



# *NZ banks go from strength to strength despite global uncertainties*

## *Banking Perspectives*

*Major banks analysis February 2012*

*PwC analysis of the major  
banks' results for the  
second half of their 2011  
financial years*

# Introduction

*New Zealand's five major banks (ANZ National, ASB, Bank of New Zealand, Kiwibank and Westpac) reported core earnings of \$2.8bn in the second half of their 2011 financial years (2H11), up from \$2.3bn in the previous six months (1H11). This was driven by growth in both net interest income of \$246m and other operating income of \$227m. Bucking the trend seen since 2010, bad debt expenses increased, albeit only by \$24m. Overall, profit before tax was up 28% to \$2.4bn (1H11: \$1.9bn) when comparing 2H11 to 1H11, a fine result.*

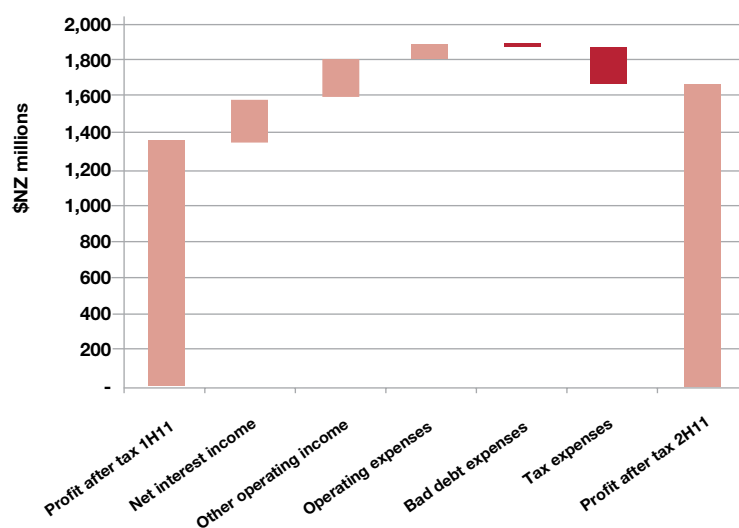


This publication focuses on the major banks' performance for 2H11 with reference to 1H11. As can be seen in figure 1, this has been a good-news six months for the banks with improving profitability. However, while this silver lining is clear to see, the rain clouds are definitely gathering in the distance.

***The extended sunny spell seen since 2010 brought on by increasing interest margins and decreasing bad debt expenses is now being threatened to be blown away in what could be as bad a storm as the first GFC***

These rain clouds have gathered in the powerhouses of the western economy. The US sovereign credit rating was downgraded during 2011 and nine European countries in mid-January 2012. The European credit rating downgrades have been brought on by the systemic stresses in Europe. Standard and Poor's refer to these stresses as tightening credit conditions, an increase in risk premiums for a widening group of Eurozone issuers, a simultaneous attempt to deleverage by governments and households, weakening economic growth prospects, and an open and prolonged dispute among European policymakers over the proper approach to address challenges.

Figure 1: NZ major banks' change in profit after tax



The unknown question is how deep and prolonged the European recession will be and the impact this will have on its major trading partners. New Zealand banks are unlikely to be directly impacted by this as the banks on this side of the world do not typically hold significant investments in these countries. Indirectly however, this recession may impact the New Zealand major banks' funding and undermine general business confidence given our exporters will be affected by reduced demand and high exchange rates. It should also be noted that New Zealand was not spared from recent rating downgrades, with Standard & Poor's slicing New Zealand's long-term foreign currency rating from AA+ to AA.

Rain clouds are beginning to gather over our major trading partners as well, with reports coming out of Australia suggesting that tough times are ahead for many businesses across the Tasman, as well as comments coming from China during the six-month period that their forecasted medium-term economic growth will not offset the woes elsewhere in the global economy despite strong current growth.

In 2H11, the banks have continued to make the most of this sunny weather, continuing to improve their interest margins which has driven net interest income growth. This has been important in order to stimulate the banks' returns as their lending portfolios have remained flat for another six months at \$276.3bn. With the global economic situation seeming to worsen again, it is hard to see margins continuing to widen unless the banks can pass on the likely increase in funding costs to their borrowers, which will be difficult in this low credit growth environment. It is hard to see growth in the lending books as local confidence remains shaky in both the consumer and business sectors.

Instead we expect the New Zealand major banks to seek to improve returns to their shareholders through cost cutting and efficiency. This has been seen in the current period with a 4% decrease in operating expenses seen half-on-half.

The banks will be looking to continue this with many of them considering new core banking systems to unlock efficiency gains. However the torrent of regulation continues to pour down on the banks, including New Zealand specific regulation such as the Open Bank Resolution which promises to be a significant undertaking but with no leveraging from Australia possible.

One area in which we expect to see increased efficiency gains as well as differentiation in order to aid balance sheet growth is through digital banking, such as through the use of smartphones. We have already seen some forays into this area but suspect that many will need to have their new core banking platform in place first. This puts some time pressure on any system upgrades needed as the area of digital banking is currently largely undeveloped but has the potential to cause customers, especially Gen Ys (those in the younger age brackets), to switch banks. Digital banking will ultimately evolve into a deeper set of offerings, providing new value for the New Zealand major banks and their customers.

The evolution of digital banking is also reopening discussions on the future of branches and how they should operate. Branches are being used less and less on the retail side by younger (and more profitable) customers but do still house the big-ticket items such as the signing of a mortgage. Also the branch visibility on the main street is still valued by many customers. The layout of future branches is changing though, with increasing use of technology and varying footprints depending on brand and function.

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In the current period we have also seen volatility in the mark-to-market of the banks' financial instruments held at fair value driven by the global economic situation. This volatility has caused a \$0.2bn increase in other operating income during the period but is typically only a book profit, not contributing to the underlying cash profitability of the banks.

With this global financial uncertainty, the New Zealand major banks will also be focusing on funding. The lack of growth in the lending books means that the banks have been able to self-fund (i.e. the increase in retail deposit funding is greater than the increase in lending) since the second half of 2009. With no significant growth in lending likely, we expect the New Zealand majors to be able to continue to self-fund in their 2012 financial years as deposit growth continues to outpace lending growth. However, as has been the case in recent years, there are several significant debt maturities in 2012 which will need to be rolled over. Therefore the New Zealand banks will carefully choose their timing given these potentially volatile international funding markets.

With these rain clouds on the horizon the New Zealand economy will need a strong banking sector. The New Zealand major banks are profitable with strong liquidity and capital positions and according to the recent joint Centre for the Study of Financial Innovation and PwC global survey, Banking Banana Skins, the New Zealand banks consider themselves among the better prepared for the risks currently facing the global banking industry.



***With the global economic situation seeming to worsen again, it is hard to see margins continuing to widen unless the banks can pass on the likely increase in funding costs to their borrowers***

# Five majors' combined performance

## Annual results

*On an annual basis, an 18% increase in statutory profits (\$2.6bn to \$3.0bn) has been driven by the banks improving their net interest margin (NIM), increasing their net interest income by 10% (\$6.4bn to \$7.0bn).*

*There have also been positive impacts on the bottom line by:*

- A 4% increase in other operating income, largely driven by the impact of the global economic situation on the mark-to-market of financial instruments held at fair value; and
- A 35% decrease in bad debt expenses due to continued improvements in the New Zealand economy, albeit tempered by the credit provisioning impact of the February 2011 Christchurch earthquake.

*And these have been to some extent offset by:*

- A 5% increase in operating expenses as the flat performance of the banks was skewed by restructuring costs taken up by one bank in the current year; and
- A 47% increase in tax expenses as the effective tax rate increases from 25.7% in the major banks' 2010 financial year (FY10) reflecting the impacts of the conduit tax cases unwinding in FY10 to 30.2% in their 2011 financial year (FY11), combined with the increased profit in the current year.

Figure 2: NZ major banks' combined performance (\$NZ millions)

	2H11	1H11	2H11 v 1H11	FY11	FY10	FY11 v FY10
Interest income	9,623	9,759	-1%	19,382	18,617	4%
Interest expense	(6,000)	(6,382)	6%	(12,382)	(12,229)	-1%
Net interest income	3,623	3,377	7%	7,000	6,388	10%
Other operating income	1,299	1,072	21%	2,371	2,283	4%
Operating expenses	(2,094)	(2,187)	4%	(4,281)	(4,059)	-5%
Core earnings	2,828	2,262	25%	5,090	4,612	10%
Bad debt expenses	(379)	(355)	-7%	(734)	(1,132)	35%
Profit before tax	2,449	1,907	28%	4,356	3,480	25%
Tax expenses	(756)	(559)	-35%	(1,315)	(896)	-47%
Outside equity interest	(11)	(11)	0%	(22)	(20)	-10%
Statutory profits	1,682	1,337	26%	3,019	2,564	18%

# 26%

increase in statutory profits half-on-half

## **Semi-annual results**

**Comparing 2H11 to 1H11 we see a similar story of increasing NIMs with a 7% increase in net interest income (\$3.4bn to \$3.6bn) driving a 26% increase in statutory profits (\$1.3bn to \$1.7bn).**

### *This increase has been supported by:*

- A 21% increase in other operating income with the volatility again being driven by the global markets impact on those financial instruments held at fair value; and
- A 4% decrease in operating expenses as the one-off restructuring costs experienced at one bank in the first half of the year were not repeated.

### *But partially offset by:*

- A 7% increase in bad debt expenses. After excluding the credit provisioning impact of the February 2011 Christchurch earthquake in both periods, underlying bad debt expenses have increased even more than this headline rate; and
- A 35% increase in tax expenses in line with the increased profit as well as an increased effective tax rate of 30.9% in 2H11 compared with 29.3% in 1H11.

**The return on equity for the banks has increased from 12.9% in 1H11 to 15.5% in 2H11 due to the increase in profit seen in this period**



# *Net interest income*





**The New Zealand major banks' net interest income has continued the growth seen since the beginning of the 2010 financial year, increasing in 2H11 by \$246m to \$3,623m.**

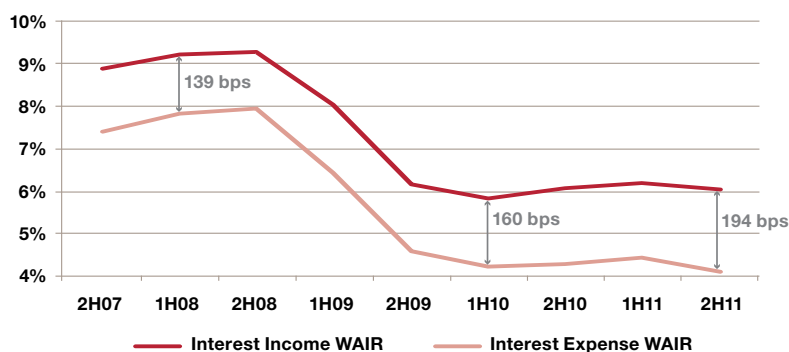
With the major banks' balance sheets not changing significantly in the last six months, this 7.3% increase in net interest income has continued to come from improved NIMs. The banks have reported an average NIM of 2.27% for the second half of the year, up from 2.23% for 1H11. This increase maintains the difference with the major Australian banks which increased from 2.25% to 2.29% during the same six month period. These reported NIMs are adjusted by the banks for various factors and are not prepared on a consistent basis. Therefore we have produced some simple analysis based on the interest bearing assets and liabilities disclosures made in the disclosure statements to calculate the weighted average interest rate (WAIR) for both interest income and interest expense.

As can be seen in figure 3, the major banks' NIM has widened post-GFC. This has been made possible by:

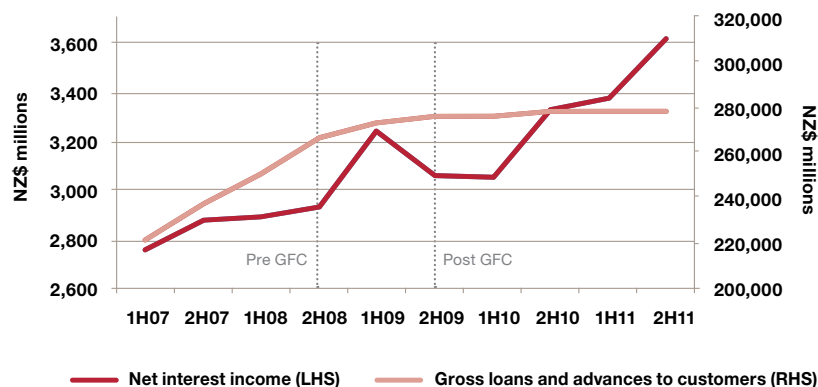
- The refocus by all banks on credit risk following the lessons learnt during the GFC;
- The trend of New Zealand households moving to floating mortgages, reducing some of the competitive pressures exerted on fixed mortgages; and
- The falls in market interest rates pushing down the banks' funding costs, allowing the banks to reduce their borrowing rates while gradually improving their margins.

However it seems unlikely that this increasing margin is sustainable.

**Figure 3: Movements in the NZ major banks' interest margins**



**Figure 4: Net interest income of NZ major banks in relation to loans and advances to customers**



# Credit growth ... or the lack thereof

*The major banks' lending portfolio as a whole has continued to stagnate, remaining relatively flat from \$276.4bn at 1H11 to \$276.3bn at 2H11. The same dichotomy exists as in previous periods with household lending continuing to grow, up 0.6% since 1H11 to \$175.9bn, while corporate lending continues to fall, down 1.2% since the first half of 2011 to \$103.2bn.*

Both consumer confidence (as measured by Westpac: McDermott Miller) and business confidence (as measured by Bank of New Zealand) have fallen off significantly from the strong sense of optimism seen in June 2011 to uncertainty with both sitting in the middle between optimism and pessimism as at December 2011.

A lot of this will have been driven by the events overseas in Europe and North America but regional problems within New Zealand are also likely to have had an impact. This suggests that credit growth is unlikely to change from a system perspective in the near term.

The move to floating lending within the residential mortgage sector has continued with 58% of mortgages floating as at September 2011 (50% at March 2011). With the uncertainty in local confidence and possible increases in mortgage rates coming as a result of the continued Northern Hemisphere woes, it will be interesting to see whether the current state represents a permanent shift in the market or whether borrowers will move back in to the fixed rate mortgage market as rates begin to increase.



**0.6%**

increase in household lending

**1.2%**

decrease in corporate lending

Figure 5: NZ major banks' lending portfolios (by class)

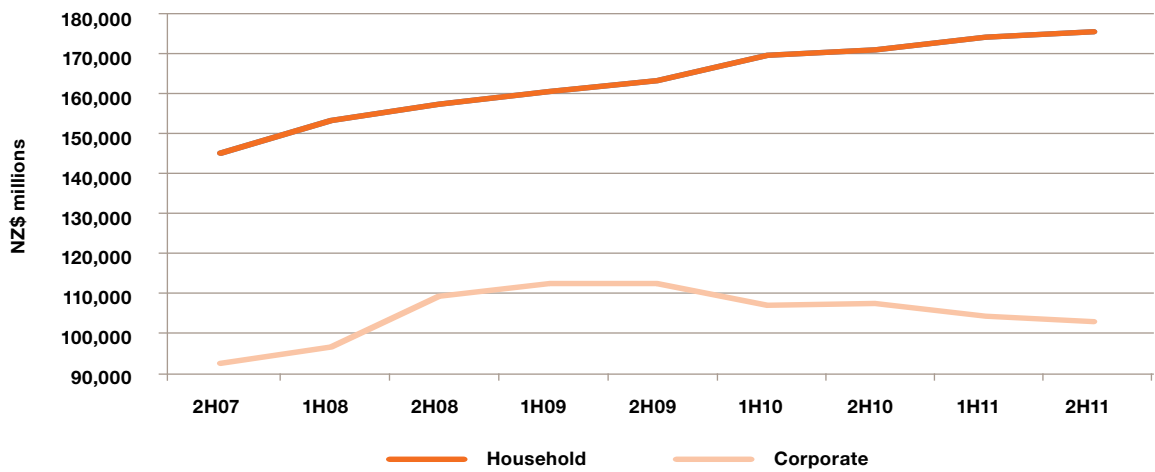
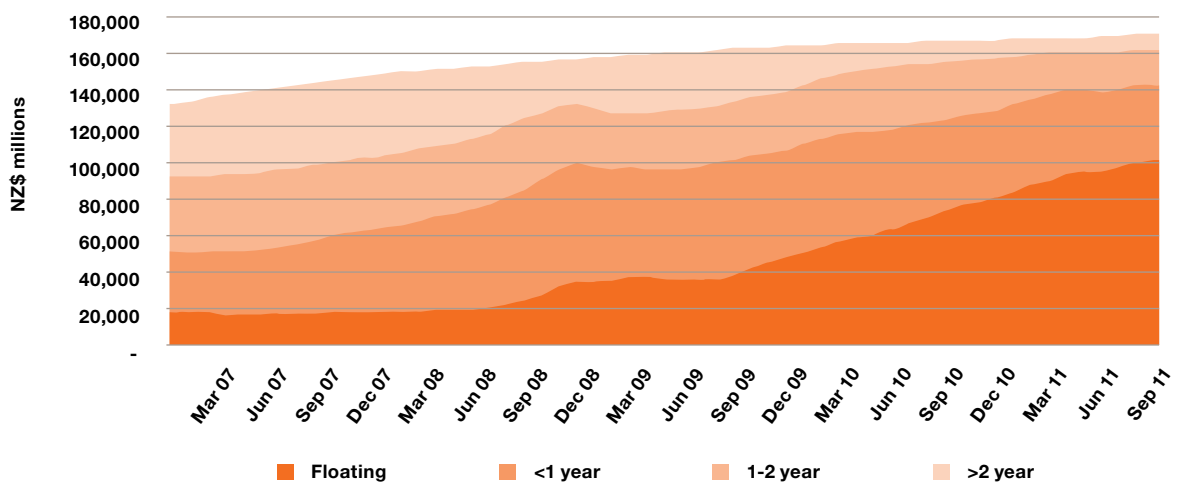


Figure 6: Maturities of residential mortgage lending performed by NZ registered banks



Source: Reserve Bank of New Zealand

# Funding costs

**Despite the lack of movement in the major banks' lending portfolio, the funding of the banks has increased from \$301.0bn at 1H11 to \$305.9bn at 2H11.**

*This growth has come from increased funding from the market of a net \$3.4bn combined with an increase in deposits from customers of \$1.0bn. Interestingly this 0.6% increase in deposits from customers is at a much lower rate than those seen over the last few years with an average six-monthly growth of 3.6% seen since the beginning of the 2007 financial years.*

This slow down in retail deposit growth is interesting but the meaning as of yet uncertain. On one hand it could be a worrying sign about the decrease in surplus funds that customers are able to save; on the other it could indicate that customers are increasing in confidence, spending more and investing outside of banks. More likely in our view, this is the result of an end of a temporary structural change caused by the flight to quality during the issues with the finance companies and prolonged by the deposit war between the New Zealand major banks.

Despite this lower rate of increase in deposits from customers, the major banks continue to self-fund their lending book, as they have done since the stagnation of the lending growth seen since 2010. Figure 7 underlines this change in customer behaviour showing the net lending before 2009 (net cash outflow) changing to net depositing after 2009 (net cash inflow) as the GFC concerns hit New Zealand resulting in a focus on deleveraging from both a household and corporate perspective.

We expect this ability to be able to self-fund to continue until the overseas concerns lighten and local confidence lifts for a sustained period. However there are still significant wholesale debt maturities which still need to be rolled-over by the New Zealand major banks, and the volatility in the international funding markets will cause some concerns. For example, shortly after the September year ends we saw credit spreads spike to their highest point since mid-2009 which subsequently were alleviated. The continuing European sovereign debt situation could cause another pricing spike or even liquidity freeze as the markets continue to show their fragility to bad news.



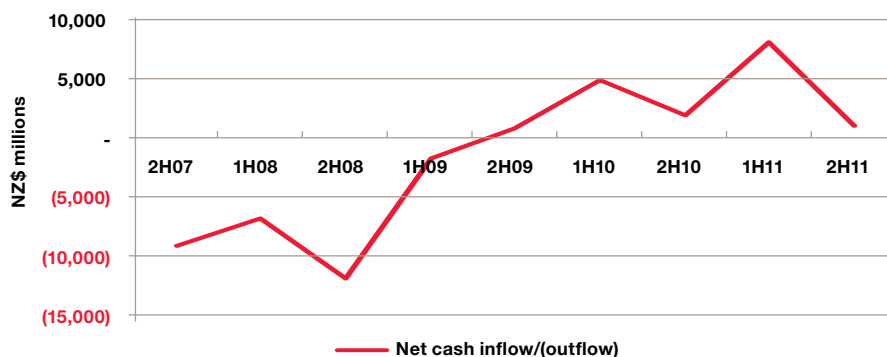
**How to roll-over funding will remain a key focus for the banks**

It was these concerns which resulted in the Australian-owned New Zealand banks being downgraded by Moody's during the period. Similar concerns, albeit from a country-wide perspective, resulted in downgrades from Standard & Poor's. These downgrades have not had much impact on the cost of funding for the New Zealand major banks as they have maintained the important 'double A' rating, albeit now AA-. The ratings are now stable and we do not expect any further downgrades.

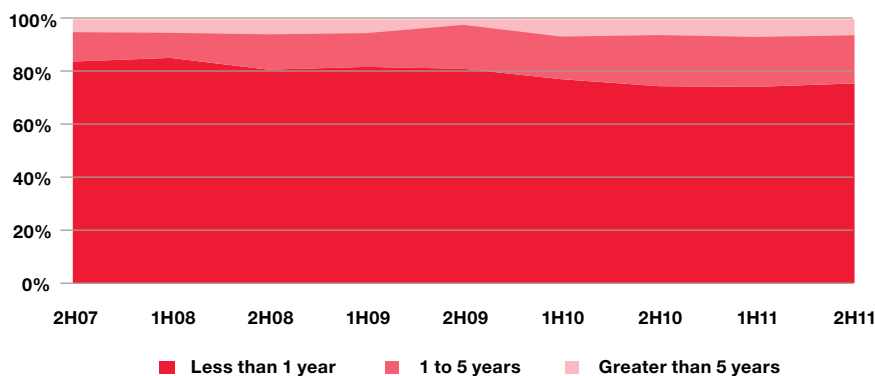
The situation in Europe continued to cause concerns in December with a European Banking Authority report finding that many EU banks are still undercapitalised in the current environment. This capital shortfall is 8% higher than originally thought and means that EU banks need to raise an estimated 114.7bn Euros as an exceptional and temporary capital buffer against sovereign debt exposures and to ensure that Core Tier 1 capital reaches 9% of risk weighted assets by the end of June 2012. This requirement is likely to increase the competition in the funding market, driving up costs or making it harder to get the funding required.

The Reserve Bank has also recognised the market volatility and has deferred by six months their planned increase in the core funding ratio from 70% to 75% from 1 July 2012 to 1 January 2013 in order to give New Zealand banks "more latitude in managing their funding programmes". These requirements only currently impact locally incorporated banks but are also likely to be placed on New Zealand branches of overseas banks in the near future with a Reserve Bank consultation paper released in the last few days.

**Figure 7: Net cash flows with customers**



**Figure 8: Relative maturities of funding for the NZ major banks**



# Other operating income

*Other operating income has increased 21% half-on-half from \$1,072m in 1H11 to \$1,299m in 2H11, but is much less volatile year-on-year at \$2,371m in FY11 compared with \$2,283m in FY10.*

Looking behind these headline numbers we see a stable fee income of \$1,989m in FY11, similar to the \$1,983m recorded in FY10, making up the majority of the income figure with much of the volatility coming from the mark-to-market of the financial instruments held at fair value.

The banks increased their trading income in FY11 to \$403m, up from \$232m in FY10, reflecting the volatility in the markets during the year. Much of this increase was seen in the first half with trading income of \$179m in 2H11 down from \$224m in 1H11.



*Stable fee income for the banks year-on-year*

# Expenses/Efficiency

**Operating expenses have decreased 4% half-on-half from \$2,187m in 1H11 to \$2,094m in 2H11. However, when removing a one-off cost disclosed by one of the banks in the first half of FY11 relating to a restructure, operating expenses have remained constant at just over \$2bn for the last three six-month periods.**

With headline operating expenses reducing and income increasing, the cost to income ratio for the New Zealand banks has reduced to 42.5%. This level has not been seen since 1H09 and is significantly below the 46.1% recorded by the Australian majors over the same period. Looking at the trend in figure 9 we can see significant fluctuations in the New Zealand figures. Some of the drop in the current period has come from fair value movements increasing non-interest income and as a result, must be considered a timing difference.

As this is unlikely to be stable going forward, we expect to see a retreat in this efficiency figure over the next six months. We expect continuing upward pressure on costs from the regulatory tidal wave that is still advancing on the international banking community.

Offsetting this upward pressure on costs we expect significant downward pressure from across the Tasman. Many Australian banks have already announced staff cuts, publically announcing their goals of improved cost to income ratios. With this Australian focus, the New Zealand banks are unlikely to be fully immune from these staff cuts.

The tax expenses have increased from \$559m to \$756m in the six month period, being driven by an increase in profits and an increase in the effective tax rate from 29.3% to 30.9%.

Figure 9: Cost to income ratios of the NZ and Australian major banks



# Asset quality

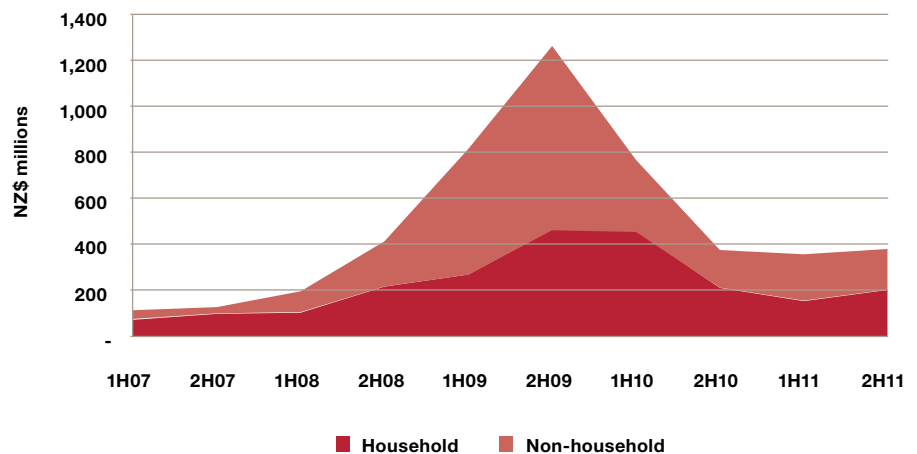
**Bad debt expenses have increased to \$379m in 2H11 from \$355m in 1H11 (increase of 6.8%), driven by an increase in the household sector from \$152m to \$200m (increase of 31.6%) offset by a decrease in the non-household sector from \$203m to \$178m (decrease of 12.3%).**

Both 2H11 and 1H11 were hit by the credit provisioning impact of the major Christchurch earthquake. When examining total bad debt expenses for the banks' 2011 financial years to that of 2010, bad debt expenses were down by approximately \$400 million or 35%. This is a remarkable result given the significant impact that the Christchurch earthquake would have had on bad debt expenses in 2011.

There is still uncertainty in the credit provisions held against the major Christchurch earthquake. As the anniversary of this quake approaches, we expect losses to begin to crystallise as insurance payouts cease in regards to business interruption or mortgage cover.

However, a good news story emerges on the balance sheet where we have seen total provisioning levels continuing to drop in both the household (from \$1,099m to \$1,042m) and non-household (from \$1,796m to \$1,577m) sectors.

Figure 10: NZ major banks: composition of bad debt expenses



This good news story is also reflected in us finally seeing a downturn in the impaired assets figure, dropping \$569m or 13.3% to \$3,725m in the last six months, although some of the decrease is due to the Reserve Bank removing the often confusing restructured assets category. This movement is supported by an acceleration in the fall of 90 day past due assets, down \$457m or 35.6% in the current period to \$827m.

This story reflects the Westpac: McDermott Miller consumer confidence level which is floating around the 100 mid-point between optimism and pessimism at December 2011 as well as the gloomier conditions in Europe. This paints the picture of current fine weather whilst the rain clouds gather on the horizon with the potential to experience GFC II given the issues being faced in Europe.

If GFC II occurred, then it could worsen the asset quality of the banks' portfolios, among other things. However, with memories of the GFC fresh in all companies' minds, many borrowers will be better positioned through the deleveraging that has occurred since 2009 and considered business plans now in place for such an event, as well as the banks already holding increased provisions. Instead it is likely to be those borrowers that are still struggling after the first GFC that experience the most pronounced problems.

Also the New Zealand major banks' responses to a GFC II would be interesting. Many increased lending criteria to filter out all but the highest quality loans during the first GFC. With the banks now also better prepared for any eventuality, the impact on the major banks' lending activities may be much less severe. This would in turn reduce any impact on the economy as a whole.



Figure 11: NZ major banks: basis point loan loss provisions

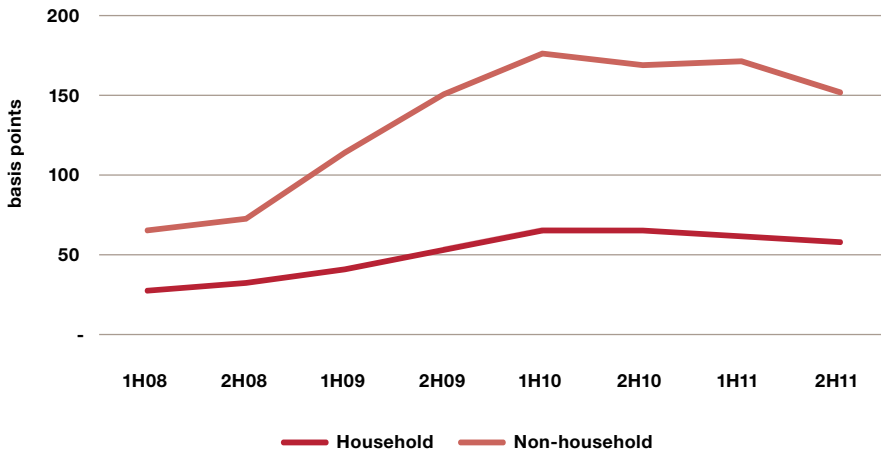
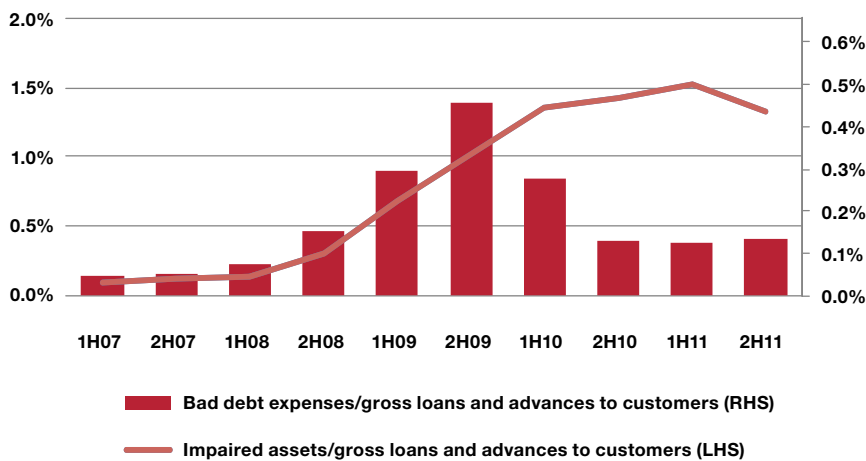


Figure 12: NZ major banks: impaired assets and bad debt expenses



***Bad debt expenses up but encouraging signals from 90 days past due and impaired asset levels***

# A longer term view

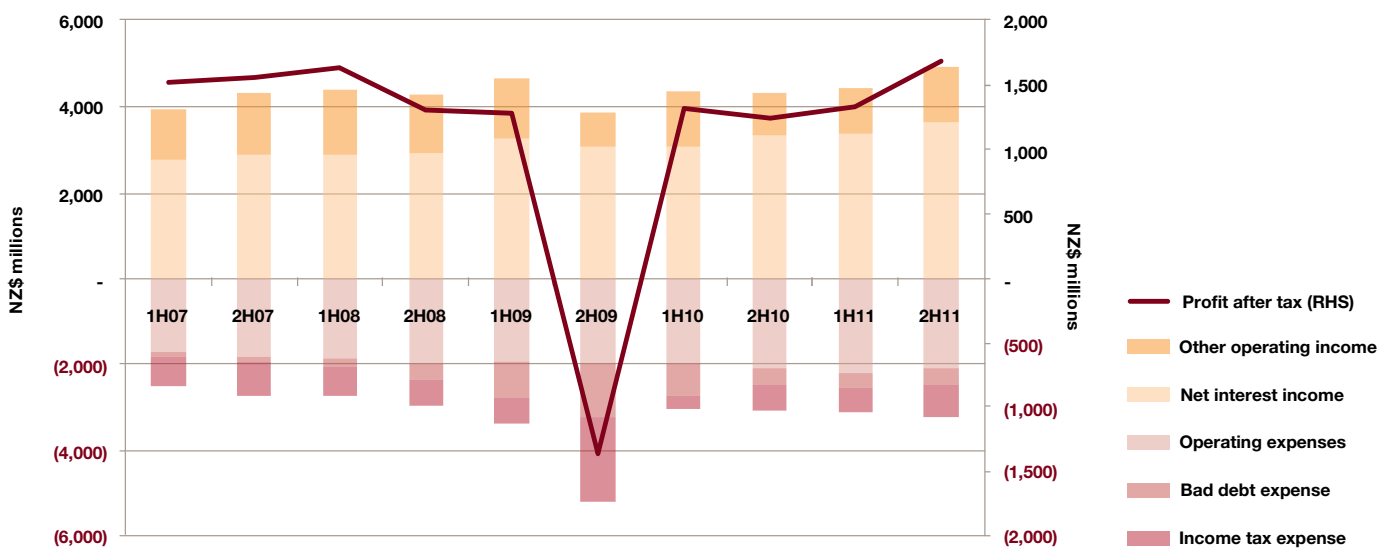
*Taking a longer term view of bank's profits we can see a strongly increasing trend since the worst of the GFC.*

Profits are now above those seen pre-GFC. However, the banks' equity has also increased and the 15.5% return on equity seen in 2H11 is still below the 17.3% seen in 1H08. The rise in equity levels seen since the GFC is partly due to the banks preparing themselves for Basel III.

The trend seen in figure 13 can be broken down into:

- Increasing net interest income driven by balance sheet growth pre-GFC and NIM growth post-GFC;
- Volatile other operating income caused by unsettled markets impacting those financial instruments held at fair value but underpinned by a core, but decreased fee and commission income;
- Increasing operating expenses, likely due to increasing regulation;
- Bad debt expenses which rapidly increased with the onset of the GFC, then subsequently abated;
- Tax expenses which remained relatively flat apart from the peak seen in 2H09, and subsequent smaller release of over-provisions in 1H10, due to the banks settling the conduit tax disputes with the Inland Revenue.

Figure 13: A longer term view of the NZ major banks' profit after tax



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Looking forward longer-term we expect to see some new strategies employed by the banks to help continue this upward profit trend. These are likely to include:

### ***Improved pricing techniques***

Work is needed in the current environment to ensure that product prices reflect the changing regulations relating to capital and liquidity. However, this can be taken further by the banks to reach a pricing optimisation approach that also focuses on customer preferences, behaviour patterns and price elasticity of demand within different customer segments. This, when combined with an appropriately detailed risk-based pricing tool, will be able to unlock higher profit margins.

### ***Efficiency***

Banks can continue to eliminate processes and activities that do not create value for customers or the banks and do not weaken the control environment. The first step of this process is already underway with the core banking upgrades. The next stage will be to convert this into speed and quality in banking processes and reducing variability in the service delivery.

### ***Cross-selling***

A key part of the banks' growth strategies is deepening their relationship with their customers, both retail and non-retail. This will be driven by understanding their customers' needs and behaviours and by using analytics to help understand trends where individual relationships are not maintained. It will also involve planning the use of the various customer channels and anticipating new consumer trends and preferences. The evolution of digital banking past the basic mobile and internet banking services currently offered will unlock many of these opportunities, but there is still value to be unlocked from providing these basic services well.

With much of this opportunity coming from digital offerings, it will be interesting to see how the banks approach these changes. Banks are likely to be looking for new innovative partners in this area with in-house development being an expensive and risky effort.

Another key focus area which the banks will be hoping to unleash through cross-selling is their wealth offerings. Several of the banks have increased their presence in this area in recent years and it is seen by many as an important income stream for the banks. The challenge for banks is how best to leverage their significant presence to take full advantage of this offering.

This cross-selling may also introduce new partnerships, allowing banks access to new customers through offering tailored products. We have seen this recently with one New Zealand bank partnering with an airline.

### ***Stream-lined product design***

We have already seen some product rationalisation within the New Zealand market. This strategy takes this to the next level with product bundles designed around customer life-cycle and needs based on a smaller number of underlying products. This, when combined with the cross-selling point above, allows banks to service their customers in a more personalised manner while increasing efficiencies through a smaller product base.

***Strong profit growth seen in recent times with new strategies expected in order to continue this going forward***

# Technology in banking



by **Malcolm McCay**

+64 9 355 8084

[malcolm.j.mccay@nz.pwc.com](mailto:malcolm.j.mccay@nz.pwc.com)

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*Like the rest of the world, the speed of technological development in banking over the past three decades has been truly spectacular and has changed the dynamics of the industry.*

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Starting in the 1980s, each successive decade has introduced technology changes that have fundamentally revolutionised banking distribution models, with the advent of phone, internet and mobile banking channels. Payment systems have gone from postponed value execution to real-time execution and settlement, removing the banks' access to the free funding that had been provided by past settlement regimes. Online channels have massively increased the quantity and quality of customer and transaction data that is available for capture and analysis that, coupled with predictive techniques, have enabled the banks to focus products and target their marketing investments much more accurately.

As a result, technological innovation in most large banks has necessarily concentrated upon three major areas:

- channel delivery services that have enabled them to meet the spectacular rate of introduction and evolution of new distribution models;
- real-time payment and settlement systems that are required by online channels; and
- customer information management that enable better focus on customer demand and targeting.

Alongside these areas of innovation are the core banking systems that support products and operations. Most of the more established banks operating in the New Zealand market have a legacy of large complex core systems that have been evolved to meet their specific business requirements.

Such evolved systems are often highly functional and tailored towards the bank's operational vision of the environment and time in which they were developed. Typically, however, in-house developed bespoke systems lack the architectural flexibility that would make them readily configurable for new products and services. They struggle to keep pace with the rate of innovation and personalisation that the industry now demands.



**Technology continues to revolutionise the banking sector**

Also typically, legacy systems use technologies for which the pool of skilled resources to support them is progressively reducing. This creates adverse cost and risk dynamics that are major drivers for the banks' need to migrate away from their legacy systems.

The packaged application software market for the banking industry offers a wide range of competitive products that use technologies that are better supported in the current environment and which generally offer broader capability and more flexibility than banks' bespoke systems.

Packages generally benefit from the cross-fertilisation of ideas generated by a diverse user base that drive innovation, the mitigation of implementation risk offered by suppliers' experience of past implementations and migration from legacy systems, and the sustainability of development and support that are essential to the suppliers' ability to continue operating.

A common challenge, however, is that the cost of replacing core banking systems is considerable and the risk profile for a core system replacement project is high. Conversely, the business benefits that support the initiative are generally 'soft', based on improved productivity, increased flexibility, lower future cost of ownership and future risk avoidance. In today's environment of tight budgets and near-term Return on Investment (ROI) targets within the banks, core systems initiatives frequently struggle to pass the investment thresholds.

However, such an investment may be necessary as competition starts to come from new angles such as the likes of Google, Microsoft or Facebook. These new entrants to the banking arena arrive unencumbered by any legacy software, allowing them to be much more nimble. Banks must be prepared or potentially face significant loss of revenue. While replacement of traditional banking channels may occur, it is likely to be much slower than has been seen with high-street book stores due to the increased trust needed for a bank. However banks will need to act now in order to avoid losing an important part of their business.

***Competition is coming from new angles***

***Partnerships with traditionally non-banking companies expected***

**Key Banking Statistics**  
**– Second Half Year 2011**  
**\$NZ millions**

	BNZ			WBC (i)			CBA (ii)			ANZN (iii)			Kiwibank		
	6 months		6 months	6 months		6 months	6 months		6 months	6 months		6 months	6 months		6 months
	1H11	2H10	2H11	1H11	2H10	2H11	1H11	2H10	2H11	1H11	2H10	2H11	1H11	2H10	2H11
<b>Income statement</b>															
Interest income	1,881	1,861	1,759	2,118	2,036	1,977	1,948	2,061	2,093	3,304	3,453	3,375	372	348	296
Interest expense	(1,169)	(1,186)	(1,100)	(1,278)	(1,342)	(1,261)	(1,294)	(1,427)	(1,550)	(1,989)	(2,168)	(2,027)	(270)	(259)	(229)
Net interest income	712	675	659	840	694	716	654	634	543	1,315	1,285	1,348	102	89	67
Other operating income	337	165	140	262	247	253	185	205	184	434	375	324	81	80	80
Operating expenses	(393)	(382)	(414)	(422)	(423)	(413)	(377)	(354)	(346)	(778)	(910)	(817)	(124)	(118)	(108)
Core earnings	656	458	385	680	518	556	462	485	381	971	750	855	59	51	39
Impairment losses on credit exposures	(57)	(95)	(99)	(107)	(119)	(112)	(62)	(25)	(14)	(105)	(85)	(131)	(48)	(31)	(8)
Total operating profit before income tax expense	599	363	286	573	399	444	400	460	367	866	665	724	11	20	31
Income tax expense	(183)	(108)	(99)	(187)	(120)	(137)	(122)	(138)	(110)	(259)	(187)	(243)	(5)	(6)	(9)
Net profit to minorities	0	0	0	(2)	(2)	(2)	(9)	(9)	(8)	0	0	0	0	0	0
Net profit attributable to shareholders	416	255	187	384	277	305	269	313	249	607	478	481	6	14	22
<b>Balance sheet</b>															
Net loans and advances to customers	56,661	55,719	54,986	58,114	56,770	56,738	56,419	57,546	58,295	93,613	95,395	96,015	11,495	10,933	10,419
Total assets	74,085	68,668	69,647	78,293	74,564	72,783	68,674	69,805	69,941	129,083	125,059	127,029	13,875	12,968	12,238
Deposits from customers	31,354	30,608	28,663	38,019	37,230	36,118	33,062	32,242	31,202	61,994	62,822	59,743	10,586	11,141	10,295
Total liabilities	69,736	64,598	65,645	73,532	70,186	68,655	64,492	65,687	66,122	120,618	117,095	119,208	13,267	12,368	11,649
Total shareholders equity	4,349	4,070	4,002	4,761	4,378	4,128	4,182	4,118	3,819	8,465	7,964	7,821	608	600	589
<b>Asset quality &amp; provisioning</b>															
Gross loans and advances to customers	57,099	56,172	55,369	58,779	57,617	57,568	56,675	57,810	58,575	94,927	96,695	97,316	11,582	10,979	10,438
Gross other individually impaired assets	659	796	769	919	1,018	890	269	289	273	1,772	2,127	2,038	106	64	38
Gross impaired assets as a % of loans and advances	1.15%	1.42%	1.39%	1.56%	1.77%	1.55%	0.47%	0.50%	0.47%	1.87%	2.20%	2.09%	0.92%	0.58%	0.36%
Gross restructured assets	0	34	3	1	0	0	0	137	166	20	0	9	0	0	0
Gross other assets under administration	10	10	29	0	0	0	38	79	37	6	12	4	0	0	0
90 day past due assets	202	263	196	256	264	397	336	387	369	0	335	313	33	35	30
Allowance for impairment losses on individual financial assets	170	176	148	266	430	356	84	87	67	511	552	616	37	32	10
Individual assessed provision as a % of impaired assets	25.80%	22.11%	19.25%	28.94%	42.24%	40.00%	31.23%	30.10%	24.54%	28.84%	25.95%	30.23%	34.91%	50.00%	26.32%
Allowance for impairment losses on groups of financial assets	207	219	203	437	454	516	185	192	223	672	738	804	50	14	10
Bad debt charge as a % of loans and advances	0.10%	0.17%	0.18%	0.18%	0.21%	0.19%	0.11%	0.04%	0.02%	0.11%	0.09%	0.13%	0.41%	0.28%	0.08%
<b>Other key data</b>															
Other operating income (% of total income)	32.1%	19.6%	17.5%	23.8%	26.2%	26.1%	22.1%	24.4%	25.3%	24.8%	22.6%	19.4%	44.3%	47.3%	54.4%
Expense/income ratio (iv)	37.5%	45.5%	51.8%	38.3%	45.0%	42.6%	44.9%	42.2%	47.6%	44.5%	54.8%	48.9%	67.8%	69.8%	73.5%
Tier 1 capital ratio (v)	9.0%	9.2%	8.9%	10.5%	10.3%	9.9%	11.2%	11.0%	10.9%	10.5%	10.5%	9.0%	9.0%	9.5%	9.8%
Total capital ratio (v)	11.8%	11.3%	11.8%	13.0%	13.0%	12.7%	12.8%	13.3%	13.2%	13.0%	12.1%	12.2%	10.5%	11.7%	11.7%

(i) Represents the aggregated results of the New Zealand banking operations of Westpac Banking Corporation.

(ii) Represents the aggregated results of the New Zealand banking operations of Commonwealth Bank of Australia including ASB Bank.

(iii) Represents the aggregated results of the New Zealand banking operations of Australia and New Zealand Banking Group including ANZ National Bank.

(iv) Recalculated from the banks' disclosure statements based on net interest income, other operating income and operating expenses.

(v) Taken from the relevant locally incorporated bank's disclosure statement.

*Notes:*

A series of horizontal dotted lines for writing notes.

# Get in touch



**Sam Shuttleworth**  
**Partner**

Financial Services  
+64 9 355 8119  
sam.shuttleworth@nz.pwc.com



**Paul Skillender**  
**Partner**

Financial Services  
+64 9 355 8004  
paul.skillender@nz.pwc.com



**Karl Deutsche**  
**Director**

Financial Services  
+64 9 355 8067  
karl.p.deutsche@nz.pwc.com



**Matt Hearley**  
**Senior Manager**

Financial Services  
+64 9 355 8531  
matthew.c.hearley@nz.pwc.com

***pwc.co.nz***

