

# ANZ Half Year Result 2020

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## **ANZ Chief Financial Officer Michelle Jablko Speaking Notes**

As Shayne said, we entered the crisis in good shape.

After bolstering credit reserves with a \$1.7 billion provision charge, and using our balance sheet to support customers, our capital position remains above unquestionably strong.

This is the direct result of four years of conservative portfolio and balance sheet decisions.

Of course there is much uncertainty about the economic impacts of this crisis... but ANZ is in a strong position to support customers... and protect shareholder interests.

Naturally, the clear focus today is on the implications of COVID-19, so I'll frame my presentation from that perspective.

Firstly, I'll describe the key pillars protecting our balance sheet:

- liquidity
- funding
- and capital.

Secondly, drilling down within capital, I'll discuss the major components, which are earnings, credit risk impacts and business growth.

And finally, I'll describe what all this means for the outlook on capital and dividends.

Let's start with liquidity and funding on slide 12.

ANZ entered this crisis well positioned. Key ratios were well in excess of regulatory minimums and well above our own management targets.

This, combined with the response from our regulators as well as the changing savings behaviour of our customers across all businesses has ensured we have the liquidity and funding to support customers and maintain balance sheet strength.

The RBA's Term Funding Facility will provide access to an additional \$12bn in funding for the next three years, and this will grow as we further support Australian businesses. All of this gives us the flexibility to stay out of term funding markets for an extended period of time, if we choose to do so.

We also start with a strong capital position.

You can see on Slide 13, we're above unquestionably strong with a CET1 ratio of 10.8% or 15.5% on an internationally comparable basis.

The best way to think about capital movements for the first half is to start with earnings before credit impacts – you can see here that it was 87bps.

Credit impacts reduce this by 43 bps, largely as a result of increased credit reserves.

And portfolio growth was 44 bps, as we supported customers – at appropriate returns – in the early phase of the crisis.

There was no capital impact from the impairment of our two Asian associate investments as they're already a full capital deduction.

Moving on to our financial performance for the half. Cash profit from continuing operations was down 51%.

You can see on slide 15, that in addition to higher credit provision charges, the major contributor to the fall cash profit was the \$1.038 billion of large and notable items.

This was mainly due to the \$815 million impairment to our associate investments.

Looking through these, profit before provisions was up 1% this half with income and expenses both up 1%.

Naturally, we now move into a very different world so I'll start with some brief insights into margin, volume and expense dynamics, as we're seeing them today.

I'll then discuss in detail the increased credit reserves, which resulted in lower profits in all our businesses.

So starting with margin on slide 16 Underlying NIM was down 4bps.

3bps of this was rate cuts made before our FY results announcement net of re-pricing. We foreshadowed this at the full year result. And, of course, there were more rate cuts during the half, and continuing impacts of competition.

Headwinds from low rates will continue. This is around 6 bps in the second half, net of recent pricing decisions.

Replicating deposits and lower earnings on capital contribute around half of this.

Against this, there are some potential positives. For example, higher institutional lending margins, deposit mix benefits and lower Bills/OIS spreads.

But, there may also be further headwinds from asset mix and competition, along with a cost to margins from our strong liquidity position.

Let's run through our business segments, starting on Slide 18.

In Australia Retail and Commercial, revenue was down 2% half on half. Retail income was broadly flat and commercial revenue was lower.

Within retail, higher margins were offset by lower fees ... and lower unsecured lending volumes are being impacted by industry-wide trends, like lower use of credit cards.

Commercial income was lower due to deposit margin headwinds from lower rates.

On volumes, Home Loan balances stabilised over the half. Commercial volumes remained flat, as many customers are taking a prudent approach in uncertain conditions.

Mortgage application volumes have been improving, but we'd expect the number of property transactions to reduce in the near term.

And, while some customers are taking up the offer of payment pauses, others are choosing to pay down their debt faster given lower interest rates.

Many of these same dynamics are playing out in our New Zealand business.

So for Australia and New Zealand, balance sheet growth is likely to remain modest.

Turning to Institutional on Slide 19, revenue was up 10% this half.

This was driven by Markets, which grew 41% benefiting from increased customer hedging activity and market volatility.

We still manage Markets as a \$1.8-2.0bn business in terms of capital and resource allocation, but some periods will of course be higher or lower, depending on customer behaviour and market volatility.

Lower interest rates negatively impacted our other Institutional businesses, especially in payments and cash management ... where lower deposit margins offset strong growth in volumes.

Our lending businesses experienced strong growth, particularly in March.

Excluding FX and short term asset growth in Markets, lending growth was around 12%, and focused on existing customers in our priority segments.

Importantly, this growth was priced for current conditions, based on a disciplined approach to risk settings, and additional approval requirements.

Lending activity has moderated significantly in April with volumes broadly flat.

You can see on slide 20 that we continued our track record of managing costs well.

Adjusted for FX, costs were broadly flat for the half. This is after absorbing \$69 million of inflation and \$63 million of increased investment spend.

This is below the guidance we provided at the FY, as we adjusted to current conditions.

Increased investment spend was focussed on our digital transformation, operational process optimisation and delivering on our regulatory commitments. Importantly ~75% of our investment spend was recognised upfront as OPEX given our \$20 million capitalisation threshold.

We remain committed to reducing absolute costs over time. The timing and extent of this will evolve as we make decisions on our cost base.

Turning to Slide 21, COVID-19 has had a significant impact on provisions this half as we bolstered our credit reserves by \$1.4 billion.

The credit provision charge was \$1.7 billion, and our annualised charge rate was 53bps, which is double our through-the-cycle expected credit loss of 26bps.

The IP loss rate was 20 bps. It was \$228 million higher half on half, as new and increased IP was up \$150 million, and we had \$78 million less recoveries and write backs.

You can see on Slide 22, our collective provision balance has been increased to \$4.5 billion. This compares to \$2.5 billion before the adoption of AASB 9 in September 2018.

The increase in the collective provision almost solely reflects a more negative view of economic forecasts, rather than customer downgrades or increased delinquencies.

Under AASB9, the collective provision balance is based on probability weighting four macro-economic scenarios.

We use a base case, which represents our current economic forecast as well as upside, downside and severe stress cases. We assess these differently in each of our key geographies.

Slide 23 sets out the base case economic assumptions. You can see here a sharp deterioration in the near term, with gradual improvement over time.

As you'd expect, the outlook is subject to significant uncertainty.

Including the extent and duration of business closures the impact of various support measures along with the extent and duration of the economic downturn.

At the bottom of the slide you can see the provision balance that would result if we applied 100% weighting to any of the economic scenarios. We've applied most of our weighting to the base case and downside scenarios.

As part of this process, careful consideration was also given to the pressures on small business customers, and higher risk industries. For some of these we applied a greater probability to downside risk.

AASB9 is very different to the accounting rules that used to apply.

For one, it's forward looking whereas we used to account for losses as they were incurred. Also, as conditions worsen, we provide for more of the portfolio on a lifetime loss basis, compared to 12 month loss in more normal times.

These factors essentially bring forward the build in provision balances.

I've mentioned that we enter this crisis with a strong balance sheet. It's significantly stronger than during the last crisis in 2008.

Shayne mentioned some of the choices we've made in our wholesale portfolio, and the industry stress tests we've done. We'd be happy to go into these more in Q&A.

We've also made very deliberate choices on the composition of our Consumer Portfolio. We've set out some of these data points on Slide 25.

We've preferred owner occupier and principal and interest mortgages. We've been cautious in unsecured lending.

Across our Australian housing portfolio, the average dynamic LVR is 56%. Customers ahead on repayments have increased from 71 to 76%.

And, 88% of customers are also paying principal and interest.

Australian Mortgage 90DPD were 110bp at the end of March, down 6 bp since September.

The absolute number of loans past due, and losses remain small.

As Shayne highlighted, we've rolled out a range of support packages for customers to ease any immediate financial pressures.

This includes the opportunity to pause payments, for up to six months, across a range of products. We've done this on an opt-in basis.

By way of example, in Australia:

- We've received approximately 105,000 requests for home loan deferrals, around 14% of home loan balances. The average dynamic LVR is 66%.
- Within Commercial... we have received 17,000 requests for business customers to pause payments.

So, with significant uncertainty around the broader economy, three key factors are influencing our thinking on capital and dividends:

1. Firstly, the impacts on earnings and risk weight migration.
2. Secondly, the use of existing capital buffers, and capital rebuild requirements over time. Shayne mentioned that we're being conservative here.
3. And finally our responses. These include disciplined capital allocation, balance sheet growth and productivity measures.

On earnings...low rates will continue to provide margin headwinds. Growth in our retail and commercial businesses is expected to be modest. Institutional growth has now moderated, and was broadly flat in April.

We remain committed to further absolute cost reduction over time. How we get there will evolve with the environment.

Credit impacts on capital will ultimately depend on actual losses, and the extent of customer recovery.

In the near term, future credit provisioning and customer downgrades will depend on the length and depth of the crisis, the shape of recovery, the responses of our customers, and the effectiveness of various support packages.

By downgrades, I mean that as we observe changes in the credit risk of individual customers or portfolios, we increase the amount of capital we hold against them.

If the economy worsens in line with our base case economic forecasts, we could see customer and portfolio downgrades equivalent to around 110bps of capital cumulatively through to 2021.

Some of the impact of this on collective provisions has already been factored in...given the forward looking nature of AASB9. However, further collective provision charges may occur as a result of changes to portfolio mix or migration between stages, and our view on scenario probability weights.

Of course, we don't know whether this will be the way that the economy unfolds. We've also looked at a range of more severe stress scenarios; including a more extreme scenario that might arise from an economy-wide shut down for a full 6 months, and a 24% fall in GDP.

This would take us further into management and regulatory capital buffers, and would therefore take more time for us to rebuild to unquestionably strong. While this scenario is becoming increasingly unlikely given the way that Australia and New Zealand have managed the COVID 19 crisis it's these uncertainties that have influenced our announcement to defer the decision on the dividend.

We intend to provide an update on the operating environment in August at the time of our Pillar3 disclosures.

With that, I'll hand back to Shayne.

**ENDS**

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