# Media Release

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# ANZ Trading Update

## Underlying business strong; 2008 cash profit* over $3 billion expected; legacy issues and weak economic outlook continues to drive provisions

In a shareholder update today ANZ said its underlying business was continuing to deliver solid results however the continuing deterioration in global credit markets, a weak New Zealand economy and softening Australian economy would continue to give rise to further provisions and valuation adjustments in the second half of 2008.

**Key Points**

- ANZ's underlying business is performing well, particularly Personal and Asia Pacific. Profit before Provisions is expected to be up by around 8% compared to 2007 and cash profit to be over $3 billion. Income is expected to be up around 8-9% (10% FX adjusted). Margins have stabilized.

- 2008 Cash EPS is expected to fall 20-25% on 2007 reflecting the impact of high provisions.

- Credit impairment costs will remain high in the second half as a result of the ongoing deterioration in global credit markets, a weak New Zealand economy and a softening Australian economy. Provisions in the second half are likely to be around $1.2 billion ($980 million for the first half 2008).

  - Collective Provision. The Collective Provision will be reset to above one percent of credit risk weighted assets. This is a prudent response to the sustained deterioration in the global credit environment and softening domestic economies in New Zealand and to a lesser extent in Australia. As a result, the Collective Provision charge is expected to be around $375 million in second half ($376 million in the first half 2008).

  - Individual Provisions. Known credit issues have deteriorated including certain commercial property clients, securities lending and Bill Express. As a result Group Individual Provisions are expected to be around $850 million in the second half ($604 million in the first half).

- The value of US credit intermediation trades, previously disclosed, is expected to be adjusted down as a deduction from income by a further $160 million.

- ANZ is continuing to invest to maintain underlying business momentum including growth in Asia. Cost growth for the year will be around 9%. Strategic cost reduction initiatives are being accelerated.

- ANZ continues to maintain a strong capital position. ANZ plans to exchange the ANZ StEPS hybrid securities into ordinary shares at a 2.5% discount. A discount of 1.5% on the ANZ Dividend Reinvestment Program will be continued and ANZ retains the flexibility to underwrite the 2008 Final Dividend. The full-year dividend is expected to be maintained at 136 cents per share fully franked.

* Adjusted for non-core items (i.e. significant items and non-core income arising from use of derivatives in economic hedges and fair value through the profit and loss).

ANZ Chief Executive Officer Mike Smith said: “ANZ’s underlying business is continuing to deliver a solid performance, and we expect a cash profit of over $3 billion in 2008. However we need to recognise where we are at with legacy issues in Institutional and the change in the economic cycle.

“As the deterioration in global credit markets continues and the slowing of the global economy plays out in Australia and in New Zealand, there are flow-on effects for our commercial portfolios and to a lesser extent the personal portfolios.

“It is prudent in this difficult environment to continue to take a more conservative approach and further strengthen our balance sheet by increasing our collective provision to a peer-leading level of above one percent of credit risk weighted assets.

“This different operating environment also requires ANZ to be fit for the challenging economic conditions in the period ahead. We are recognising this by accelerating strategic cost management initiatives, strengthening underwriting standards, making further investments in collections and systematically working to reinvigorate our risk management culture and capabilities.

“Disappointingly though, it is very apparent that in the past ANZ had allowed the development of small areas of non-core activity in Institutional. We are addressing these issues at an operating level and I will also have the review into securities lending completed next month. While I cannot pre-empt the findings of the review, I do intend to take all the necessary actions to ensure these issues are put behind us once and for all.

“While these issues are a priority to fix, the turnaround of Institutional is going to take time. Meanwhile, we are getting on with business. That includes continuing to focus on the opportunities the current market environment is providing including to re-price risk. We will also be investing in our processes, technology and staff,” Mr Smith said.

**Divisional Update**

ANZ’s Personal Division is on track for a second half stronger than the first and good year on year growth despite higher funding costs, modest credit cost increases and high levels of investment.

Institutional, on an underlying basis, should have a very strong year reflecting strong asset growth but this will be more than offset by substantially higher credit provisions and valuation adjustments associated with credit intermediation trades. As a consequence, in Profit after Tax terms, the Division’s result is expected to be about half that of 2007.

The New Zealand economy is contracting. Credit growth has stalled and provisions have increased and as a consequence, second half income growth in New Zealand Businesses is likely to be flat. The full-year growth in Profit before Provisions is expected to be around 5% however significant growth in provisions is expected to see profit fall by around 10%. However, we expect the New Zealand geographic performance to be stronger because of a good performance in New Zealand Institutional.

In Asia, growth has been strong, confirming the prospects for our strategy in that region to provide superior returns. Profit after Tax is expected to increase over 40% compared to 2007.

**Credit Quality and Provisions**

Overall credit conditions have deteriorated since ANZ’s Interim Results and we have moved to further strengthen our balance sheet by increasing the Collective Provision so this is set at a level above 1% of credit risk weighted assets.

The charge for the full-year 2008 is forecast to include around $325 million for portfolio growth and observed credit rating deterioration.  In addition, the impact of higher oil prices, interest rates and slowing economic growth require a full-year cycle adjustment of around $425 million, or around 15% of the total balance, to reflect the likely higher level of losses inherent in the portfolio in this environment and an allowance for uncertainties associated with our exposures to securities lending.

Within Australia, individual provisions for consumer credit losses are showing only modest year on year growth and are only slightly above our expectations at the beginning of the year although arrears are beginning to trend up.  ANZ has invested in improved collection technology and staffing to stem the increase in arrears levels and is taking a proactive approach to assist customers work through more difficult conditions.

The Institutional portfolio continues to be put under significant stress from a small number of previously identified larger exposures.  It is expected Individual Provisions in the second half will be around $500 million (first half $371 million).  These provisions recognise further softening in the outlook for some commercial property clients and provisions for Primebroker Securities and Bill Express.

Credit quality in New Zealand, where the economy has slowed sharply, shows a different picture to Australia.  Significantly higher mortgage interest rates and higher food and petrol prices are weighing heavily on consumers and business.  While losses are being contained, Individual Provisions are likely to be around three times the low levels experienced in 2007.  Losses on commercial and corporate lending have also increased.

Credit quality in our Asian and Pacific operations remains very sound despite the market turmoil.

**Legacy Credit Intermediation Activities**

In February, ANZ provided an explanation of how the mark to market accounting for legacy credit intermediation trades resulted in recognition of losses that are expected to be substantially reversed over time.

These trades involved ANZ selling protection through credit default swaps over a basket of corporate names.  The trades were structured with significant levels of “first loss” protection achieving a AAA rating.  To further mitigate the risk on these transactions, ANZ simultaneously purchased credit protection from a series of mostly AAA rated US financial guarantors (including so called “monoline insurers”).

The structures consist of over 800 high quality corporate names and the structures continue to meet AAA rating criteria.

The widening of credit spreads has seen market values fall disproportionately to our assessment of the underlying risk and there is currently a negative market value of US$1.14 billion (up from US$0.87 billion in February) on the sold protection offset by a corresponding positive value on the protection purchased from the financial guarantors.

In February we recognised one of these guarantors was in financial difficulty and made a provision for $226 million in the first half results.  Around 80% by value of the remaining exposure is with AAA rated financial guarantors.  We have assessed the total market value of these obligations and have currently recognised a further adjustment of around $160 million against income.  The size of this valuation adjustment will vary over time with changes in the market value of the underlying assets and the assessed credit valuation adjustment.

While there will continue to be volatility, ANZ expects these amounts to be recovered over time.

**Funding, Liquidity and Capital**

ANZ has successfully completed its 2008 term funding program and is now focusing on pre-funding 2009. During the year we have raised $34 billion in term funding with an average duration of 35 months and an average cost of 70 basis points over swap rates. Our overall funding profile remains unchanged from that reported in March, with no increased reliance on short-term wholesale funding. Liquid assets total $32 billion placing ANZ in a strong liquidity position.

ANZ plans to exchange the ANZ StEPS hybrid securities, which are exchangeable on 15 September, into ordinary shares at a 2.5% discount under the terms and conditions detailed in the original prospectus. The Group also intends to continue the discount of 1.5% on its Dividend Reinvestment Program and maintain flexibility to underwrite the balance of the 2008 Final Dividend.

The Group intends to maintain the full-year dividend at 136 cents per share fully franked - the same level as 2007.

ANZ anticipates its Tier 1 ratio at 30 September to be above 7%.

Mr Smith added: "While we need to manage our business for potential risks arising from deteriorating global markets, we also need to get on with the business of growing and delivering on our aspiration to build a Super Regional Bank.

"In the short term however we need to manage the impact of the global economic environment so that we maintain a strong balance sheet and build our business for the longer term.

"We have a good foundation. Personal continues to be a standout business, Institutional is turning around although affected by identified legacy issues and more difficult market and economic conditions, New Zealand is performing reasonably well given challenging economic circumstances and Asia Pacific is providing rapid, well-managed growth," Mr Smith said.

A conference call for investors will be held at 10.00am today with Chief Executive Officer, Mike Smith and Chief Financial Officer, Peter Marriott. This call can be accessed live at http://www.anz.com/aus/shares/presentations.

ANZ will report its Full Year Results for the period ended 30 September 2008 in Sydney on 23 October 2008.

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