Jamie to ask "How do I…?" questions. The more questions Jamie receives, the more experienced she will get allowing her to develop her knowledge and become more efficient with customers' questions. The New Zealand artificial intelligence company, Soul Machine, has developed the tech behind Jamie[56].

FOOTNOTE 56

Both the above technological additions are further pushing the banks into the digital age, and as a result, making physical branches more redundant. However, no matter how quiet and impractical they become, banks are finding it hard to close all branches due to the social role they play in the community, especially for less tech-savvy customers and where the customer wants to discuss significant transactions (such as mortgages) in person with a human.

Blockchain

Although cryptocurrencies took a dive this year, many believe blockchain outside the cryptocurrency space provides an opportunity to enhance services using Fintech. While banks may be struggling with cryptocurrencies from an anti-money laundering (AML) perspective, they have been able to adapt and use blockchain to assist in making complicated transactions easier.

As a New Zealand first, ASB used a blockchain single trade window to process a meat export deal, uploading all relevant documents onto a secure platform for all relevant parties to access, saving time and reducing the risk of fraud and cyber security threats[57]. Blockchain's potential is also looking to be utilised by ANZ, who is looking to use blockchain with its insurance brokers, and IBM is developing an international money transfer system based on blockchain[58].

FOOTNOTE 57

FOOTNOTE 58

Market size, share and penetration

A common point made this year by a number of participants was made while discussing open banking. Many of the smaller players were keen to see this regulation for on the basis that it would open up the market. Many mentioned that one of the unintended consequences of all the regulatory change of the last few years had been that it had assisted the incumbents in the market. Open banking could provide greater choice.

Looking ahead in 2019

The trade war: USA vs. China

One of the biggest talking points heading into 2019 is the continued 'trade war' between China and the USA. Many economists have noted this as the biggest threat to the USA and global economies in 2019[59].

FOOTNOTE 59

However, there are now early signs that the tensions may have ceased escalating, with no new retaliatory measures being announced for some time, with the countries agreeing to no new tariffs until 1 March 2019[60]. One issue that has recently arisen that could derail the good progress made to date is the detention of Meng Wanzhou, the CFO of Huawei, in Canada due to an extradition request from the USA. This case could be the latest pawn in the tit-for-tat, and may be a bargaining chip for the parties in future discussions. One thing is for certain: there is plenty more to play out before this issue is likely to be resolved.

FOOTNOTE 60

Brexit

While the economy may be feeling uneasy due to the possible impacts of a 'no deal' Brexit, the financial services industry in the UK will be one of the hardest hit. With London once seen as the financial hub of Europe, many banks and other financial institutions are moving to other European financial cities such as Dublin, Luxembourg, Frankfurt and Paris, with an estimate that £800 billion worth of assets have already been moved out of the UK and into the European Union[61].

FOOTNOTE 61

This proactive move by the banks is to ensure that they can continue to operate in the frictionless financial environment that the EU brings, and to continue to satisfy the EU regulators.

This impact is even being felt down under, with CBA applying for a banking license with Dutch authorities and Westpac announcing they are shifting a significant amount of their London-based business to Frankfurt, while ANZ is less impacted as it already operates out of France and Germany[62].

FOOTNOTE 62

With the deadline for the UK exiting the EU approaching, and the UK Government seemingly very far away from reaching any agreeing on an exit deal, many in the world will be watching closely to see what this will mean for them.

FED Rates

2018 saw a number of changes to the Federal Funds Rates with four separate hikes being made by the Federal Reserve. However, the outlook for 2019 appears to have slightly eased, with only two hikes planned rather than the initial three that were expected, due to early signs of economic softening and tightening financial conditions[63]. However, beyond 2019, gradual rate hikes can still be expected. The eventual path the US Federal Reserve takes will impact funding costs in New Zealand, and could be one of the defining factors as to what happens with longer-term fixed mortgage rates in 2019 within New Zealand.

FOOTNOTE 63

Timeline of events[64]

FOOTNOTE 64

Jan. 2018

17th
ANZ, ASB, BNZ and Westpac, equal Paymark shareholders, have agreed to sell the electronic payments processor to Ingenico Group for $190 million, payment approved by Commerce Commission and Overseas Investment Office.

25th
POLi, an online payment processing system, announced that it wants to work with banks to embrace open banking, by introducing an application programming interface that allows the bank to control the authorisation process of the payment.

Feb. 2018

1st
ANZ announced that it is using Blockchain to reduce administration and double handling in three areas: cross boarder payments, digital identities and Anti-Money Laundering compliance (in testing), and to take paper out of bank guarantees by making all relevant information available on the Blockchain.

16th
Kris Faafoi, Commerce and Consumer Affairs Minister, wants to see a decrease in default KiwiSaver fees as bank providers have kept their fees consistent since 2011. ANZ has reduced their default KiwiSaver fee by 0.02% while ASB, BNZ and Westpac's remain unchanged.

21st
Standard & Poor's predicted housing related economic imbalances will peak this year, on the back of five years of strong growth, in house price and household credit growth.

28th
The RBNZ announced that it is committed to improving public disclosure as a part of sensible regulation and supervision, to maintain consumer confidence.

Mar. 2018

6th
Dr Chris Eichbaum, a previous board member for the RBNZ, has been appointed again to the board of the RBNZ.

21st
BNZ cut a range of its fees, including those relating mortgages, personal loans and credit cards. This is partly due to the activity in Australia and the regulation emphasis in New Zealand on fees needing to reflect associated costs. Competitors may be prompted to reassess some of their fees in response.

26th
The RBNZ announced that the New Policy Targets Agreement will set out specific targets for maintenance of price stability and requires consideration of employment outcomes in conducting monetary policy.

ASB, BNZ and Westpac announced that they are committed to partake in Payment's NZ open banking software trial.

29th
Bank of China was granted its branch banking license, making it dual registered as a registered bank and overseas branch in New Zealand.

Apr. 2018

6th
The results of a consumer survey showed 87% of TSB customers were very satisfied with their banking service, followed by The Co-operative Bank (82%) and Kiwibank (71%). On the other hand, ASB and ANZ were called out for being the most likely to upsell, with a third of customers indicating that they have been offered unrequested products.

23rd
Kris Faafoi announced that he wants to see more momentum around adoption of open banking from Payments NZ, and is willing to force banks to proceed if they do not do it on their own accord.

26th
Kiwibank appointed former ASB executive, Steve Jurkovich, as CEO.

May 2018

1st
ASB's parent, the Commonwealth Bank of Australia, announced that it is being forced by its regulator to hold A$1 billion of additional capital following a prudential inquiry into the bank.

2nd
FMA CEO and RBNZ Governor have requested evidence that New Zealand's big banks are different to their Australian parents in wake of issues highlighted by the Australian Royal Commission of Inquiry into Banking Conduct in Australia.

9th
The Commerce Commission announced that it is investigating a problem with an ANZ loan calculator that has undercharged interest to around 100,000 home, personal and commercial loan customers.

23rd
ASB executive, General Manager for Retail Banking, Russell Jones, announced that he will move to BNZ as the General Manager for Technology and Operations, pending RBNZ approval.

30th
ANZ is to sell OnePath Life to Cigna Corporation for $700 million, as part of ANZ's strategy to simplify operations. Cigna will underwrite for ANZ for 20 years as part of the agreement.

30th
The RBNZ released its May *Financial Stability Report*. Household debt levels remain high, but are increasing at a lower rate than previously, and New Zealand banks have decreased their exposure to global risks. Dairy farms remain vulnerable to a downturn in dairy prices and need to decrease their debt to address this risk. Financial institutions must conduct in a way that supports public confidence, and the Bank Financial Strength Dashboard was released.

Jun. 2018

5th
The Commonwealth Bank of Australia has been served with an A$700 million (NZ$761 million) fine for failing to carry out appropriate anti-money laundering controls.

13th
Ian Hankins promoted to CFO after 16 years with Westpac.

14th
Chairman of Parliament's Finance and Expenditure Select Committee, Michael Wood, requested banking and insurance bosses to come in front of MPs due to the significant public interest in the banking sector's issues coming to light.

Jul. 2018

4th
TSB has announced the appointment of former CEO of The Warehouse Financial Services Group, Donna Cooper, as new CEO.

6th
RBNZ stress testing overview and results were released. Results are used as a factor in the review of capital requirements.

HSBC offered the lowest home interest rate in New Zealand for over 50 years, at 3.85% fixed interest for 18 months.

10th
ANZ launched a digital assistant 'Jamie' on their website to answer customer's basic banking questions.

11th
ANZ advanced $232 million to grow UDC Finance's loan book, allowing UDC's assets to surpass a record $3 billion as profitability remains strong. However, UDC's assets are still sitting under assets held for sale in ANZ's accounts.

12th
Kiwibank announced that it has appointed Tim Main as its new Treasurer, who was previously the Treasurer for BNZ and ANZ NZ.

19th
An estimated 450,000 people have invested in conservative KiwiSaver funds which earn lower returns. ANZ supports the change of moving long-term contributors to KiwiSaver funds with higher growth.

Aug. 2018

1st
The RBNZ revealed that they were not aware of the announcement made claiming bank bosses were to be brought in front of MPs for questioning. With banks effectively under a confidentiality order due to the FMA review, MP Michael Wood now wants to bring the New Zealand Bankers' Association up front instead.

Sep. 2018

3rd
Rabobank confirmed that the RBNZ requested an independent report on its governance and management, as Rabobank Australia's executive team makes key decisions for Rabobank NZ.

5th
ASB announced that it will issue $450 million of five-year bonds at 3.31% p.a.

7th
ASB offered $2,500 cash contribution to customers taking out home loans for KiwiBuild homes and dropped the deposit requirement to 5%.

12th
Rod Carr, former chair of RBNZ, was appointed as a director of ASB.

28th
'Profits before people' – the Australian Royal Commission released its interim report into Banking Misconduct; the large majority of misconduct identified in the report directly related to a financial benefit.

Oct. 2018

1st
Armistice Day coin begins circulation, as a tribute to the sacrifices made by military service personnel and their families for their part in bringing peace to New Zealand and the world.

4th
ANZ, BNZ, and Westpac all axed sale targets and sale target bonuses for all frontline staff. Difficulties creating another appropriate performance measure are expected, as the best advice for a customer may be not to use the bank's services.

17th
BNZ announced its new sign up service, by way of selfie video. New customers will no longer need to visit a branch to sign up, provided they have a device with a camera and their passport as ID.

19th
The RBNZ announced the appointment of Naomi Mitchell as Manager Communications.

21st
ANZ Australia CEO admitted that the bank has become unbalanced while focusing on pursuing financial goals.

23rd
The RBNZ released a consultation paper on breach reporting, proposing banks be formally required to notify the RBNZ of any breaches of their registration conditions, and then the RBNZ would publish it on their website if the breach is considered material.

31st
ANZ announced that it will hold on to UDC Finance as it has again achieved strong performance.

ANZ achieved a net profit of $1.98 billion for the year ended 30 September 2018, up 12% from prior year.

Nov. 2018

1st
ASB used a blockchain-based service to process and wrap up a meat export deal in just one hour, instead of the two to four days it would have taken if done in the traditional way.

BNZ delivered its best financial result since 2015, with an increase of 9.8% in profit to $1.029 billion.

Heartland Group Holdings Limited completed a corporate restructuring. All shares in Heartland Bank Limited have been exchanged for shares in Heartland Group Holdings Limited, where Heartland Bank has become a wholly-owned subsidiary of Heartland Group.

2nd
ANZ, ASB, BNZ and Westpac will receive $47.5 million each, as the Commerce Commission and the Overseas Investment Office approve the sale of Paymark.

5th
Westpac reported a 5% increase in profit to $1.017 billion, attributing this to a three-year focus on business transformation, delivering benefits to the bank, its customers and communities.

The FMA and RBNZ's review of New Zealand banks has discovered some significant weaknesses, including governance, poor conduct of staff and managing conduct risk.

The RBNZ and FMA warned banks that removing front-facing staff's sales incentives, was not enough, when higher level staff are still driven by sales-based incentives. Full changes to achieve sustainable profitability have an implementation deadline of 30 September 2019.

8th
ANZ CEO in New Zealand took a $300,000 pay cut, reducing his remuneration to $3.35 million, while Westpac CEO received a $70,000 increase to $1.9 million. ANZ's incentive scheme across all staff levels has been cut back following conduct failures brought to light by the Royal Commission in Australia.

OneRoof.co.nz announced a strategic partnership with BNZ with the idea of helping more Kiwis into their own homes.

The RBNZ announced that the OCR will remain unchanged at 1.75%.

9th
Following the Royal Commission of Inquiry into banking misconduct in Australia, FMA announced that it is willing to name and shame banks that are not operating up to scratch by 31 March 2019.

13th
The RBNZ released its bi-annual *Credit Conditions Survey*.

17th
BNZ's new Chief Executive, Angela Mentis, was disclosed as the highest paid New Zealand bank boss, receiving a statutory remuneration of $3.8 million.

21st
ASB has also started using facial recognition technology to enable customers to open new bank accounts in 15 minutes, without having to visit a physical branch.

22nd
Bank of China celebrated four years in New Zealand and stated that it aims to continue to use cross-border advantages to promote bilateral cooperation.

28th
The RBNZ loosened LVR restrictions for mortgage lending.

30th
The RBNZ proposed increasing capital requirements to allow banks to better cope with unexpected events.

Dec. 2018

5th
BNZ will refund $3.8 million to 10,000 customers, resulting from errors following changes to the Credit Contracts and Consumer Finance Act in 2015.

14th
The RBNZ's announced proposal requires banks to hold significantly more capital to make them resilient to 1 in 200-year events, with the intention of increasing their tier one capital requirement from 8.5% to 16% for larger banks and 15% for smaller banks.

Jan. 2019

4th
The national average increase in asking prices for homes has slowed to the smallest annual increase since 2012, with a 1.9% increase.

9th
The RBNZ appointed Scott Fisher as CIO. Scott has previously worked as Head of Service Operations at TAB and technical and management roles at BNZ.

25th
In response to feedback received regarding the proposed capital changes, the RBNZ has extended its consultation process by a month.

Sector performance

Net profit after tax

The overall net profit after tax (NPAT) for the New Zealand banking sector increased by 11.21% ($581.75 million) from $5.19 billion to $5.77 billion, another record profit for the industry. A continued strong economy has allowed for increased profits, primarily driven by an increase in gross loans and advances, which in turn increased the net interest income, and continued strong asset quality, assisted by the strong economic conditions.

VIEW FIGURE 5

The increase in profitability was driven by an increase in net interest income of $710.56 million (7.35%) and non-interest income of $313.83 million (10.67%). The increase in net interest income is driven by both continued strong asset growth as well as a slightly improved net interest margin, while the increase in non-interest income is mainly due to movements in fair value of financial instruments.

On the other side, there was an increase in operating expenses of 3.02% ($157.49 million) and an increase in impaired asset expense of 45.19% ($80.28 million), albeit of a fairly low base.

The four major banks (ANZ, BNZ, CBA and Westpac) in total contributed $482.00 million of the increase in NPAT, with increases ranging from 5.48% (Westpac) to 12.59% (CBA). Kiwibank, the fifth major bank, presented a huge 116.98% increase in NPAT; however, this was largely driven by the absence of significant impairment expenses on IT projects in the current year, bringing their profits back to more historically normal levels.

The financial performance of the survey participants can be summarised as follows:

- Net interest income rose by $710.56 million (7.35%) to $10.37 billion;
- Non-interest income increased by 10.67% ($313.83 million) to $3.25 billion;
- Operating expenses (and amortisation expenses) rose by 3.02% ($157.49 million) to $5.37 billion;
- Impaired asset expense grew by 45.19% ($80.28 million) to $257.95 million; and
- Tax expense increased by 10.14% ($204.87 million) to $2.22 billion.

Net interest margin

The net interest margin (NIM) for the banking sector rose 4 bps from 2.08% to 2.12%, with net interest income increasing by 7.35% ($710.56 million) for the year compared to a 6.03% increase in gross loans and advances, with half of the survey participants seeing increases and half seeing decreases in their NIM.

All major banks reported increases in their NIM, with Kiwibank having the biggest increase of 14 bps (to 2.05%), and ANZ maintaining the highest NIM of the major banks at 2.18% (a 1 bps increase). With the exception of Kiwibank, the major banks all saw decreases in the rate earned on interest earning assets. However, this was more than offset by the decrease in funding costs, showing the continued story of decreasing funding costs, and the retention of a portion of these decreases, driving the top line growth. This is discussed in further detailed in the Cost to income ratio section on page 28.

Interestingly, 16 of the survey participants experienced increases in interest bearing liabilities, and an overall increase of 4.51% ($18.98 billion), while only 14 had increases in their interest expense, with a proportionately smaller total increase on 0.44% ($50.37 million). This shows the large influx of cash banks have had, enabling them to lower deposit rates. Interest income has grown 3.59% or $760.94 million, slightly less than gross loans and advances (GLA) growth of 6.03%, but still proportionately more than interest expenses, enabling for the general increase in net interest income of 7.35% ($710.56 million).

See Table 4 – page 23.

Of the non-major banks, Bank of China and Industrial and Commercial Bank of China (ICBC) saw the largest decreases in NIM, down 39 bps (to 1.08%) and 38 bps (to 1.81%) respectively, with growth in their loan books outstripping their growth in net interest income.

One bank that was able to grow their loan book while retaining margins was China Construction Bank, seeing the biggest increase in NIM for the banking sector with a 45 bps increase, to 1.83%, while experiencing significant growth, with their loan book growing by 121.13%.

Heartland Bank remained at the top of the pack with the highest NIM in 2018 of 4.44%, marginally down from 4.45% in 2017, as it continues to operate in its market niche.

TABLE 2: REGISTERED BANKS – PERFORMANCE TRENDS						
Year	**Increase in total assets**	**Increase in net profit after tax**	**Net profit after tax/Average total assets**	**Interest margin**	**Operating expenses/ Operating income**	**Impaired asset expense/ Average gross loans & advances**
2018	5.07%	11.21%	1.12%	2.12%	37.95%	0.06%
2017	1.42%	7.35%	1.04%	2.08%	39.61%	0.04%
2016	6.35%	-6.58%	1.00%	2.17%	39.25%	0.12%
2015	10.20%	6.94%	1.16%	2.28%	37.32%	0.12%
2014	5.28%	20.41%	1.17%	2.24%	39.44%	0.08%
2013	1.15%	8.53%	1.00%	2.26%	42.05%	0.16%

TABLE 3: REGISTERED BANKS: NON-PERFORMING LOANS[65]	2015	2016	2017	2018
Past due assets to gross loans and advances	0.19%	0.13%	0.14%	0.13%
Gross impaired assets to gross loans and advances	0.48%	0.37%	0.33%	0.37%
Total	**0.67%**	**0.50%**	**0.47%**	**0.50%**

FOOTNOTE 65

TABLE 4: MOVEMENT IN INTEREST MARGIN	2018	2017	Movement
Entity	**%**	**%**	**(bps)**
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	2.18%	2.17%	1
Bank of Baroda (New Zealand) Limited	2.89%	2.90%	-1
Bank of China (New Zealand) Limited	1.08%	1.47%	-39
Bank of India (New Zealand) Limited	2.96%	3.06%	-10
Bank of New Zealand	2.15%	2.10%	5
China Construction Bank (New Zealand) Limited	1.83%	1.38%	45
Citibank, N.A. New Zealand Branch	1.39%	1.69%	-30
Commonwealth Bank of Australia New Zealand Banking Group	2.02%	1.98%	4
Heartland Bank Limited	4.44%	4.45%	-1
Industrial and Commercial Bank of China (New Zealand) Limited	1.81%	2.19%	-38
JPMorgan Chase Bank, N.A. New Zealand Branch	0.89%	1.25%	-36
Kiwibank Limited	2.05%	1.91%	14
Kookmin Bank Auckland Branch	1.52%	1.25%	27
MUFG Bank, Ltd – Auckland Branch	0.46%	0.33%	13
Rabobank Nederland New Zealand Banking Group	2.25%	2.08%	17
SBS Bank	2.56%	2.49%	7
The Co-operative Bank	2.27%	2.39%	-12
The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch	1.57%	1.60%	-3
TSB Bank Limited	1.80%	2.01%	-21
Westpac Banking Corporation – New Zealand Division	2.11%	2.02%	9
Sector average	**2.12%**	**2.08%**	**4**

Non-interest income

Twelve survey participants reported increases in non-interest income in 2018, leading to a 10.67% ($313.83 million) rise in non-interest income to reach $3.25 billion. This movement was primarily driven by ANZ, who had an increase of $227.00 million. Their increase was mainly driven by movements in financial instruments, increased net insurance and funds management income and income from insurance proceeds. BNZ also helped drive the increase, with a 17.08% rise ($89.00 million), with the majority of this increase being due to net gains on financial instruments. Westpac was the only one of the major banks to see a decrease in non-interest income, dropping by $23.00 million (-3.68%), mainly from a reduction in transaction fees and commissions.

Of the non-major banks, ICBC and Bank of China saw the highest increases in non-interest income, reporting rises of 226.69% ($1.84 million) and 184.00% ($6.34 million), respectively. ICBC's increase was largely due to gains on derivative financial instruments on the back of a large decrease in 2017, while Bank of China's was largely driven by lending and credit facility related fee income. In contrast, Rabobank and China Construction Bank reported the largest reductions, in percentage terms, for non-interest income of 408.30% ($40.38 million) and 63.81% ($1.08 million) respectively. Rabobank's significant decrease was primarily driven by losses on its trading derivatives.

Total assets

Total assets for the sector have continued to increase, up to $529.76 billion. The 5.07% ($25.67 billion) increase is up from last year's 1.42% increase, but down from the high growth rates experienced in 2016 and 2015 of 6.35% and 10.20% respectively.

The majority of this growth is driven by GLA rising by 6.03% ($24.98 billion) to reach $438.94 billion, up from last year's increase of 4.68%, but slightly lower than the increases in 2016 and 2015 of 8.12% and 7.07% respectively.

VIEW FIGURE 6

VIEW FIGURE 7

VIEW FIGURE 8

All survey participants saw increases in their loan books over the year. The major banks saw an increase in loans of 4.84% ($18.39 billion), while other banks collectively increased their loan book by 19.39% ($6.58 billion). However, the major banks only saw their collective market share slightly drop, from 91.80% to 90.77%, with this combined dominant market position meaning that these five banks largely drive the trends of the industry overall.

The major banks all retained their respective market share rankings from last year, with ANZ being top at 29.43%, while Rabobank retained its position as the largest non-major, with 2.57% market share. The Chinese banks (Bank of China, China Construction Bank and ICBC) and The Hongkong and Shanghai Banking Corporation (HSBC) gained the most market share of all banks, rising by 24 bps (to 0.33%), 20 bps (to 0.38%), 12 bps (to 0.28%) and 18 bps (to 1.01%), respectively.

Of the major banks, CBA had the largest increase of GLA at 5.50% ($4.49 billion), closely followed by ANZ at 5.42% ($6.64 billion). Kiwibank saw the slowest loan growth of all banks over the year, with only a 2.72% ($485.00 million) increase, off the back of a strong 6.65% growth rate the year before.

Continuing the pattern from previous years, the Chinese banks claimed the largest percentage-based increases in loan book growth. Bank of China had the largest increase at 312.45%, to reach $1.43 billion, while China Construction Bank saw the second largest at 121.13%, bringing their total loans to $1.65 billion, and ICBC saw an 82.59% increase in GLA, to now have loans of $1.29 billion.

Funding costs

In FIPS Banks Review of 2017, we reported that the registered banks recorded their lowest ever funding costs (interest expense as a ratio of average interest-bearing liabilities) in the banking sector at 2.82%, a drop of 40 bps from the year before. This record has already been broken, with a new record low funding cost of 2.69% (a drop of 13 bps) being recorded for 2018. This is on the back of interest expense increasing by 0.44% ($50.38 million), while interest-bearing liabilities grew by a greater rate of 4.51% ($18.98 billion). This is driven by lower global wholesale rates, which is driven by a lot of money searching for yield globally, and the OCR continuing to be held at record lows. This is shown in the Cost to income ratio analysis at page 28, and is one of the main reasons that consumers continue to enjoy low loan rates.

VIEW FIGURE 9

VIEW FIGURE 10

Collectively, the major banks saw a $40 million increase (0.38%) in interest expense, while their interest-bearing debt rose by $11.25 billion (2.87%).

TABLE 5: MAJOR BANKS – PERSONNEL COST						
Entity	2018			2017		
	Employee numbers	Personnel cost $Million	Cost/ average employees $000's	Employee numbers	Personnel cost $Million	Cost/ average employees $000's
ANZ	7,374	891	119	7,565	856	112
BNZ	4,703	537	113	4,787	493	101
CBA	4,961	537	110	4,786	509	107
Kiwibank	1,491	153	103	1,493	141	97
Westpac	4,124	484	114	4,332	482	112

CBA experienced the greatest decline in funding costs at 24 bps (to 2.87%), followed by Westpac at 11 bps (to 2.79%). CBA and Westpac have had and still have the highest funding cost rates among the major banks, leaving them with more opportunity to find reductions.

Kiwibank reported the smallest decrease out of the major banks, dipping 4 bps to 2.78%, while the latest results show BNZ has achieved the lowest funding costs of the major banks, dropping 9 bps to 2.61%, just slightly lower than ANZ on 2.65% (which had a 5 bps decrease).

Among the smaller banks, ICBC and Bank of India saw their funding costs increase by 67 bps (to 2.40%) and 66 bps (to 4.76%), bringing Bank of India to having the highest funding cost out of all of the non-major banks, and 115 bps clear of the next highest bank (The Co-operative Bank at 3.61%).

Asset quality

Impaired asset expense increased in 2018, up by 45.19% ($80.28 million) to reach $257.95 million in 2018. It should be noted that impaired asset expense as a proportion of GLA remains very low from an historical perspective, with a ratio of 0.06% (up to from 0.04% in 2017) compared to an average of 0.14% for the five years from 2012 to 2016.

The increase in impaired asset expense was mainly driven by Westpac, who saw an increase of $73.00 million (96.05%). However, this was mainly bringing their impaired asset expense back to a more normal level after significant recovery write-backs for the agricultural sector in 2017[66]. Kiwibank also saw a large increase in impaired asset expense of $7.00 million (116.67%); however, like Westpac, this comparison is mainly driven by significant recovery write-backs in 2017, with Kiwibank only having impaired asset expense of $1.00 million in 2018 (0.01% of GLA).

FOOTNOTE 66

Total provisions as a percentage of average GLA improved over the year, with a 4 bps reduction to 0.46%. The overall improvement in asset quality for the banking sector is due to specific provisioning decreasing by 3.46% ($12.81 million) to $370.56 million and collective provisioning reducing by 2.38% ($38.33 million) to $1.57 billion.

VIEW FIGURE 11

VIEW FIGURE 12

For specific provisions, Westpac saw the biggest improvement out of the major banks, with a $12 million (33.33%) decrease in their specific provisions. Out of all the banks, TSB saw the greatest improvement, with a decrease of $0.83 million (273.11%), driven by the writeback of a Solid Energy provision.

For collective provisions, all major banks except for BNZ saw a reduction, with a net reduction overall of $50 million from among the five major banks. Of the non-major banks, Rabobank reported the largest decrease in collective provision of $7.43 million (21.46%), partially offset by their $2.20 million (33.97%) increase in specific provision.

Past due but not impaired assets decreased by 1.97% ($11.78 million) to $585.97 million for the banking sector, slightly clawing back the 14.15% increase from last year. All major banks saw increases in past due assets, and Kiwibank reported the largest increase of 71.43% ($5.00 million), with the exception of BNZ who had a 24.67% ($37.00 million) decrease in past due assets). Rabobank also had the largest increase of all banks reporting past due assets, at 189.96% ($4.35 million).

Across the banking sector, there was a general feeling that the credit cycle was as good as it gets. Looking forward, survey participants felt that things could not get much better, and thus it could only get worse. Given the slightly uptick in impairment, this may be a very early indication of a turn in the credit cycle, but could also be partly driven by the implementation of NZ IFRS 9 *Financial Instruments*.

Operating expenses

The cost to income ratio decreased by 166 bps from 39.61% to 37.95% in 2018. The banking sector saw a significant increase in operating income by 8.13% ($1.02 billion), partly due to the $313.83 million (10.67%) rise in non-interest income, while operating expenses rose proportionately less, at 3.61% ($180.40 million).

VIEW FIGURE 13

All major banks except BNZ achieved decreases in their cost to income ratio. Although BNZ experienced a 10.41% increment in operating income, operating expenses further rose 11.04%, leading to an increase of 21 bps to 38.18%. BNZ reported that their increase in operating expenses was mainly driven by investments in technology[68]. Kiwibank saw the largest decrease in the cost to income ratio of 1,538 bps to 66.60%, but remains the highest of the major banks, reflecting that they have significantly less economies of scale given their much smaller loan book than the big four.

FOOTNOTE 67

TABLE 6: MAJOR BANKS – FUNDS MANAGEMENT ACTIVITIES

Entity	2018 $Million	2017–2018 Movement %	2017 $Million
ANZ	30,665	7.63%	28,490
BNZ	7,058	21.88%	5,791
CBA	14,234	32.66%	10,730
Kiwibank[67]	7,728	21.26%	6,373
Westpac	13,468	12.43%	11,979
Total	**73,153**	**15.45%**	**63,363**

FOOTNOTE 68

The cost to income ratio for the remaining major banks ranged between 33.36% (CBA) and 36.71% (Westpac), with Westpac having the biggest drop of 295 bps. Of the non-major banks, Kookmin Bank and the MUFG Bank, Ltd – Auckland Branch reported the lowest operating ratios of 38.43% and 16.69% respectively.

Personnel expenses rose by 5.35% ($146.15 million), driving a large portion of the increase in operating expenses, with all but one survey participant seeing an increase. Bank of Baroda was the only survey participant to achieve a decrease, dropping 8.93% ($136,000). Of the major banks, BNZ had the largest increase of 8.92% ($44.00 million), followed by Kiwibank with an 8.51% ($12.00 million) rise, whereas Westpac only had a small increase of 0.41% ($2.00 million), the smallest percentage increase of all the survey participants.

See Table 5 – page 25.

Return on equity/Return on assets

2018 saw the banking sector improve its return on equity (ROE) by 46 bps, to 14.88%. This was driven by further record profits for the banking sector.

Three of the major banks increased their ROE, namely Kiwibank (380 bps to 8.02%), ANZ (178 bps to 17.61%) and BNZ (93 bps to 14.73), with ANZ retaining the highest ROE for the major banks. The only banks with a higher ROE across the banking sector were HSBC (186.84%) and Kookmin Bank (98.51%), significantly benefiting from their branch structure.

VIEW FIGURE 14

CBA saw a 173 bps drop in their ROE to 17.34%, losing its place as the highest ROE out of the major banks, following a significant increase in capital of $3.0 billion. Westpac also saw a slight drop in their ROE of 47 bps to 13.78%, likely driven by their increased capital requirements from the RBNZ.

This year saw another rise in the return on assets (ROA) ratio for the banking sector, increasing by 8 bps to reach 1.12%, following 2017's 3 bps increase. Driving this increase was the NPAT growth of 11.21% that was at a faster rate than total assets, which increased by 5.07%. Kiwibank reported the largest increase in ROA of 29 bps (to 0.56%), driven by its significant increase in NPAT due to the impairment loss in 2017; however, this ROA is still much lower than its major bank peers which averaged 1.16%.

TABLE 7: REGISTERED BANKS – ANALYSIS OF PERFORMANCE OF BANKS	New Zealand incorporated banks		New Zealand branch banks		All banks	
	2018	2017	2018	2017	2018	2017
Increase in total tangible assets	4.72%	2.13%	21.41%	-0.96%	5.07%	1.42%
Increase in operating income	7.92%	3.48%	6.01%	-11.22%	8.13%	3.12%
Increase in net profit after tax	10.35%	8.66%	4.73%	-32.97%	11.21%	7.35%
Increase in gross loans and advances	6.40%	5.44%	20.85%	3.59%	6.03%	4.68%
Net profit after tax/Average total tangible assets	1.13%	1.06%	0.73%	0.77%	1.12%	1.04%
Net profit after tax/Average equity	13.74%	13.08%	25.75%	24.90%	14.88%	14.43%
Net interest income/Average total tangible assets	2.10%	2.03%	1.11%	1.14%	2.01%	1.93%
Non-interest income/Average total tangible assets	0.60%	0.56%	0.68%	0.72%	0.63%	0.59%
Operating expenses/Average total tangible assets	1.03%	1.03%	0.76%	0.84%	1.00%	1.00%
Operating expenses/Operating income	38.23%	39.79%	42.48%	44.97%	37.95%	39.61%
Impaired asset expense/Average gross loans and advances	0.07%	0.05%	0.04%	-0.02%	0.06%	0.04%
Collective provision/Net loans and advances	0.37%	0.40%	0.02%	0.02%	0.36%	0.39%
Total provision for doubtful debts/Gross loans and advances	0.46%	0.49%	0.07%	0.04%	0.44%	0.48%

With the review into capital underway, and a likely increase in the required capital needing to be held by the registered banks, this may have a significant impact on the banks' ROEs going forward.

Fund under management

All major banks again saw strong growth for funds under management (FUM), increasing by 15.45% ($9.79 billion) to reach $73.15 billion, see Table 6. Continuing last year's trend, both BNZ and CBA experienced high growths in FUM of 21.88% ($1.27 billion) and 32.66% ($3.50 billion), respectively, with $0.53 billion and $1.50 billion being due to KiwiSaver respectively.

See Table 6 – page 26.

ANZ remains the dominating player of FUM sub-sector, with managed funds increasing by 7.63% ($2.18 billion) to $30.67 billion in 2018, again driven by their KiwiSaver fund, contributing $1.88 billion of the growth.

Kiwibank's FUM also increased a notable 21.26% ($1.36 billion), as a result of KiwiWealth growing beyond 200,000 KiwiSaver accounts, and contributing $739 million of the overall increase.

Capital adequacy ratio

The majority of survey participants saw an increase in their capital ratios in 2018, likely reflecting the record profits more than offset the dividends paid last year.

Of the major banks, Kiwibank had the largest increase in tier one capital ratio, up 250 bps to 14.80%, the highest of the major banks. ANZ was the next largest with an 80 bps increase to 13.40%, with all other major banks having small increases between 10–20 bps. BNZ continues to have the lowest tier one capital ratio of the major banks at 11.95%.

China Construction Bank and ICBC reported the largest decreases in their capital adequacy ratios. They saw their total capital ratios decrease by 1,121 bps to 13.09% and 744 bps to 11.74%, respectively, and their tier one capital ratios decreased by 1,057 bps to 12.43% and 988 bps to 9.30% for tier one, respectively. The decrease for China Construction Bank was driven by their significant growth in lending, whilst ICBC's was driven by both growth in lending and significant impairment losses on CBL Insurance Limited.

As with last year, Indian banks, Bank of Baroda and Bank of India continued to have highest capital adequacy ratios of 78.06% and 57.00%, with an 85 bps increase and a 100 bps decrease, respectively.

Capital adequacy ratios will be significant impacted by the RBNZ's ongoing review of capital requirements. While the result is almost certain to be that more capital will need to be held, the main questions are how much capital will be required, and how much buffer each bank's hold on top of the new minimum requirements.

Cost to income ratio

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SEAN'S BIO

The banking sector has generally reported strong increases in their NPAT over the past few years. This has largely been driven off the back of high lending growth, offset slightly by small contractions in interest margins.

When looking at drivers of profit, there are several different metrics that are looked at, including net interest margin, asset growth and impaired asset expense, and from these, especially important to investors, a bank's ROE and ROA.

None of these metrics individually capture how well a bank has done; as for example, while a bank's NPAT may have increased, these ratios do not assess whether a bank could have increased their NPAT by even more.

One measure that attempts to get a more fulsome picture is the 'cost to income ratio', being operating expenses as a proportion of operating income. This ratio looks at both the efficiency of a bank in an absolute perspective, especially when compared to its peers, but it also allows stakeholders to see how much of the incremental operating income makes it way down to the bottom line. This is also a useful measure to see how a bank is performing over time.

Over the past few years, the banking sector has been able to improve its cost to income ratio, from 44.40% to 37.95%. Figure 15 breaks this ratio down into its component parts, looking into what has driven this improvement over the past few years. The main components are interest income, interest expense and non-interest income, which together make up operating income, and operating expenses.

VIEW FIGURE 15

Figures 16 to 19 break this analysis down into the four major banks. While these banks are large enough to drive most of the sector's performance themselves, their individual experiences have differed over the period analysed.

VIEW FIGURE 16

VIEW FIGURE 17

VIEW FIGURE 18

VIEW FIGURE 19

At a banking sector level, the sector has been able to increase its net interest income by 22% and non-interest income by 35%, while only increasing operating expenses by 11%. On the face of it, it appears that the banks have done very well to only increase their operating expenses at half the rate of net interest income. There are two main drivers for this.

The first is that the banks have benefited from significant asset growth over this period, with increases of up to the 10.20% seen in 2015. This has been driven by a strong economy close to full employment, and lower interest rates causing asset prices to increase, especially residential housing. This absolute increase in lending causes interest income to increase, but was only slightly offset by the decrease in lending rates being offered.

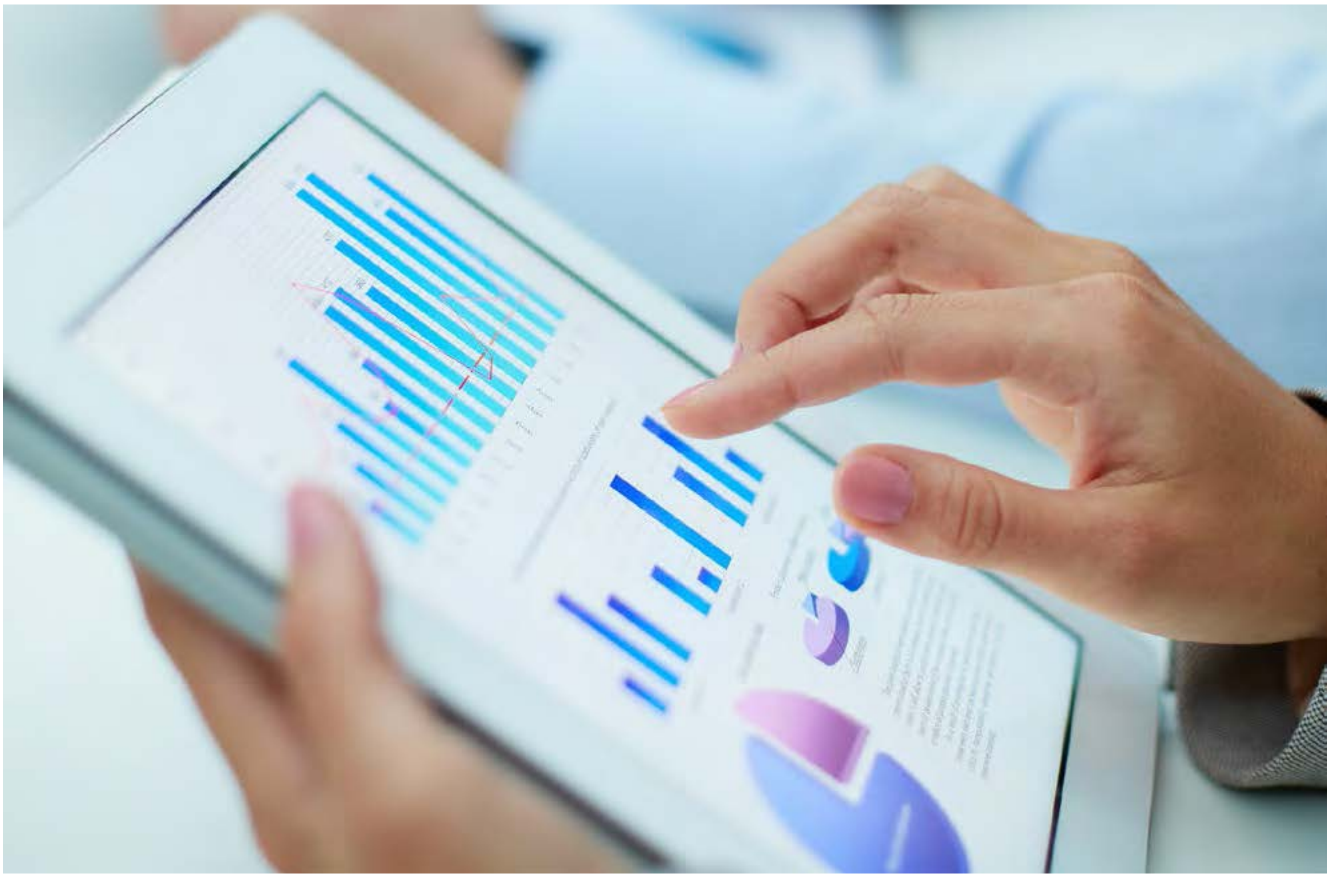
The second was that these lower lending rates offered were largely a result of lower funding costs being obtained. Funding costs dropped from 3.83% in 2012 to 2.70% in 2018 (down 113 bps). This was partly driven by lower overseas wholesale rates, and partly driven by reductions to the RBNZ's OCR.

As shown by the NIM decreasing from 2.26% in 2012 to 2.12% in 2018, the banks reduced their lending rates by more than the reduction in funding costs. However, the sacrifice of NIM was more than offset by the increase in absolute net interest income that resulted from the increase in total lending.

As a sector, what this appears to show is that banks have largely performed well over this period due to access to lower funding costs, leading them to being able to offer lower lending rates. This in turn has fuelled asset growth, allowing a smaller NIM to still result in stronger net interest income.

On the other hand, operating expenses have only slightly increased in comparison, but these are efficiencies you would expect for growth coming from higher asset prices, where it does not cost the bank much more to lend a $2 million mortgage compared to a $1 million mortgage.

Based on the above, it does not appear that there has any fundamental efficiency shift or drive that has resulted in an improved cost to income ratio over the past few years, more so that the banks have merely rode the economic cycle and enjoyed lower funding costs to drive new borrowing.



Analysis of annual results

Analysis of financial statements

Entity	Location of head office	Balance date	Survey year	Rank by total assets	Total assets* $Million	Net assets $Million	Total capital adequacy ratio %
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	Wellington	30 Sep 2018	2018	1	158,180	8,000	15.20
		30 Sep 2017	*2017*	*1*	*154,977*	*8,105*	*14.80*
Bank of Baroda (New Zealand) Limited	Auckland	31 Mar 2018	2018	19	116	47	78.06
		31 Mar 2017	*2017*	*20*	*103*	*46*	*77.21*
Bank of China (New Zealand) Limited	Auckland	31 Dec 2017	2018	15	1,666	214	14.13
		31 Dec 2016	*2017*	*17*	*515*	*55*	*12.74*
Bank of India (New Zealand) Limited	Auckland	31 Mar 2018	2018	20	103	54	57.00
		31 Mar 2017	*2017*	*19*	*121*	*53*	*58.00*
Bank of New Zealand	Auckland	30 Sep 2018	2018	3	99,639	7,027	13.59
		30 Sep 2017	*2017*	*3*	*95,038*	*6,664*	*13.02*
China Construction Bank (New Zealand) Limited	Auckland	31 Dec 2017	2018	14	1,826	206	13.09
		31 Dec 2016	*2017*	*15*	*888*	*196*	*24.30*
Citibank, N.A. New Zealand Branch	Auckland	31 Dec 2017	2018	13	2,045	193	14.60
		31 Dec 2016	*2017*	*13*	*2,065*	*195*	*14.25*
Commonwealth Bank of Australia New Zealand Banking Group	Auckland	30 Jun 2018	2018	2	101,016	7,674	15.00
		30 Jun 2017	*2017*	*4*	*92,505*	*4,679*	*14.20*
Heartland Bank Limited	Auckland	30 Jun 2018	2018	9	4,451	619	14.12
		30 Jun 2017	*2017*	*9*	*3,990*	*524*	*13.56*
Industrial and Commercial Bank of China (New Zealand) Limited	Auckland	31 Dec 2017	2018	16	1,662	139	11.74
		31 Dec 2016	*2017*	*14*	*904*	*140*	*19.18*
JPMorgan Chase Bank, N.A. New Zealand Branch	Wellington	31 Dec 2017	2018	17	1,573	0	15.44
		31 Dec 2016	*2017*	*16*	*845*	*0*	*14.62*
Kiwibank Limited	Wellington	30 Jun 2018	2018	5	20,715	1,487	15.80
		30 Jun 2017	*2017*	*5*	*20,616*	*1,380*	*13.40*
Kookmin Bank Auckland Branch	Auckland	31 Dec 2017	2018	18	425	4	16.01
		31 Dec 2016	*2017*	*18*	*394*	*3*	*16.32*
MUFG Bank, Ltd – Auckland Branch	Auckland	31 Mar 2018	2018	11	4,057	164	15.90
		31 Mar 2017	*2017*	*11*	*3,560*	*143*	*15.28*
Rabobank Nederland New Zealand Banking Group	Wellington	31 Dec 2017	2018	6	15,271	1,731	26.20
		31 Dec 2016	*2017*	*6*	*14,306*	*1,598*	*25.00*
SBS Bank	Invercargill	31 Mar 2018	2018	10	4,447	289	12.84
		31 Mar 2017	*2017*	*10*	*3,987*	*268*	*12.56*
The Co-operative Bank	Wellington	31 Mar 2018	2018	12	2,629	182	16.80
		31 Mar 2017	*2017*	*12*	*2,363*	*171*	*16.90*
The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch	Auckland	31 Dec 2017	2018	8	6,391	11	18.90
		31 Dec 2016	*2017*	*8*	*5,071*	*10*	*19.00*
TSB Bank Limited	New Plymouth	31 Mar 2018	2018	7	7,416	613	14.28
		31 Mar 2017	*2017*	*7*	*6,803*	*588*	*14.60*
Westpac Banking Corporation – New Zealand Division	Auckland	30 Sep 2018	2018	4	96,131	7,861	14.70
		30 Sep 2017	*2017*	*2*	*95,141*	*7,306*	*14.80*
Bank sector total			**2018**		**529,759**	**36,516**	**n/a**
			2017		***504,192***	***32,124***	***n/a***

* Total Assets = Total Assets - Goodwill - Other Intangibles

Size & strength measures						Growth measures		
Tier 1 capital adequacy ratio %	Net loans and advances $Million	Customer deposits $Million	Number of employees	Number of branches	Number of owned ATMs	Increase in net profit after tax %	Increase in underlying profit %	Increase in total assets %
13.40	129,061	103,124	7,374	179	591	11.57	9.43	2.07
12.60	*122,400*	*94,751*	*7,565*	*191*	*655*	*15.43*	*12.69*	*-5.13*
78.06	86	67	20	3	3	25.05	21.22	12.48
77.21	*70*	*56*	*19*	*3*	*3*	*-34.48*	*-4.35*	*12.37*
14.13	1,417	393	n/a	n/a	n/a	57.41	-53.60	223.72
12.74	*346*	*214*	*36*	*0*	*0*	*73.63*	*73.53*	*146.95*
57.00	91	21	12	3	0	-11.00	-11.93	-14.80
58.00	*88*	*24*	*12*	*3*	*0*	*23.72*	*24.37*	*18.96*
11.95	83,549	59,776	4,703	153	633	9.82	10.72	4.84
11.83	*79,920*	*56,131*	*4,787*	*160*	*549*	*2.63*	*3.84*	*2.94*
12.43	1,648	459	41	0	0	480.50	3273.44	105.75
23.00	*745*	*139*	*38*	*0*	*0*	*137.94*	*109.15*	*120.86*
13.23	896	919	28	1	0	-7.65	-7.10	-0.99
12.99	*811*	*840*	*29*	*1*	*0*	*-2.46*	*-2.92*	*4.62*
12.30	85,986	58,772	4,961	122	458	12.59	12.69	9.20
12.10	*81,494*	*54,713*	*4,786*	*124*	*440*	*10.24*	*9.97*	*7.81*
13.71	4,006	2,882	428	4	0	11.03	14.45	11.56
13.15	*3,563*	*2,574*	*401*	*7*	*0*	*12.27*	*15.36*	*13.92*
9.30	1,276	420	57	1	0	-204.08	-322.44	83.95
19.18	*704*	*150*	*54*	*1*	*0*	*138.97*	*162.17*	*21.81*
15.03	130	188	12	0	0	21.94	22.16	86.10
14.20	*101*	*236*	*15*	*0*	*0*	*36.92*	*34.28*	*-4.33*
14.80	18,335	16,152	1,491	244	250	116.98	88.42	0.48
12.30	*17,849*	*15,904*	*1,493*	*253*	*237*	*-57.26*	*-49.47*	*6.50*
14.86	218	207	13	1	0	10.15	10.71	8.05
14.83	*169*	*190*	*14*	*1*	*0*	*11.11*	*10.92*	*-12.49*
13.59	3,543	346	17	1	0	19.65	38.37	13.95
12.70	*3,113*	*219*	*17*	*1*	*0*	*-31.88*	*-34.39*	*12.36*
18.80	11,281	4,520	327	32	0	12.25	10.36	6.75
17.60	*10,559*	*4,981*	*320*	*33*	*0*	*6.05*	*7.55*	*-1.23*
10.92	3,824	3,233	535	16	0	-2.86	-2.68	11.53
11.74	*3,429*	*2,945*	*480*	*16*	*0*	*37.43*	*32.18*	*17.02*
14.10	2,297	2,200	327	33	0	1.34	5.34	11.22
14.00	*2,107*	*2,035*	*313*	*34*	*0*	*0.74*	*10.52*	*15.80*
17.00	4,445	3,154	207	1	0	1.73	0.90	26.02
17.20	*3,448*	*3,118*	*214*	*1*	*0*	*-45.29*	*-44.96*	*-9.05*
14.28	5,334	6,741	464	25	40	11.94	12.39	9.02
14.60	*4,680*	*6,157*	*440*	*26*	*40*	*-24.73*	*-23.80*	*5.84*
12.80	81,148	61,884	4,124	161	538	5.48	4.05	1.04
12.70	*77,983*	*58,405*	*4,332*	*169*	*611*	*9.97*	*9.43*	*2.49*
n/a	**438,570**	**325,459**	**25,141**	**980**	**2,513**	**11.21**	**10.28**	**5.07**
n/a	***413,579***	***303,782***	***25,365***	***1,024***	***2,535***	***7.35***	***6.73***	***1.42***

Analysis of annual results

Analysis of financial statements		Credit quality measures						
Entity	**Survey year**	**Impaired asset expense $Million**	**Past due assets $Million**	**Gross impaired assets $Million**	**Individual provision for doubtful debts/ Gross impaired assets %**	**Collective provision/ Net loans and advances %**	**Total provision for doubtful debts/ Gross loans and advances %**	**Impaired asset expense/ Average gross loans and advances %**
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	2018	53	221	323	40.87	0.30	0.40	0.04
	2017	*60*	*205*	*361*	*42.66*	*0.35*	*0.48*	*0.05*
Bank of Baroda (New Zealand) Limited	2018	0	0	0	0.00	0.41	0.41	0.09
	2017	*0*	*0*	*0*	*0.00*	*0.41*	*0.41*	*0.04*
Bank of China (New Zealand) Limited	2018	12	0	33	30.00	0.21	0.91	1.36
	2017	*1*	*0*	*0*	*0.00*	*0.27*	*0.27*	*0.20*
Bank of India (New Zealand) Limited	2018	0	0	0	0.00	0.37	0.37	0.01
	2017	*0*	*0*	*0*	*0.00*	*0.39*	*0.39*	*0.05*
Bank of New Zealand	2018	82	113	265	39.62	0.60	0.72	0.10
	2017	*83*	*150*	*250*	*40.80*	*0.60*	*0.73*	*0.11*
China Construction Bank (New Zealand) Limited	2018	1	0	0	0.00	0.10	0.10	0.08
	2017	*0*	*0*	*0*	*0.00*	*0.10*	*0.10*	*0.08*
Citibank, N.A. New Zealand Branch	2018	0	0	0	0.00	0.00	0.00	0.00
	2017	*0*	*0*	*0*	*0.00*	*0.00*	*0.00*	*0.00*
Commonwealth Bank of Australia New Zealand Banking Group	2018	54	102	474	10.34	0.30	0.36	0.06
	2017	*66*	*96*	*384*	*14.32*	*0.32*	*0.39*	*0.08*
Heartland Bank Limited	2018	22	29	42	21.40	0.51	0.74	0.58
	2017	*15*	*36*	*28*	*29.83*	*0.49*	*0.72*	*0.45*
Industrial and Commercial Bank of China (New Zealand) Limited	2018	13	0	0	0.00	0.50	1.29	1.26
	2017	*3*	*0*	*0*	*0.00*	*0.58*	*0.58*	*0.52*
JPMorgan Chase Bank, N.A. New Zealand Branch	2018	0	0	0	0.00	0.00	0.00	0.00
	2017	*0*	*0*	*0*	*0.00*	*0.00*	*0.00*	*0.00*
Kiwibank Limited	2018	1	12	10	50.00	0.17	0.20	0.01
	2017	*-6*	*7*	*12*	*50.00*	*0.19*	*0.22*	*-0.03*
Kookmin Bank Auckland Branch	2018	0	0	0	0.00	0.15	0.15	0.00
	2017	*0*	*0*	*0*	*0.00*	*0.19*	*0.19*	*-0.13*
MUFG Bank, Ltd – Auckland Branch	2018	0	0	0	0.00	0.00	0.00	0.00
	2017	*0*	*0*	*0*	*0.00*	*0.00*	*0.00*	*0.00*
Rabobank Nederland New Zealand Banking Group	2018	-1	0	293	2.21	0.24	0.30	-0.01
	2017	*16*	*8*	*131*	*3.25*	*0.33*	*0.37*	*0.16*
SBS Bank	2018	15	7	7	36.46	0.68	0.74	0.41
	2017	*11*	*2*	*8*	*37.76*	*0.53*	*0.62*	*0.34*
The Co-operative Bank	2018	3	7	2	33.30	0.18	0.21	0.12
	2017	*2*	*6*	*2*	*30.35*	*0.18*	*0.20*	*0.11*
The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch	2018	3	0	9	48.06	0.03	0.13	0.08
	2017	*-1*	*0*	*3*	*40.52*	*0.04*	*0.07*	*-0.04*
TSB Bank Limited	2018	4	9	4	6.93	0.46	0.47	0.08
	2017	*4*	*8*	*9*	*12.76*	*0.47*	*0.50*	*0.09*
Westpac Banking Corporation – New Zealand Division	2018	-3	86	145	24.83	0.35	0.40	0.00
	2017	*-76*	*80*	*173*	*27.75*	*0.39*	*0.45*	*-0.10*
Bank sector total	**2018**	**258**	**586**	**1,608**	**23.05**	**0.36**	**0.44**	**0.06**
	2017	***178***	***598***	***1,361***	***28.17***	***0.39***	***0.48***	***0.04***

* Operating Expenses = Total Expenses - Interest Expense - Loan Write Offs and Bad Debts - Abnormal Expenses.

n/a = not available

Profitability measures										Efficiency measures	
Total operating income $Million	Net interest income/ Average total assets %	Interest margin %	Interest spread %	Non-interest income/ Average total assets %	Net profit after tax $Million	Net profit after tax/ Average equity %	Net profit after tax/ Average total assets %	Underlying profit $Million	Underlying profit/ Average total assets %	Operating expenses*/ Average total assets %	Operating expenses*/ Operating income %
4,320	2.03	2.18	1.85	0.73	1,986	17.61	1.27	2,750	1.76	0.97	35.12
3,994	*1.93*	*2.17*	*1.84*	*0.58*	*1,780*	*15.84*	*1.12*	*2,513*	*1.58*	*0.89*	*35.58*
5	2.82	2.89	1.67	1.35	1	2.45	1.04	2	1.44	2.68	64.15
4	*2.81*	*2.90*	*1.63*	*1.81*	*1*	*2.00*	*0.94*	*1*	*1.33*	*3.26*	*70.60*
22	1.08	1.08	0.85	0.90	-1	-0.52	-0.06	-3	-0.26	1.14	57.49
9	*1.46*	*1.47*	*1.09*	*0.95*	*-2*	*-2.93*	*-0.45*	*-2*	*-0.51*	*2.79*	*115.45*
4	2.89	2.96	0.61	0.54	1	1.52	0.73	1	1.02	2.41	70.13
4	*3.00*	*3.06*	*1.06*	*0.52*	*1*	*1.74*	*0.83*	*1*	*1.16*	*2.32*	*65.97*
2,556	2.00	2.15	1.86	0.63	1,029	14.37	1.06	1,498	1.54	1.00	38.18
2,315	*1.91*	*2.10*	*1.78*	*0.56*	*937*	*13.44*	*1.00*	*1,353*	*1.44*	*0.94*	*37.97*
27	1.81	1.83	1.40	0.20	10	5.20	0.77	15	1.08	0.87	43.15
11	*1.37*	*1.38*	*0.85*	*0.26*	*2*	*1.45*	*0.28*	*0*	*0.07*	*1.50*	*91.71*
46	1.38	1.39	1.26	0.85	18	9.28	0.88	25	1.22	1.01	45.13
47	*1.67*	*1.69*	*1.54*	*0.67*	*19*	*10.00*	*0.96*	*27*	*1.34*	*1.00*	*42.67*
2,506	1.98	2.02	1.70	0.61	1,127	17.34	1.16	1,616	1.67	0.86	33.36
2,297	*1.94*	*1.98*	*1.64*	*0.64*	*1,001*	*19.07*	*1.12*	*1,434*	*1.61*	*0.89*	*34.70*
195	4.36	4.44	4.00	0.27	68	10.94	1.60	96	2.27	1.83	39.55
169	*4.35*	*4.45*	*4.00*	*0.17*	*61*	*11.39*	*1.62*	*84*	*2.24*	*1.89*	*41.70*
23	1.71	1.81	1.50	0.08	-1	-0.86	-0.09	-4	-0.32	1.13	63.14
16	*1.99*	*2.19*	*1.95*	*-0.10*	*1*	*1.18*	*0.14*	*2*	*0.22*	*1.33*	*70.16*
21	0.62	0.89	0.85	1.09	7	0.00	0.55	10	0.80	0.91	53.26
21	*0.69*	*1.25*	*1.12*	*1.74*	*5*	*0.00*	*0.63*	*8*	*0.91*	*1.52*	*62.39*
539	1.99	2.05	1.60	0.62	115	8.02	0.56	179	0.87	1.74	66.60
494	*1.84*	*1.91*	*1.50*	*0.63*	*53*	*4.22*	*0.27*	*95*	*0.48*	*2.03*	*81.98*
8	1.51	1.52	1.51	0.47	4	98.51	0.86	5	1.22	0.76	38.43
7	*1.24*	*1.25*	*1.24*	*0.53*	*3*	*103.99*	*0.76*	*5*	*1.07*	*0.75*	*42.27*
32	0.45	0.46	0.40	0.40	22	14.07	0.57	27	0.71	0.14	16.69
24	*0.32*	*0.33*	*0.28*	*0.38*	*18*	*13.48*	*0.54*	*19*	*0.58*	*0.13*	*18.01*
297	2.22	2.25	1.98	-0.21	132	7.94	0.89	191	1.29	0.73	36.39
306	*2.06*	*2.08*	*1.76*	*0.07*	*118*	*7.65*	*0.82*	*173*	*1.20*	*0.81*	*38.17*
139	2.51	2.56	2.35	0.79	27	9.32	0.63	36	0.86	2.09	63.17
123	*2.45*	*2.49*	*2.26*	*0.89*	*27*	*10.66*	*0.74*	*37*	*1.01*	*2.03*	*60.93*
77	2.25	2.27	1.86	0.84	10	5.95	0.42	19	0.76	2.24	72.27
73	*2.36*	*2.39*	*1.97*	*0.95*	*10*	*6.31*	*0.47*	*18*	*0.81*	*2.40*	*72.46*
130	1.53	1.57	1.50	0.74	47	186.84	0.82	66	1.16	1.06	46.51
124	*1.52*	*1.60*	*1.50*	*0.81*	*46*	*116.60*	*0.87*	*66*	*1.23*	*1.12*	*48.22*
163	1.78	1.80	1.44	0.51	52	8.64	0.73	74	1.04	1.21	52.49
149	*1.99*	*2.01*	*1.64*	*0.26*	*46*	*8.11*	*0.70*	*66*	*0.99*	*1.20*	*53.23*
2,514	2.00	2.11	1.70	0.63	1,117	13.78	1.17	1,594	1.67	0.97	36.71
2,413	*1.90*	*2.02*	*1.61*	*0.66*	*1,059*	*14.25*	*1.13*	*1,532*	*1.63*	*1.02*	*39.66*
13,625	**2.01**	**2.12**	**1.78**	**0.63**	**5,770**	**14.88**	**1.12**	**8,196**	**1.59**	**1.00**	**37.95**
12,600	***1.93***	***2.08***	***1.73***	***0.59***	***5,188***	***14.43***	***1.04***	***7,432***	***1.48***	***1.00***	***39.61***

Analysis of annual results

Balance sheet breakdown		Assets ($Million)								
Entity	Balance date	Cash on hand, money at call and balances with other banks	Trading, investment securities, investments in subsidiaries and investment properties	Derivative financial instruments	Loans and advances (less provisions)	Balances with related parties	Fixed assets	Intangibles	Other assets	Total assets
2018										
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	30 Sep	4,742	14,526	5,656	128,677	2,701	325	3,289	1,500	**161,416**
Bank of Baroda (New Zealand) Limited	31 Mar	24	0	0	86	5	0	0	1	**116**
Bank of China (New Zealand) Limited	31 Dec	239	0	1	1,414	0	1	0	12	**1,666**
Bank of India (New Zealand) Limited	31 Mar	14	0	0	91	-3	1	0	0	**103**
Bank of New Zealand	30 Sep	3,232	6,842	4,336	83,051	1,253	172	352	753	**99,991**
China Construction Bank (New Zealand) Limited	31 Dec	155	0	21	1,646	2	1	0	1	**1,826**
Citibank, N.A. New Zealand Branch	31 Dec	402	0	0	896	213	1	0	534	**2,045**
Commonwealth Bank of Australia New Zealand Banking Group	30 Jun	2,885	9,193	1,527	85,728	914	184	467	441	**101,339**
Heartland Bank Limited	30 Jun	50	341	0	3,985	0	9	74	37	**4,496**
Industrial and Commercial Bank of China (New Zealand) Limited	31 Dec	328	40	0	1,270	13	0	0	11	**1,662**
JPMorgan Chase Bank, N.A. New Zealand Branch	31 Dec	198	877	0	130	100	0	1	267	**1,573**
Kiwibank Limited	30 Jun	579	1,220	344	18,304	87	45	78	58	**20,715**
Kookmin Bank Auckland Branch	31 Dec	4	0	0	217	203	0	0	0	**425**
MUFG Bank, Ltd – Auckland Branch	31 Mar	286	129	12	3,543	67	0	0	20	**4,057**
Rabobank Nederland New Zealand Banking Group	31 Dec	488	604	17	11,254	2,885	4	0	19	**15,272**
SBS Bank	31 Mar	98	476	3	3,799	6	22	8	44	**4,455**
The Co-operative Bank	31 Mar	302	5	4	2,292	0	7	14	5	**2,629**
The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch	31 Dec	777	244	12	4,444	889	1	14	23	**6,405**
TSB Bank Limited	31 Mar	138	1,933	1	5,309	0	20	8	7	**7,416**
Westpac Banking Corporation – New Zealand Division	30 Sep	1,709	6,826	3,509	80,860	2,023	144	683	902	**96,656**
Bank sector total		**16,651**	**43,256**	**15,442**	**436,995**	**11,358**	**937**	**4,989**	**4,634**	**534,263**

Liabilities ($Million)								Equity ($Million)					
Customer deposits	Balances with other banks and money market deposits	Debt securities	Derivative financial instruments	Balances with related parties	Subordinated debt	Other liabilities	Total liabilities	Share capital – ordinary shares	Head office account	Convertible debentures/ Perpetual preference shares	Other equity/ Cash flow hedge reserves	Retained earnings	Total equity
103,124	3,141	27,023	5,848	7,851	1,549	1,644	**150,180**	11,044	11	0	33	148	**11,236**
67	0	0	0	1	0	1	**69**	40	0	0	0	7	**47**
393	302	150	0	595	0	12	**1,452**	223	0	0	0	-9	**214**
21	0	0	0	27	0	0	**49**	50	0	0	0	4	**54**
59,776	1,944	23,421	3,053	2,313	546	1,559	**92,612**	3,456	0	0	38	3,885	**7,379**
459	0	454	6	696	0	5	**1,621**	199	0	0	0	7	**206**
919	1	0	0	923	0	8	**1,852**	29	34	0	0	131	**193**
58,772	1,000	23,049	918	1,418	7,430	755	**93,342**	667	2,887	0	478	3,965	**7,997**
2,882	0	914	2	0	0	34	**3,832**	542	0	0	5	117	**664**
420	0	366	0	720	0	17	**1,523**	145	0	0	-6	0	**139**
188	0	622	0	402	0	361	**1,573**	0	0	0	0	0	**0**
16,152	128	2,265	293	29	254	107	**19,228**	737	0	0	-5	755	**1,487**
207	64	0	0	149	0	1	**421**	0	4	0	0	0	**4**
346	0	0	13	3,519	0	15	**3,893**	0	83	0	0	81	**164**
4,520	0	3,781	28	5,185	0	26	**13,540**	551	256	0	2	923	**1,731**
3,233	487	279	23	0	88	49	**4,158**	0	0	0	-3	300	**297**
2,200	0	219	9	0	0	19	**2,447**	0	0	0	-1	183	**182**
3,154	275	389	20	2,495	0	46	**6,379**	0	23	0	3	0	**25**
6,741	0	0	8	0	0	54	**6,803**	10	0	0	5	598	**613**
61,884	1,253	14,943	3,569	2,440	2,866	1,315	**88,270**	143	2,169	0	-55	6,126	**8,383**
325,459	**8,595**	**97,873**	**13,790**	**28,764**	**12,733**	**6,028**	**493,243**	**17,837**	**5,466**	**0**	**494**	**17,220**	**41,016**

Analysis of annual results

Balance sheet breakdown		Assets ($Million)								
Entity	Balance date	Cash on hand, money at call and balances with other banks	Trading, investment securities, investments in subsidiaries and investment properties	Derivative financial instruments	Loans and advances (less provisions)	Balances with related parties	Fixed assets	Intangibles	Other assets	Total assets
2017										
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	30 Sep	4,114	14,146	7,251	121,968	2,722	367	3,275	4,342	**158,185**
Bank of Baroda (New Zealand) Limited	31 Mar	26	0	0	70	5	0	0	1	**103**
Bank of China (New Zealand) Limited	31 Dec	166	0	0	345	0	1	0	3	**515**
Bank of India (New Zealand) Limited	31 Mar	30	0	0	87	2	1	0	0	**121**
Bank of New Zealand	30 Sep	4,453	5,778	3,805	79,441	677	173	277	711	**95,315**
China Construction Bank (New Zealand) Limited	31 Dec	132	0	5	744	2	2	0	2	**888**
Citibank, N.A. New Zealand Branch	31 Dec	531	0	0	811	208	1	0	515	**2,065**
Commonwealth Bank of Australia New Zealand Banking Group	30 Jun	3,085	6,003	856	81,232	613	186	453	400	**92,828**
Heartland Bank Limited	30 Jun	57	319	0	3,546	0	8	71	34	**4,035**
Industrial and Commercial Bank of China (New Zealand) Limited	31 Dec	159	41	0	700	0	1	0	3	**904**
JPMorgan Chase Bank, N.A. New Zealand Branch	31 Dec	214	161	0	101	102	0	1	267	**846**
Kiwibank Limited	30 Jun	692	1,474	370	17,815	80	28	97	60	**20,616**
Kookmin Bank Auckland Branch	31 Dec	7	0	0	168	218	0	0	0	**394**
MUFG Bank, Ltd – Auckland Branch	31 Mar	298	26	12	3,113	77	0	0	34	**3,560**
Rabobank Nederland New Zealand Banking Group	31 Dec	518	724	13	10,524	2,495	5	0	27	**14,306**
SBS Bank	31 Mar	101	418	5	3,411	4	21	7	29	**3,994**
The Co-operative Bank	31 Mar	225	6	3	2,103	0	6	15	5	**2,364**
The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch	31 Dec	606	487	117	3,447	391	2	15	22	**5,086**
TSB Bank Limited	31 Mar	144	1,970	0	4,658	0	18	8	4	**6,803**
Westpac Banking Corporation – New Zealand Division	30 Sep	2,232	8,036	3,420	77,681	2,623	146	665	863	**95,666**
Bank sector total		**17,791**	**39,588**	**15,857**	**411,966**	**10,219**	**965**	**4,885**	**7,321**	**508,592**

Liabilities ($Million)								Equity ($Million)					
Customer deposits	**Balances with other banks and money market deposits**	**Debt securities**	**Derivative financial instruments**	**Balances with related parties**	**Subordinated debt**	**Other liabilities**	**Total liabilities**	**Share capital – ordinary shares**	**Head office account**	**Convertible debentures/ Perpetual preference shares**	**Other equity/ Cash flow hedge reserves**	**Retained earnings**	**Total equity**
94,751	2,192	27,999	7,341	9,587	2,375	2,627	**146,872**	8,044	11	0	48	3,210	**11,313**
56	0	0	0	1	0	0	**57**	40	0	0	0	6	**46**
214	25	0	0	215	0	5	**460**	63	0	0	0	-9	**55**
24	0	0	0	43	0	1	**67**	50	0	0	0	3	**53**
56,131	1,594	23,938	3,219	1,799	544	1,149	**88,374**	2,351	0	0	52	4,538	**6,941**
139	28	293	5	226	0	1	**692**	199	0	0	0	-4	**196**
840	4	0	0	1,021	0	5	**1,871**	29	33	0	0	132	**195**
54,713	416	21,273	1,251	2,294	7,181	698	**87,826**	667	462	0	461	3,412	**5,002**
2,574	0	856	3	0	0	32	**3,465**	473	0	0	-1	98	**570**
150	0	137	0	467	0	8	**763**	145	0	0	-5	0	**140**
236	0	71	0	184	0	354	**846**	0	0	0	0	0	**0**
15,904	59	2,258	416	91	405	103	**19,236**	737	0	0	-8	651	**1,380**
190	58	0	0	141	0	1	**390**	0	3	0	0	0	**3**
219	0	0	11	3,167	0	20	**3,418**	0	83	0	0	59	**143**
4,981	0	2,652	34	5,027	0	14	**12,708**	551	232	0	1	815	**1,598**
2,945	401	259	27	0	39	49	**3,719**	0	0	0	-2	277	**275**
2,035	0	134	8	0	0	17	**2,193**	0	0	0	-1	172	**171**
3,118	232	331	44	1,293	0	42	**5,061**	0	23	0	2	0	**25**
6,157	0	0	8	0	0	49	**6,215**	10	0	0	12	566	**588**
58,405	1,043	17,322	3,475	3,646	2,822	1,122	**87,835**	143	2,040	0	-64	5,712	**7,831**
303,782	**6,052**	**97,522**	**15,843**	**29,204**	**13,366**	**6,299**	**472,068**	**13,503**	**2,887**	**0**	**495**	**19,639**	**36,524**

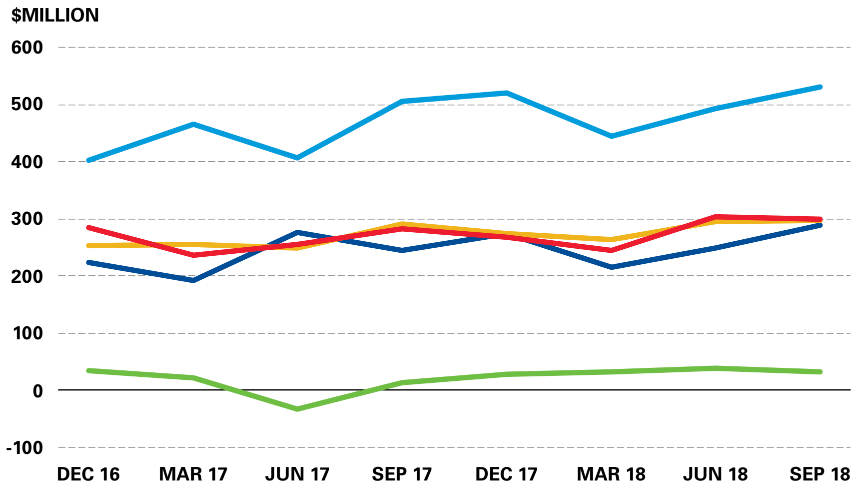
Major banks - Quarterly analysis

Entity	Size & strength measures							
	31 Dec 16	31 Mar 17	30 Jun 17	30 Sep 17	31 Dec 17	31 Mar 18	30 Jun 18	30 Sep 18
	Total assets[70] ($Million)							
ANZ	163,155	161,007	164,071	158,185	160,583	159,719	164,588	161,416
BNZ	94,137	94,023	95,324	95,315	97,742	97,065	101,678	99,991
CBA	91,281	92,077	92,828	92,801	97,762	98,643	101,338	101,906
Heartland Bank	3,820	3,896	4,035	4,222	4,307	4,388	4,496	4,596
Kiwibank	20,008	20,428	20,616	20,449	20,381	20,498	20,715	20,935
SBS Bank	3,745	3,994	4,060	4,237	4,347	4,455	4,501	4,574
The Co-operative Bank	2,272	2,364	2,449	2,527	2,589	2,629	2,661	2,689
TSB Bank	6,629	6,803	6,958	7,072	7,278	7,416	7,454	7,527
Westpac	96,551	92,533	94,215	95,666	96,041	96,216	98,438	96,656
Total	**481,598**	**477,125**	**484,555**	**480,474**	**491,031**	**491,030**	**505,868**	**500,290**
	Increase in gross loans and advances (%)							
ANZ	0.99	0.90	0.93	0.64	0.36	0.82	1.69	0.17
BNZ	2.08	1.19	1.86	1.68	0.63	0.51	2.01	1.64
CBA	1.58	1.06	1.37	0.82	1.93	0.97	1.68	1.11
Heartland Bank	2.93	3.62	2.64	3.78	2.81	2.48	2.69	3.12
Kiwibank	2.59	2.25	-0.08	0.21	0.96	1.01	0.93	2.49
SBS Bank	6.06	5.10	3.45	4.53	2.07	1.11	1.02	0.37
The Co-operative Bank	3.69	3.00	3.25	2.00	2.26	1.21	1.51	2.48
TSB Bank	6.70	4.79	2.97	4.16	3.21	2.95	2.66	1.88
Westpac	0.71	1.03	0.69	0.20	0.64	1.79	0.89	0.67
Average	**1.48**	**1.19**	**1.18**	**0.89**	**0.90**	**1.04**	**1.58**	**0.93**
	Capital adequacy (%)							
ANZ[69]	14.00	14.50	14.20	14.80	15.10	14.40	14.80	14.40
BNZ	13.09	13.29	12.79	13.32	13.47	13.10	13.20	13.60
CBA[69]	13.70	13.80	14.20	14.10	14.80	13.60	13.90	13.90
Heartland Bank	12.96	13.19	13.56	13.04	14.76	14.10	14.10	13.40
Kiwibank	13.40	13.50	13.40	16.00	15.00	15.40	15.80	15.70
SBS Bank	13.27	12.56	11.91	11.35	11.80	12.80	13.00	13.10
The Co-operative Bank	17.50	16.90	16.60	16.60	16.70	16.80	16.70	17.20
TSB Bank	14.65	14.60	14.85	14.55	14.54	14.30	14.70	14.50
Westpac[69]	13.40	14.00	14.00	14.80	14.30	16.60	17.10	16.60
	Net profit ($Million)							
ANZ	403	466	406	505	520	444	492	530
BNZ	223	193	276	245	275	215	250	289
CBA	253	255	248	292	275	264	296	297
Heartland Bank	15	16	16	16	15	18	19	17
Kiwibank	35	22	-32	14	28	33	39	32
SBS Bank	6	6	7	6	7	7	8	8
The Co-operative Bank	3	2	3	3	3	1	3	3
TSB Bank	14	5	11	17	10	14	14	13
Westpac	285	237	255	282	268	246	305	299
Total	**1,237**	**1,202**	**1,190**	**1,380**	**1,401**	**1,242**	**1,424**	**1,489**

FOOTNOTES 69–70

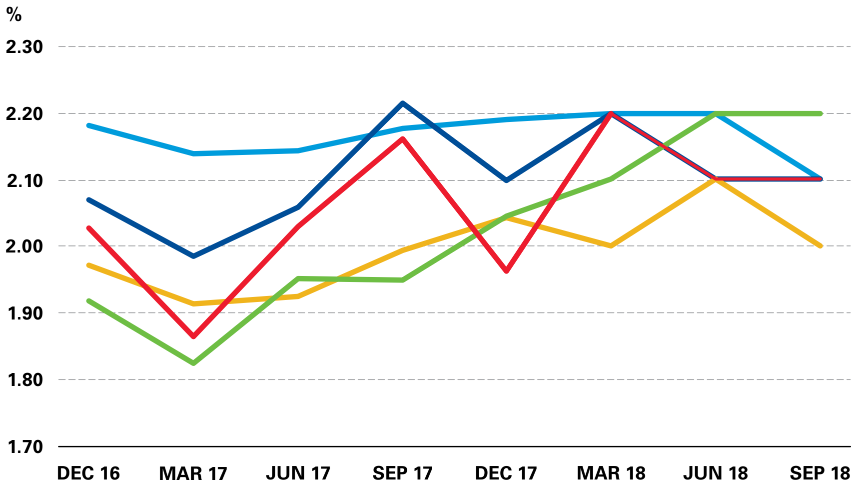
Entity	Profitability measures							
	31 Dec 16	31 Mar 17	30 Jun 17	30 Sep 17	31 Dec 17	31 Mar 18	30 Jun 18	30 Sep 18
	Interest margin (%)							
ANZ	2.18	2.14	2.14	2.18	2.19	2.20	2.20	2.10
BNZ	2.07	1.98	2.06	2.21	2.10	2.20	2.10	2.10
CBA	1.97	1.91	1.92	1.99	2.04	2.00	2.10	2.00
Heartland Bank	4.44	4.35	4.54	4.49	4.37	4.50	4.40	4.40
Kiwibank	1.92	1.82	1.95	1.95	2.05	2.10	2.20	2.20
SBS Bank	2.60	2.38	2.43	2.52	2.68	2.60	2.60	2.60
The Co-operative Bank	2.39	2.25	2.22	2.24	2.29	2.30	2.40	2.40
TSB Bank	2.18	1.80	1.82	1.84	1.80	1.80	1.80	1.90
Westpac	2.03	1.86	2.03	2.16	1.96	2.20	2.10	2.10
	Non-interest income/Total tangible assets (%)							
ANZ	0.47	0.62	0.45	0.72	0.82	0.62	0.64	0.76
BNZ	0.58	0.35	0.74	0.54	0.65	0.63	0.55	0.64
CBA	0.66	0.63	0.61	0.64	0.64	0.56	0.62	0.63
Heartland Bank	0.48	0.37	0.30	0.18	0.39	0.32	0.69	0.27
Kiwibank	0.79	0.51	0.66	0.58	0.69	0.99	1.14	0.98
SBS Bank	0.93	0.79	0.77	0.78	0.85	0.85	0.82	0.88
The Co-operative Bank	0.96	0.58	0.95	0.84	0.89	0.67	0.71	0.63
TSB Bank	0.27	0.21	0.25	0.79	0.29	0.71	0.28	0.35
Westpac	0.67	0.68	0.73	0.57	0.78	0.48	0.74	0.60
Average	**0.58**	**0.57**	**0.60**	**0.63**	**0.73**	**0.60**	**0.65**	**0.68**
	Impaired asset expense/Average gross loans and advances (%)							
ANZ	0.12	0.01	0.04	0.03	0.04	0.19	0.02	-0.07
BNZ	0.11	0.12	-0.01	0.21	0.01	0.20	0.14	0.03
CBA	0.10	0.05	0.06	-0.08	0.12	0.16	0.06	0.05
Heartland Bank	0.36	0.46	0.47	0.56	0.57	0.60	0.60	0.61
Kiwibank	-0.05	0.05	-0.13	0.25	-0.22	0.03	-0.04	0.01
SBS Bank	0.40	0.33	0.30	0.32	0.45	0.55	0.40	0.40
The Co-operative Bank	0.10	0.11	0.11	0.10	0.11	0.12	0.17	0.15
TSB Bank	0.13	0.06	0.08	0.06	0.10	0.08	-0.01	0.10
Westpac	-0.19	0.01	-0.07	-0.14	0.03	0.10	-0.01	-0.14
Average	**0.05**	**0.05**	**0.01**	**0.03**	**0.05**	**0.17**	**0.05**	**-0.02**
	Operating expenses/Operating income (%)							
ANZ	38.24	35.67	39.28	34.30	34.46	35.08	35.28	35.64
BNZ	42.11	42.91	38.65	37.99	38.69	46.85	40.48	37.85
CBA	36.32	36.25	38.02	35.00	35.19	35.69	35.91	35.39
Heartland Bank	43.43	41.23	42.93	43.70	44.54	39.76	40.66	41.60
Kiwibank	64.62	73.04	138.17	78.74	79.41	69.43	69.20	72.87
SBS Bank	62.30	62.36	60.78	67.09	64.26	61.60	61.38	60.91
The Co-operative Bank	72.22	79.33	76.96	74.55	73.32	86.39	76.50	75.00
TSB Bank	48.60	77.37	55.00	47.54	59.48	53.44	50.77	53.75
Westpac	40.69	42.26	43.81	40.03	40.00	39.29	36.77	38.26
Average	**40.93**	**40.92**	**44.82**	**38.96**	**39.34**	**40.95**	**39.21**	**39.15**

20 MAJOR BANKS: NET PROFIT



ANZ
BNZ
CBA
KIWIBANK
WESTPAC

21 MAJOR BANKS: INTEREST MARGIN



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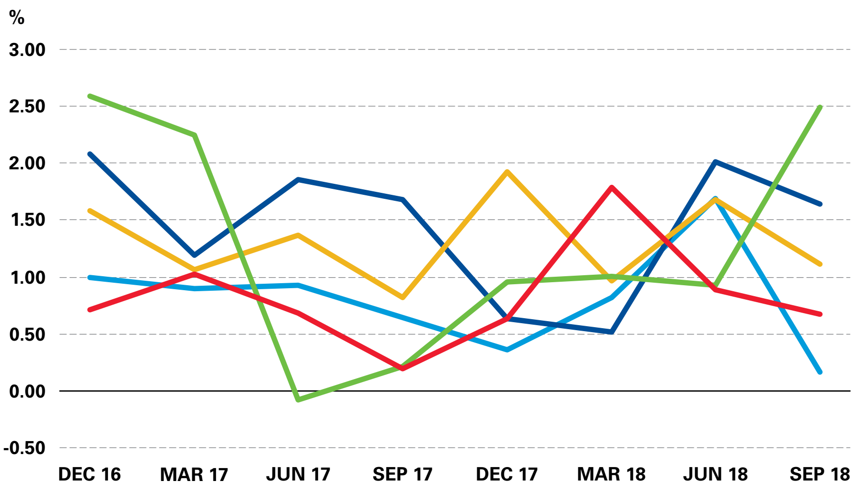
WESTPAC

22 MAJOR BANKS: INCREASE IN GROSS LOANS AND ADVANCES



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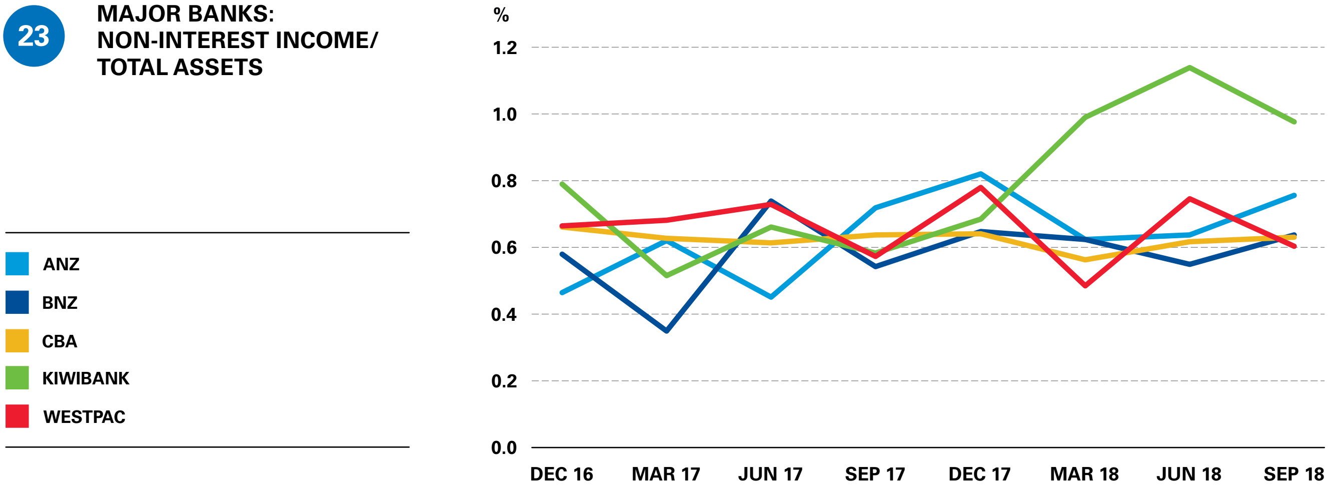
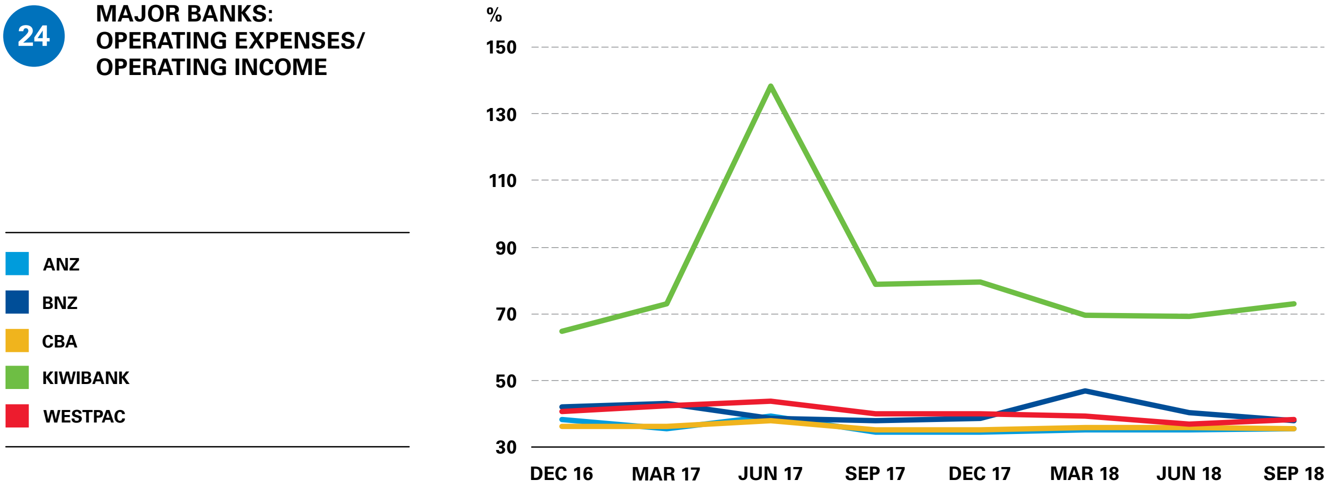
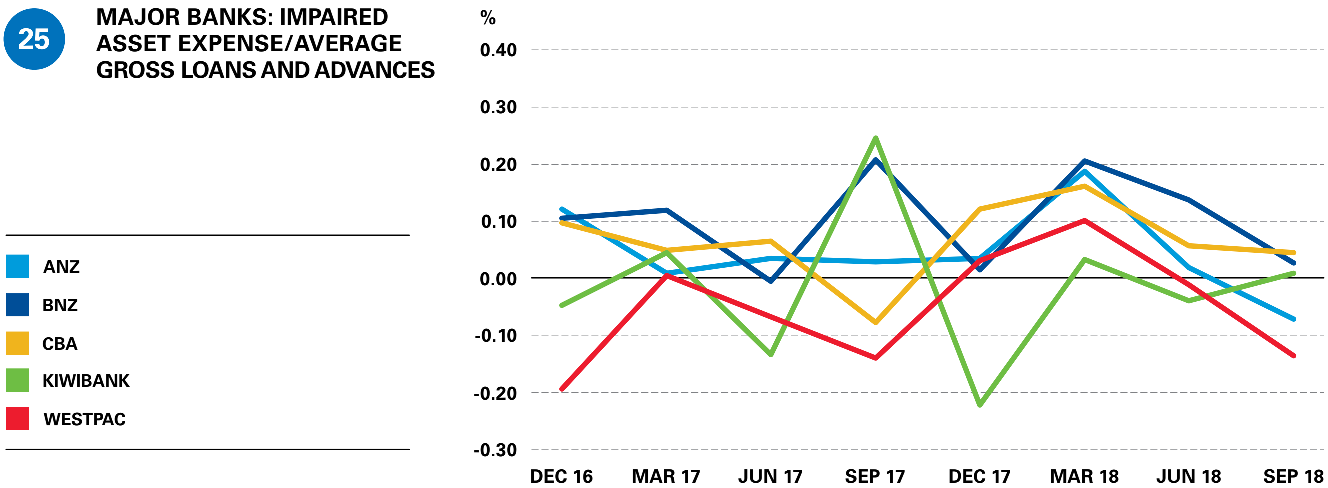
23 MAJOR BANKS: NON-INTEREST INCOME/ TOTAL ASSETS



24 MAJOR BANKS: OPERATING EXPENSES/ OPERATING INCOME



25 MAJOR BANKS: IMPAIRED ASSET EXPENSE/AVERAGE GROSS LOANS AND ADVANCES



Conduct: Success will mean exceeding clear expectations

Kate Stewart
Senior Manager,
Risk consulting
KPMG

KATE'S BIO

In our previous FIPS publications we have discussed the emergence of conduct legislation and the impact that the Australian Royal Commission has had on community expectations and standards. In November 2018 the Financial Markets Authority (FMA) and the Reserve Bank of New Zealand (RBNZ) published their joint review into conduct and culture within New Zealand's registered banks. Now, more than ever, regulators and society in general, expect more from their financial services providers. We discuss these expectations and how financial services providers can succeed in the new environment.

The focus on behaviours and conduct of organisations in the financial services industry has been significant over the last year, and in New Zealand, for banks and insurers particularly. Recent publications[71] from both the FMA and the RBNZ have provided key insights into the conduct of banks and insurers in New Zealand.

FOOTNOTE 71

These publications have made clear, regulatory expectations for the financial services industry at large. It is fair to say that regulatory expectations have not changed, rather, the current environment has focused the spotlight. Successful financial services providers will put customers at the centre of everything they do, to demonstrate not only to regulators, but to customers and the public; that they are consistently delivering good customer outcomes. Additionally, regulators have clearly articulated a requirement for providers of financial services to act with a sense of urgency. It can be assumed that those that do not act quickly to make changes will be left behind.

Regulators have clearly articulated a requirement for providers of financial services to act with a sense of urgency.

Clear regulatory and societal expectations

The recent FMA/RBNZ joint review report on *Bank Conduct and Culture*[72] (the Review report) makes recommendations across wide-ranging themes, from governance and setting the cultural tone at the top, to delivery of good customer outcomes at the front-line of banks. The overarching sense of the report is that even though the review did not find widespread conduct and culture issues, there is significant work to be done for banks to demonstrate that they are consistently providing customers with good outcomes; and that they have identified all the issues that currently exist.

FOOTNOTE 72

In response to a question as to whether insurers should brace themselves for a sterner report back on conduct and culture compared to the banks, Adrian Orr, Governor of the RBNZ, confirmed that this would be the case. He also indicated that the insurance industry would be foolish to be surprised by this as there are a lot of issues [in the industry], some of which have already been put on the table by the FMA[73]. It is safe to say that although focusing on banks, the Review themes, recommendations, and expectations are relevant to other providers of financial services.

FOOTNOTE 73

It is safe to say that although focusing on banks, the Review themes, recommendations, and expectations are relevant to other providers of financial services.

Not only do regulators have expectations of providers of financial services, so too do customers and society in general. We have previously discussed[74] the concept of 'community standards and expectations' in the context of the Australian Royal Commission (ARC) into *Misconduct in the Banking, Superannuation and Financial Services Industry* findings. As noted then, this concept is subject to individual judgements and can change over time. Successful providers of financial services are aware of what the community, and their customers, expect from them, and continually adjust their behaviour to deliver good customer outcomes and avoid falling short of these expectations.

FOOTNOTE 74

Demonstrating the delivery of good customer outcomes

Regulators and the community expect that providers of financial services can demonstrate that they are putting customers at the heart of their businesses and are delivering good outcomes. Customers want to know that when they approach a provider that they will not walk away having purchased products that they do not need, or that they do not understand. The Review defines delivering good customer outcomes as being "how the bank has embedded a customer-centric perspective in the design and delivery of their products and services to ensure customers understand the products and services they are receiving, and that these are appropriate for them on an ongoing basis"[75].

FOOTNOTE 75

The FMA has been discussing good customer outcomes for some time[76], however, the terminology has gained significant attention given associated recommendations within the Review. Organisations that are able to demonstrate delivery of good customer outcomes have spent time and effort to define what 'good customer outcomes' means in the context of their business. There can be no, single, definition of what good customer outcomes means, as every business is different, with a different set of values and driving purposes. To be effective, management needs to build an understanding of what good customer outcomes are, and define what this means for their organisations.

FOOTNOTE 76

There is an important distinction to be made between good customer outcomes and good customer experience.

The Review commented that, to date, banks have focused attention on customer experience, or service. Understanding the distinction is key, because in some instances, good customer service (or experience) could, ultimately, lead to an unintended poor customer outcome. For example, a bank lending to a customer, because that is what the customer wanted, when the customer cannot afford it, may be seen as good service; but it could lead to potential financial hardship, and a poor outcome for the customer.

Once 'good customer outcomes' are clearly defined, the challenge turns to setting the organisation up to consistently deliver. In a recent presentation Rob Everett (FMA CEO) stated "there's no point pontificating at the top about treating customers well unless you build the systems, the controls and the culture that does it for you. Even the best management team has little chance of being everywhere at once and in every decision. As the moral academics will tell you – it's the instinctive decisions your staff make when no one is watching that define your firm's 'moral sense'"[77].

FOOTNOTE 77

With a clear definition of 'good customer outcomes', successful organisations embed this customer focus into everything they do. Success is all systems, controls, processes and policies being oriented toward delivering good customer outcomes as defined by management. For some, this will be a paradigm shift in thinking, particularly thinking about delivering good customer outcomes on an ongoing basis. It is no longer acceptable to simply sell a customer a product and then not worry about its ongoing appropriateness, whether a customer tells you their circumstances have changed, or not.

The future of conduct

Given the intensity of focus on conduct, and a shift in customer expectations, the financial services industry should not take the bank (and insurance) Review findings lightly. At the same time, there are a number of pieces of wholly relevant reform underway such as the Financial Services Legislation Amendment Bill, Insurance Contract Law, and the Credit Contracts and Consumer Finance Act. While banks and life insurers involved in the FMA/RBNZ conduct and culture reviews will have individual feedback that they need to address; organisations that have not been involved directly should not sit back and wait for the regulator to come knocking before addressing conduct gaps within their own businesses.

It is worth highlighting that conduct and customer outcomes cannot be a 'tick box' exercise that risk and compliance will take care of. To have a chance of embedding, messaging and, perhaps more importantly, visible actions, to deliver good customer outcomes need to come from the top. Simply adding the words 'good customer outcomes' to an existing strategy or purpose statement will not be enough. To be successful in this new world, strategic direction and focus will need to be recalibrated to these clear expectations of society and regulators. This will not be an easy road, and focused workstreams of review, challenge and change will be needed to succeed.

Organisations that proactively take note of the current environment, regulator, and community expectations and act to change now, will ultimately succeed where others fall behind. The focus on conduct and culture from all areas is only going to continue and those providers that embrace the change and look to truly exceed expectations, will succeed at building long-term sustainable businesses.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Jun-16
Jul-16
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Commissions and bonuses
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Web Research
Independent Reaearch
Firm Research Fees
Market Research Total
Promotions
Branding
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Newspaper Advertising
Communication Total
Travel
Phone
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Postage
Other Total
Categories
Expense by month
Sheet 1
Sheet 2

Capital gains tax – Will Kiwis really say 'Let's do this'?

Bruce Bernacchi
Partner – Taxation
KPMG

BRUCE'S BIO

"We finally really did it. You maniacs! You blew it up!"
– Charlton Heston, *Planet of the Apes*

Charlton Heston, falling to his knees as he utters these words, is one of the most iconic scenes of 20th century cinema. The disbelief he experienced is also being felt by many at present in the 21st century, whether it is 'Remain' supporters in the UK or those in the US who simply want a Government that is not plagued by lengthy shutdowns. While here in New Zealand we are not experiencing such massive political change, many of us in the tax community are sharing a similar level of disbelief about proposed changes to the New Zealand taxation system.

New Zealand currently has one of the most efficient tax systems in the world. We have a GST regime that is globally recognised as the 'gold standard', no distortive transaction taxes (such as stamp duties), a straightforward progressive personal taxation system, a pragmatic and fair revenue authority and, of course, we do not have a comprehensive capital gains tax (CGT).

This could all be about to change.

The coalition Government's Tax Working Group (TWG) is due to issue its final recommendations during February 2019 (indeed by the time of this publication they may well have been just released). Of all the issues considered by the TWG, by far the most important and controversial is the introduction of a CGT. Within many circles this would certainly be seen as 'blowing up' New Zealand's current approach to taxation, which is widely recognised as simple (by global standards) and yet still highly effective in collecting taxes. Just ask anyone who's had to deal with tax regimes in Europe, North America or Australia. We have a tax system that is the envy of the developed world.

You don't always get what you want… but is it what we need?

Chaired by Sir Michael Cullen, the TWG was established in December 2017, following an election pledge by the Labour Party to undertake a comprehensive review of New Zealand's taxation system. The fact that the Government followed through on this pledge so quickly is to be applauded, as is the diversity of members on the TWG and the broad scope of the review.

It was clear from the outset that the biggest issue under consideration would be the introduction of a CGT. This has been an on-going question for decades, particularly since the mid-1980s when Australia introduced its CGT. Rampant increases in property values over the past two decades along with growing international and local concerns about rising income inequality has brought the question of the fairness of a lack of a CGT into sharp focus.

If there was ever a time when the introduction of a CGT was likely to garner a decent level of public support it feels like now maybe it. This is in stark contrast to the elections of 2011 and 2014 when the Labour Party went to the polls proposing to introduce versions of a CGT and suffered some of their worst electoral results in decades.

But the world changes, and what would be the biggest change to the New Zealand taxation system since GST was introduced in 1986 is on the verge of becoming a reality.

TWG interim report – the Seinfeld approach to report writing

"I think I can sum up the show for you with one word: *Nothing*."
– George Costanza (character), Seinfeld

The TWG released its interim report in September 2018. The eagerly awaited report was perhaps more famous for what it concluded should not change, rather than providing any guidance as to what should actually change. As was largely expected, the report ruled out recommending the introduction of land taxes, wealth taxes or transaction taxes. It also recommended keeping our current progressive approach to personal income taxation and that our GST regime should not be changed.

Unfortunately, the report did not provide much meaningful guidance on the key changes under consideration. The interim report noted that there was more work to be done on these issues and that the detail would be released in the final February 2019 report.

Clear hints have nevertheless been given

"You might very well think that; I couldn't possibly comment"
– Francis Urquhart (character), House of Cards

To be fair to the TWG, the introduction of a CGT will be very complex. Additional time has been necessary to work through some of the many design issues before a formal recommendation is made.

In the meantime, Sir Michael Cullen has made a number of statements in the media and various tax conferences that have provided some pretty clear guidance about what we can expect. Based on all of his hints it is clear that:

- A CGT will be recommended by at least a majority of the TWG.
- The CGT will apply to all assets from implementation date.
- Only capital gains that accrue from the date of implementation of the regime will be taxed. There will be no retrospective taxation of capital gains already accrued, but which are to date unrealised.
- This will require the value of assets to be determined as at the implementation date, but some latitude and flexibility around this will be expected.
- Capital gains will be taxed as ordinary income, at applicable marginal tax rates.

What do we think?

The design of a CGT is a very complex task and the final February report will not have all the answers. We think that it is unlikely that a risk-free return method will be recommended. In the interim report this was noted as an option still on the table, but the idea of taxing people when they have not actually crystallised a gain will probably be politically unpalatable (despite the fact that some sections within the Income Tax Act already require this).

We, therefore, expect that the regime will apply on realisation of a gain and it will be comprehensive in nature, or at the very least will extend the tax net to cover all types of property and equity investments. A number of detailed questions will remain to be worked through if the Government accepts the final recommendations of the TWG, including:

- What valuation options will be allowed for assets owned on implementation date?
- Will 'rollover relief' be provided for asset transfers within corporate groups?
- How will assets transfer on the dissolution of a relationship or upon death be treated?
- How will the regime deal with assets held in family trusts (the use of which could defer gains on assets beneficially transferred between family members for decades)?
- How will the CGT interact with the PIE regime?

Let's do this…?

The Government will announce during April 2019 which of the TWG's recommendations it will be adopting. It would be a huge surprise if it does not adopt the recommendation to proceed with the introduction of a CGT. From there, further consultation will be held through to August, after which draft legislation will be released in September. The plan is to finalise and enact the new legislation by mid-2020, with an effective date of 1 April 2021.

So there's a lot more water to go under the bridge, and of course there's an election due in late 2020, with the National Party clearly on record with a promise to repeal any CGT before it comes into effect. As a result, 2019 will be full of discussion and debate and a CGT will no doubt be a hot topic in the 2020 election, ultimately giving the New Zealand public the right to say 'let's do this', or not.

The Reserve Bank: Enriching disclosures and relationships

Geoff Bascand
Deputy Governor/
General Manager Financial Stability
Reserve Bank of New Zealand

RESERVE BANK OF NEW ZEALAND
TE PŪTEA MATUA

GEOFF'S BIO

The RBNZ has initiated a number of new strategies, ranging from an over-arching philosophy of approach to improvements in public disclosure required from the financial sector, and a relationship charter with the banks.

The philosophy of approach recognises the role and place that the RBNZ has in New Zealand's financial ecosystem. This way of thinking has been captured in a conceptual metaphor, 'Tāne Mahuta' – the kauri', taking its place in the wider ecosystem of a living forest. The metaphor allows the place and function of the RBNZ within the economic and financial system to be presented in a manner that is clear to a wide audience.

A key way in which market discipline is enforced involves public disclosure by financial institutions.

One of the RBNZ's key statutory functions is to enable and support a sound and efficient financial system. This is broadly built around a 'three-pillar' prudential regime in which the system is supported by market, self- and regulatory discipline. A key way in which market discipline is enforced involves public disclosure by financial institutions. This has been a cornerstone of the RBNZ's approach to prudential regulation and supervision, particularly since 1996 when the disclosure regime for registered banks was introduced.

The RBNZ regularly reviews the specific requirements it imposes on registered banks to ensure the disclosure regime remains 'fit for purpose'. A major review over 2009–2011 streamlined requirements, resulting in cost savings for banks without weakening the quality of market information. More recently, the RBNZ undertook a Regulatory Stocktake over 2014–2015. The objective was to enhance the efficiency, clarity and consistency of the prudential requirements for banks and non-bank deposit takers. Reviewing bank disclosure requirements was a key part of the Stocktake, in particular determining whether off-quarter disclosure requirements continued to deliver clear benefits, relative to the costs imposed on banks to prepare them.

The Dashboard is a user-friendly interactive online tool that provides a central repository of key information about the prudential and financial condition of New Zealand incorporated banks.

The Stocktake highlighted issues with accessing and comparing disclosure statements; and, as a consequence, the RBNZ developed the Bank Financial Strength Dashboard (the Dashboard). The Dashboard is a user-friendly interactive online tool that provides a central repository of key information about the prudential and financial condition of New Zealand incorporated banks. The underlying data is updated quarterly and drawn from the data that banks provide to the RBNZ.

An important feature of the Dashboard is that it allows users to make side-by-side comparisons of banks in an `apples-with-apples' way on key subject areas such as credit ratings, capital adequacy, asset quality, profitability, the balance sheet and liquidity. In total, the Dashboard improves the accessibility and comparability of more than one hundred relevant metrics available to market participants, materially enhancing market discipline. It not only challenges banks to be open and transparent with their disclosures, but also gives the public the opportunity to take an active interest in monitoring their bank's performance.

The Dashboard improves the accessibility and comparability of more than one hundred relevant metrics available to market participants.

The Dashboard was launched in May 2018, supported by a promotional campaign on digital media to help build awareness. It has proven exceptionally popular, fielding over 10,000 visits per quarter since its launch. The underlying data has been frequently downloaded, indicating that users are making use of the data and potentially communicating it to a broader audience.

International publisher Central Banking Publications has named the Dashboard as 'Initiative of the Year' in its annual awards. Central Banking commented that very few central banks have opened up their financial system to public scrutiny to quite the same level as the RBNZ. They said that by revealing key metrics on the banking sector in a visual format that can be taken in at a glance, the RBNZ has hit on a simple method of boosting discipline among banks.

The RBNZ is committed to enhancing the Dashboard to further enrich disclosures and address user needs. A version in te reo Māori is planned, and work is also under way on a Dashboard public application programming interface (API) which will make it easier for interested parties to access and use the data for further analysis or reporting purposes. Inclusion of stress test results is also being considered. We are also starting to look at extending the Dashboard concept to the insurance sector, where market participants will benefit from better quality and more comparable benchmark information.

The Dashboard is not the only new initiative undertaken by the RBNZ in its role as a regulator and steward of the financial system. As part of the mix of new initiatives to develop the best 'regulator-regulated' relationships possible, the RBNZ has established a Relationship Charter (the Charter) for working effectively with regulated entities. The Charter offers real benefits for the relationship between the RBNZ and the organisations it regulates, notably in the way it makes the parties' intent explicit, a strategy which helps facilitate better working relationships between the RBNZ and the financial sector, and makes it easier for us to hold each other to our promises. The mutual commitments laid out in the Charter set standards on our behaviours. These standards include being honest and candid – in which positions are openly stated in a constructive, free and frank manner, achievement focused, diligent, open-minded, and professional.

The Charter promises clear, targeted, consistent and timely communication.

To achieve this goal, the Charter promises clear, targeted, consistent and timely communication. The challenge with the Charter, as with any such document, is not in the writing of it but rather in the behaviours required by all parties to bring it to reality. Industry and the regulator will not always agree, but we are committed to respectful, purposeful engagement to achieve a healthy and efficient financial system that benefits all New Zealanders.

Like the Dashboard, the Charter is a living tool and will evolve over time.

Like the Dashboard, the Charter is a living tool and will evolve over time. Discussions about the Charter have taken place with banks and will soon begin with insurers.

FMA: Conduct sets the agenda for the year ahead

Liam Mason
Director of Regulation
Financial Markets Authority

LIAM'S BIO

One year ago, the headline to this article was 'FMA: Show us better outcomes for your customers'. Much has happened in between, but that mantra remains the same, especially considering the stories of poor customer outcomes and misconduct that have been highlighted in Australia.

The FMA and Reserve Bank of New Zealand (RBNZ) joint review report into bank and life insurer culture and conduct (the Review) shone a light on major players in New Zealand financial services and their attitude to conduct risk. The experience in Australia has shown weaknesses identified here in New Zealand, if left unchecked, will expose the industry and their customers to serious risks in the future. Fundamentally, however, the question that the FMA is focused on remains the same one year on: 'How is your conduct, the way you do business, benefiting your customers?'

The issue of conduct risk should not have been a new concept for the industry's directors and senior leaders. In his first speech in 2014, FMA Chief Executive, Rob Everett, warned about complacency and spoke of the need to put the interests of the customer at the heart of financial services businesses. In the Bank Review report, the FMA and RBNZ found significant variation between how banks identify, manage and remediate conduct risks. Some have been thinking about this issue for some time. For others, the approach was reactive at best, and complacent at worst. Those banks know who they are and the work that they need to do.

It is a senior manager's job, as well as board directors', to lead the changes required by the industry to deliver a focus on long-term good customer outcomes. In some instances where we discovered boards and senior leaders did receive reports on conduct risk, lagging indicators dominated, talking to what had already occurred. Governance and executive functions should be seeking out lead indicators and monitoring trends that could identify and prevent future issues occurring. Prevention of issues is always going to be better than having to remediate and repair a battered reputation.

The Review report stated that incentives linked to sales measures for sales people and their managers should be removed.

The Review report stated that incentives linked to sales measures for sales people and their managers should be removed. If sales-based incentives remain, businesses will then have to explain how their control systems will address the risks of poor customer outcomes from conflicted conduct. It is clear from our work that incentivising behaviours predominantly with a sales focus is ineffective at mitigating conduct risks and does not promote the interests of the customer. New Zealand firms should act swiftly to avoid the reputational damage we have seen in Australia.

Regulatory change

We can already see 2019 will also deliver further regulatory change. At the time of writing, an overhaul of financial advice laws is awaiting its third reading in Parliament. The changes it will bring reflect concerns around the uneven standards for conduct obligations in the financial advice sector.

No longer will the sector have some advisers held to much higher conduct standards, while others are not required to disclose the commission they receive from providers. The government's review of insurance contract law is also ongoing.

By the end of March, banks will report back on the steps they have taken in response to our findings on culture and conduct.

The start of 2019 has also seen the publication of the RBNZ/FMA examination of the culture and conduct at New Zealand's life insurers. By the end of March, banks will report back on the steps they have taken in response to our findings on culture and conduct. Insurers will follow later in the year. Providers should have no doubt that the issues raised in 2018, which affect the products ordinary New Zealanders interact with on a daily basis, will continue through 2019. During this period, the impact of the final Hayne report from the Australian Royal Commission, published in February 2019, will also start to become clear.

KiwiSaver is now in its second decade, with total assets of almost $50 billion.

KiwiSaver: helping investors

KiwiSaver is now in its second decade, with total assets of almost $50 billion. This has coincided with steadily rising asset prices following the global financial crisis. However, last year saw the return of volatility to the markets, with big swings in February 2018, and in the final quarter of 2018.

The FMA developed campaigns to inform KiwiSaver members about preparing for investment storms. Providers should also be helping members understand investment cycles and how their KiwiSaver account will be impacted by these movements over the long term.

KiwiSaver providers collected fees of $415 million from KiwiSaver members who have actively chosen a scheme.

KiwiSaver providers collected fees of $415 million from KiwiSaver members who have actively chosen a scheme. This amount will only compound as the balances grow. The FMA will be carrying out further work on fees in the market in the year ahead. Default fund members paid out $32.4 million in fees. In terms of member engagement and capability, of the nine default providers, the majority stepped up to support their members so that they could make an active choice about their investment fund, but a few providers have not. The FMA will continue to focus on this issue. The government has indicated the conduct of default providers and their engagement with members will be considered as part of the tendering and review process for the next round of default appointments which will kick off later this year.

The FMA is mindful of the potential impost from regulatory burden.

Supporting innovation

The last year has seen some of the steps the FMA has taken to support innovation come to fruition. There are now three providers who offer personalised digital advice, or robo-advice, following the FMA move to offer an exemption. The interest in green and sustainable finance is expected to grow. The FMA is mindful of the potential impost from regulatory burden, and will always try to support innovation and reduce barriers to industry.

There are now three providers who offer personalised digital advice, or robo-advice.

Our approach reflects that New Zealand has some of the most flexible capital market regulations in the world, and we are keen to take full advantage of that in supporting innovation and market participants. Nonetheless, the laws that make up these regulations have now been in force for a number of years. Conduct regulation is no longer new. Everyone involved should be fully aware of their licence conditions and their obligations. We will continue to be a regulator that is open and collaborative, with a preference for encouraging and enabling good conduct, rather than having to respond to poor behaviour. However, this will require businesses to place the interests of the customers at the heart of everything they do. Given the length of time that the new laws have now been in place, lack of time or experience will not be a valid excuse for non-compliance.

Spotlight on banking conduct

Roger Beaumont
Chief Executive,
New Zealand Bankers' Association

NEW ZEALAND BANKERS ASSOCIATION

ROGER'S BIO

In 2018, the spotlight went on bank conduct and culture in New Zealand. The Financial Markets Authority and the Reserve Bank of New Zealand (RBNZ) launched a joint review in response to the Australian Royal Commission into financial services misconduct, a theme which has dominated headlines in the business pages across the Tasman over the last year.

Last November, our regulators reported back on their *Bank Conduct and Culture* review (the Review). They found no evidence of widespread misconduct and culture issues across the banking industry in New Zealand. The key finding provided a welcome reassurance to many that our banking system had not been affected by the same kind of misconduct issues investigated by the Australian Royal Commission.

That said, our regulators made a series of recommendations to ensure that our banks maintain the trust of their customers, and the public as a whole. As a result, our banks have been asked to tighten up their systems to more effectively identify, manage, remediate and report on conduct risks and issues than was previously expected. They have undertaken to do exactly that.

Our regulators made a series of recommendations to ensure that our banks maintain the trust of their customers, and the public as a whole.

That process is ongoing with individual banks due to deliver their respective board-endorsed work plans to the regulators in March this year. The New Zealand banking industry is determined to maintain the standards that the community expects of its banks, and ensure it avoids both actual and perceived conduct issues. We know that trust is hard won and easily lost.

We know that trust is hard won and easily lost.

New Zealand's banking culture

Given the nature of the New Zealand banking industry, it was not surprising for people to ask if we were experiencing the same conduct issues as our trans-Tasman cousins. In short, we are different from them. That is mainly because we are a smaller country and have smaller banks than they do. We also have different lending and financial advice laws in New Zealand, and independent regulators. In addition, we also have independent bank boards that make sure our banks are working well.

Our banking culture is strongly influenced by the New Zealanders who work in our banks, and the customers who bank with them. In turn, that social climate influences how our banks operate and engage with customers.

We also have a different financial legal and regulatory framework. After the global financial crisis, our regulators, the government and industry had a close look at our financial advice rules and lending practices. That examination resulted in legislative and regulatory changes that led to better outcomes for customers.

Another important difference is that our banks are independently managed and governed. RBNZ rules require the organisation to act in the local bank's interests. If they fail to do that, they could lose their licence to operate in New Zealand.

All these safeguards lower the chance of conduct issues going unnoticed in New Zealand banks.

The free and independent dispute resolution service is, in many respects, the canary in the coal mine.

The customer voice is also an essential part of this discussion. If we were experiencing similar issues to those seen in Australia, customers would be telling the Banking Ombudsman. The free and independent dispute resolution service is, in many respects, the canary in the coal mine. While the scheme routinely deals with customer complaints, those issues tend to be about poor communication and customer service. Importantly, the scheme has not seen any systemic conduct and culture issues in New Zealand.

To assist the Banking Ombudsman to develop a better picture of customer issues and complaints trends, banks are now providing the Ombudsman with information on individual customer complaints they deal with. The majority of those issues are resolved between the bank and the customer, and are not escalated to the Banking Ombudsman. Making this information publicly available is intended to help make customer banking issues more transparent than before, and ultimately improve the customer experience.

Sales incentives

A key recommendation of the Review report was that banks remove sales incentives for salespeople and their managers to ensure good customer outcomes. All of our banks accept that and are reviewing their sales incentives structures. This measure will involve ensuring incentives and remuneration encourage staff to prioritise good customer outcomes.

A key recommendation of the Review report was that banks remove sales incentives for salespeople.

Some banks have already removed all sales incentives and targets for customer-facing staff.

Banks value their employees because they are essential to delivering good customer experiences. It makes sense that remuneration policies drive the best possible outcomes for customers and recognise the effort that employees put in.

Meeting the needs of vulnerable customers

Another theme that emerged from the Review was how banks deal with vulnerable customers. The Review report defined circumstances of vulnerability as people who may have low levels of numeracy or literacy, an inability to use the internet, illness or disability, and older people.

The banking industry understands the importance of an inclusive approach to the diverse needs of all customers. That means acknowledging that different customers have different needs, and working to meet those ongoing needs in the design and delivery of banking products and services.

Over the last year at NZBA we have been actively engaged in initiatives that assist the financial capability of vulnerable customers.

In July, we co-hosted a forum to look at practical ways to help vulnerable consumers access responsible financial services and avoid predatory lenders. We are continuing to work with partners on how to promote inclusive banking products and services.

We have also worked with FinCap, the organisation that represents budgeting and financial mentor services in New Zealand, to develop a standard privacy waiver to help vulnerable customers. The waiver provides a consistent approach across banks that can be used by bank customers who are clients of a budgeting service. Customers can authorise financial mentors to access their financial information, to help them get independent advice on managing their money.

We are also reviewing our guidelines to help banks to meet the needs of older and disabled customers. Under the latest Code of Banking Practice, published in June 2018, banks agreed to do their best to meet the needs of all customers. Previously voluntary for our member banks, the revised guidelines will clearly set out what banks will do for their older and disabled customers.

The year ahead

In the coming year, the banking industry will progress these and other initiatives to help ensure we continue to meet and exceed customer and community expectations. Banks will also respond individually to the regulators' bank-specific recommendations that came out of the Review. Collectively, we have an opportunity to retain and enhance the confidence of our customers and ensure a solid foundation for banking in New Zealand. We are committed to taking that opportunity.

Massey: Banking industry forecasts

Christoph Schumacher
Professor of Innovation and Economics
Massey University

MASSEY UNIVERSITY
TE KUNENGA KI PŪREHUROA
UNIVERSITY OF NEW ZEALAND

CHRISTOPH'S BIO

"Banking is very good business if you don't do anything dumb."

Warren Buffett, chairman and CEO of Berkshire Hathaway

In this section, we forecast the key performance drivers for the New Zealand banking industry, namely lending, net interest margin, and credit loss rate.

This article is a regular feature in FIPS and seeks to provide insights into the performance of New Zealand's banking sector. Specifically, I review and forecast the key performance measures of the banking sector, namely before-tax profit, lending volume, net interest margin, and the credit loss rate. The review covers the period from Q4 2017 to Q3 2018 (which is the latest available information) and the forecast for the period from Q4 2018 to Q4 2020. For the forecast, I use a combination of macroeconomic variables and time-series analysis (see Table 8 on page 55). Specifically, I employ a vector autoregressive model (VAR) as it enables me to investigate how interaction between the variables changes the forecast. The results of my analysis are displayed in the Table 9 on page 56. I also revisit the forecast supplied in last year's FIPS to see how accurate it was, review the performance of the New Zealand economy in 2018 and provide an economic outlook for 2019.

VIEW FIGURE 26

2018 was a record year for our banks in regard to before-tax profit. Profits in the third quarter of 2018 reached a high of $2.18 billion, raising the annual total to $8.08 billion (Q4 2017–Q3 2018).

The third quarter performance was preceded by an increase of profits from $1.82 billion in the second quarter to $2.06 billion in the Q3 2018. Lending volume and net interest margins remained fairly constant during this period suggesting that lending business did not drive the profit increase. A closer look at the balance sheets reveals that banks managed to substantially reduce expenses for impaired loans from $168 million (in Q1 2018) to $66 million (in Q2 2018) to eventually minus $19 million (in Q3 2018). As the savings on expenses and loss reversals have now been absorbed, I expect quarterly profits to dip slightly during the Q4 2018 (actual data not available yet). The outlook for 2019–20, however, is very positive, with profits anticipated to rise gradually from around $2.06 billion to $2.09 billion. Although lending volumes are expected to slightly increase, an anticipated minor reduction in net interest margins and minor increase in the credit loss rate is expected to impact on the profit growth rate.

VIEW FIGURE 27

I now take a closer look at the industry performance drivers. The model uses a collection of past values of our drivers and before tax profits; that is, a vector of time series, in order to predict future values. The key benefit of the VAR model is its ability to rely not only on previous values of past drivers but also on previous values of profit, thus providing a two-way interaction within the model.

The definitions of industry drivers are:

- **Lending** – the total volume of lending broadly defined, that is, all interest-earning assets.
- **Net interest margin** – the difference between interest income and interest expense, expressed as a percentage of lending.
- **Credit loss rate** – provision for credit impairment, expressed as a percentage of lending.

Lending in 2018 was marginally higher than anticipated, with a total lending volume of just under $2,010 billion for the Q4 2017 to Q3 2018 period. Over the past years, annual lending growth was around 4–5%, but our forecast suggests that growth could slow down to around the 2% mark. The anticipated total lending volume for 2019 is $2,053 billion up from $2,017 billion for the 2018 calendar year. Overall the demand for loans continues to be strong due to a low OCR and strong net immigration numbers; however, the housing market, as well as economic growth, are slowing down.

VIEW FIGURE 28

Net Interest Margins (NIM) were ever so slightly lower than estimated (actual average annual NIM was 2.12% with a forecast of 2.13%). The steady level of NIM is not surprising as the OCR of 1.75% did not change during 2018 and the level of competition within the sector seems stagnant. NIM are expected to remain fairly constant over the next two years with a possible slight decrease from 2.1% in Q3 2018 to around 2.06% by Q4 2020. The unwinding of the Canterbury earthquake reconstruction and the slowdown of the housing market could intensify competition, pushing interest margins downwards.

VIEW FIGURE 29

As anticipated, the Credit Loss Rate (CLR) remained low during 2018. After falling to a record low of 0.02% in Q3 2017, CLR increased slightly during 2018 and hovered around the 0.05% mark. We anticipate that the CLR will rise slightly in 2019 to about 0.2% as a result of the economic slowdown during the second half of 2018.

VIEW FIGURE 30

Changes in our macroeconomic indicators can impact the industry drivers used in our model. The regression results suggest that changes in lending volume are inversely related to changes in unemployment. Looking back at 2018, the unemployment rate continued its decline and fell in every quarter of last year from 4.7% in Q3 2017 to 3.9% in Q3 2018. Overall, unemployment is low and this trend is expected to continue in 2019 and 2020. This provides a stable platform for lending and a positive impact on lending volume and profits.

The OCR remains at record lows with no expected changes in the near future. This also contributes to the anticipated increase in lending volume as borrowing remains relatively cheap.

As suggested earlier, population growth has a positive impact on lending volume. In the year to 31 March 2018, our population has grown by around 95,000 people to a total of 4,871,600. This total increase (net migration and natural increase) is slightly lower than the 2017 record high of 100,400 people.

TABLE 8: LIST OF MACRO-ECONOMIC INDICATORS

Macro variable	Description	Units	Source
gdp	Gross Domestic Product (expenditure based)	$mn, nominal index	RBNZ
bankbill90	90-day bank bills rate	%, annualised	RBNZ
govbond10y	10-year government bond yield	%, annualised	RBNZ
unemployed	Number of registered unemployed	Number	RBNZ
avgqhouseloancount	Average number of home loans approved	Number	RBNZ
estpop	Estimated population of New Zealand	Thousands	Statistics NZ
cpindx	Consumer Price Index	Index level	RBNZ
housepricendx	REINZ house price index	Index level	REINZ
weeklyearnings	Weekly earnings	$, nominal	Statistics NZ
nzstocksndx	New Zealand all stocks index	Index level	NZSE

Inflation can have an impact on NIM as environments of higher inflation often entail greater credit risk, which banks need to offset with higher margins. After very low inflation rates of around 0.4% in 2016, inflation rose to over 2% in 2017 and is currently sitting at 1.9% (in Q3 2018). This rate is in line with inflation in the majority of OECD countries. There is an expectation that inflation will rise above 2% in 2019 to a high of possibly 2.3%, but then it is expected to fall again below 2% by the end of 2019 or early 2020. The impact on NIM is expected to be minimal, as any possible increases in profit margins to compensate banks for increased risks is likely to be offset by the competition within the banking industry.

Low interest rates are still reducing pressure on borrowers, which contributes to the low number of loan defaults and CLR. However, house prices and household debt in relation to income remains high. In 2018, household debt as a percentage of disposable income was slightly down to 166% from the record high of 167.8% in 2017. In addition, per capita household consumption has outpaced income growth and the savings rate has fallen to -1.4% for 2018.

The high exposure to interest rate risks, as well as the low savings rate, might impact on the CLR if interest rates are to rise or households are asked to absorb unexpected income shocks. Although the present levels of household debt are not particularly alarming compared with other countries, the rate at which households become increasingly leveraged is a factor to watch.

See Table 9 with Forecasting Results VAR.

There are a few things to note about our model and data. First, although macroeconomic indicators are not explicitly used in the VAR model, the impact of these indicators is already factored into past values of the performance drivers. Secondly, despite their obvious importance, we do not attempt to take into account regulatory changes in this analysis. This is a limitation, since regulatory changes can clearly have an impact on our key industry drivers. For example the RBNZ is currently reviewing the capital adequacy framework for registered banks. A considerable increase in capital holding might be on the cards and the submission period will finish in May this year.

Holding more capital is expansive for banks. To cover this expense, banks might respond by increasing lending rates and being more prudent when it comes to considering higher-risk loans or loans that are not backed by substantial collateral. This could have an impact on all our key indicators and therefore on our forecast. Finally, the data for our model comes from official records published by the RBNZ. This year the Consumer Price Index (CPI) was recalibrated and current and historic unemployment figures adjusted. We have changed our historic records accordingly, which had a minor impact on the forecast values. Also, the years 2009–2011 were excluded from the data. Indicators during the global financial crisis have characteristics of outliers, which would influence the 2019–2020 forecast in an unrealistic way.

We now take a closer look at the performance of the New Zealand economy in 2018 and identify challenges that lie ahead. The economy grew by around 3%, which is solid in terms of global growth rates (in comparison, Gross Domestic Product (GDP) annual growth rates for Australia, USA, Japan and the UK were 2.7%, 2.7%, 1.2% and 1.5% respectively).

TABLE 9: FORECASTING RESULTS VAR

VAR industry driver		2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4
		Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Lending ($Billion)	Upper CI				517	524	530	535	539	543	546	548	550
	Forecast	497	506	506	508	511	513	514	515	516	516	515	513
	Lower CI				499	497	496	495	493	490	487	484	480
Net Interest Margin (%)	Upper CI				2.25%	2.23%	2.22%	2.22%	2.21%	2.21%	2.21%	2.21%	2.21%
	Forecast	2.13%	2.13%	2.10%	2.11%	2.08%	2.07%	2.07%	2.06%	2.06%	2.06%	2.06%	2.06%
	Lower CI				1.98%	1.95%	1.94%	1.93%	1.92%	1.92%	1.92%	1.92%	1.92%
Credit Loss Rate (%)	Upper CI				0.28%	0.33%	0.38%	0.42%	0.46%	0.50%	0.53%	0.57%	0.60%
	Forecast	0.05%	0.06%	0.06%	0.17%	0.18%	0.21%	0.23%	0.26%	0.28%	0.31%	0.34%	0.37%
	Lower CI				0.06%	0.04%	0.04%	0.04%	0.05%	0.07%	0.08%	0.10%	0.13%
Profit Before Tax ($Billion)*	Upper CI				2.28	2.32	2.33	2.35	2.36	2.38	2.40	2.41	2.43
	Forecast	1.82	2.06	2.18	2.06	2.07	2.07	2.08	2.10	2.11	2.13	2.15	2.16
	Lower CI				1.84	1.82	1.81	1.82	1.83	1.85	1.86	1.88	1.90

* Forecasts for profit before-tax will seem less than in the forecasts of previous publications due to the fact that the figures are not annualised.

However, growth in the Q3 2017–Q3 2018 period was lower than in the previous years.

Factors that have contributed to the slowdown of economic growth are a slight decline in net immigration numbers as well as a cooling down of the housing market, resulting in lower consumption and residential investment. Construction activity is slightly elevated but due to capacity constraints, future growth is expected to be low. We have a similar situation in the tourism sector. While demand to visit New Zealand is strong, infrastructure constraints are limiting growth.

The New Zealand dollar weakened during 2018 from the elevated 2016/2017 levels. The widening interest rate differential between New Zealand and the US as well as lower commodity export prices and increasing oil prices have put pressure on the New Zealand dollar. While our dollar remains strong, there is an expectation that the Kiwi dollar will weaken against all major currencies during 2019.

Terms of trade were a mixed bag during our evaluation period with exports exceeding imports in December 2017 and in February, April and May 2018. However, in August last year we experienced the largest-ever monthly goods trade deficit of $1.5 billion (the average deficit in August during the last five years was $1 billion). While the terms of trade follow a seasonal pattern, overall the annual trade deficit of $4.8 billion is at a nine-year high. Looking forward, there is an expectation of rising export figures and positive terms of trade for large parts of 2019, driven by a lower exchange rate.

Globally, 2018 was a year of moderating economic growth. China's GDP growth rate is slowing down and this trend is expected to continue. However, the Chinese GDP growth rate is still solid, which should support demand for New Zealand products. The picture for our other key trading partners is similar. GDP growth in the US, EU and Australia has marginally slowed down, but remains solid around the 2% mark. US economic expansion continues, supported by fiscal spending, which should stimulate growth. The EU has recovered from the uncertainty of 'Brexit' and the Euro and growth in Australia is solidly backed by government spending. Overall, the global outlook for 2019 is positive.

To conclude, the New Zealand banking industry is in very good shape. 2018 was a year of record profits and there is nothing to suggest that this trend will not continue. While the New Zealand economy did not do quite as well as in previous years, economic growth is solid at around 3%, driven by high tourist numbers, strong construction and building activity, solid inward migration and government monetary policies that support growth. Fiscally, New Zealand is in a sound position with a balanced budget and low public debt. As in previous years, the major vulnerability is the high level of household debt fuelled by high house prices and cost of living, especially in Auckland. The forecast for the New Zealand economy is positive. Economic growth is expected to pick up during 2019 backed by more positive terms of trade.

Ownership and credit ratings

as at 31 January 2019

			Long-term credit rating					
Registered banks	**Ultimate shareholding**	**%**	**Standard & Poor's**		**Moody's**		**Fitch Ratings**	
ANZ Bank New Zealand Limited	Australia and New Zealand Banking Group Limited	100	AA-	Negative	A1	Stable	AA-	Stable
ASB Bank Limited	Commonwealth Bank of Australia	100	AA-	Negative	A1	Stable	AA-	Negative
Australia and New Zealand Banking Group Limited – New Zealand Branch[78]	Australia and New Zealand Banking Group Limited	100	AA-	Negative	Aa3	Stable	AA-	Stable
Bank of Baroda (New Zealand) Limited[79]	Bank of Baroda (India)	100			Baa3*	Stable	BBB-	Stable
Bank of China (New Zealand) Limited[80]	Bank of China Limited (China)	100	A	Stable	A1	Stable	A	Stable
Bank of India (New Zealand) Limited[81]	Bank of India (India)	100	BB+	Stable	Baa3*	Stable	BBB-	Stable
Bank of New Zealand	National Australia Bank Limited	100	AA-	Negative	A1	Stable	AA-	Stable
China Construction Bank (New Zealand) Limited[82]	China Construction Bank Corporation	100	A	Stable	A1	Stable	A	Stable
Citibank, N.A. New Zealand Branch and Associated Banking Group[83]	Citigroup Inc.	100	A+	Stable	A1	Rating under review	A+	Stable
Commonwealth Bank of Australia – New Zealand Branch[84]	Commonwealth Bank of Australia	100	AA-	Negative	Aa3	Stable	AA-	Negative
Heartland Bank Limited	Various investment/nominee companies; various private shareholders	100					BBB	Stable
Industrial and Commercial Bank of China (New Zealand) Limited[85]	Industrial and Commercial Bank of China Limited (ICBC)	100	A	Stable	A1	Stable	A	Stable
JPMorgan Chase Bank, N.A. New Zealand Branch[86]	JPMorgan Chase & Co.	100	A+	Stable	Aa2	Stable	AA	Stable
Kiwibank Limited	New Zealand Post NZ Super Fund Accident Compensation Corporation (ACC)	53 25 22	A	Positive	A1	Stable	AA-	Stable
Kookmin Bank Auckland Branch[87]	KB Financial Group Inc.	100	A+	Stable	A1	Stable	A	Stable
MUFG Bank, Ltd – Auckland Branch[88]	Mitsubishi UFJ Financial Group, Inc. (Japan)	100	A	Positive	A1	Stable	A	Stable
Rabobank Nederland New Zealand Banking Group[89]	Coöperatieve Rabobank U.A.	100	A+	Positive	Aa3	Stable	AA-	Stable
Rabobank New Zealand Limited	Coöperatieve Rabobank U.A.	100	A	Positive	Aa3	Stable		
SBS Bank	Mutual	100					BBB	Stable
The Co-operative Bank	Mutual	100					BBB	Stable
The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch[90]	HSBC Holdings plc	100	AA-	Stable	Aa3	Stable	AA-	Stable
TSB Bank Limited	TSB Community Trust	100					A-	Stable
Westpac Banking Corporation – New Zealand Division[91]	Westpac Banking Corporation	100	AA-	Negative	Aa3	Stable	AA-	Stable
Westpac New Zealand Limited	Westpac Banking Corporation	100	AA-	Negative	A1	Stable	AA-	Stable

n/a = there is no credit rating available for this entity from the rating agency indicated.

* No Long-term credit rating, or no outlook for the rating, Long-term deposit has been used in place of Long-term debt.

FOOTNOTES 78–91

Descriptions of the credit rating grades

Long-term credit rating grades assigned by Standard & Poor's	Description of the steps in the Standard & Poor's credit rating grades for the rating of the long-term senior unsecured obligations payable in New Zealand, in New Zealand dollars.
AAA	Extremely strong capacity to meet financial commitments. Highest rating.
AA	Very strong capacity to meet financial commitments.
A	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances.
BBB	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions.
BB	Less vulnerable in the near-term, but faces major ongoing uncertainties to adverse business, financial and economic conditions.
B	More vulnerable to adverse business, financial and economic conditions, but currently has the capacity to meet financial commitments.
CCC	Currently vulnerable and dependent on favourable business, financial and economic conditions to meet financial commitments.
CC	Currently highly vulnerable. Default has not yet occurred but is expected to be a virtual certainty.
Plus (+) or Minus (-)	The ratings AA to CCC may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.
BB, B, CCC, and CC	Borrowers rated BB, B, CCC and CC are regarded as having significant speculative characteristics. BB indicates the least degree of speculation and CC the highest. While such borrowers will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.
Assigned by Moody's Investors Service	Moody's Investors Service appends numerical modifiers 1, 2 and 3 in each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic category, the modifier 2 indicates a mid-range ranking and the modifier 3 indicates the lower end of that generic category.
Assigned by Fitch Ratings	Fitch Ratings applies 'investment grade' rates 'AAA' to 'BBB' to indicate relatively low to moderate credit risk, while for those in the 'speculative' or 'non-investment grade' categories which have either signalled a higher level of credit risk or that a default has already occurred, Fitch Ratings applies a 'BB' to 'D' rating. The modifiers '+' or '-' may be appended to a rating to denote relative status within the major rating categories. Credit ratings express risk in relative rank order, which is to say they are ordinal measures of credit risk and not predictive of a specific frequency of default or loss.

Definitions

Terms and ratios used in this survey	Definitions used in this survey
Gross impaired assets	Includes all impaired assets, restructured assets, and assets acquired through the enforcement of security, but excludes past due assets.
Gross loans and advances	Includes loans and advances, lease receivables (net of unearned income) and accrued interest receivable (where identifiable), but excludes amounts due from banks, marketable securities, loans to related parties, sundry debtors and prepayments.
Gross revenue	Includes gross interest income, gross operating lease and net other income.
Impaired asset expense	The charge to the Profit and Loss Account for bad debts and provisions for doubtful debts in relation to gross loans and advances. This is net of recoveries (where identifiable).
Interest bearing liabilities	Customer deposits (including accrued interest payable where identifiable), balances with banks, debt securities, subordinated debt and balances with related parties.
Interest earning assets	Cash on hand, money on call and balances with banks, trading and investment securities, net loans and advances (including accrued interest receivable where identifiable), leased assets net of depreciation and balances with related parties.
Interest expense	Includes all forms of interest or returns paid on debt instruments.
Interest spread	Difference between the average interest rate on average interest earning assets, and the average interest rate on average interest bearing liabilities.
Net assets	Total assets less total liabilities.
Net interest income	Interest income (including net income from acting as a lessor) less interest expense.
Net interest margin	Net interest income divided by average interest earning assets.
Net loans and advances	Loans and advances, net of provision for doubtful debts.
Operating expense	Includes all expenses charged to arrive at net profit before tax (excluding interest expense, impaired asset expense, subvention payments, direct expense related to other income (where identifiable), depreciation of leased assets where a lessor, and amortisation of goodwill and other intangibles (including software)).
Operating income	Net interest income, net operating lease income and net other income (where direct expense related to other income is identifiable).
Past due assets	Includes any asset which has not been operated by the counterparty within its key terms for 90 days and which is not an impaired or restructured asset.
Provision for doubtful debts	Includes both collective and individual provisions for bad and doubtful debts.
Total assets	Excludes goodwill assets (unless specifically defined).
Ultimate shareholding	Identifies the ultimate holding company rather than any intermediate holding companies.
Underlying profit	Operating income less operating expense and impaired asset expense. Items of a non-recurring nature, unrelated to the ongoing operations of the entity, are excluded.

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