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Australia and New Zealand Banking Group Ltd.

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Related Criteria

Australia and New Zealand Banking Group Ltd.

SACP	a
Anchor	bbb+	
Business Position	Strong	+1
Capital and Earnings	Strong	+1
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Adequate	

\+

Support	+2
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	+2

\+

Additional Factors	0

Issuer Credit Rating
AA-/Negative/A-1+

Major Rating Factors

Strengths:	Weaknesses:
• Strong market position in the Australian and New Zealand retail and commercial banking sectors. • Capitalization and earnings supports credit profile in COVID-19 outbreak. • Highly likely to receive timely financial support from the Australian government, if needed.	• Material dependence on domestic and offshore wholesale borrowing. • Exposed to risks from falling house prices, rising unemployment, weakening economy due to COVID-19, and high private sector debt.

Outlook: Negative

The negative outlook on Australia and New Zealand Banking Group Ltd. (ANZ) mirrors that on the Australian sovereign (AAA/Negative/A-1+), and reflects a one-in-three likelihood that we will lower our long-term rating on the bank in the next two years.

In our base case, we expect that despite a significant fall in interest and fee income, ANZ's earnings in the next two years will remain sufficient to absorb the substantial increase in credit losses due to the COVID-19 outbreak and containment measures. Furthermore, we expect that ANZ would take actions to increase the absolute amount of capital it holds--by cutting dividend payments and issuing new capital--to maintain its regulatory capital ratios, which would be otherwise weakened due to credit transitions within the bank's internal ratings based capital models.

We forecast a strong rebound in the Australian economy by about mid 2021 following a significant downturn. Consequently, we forecast that credit losses for banks operating in the country will ease to a level broadly in line with our long-term expected average after peaking in the next year or so. We expect loan growth to remain subdued in the next two years. We also consider that the substantial monetary support package from the Reserve Bank of Australia (RBA) has allayed the funding and liquidity concerns posed by the financial market dislocation following the pandemic outbreak. We expect that ANZ will be able to adequately manage these challenges.

We also see a one-in-three possibility that COVID-19 and the resultant containment measures could hit the Australian economy and banking sector significantly more severely than our base case. In such a scenario, we expect to assess our economic risk score within our Banking Industry Country Risk Assessment (BICRA) for Australia to have worsened by one category, and consequently apply higher risk weights in our capital analysis. In that case, ANZ's stand-alone credit profile (SACP) may weaken by one notch, and consequently, we expect:

- To lower our ratings on the tier-1 and tier-2 regulatory capital instruments issued by the ANZ group, and;
- Our issuer credit rating (ICR) on ANZ and our ratings on senior debt issued by the group to remain unchanged due to increased uplift from likely sovereign support to three notches, if other things remained unchanged.

Downside Scenario

We expect to lower our long-term ICR on ANZ and its core operating subsidiary (ANZ Bank New Zealand Ltd.) as well as our long-term ratings on senior debt issued by these entities, to 'A+' if we were to lower our long-term local currency ICR on Australia to 'AA+'. We also expect to lower our short-term ratings on ANZ and its core operating subsidiary to 'A-1' in that scenario. We consider that a lower rating on the sovereign would reflect slightly reduced financial capacity to provide timely financial support to ANZ and other systemically important institutions in Australia, if needed.

In a less likely and more severe downside scenario, well beyond our current forecasts, we could assess that the economic risk score within our BICRA for Australia has worsened by more than one category, or that our overall BICRA score for Australia has worsened by one category--which would likely be reflected in widespread downgrades for Australian banks. A hypothetical example of such a scenario would be an imminent or actual rapid fall in property prices substantially greater than our current forecast, along with a materially weaker economic outlook. A material fall in our risk-adjusted capital (RAC) ratio for ANZ, for example due to very large credit losses, is another unlikely downgrade scenario.

Upside Scenario

We expect to revise the outlook to stable if we affirmed our credit rating on Australia and revised the outlook to stable and we do not see a substantially weaker economic outlook than our current forecast.

Rationale

Our ratings on ANZ reflect the bank's strong market position and business franchise in key retail market segments in Australia and New Zealand. We believe the bank's core business lines benefit from its established and long-standing franchise and well-developed business and risk-management capabilities in the two countries. Furthermore, we expect these strengths to continue to help the bank achieve strong and stable earnings over the longer term following a short-lived fall in earnings due to the significant but temporary economic downturn caused by COVID-19 and containment measures. ANZ's strong capitalization, robust key earnings and asset quality metrics relative to global peers', and adequately managed funding and liquidity risk also support our view of its credit profile. The ratings on ANZ also benefit from our expectation that the Australian government is highly likely to provide timely financial support to the bank, if needed. These strengths moderate the bank's material dependence on domestic and offshore wholesale funding and ongoing risks from still-high property prices and private sector debt.

We assess the group SACP of ANZ (and the SACP of the operating holding company Australia and New Zealand Banking Group Ltd.) as 'a'.

Anchor: Resilient economy and conservative regulations and risk appetite offset funding weaknesses in the operating environment.

The starting point for our ratings on ANZ--similar to all other banks operating predominantly in Australia--reflects our assessment of Australia's macro environment. This is because we expect that more than 70% of ANZ's customer loans would remain in its Australian home market. We expect ANZ's main lending exposures outside Australia to remain focused on New Zealand, forming about 20% of its total lending, with the rest of the world making up the remainder.

Australia benefits from being a wealthy, open, and resilient economy that has performed relatively well during and following negative cycles and external shocks. We expect a rebound in Australia's economic growth toward the end of calendar 2020 following a recession triggered by the COVID-19 outbreak and containment measures. We expect credit growth to remain muted despite an accommodative monetary policy, due to lower credit demand in Australia amidst the global economic recession. In addition, we expect a significant fall in property prices and a multifold rise in credit losses due to weak economic conditions, including rising unemployment.

In line with our forecast for economic recovery, we expect that nominal growth in private debt and house prices will resume and credit losses will ease close to our expected long-term average by fiscal 2022 (year ending June 30, 2022). Nevertheless, we consider that Australian banks are exposed to elevated risk of a substantial rise in credit losses, well above our base-case forecasts, due to the economic downturn, and high house prices and household debt, in combination with Australia's external weaknesses--in particular its high level of external debt.

We consider that Australia's prudential regulatory standards remain conservative. We expect that the implementation of recommendations by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry should boost the Australian financial sector's regulation and governance. We also believe that the structure of the banking industry is supporting stability--with a small number of strong retail and commercial banks dominating the sector. These banks are able to price for risks affording them a buffer for unforeseen losses. We expect that the banking sector earnings will remain adequate to absorb the multifold rise in credit losses due to the economic downturn.

We consider that the substantial monetary support from the RBA has alleviated funding and liquidity risks for the Australian banks. Furthermore, we note that the Australian banks have strengthened their funding and liquidity profile over recent years by increasing retail deposits, reducing dependence on short-term wholesale borrowing, lengthening average maturities, and increasing diversification. Nevertheless, the Australian banking system's material dependence on external borrowings exposes it to a disruption in access to funding as well as a rise in borrowing costs, given the dislocated global financial markets.

Table 1

Australia and New Zealand Banking Group Ltd. Key Figures

		--Year-ended Sept. 30--			
(Mil. A$)	**2020***	**2019**	**2018**	**2017**	**2016**
Adjusted assets	1,144,998	975,357	897,640	852,392	871,541
Customer loans (gross)	661,278	618,767	608,380	584,091	580,035
Adjusted common equity	51,194	47,460	46,240	41,437	39,804
Operating revenues	9,708	18,648	20,544	21,097	21,951
Noninterest expenses	4,605	8,994	10,245	10,177	11,474
Core earnings	2,100	6,165	6,703	6,716	5,830

*Data as of March 31.

Business position: Strong business franchise and market share supports earnings stability in response to COVID-19 challenges.

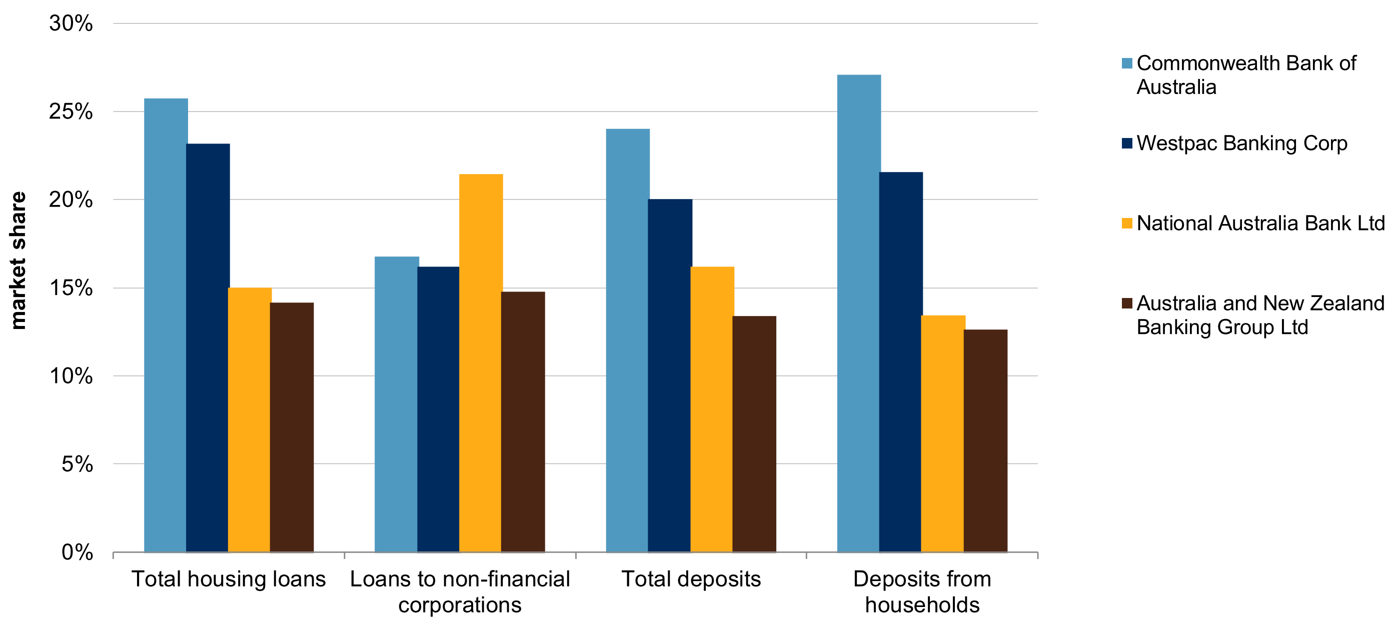
We believe that ANZ's strong position in its core business of retail and commercial banking in Australia and New Zealand should continue to support our view of the bank's credit profile, despite the economic downturn caused by COVID-19 and its containment measures.

We assess the economic downturn due to the virus outbreak will result in a drop in business volumes and earnings for ANZ; similar to other Australian banks in the next two to three years. Nevertheless, we expect that the downturn will be temporary and the bank should be able to capitalize on the opportunities provided by an expected economic rebound in about mid-2021.

ANZ is one of the four major banking groups that dominate both the Australian and New Zealand retail and commercial banking sectors; which includes Commonwealth Bank of Australia (CBA, AA-/Negative/A-1+), National Australia Bank Ltd. (NAB, AA-/Negative/A-1+), and Westpac Banking Corp. (Westpac, AA-/Negative/A-1+). We expect more than 70% of ANZ's lending activities will remain focused in Australia, where ANZ has a strong market share of about 14.1% of residential mortgages and 12.6% of customer deposits as of May 31, 2020, remaining relatively unchanged in recent years (see chart 1). We believe that ANZ should also retain its strong market position in New Zealand, where it is by far the largest bank in the country, with a market share of about 30% across all banking businesses--more than 1.5x the size of New Zealand's second largest bank.

Chart 1

ANZ Has Strong Market Share In Australian Housing Loans And Deposits



Source: APRA MBS, as of May 2020.

Despite a few unique characteristics associated with each of the four major Australian banks, the differences in their business profiles at the current rating level are relatively minor, in our view. We consider that aside from ANZ's larger presence in New Zealand, its business composition is becoming very similar to that of NAB and CBA. That is, these three banks are increasingly focusing on their retail and commercial banking within Australia and New Zealand. That said, ANZ's (and the other Australian major banks) overall business position--including its revenue stability and franchise strength--is stronger than those of the smaller, second-tier banks with a narrower geographic and product focus.

We consider that pricing flexibility for ANZ and NAB is slightly weak relative to Australia's two larger major banks. In our view, ANZ and NAB's relatively small share of deposits from household customers contributes to the banks' somewhat weaker earnings metrics.

We see ANZ's exit in the past three years from a number of businesses--that in our view were somewhat peripheral to ANZ's core strengths--as a marginal credit positive for the ANZ group. We consider that exiting these businesses should simplify the bank's business activities, release scarce capital resources to higher earnings businesses and remove sources of management distraction; but at the same time it may marginally weaken ANZ's business diversity.

ANZ stemmed the negative momentum in its Australian home loans market share as record volumes of home loan refinance applications were recorded in the first quarter of 2020; this followed a pickup in turnaround times in late 2019 as policy and risk settings saw greater clarity.

Loans to nonfinancial corporations following the onset of COVID-19 saw strong lending growth; however it included companies drawing down on committed facilities; it is our expectation that institutional lending growth will slow down for the remainder of the financial year (also see capital and earnings discussion below).

With the advent of COVID-19 the group adapted its short to medium term priorities, and in our view will position the group to manage its risk exposures. These priorities include maintaining a more prudent approach to risk and capital allocation, an increased focus on liquidity, staying closer to customers while maintaining operational agility.

Digital innovation remains core to ANZ's strategy and a key driver in the group's positive customer experience. As of September 2019, of the 2.8 million of ANZ's customers using the ANZ app, 36% of them are using mobile banking only (up 30% year on year). We also believe the COVID-19 pandemic will accelerate the adoption of financial technology in Australia. That said, we believe that technology has the potential to disrupt the competitive landscape in Australia, similar to most other banking markets globally. We have seen a resurgence in online banking recently with the approval of banking licenses for online banks in addition to use of online banking platforms and brands by some existing banks. Nevertheless, we expect that technological developments should not significantly weaken ANZ's business position. Rather, we expect that ANZ, and the other major Australian banks, will leverage on the technological developments, including through collaboration with the technology companies to drive improvements in cost efficiency, as well as product and service offerings.

We believe ANZ has a comprehensive and well-developed risk-management and governance framework across the group's activities. We expect ANZ's strong business franchise and financial strength to help it to absorb potential financial penalties and customer remediation costs associated with governance shortfalls that have emerged in the practices and operations of major Australian banks in the past three years. Many banks faced criticisms such as overcharging customers, non-adherence to responsible lending standards, or failure to timely report suspicious transactions to the financial crimes regulator. We believe policymakers have increasingly called for greater penalties for such lapses, at least partly on the basis that these profitable banks must meet community expectations. Earnings of ANZ and the other major Australian banks have been weakened by significant costs to remedy these lapses. Emergence of such issues often disrupts bank operations (for example, due to forced changes to board and senior management). Nevertheless, we consider that these banks can absorb the burden without significant downside to their creditworthiness, given their strong financial and business profiles and a high likelihood of timely financial support from the government, if needed. In addition, we believe the consequent damage to the customer franchise is unlikely to be significant or long-lasting.

Table 2

Australia and New Zealand Banking Group Ltd. Business Position

		--Year-ended Sept. 30--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Total revenues from business line (currency in millions)	9,708	18,785	21,116	21,273	21,951
Return on average common equity	5.1	9.9	10.8	11.0	9.9

*Data as of March 31.

Capital and earnings: Good risk-adjusted capitalization should persist despite a material hit to earnings because of COVID-19.

ANZ's common equity Tier 1 (CET1) ratio was 10.8% as of March 31, 2020, which is well in excess of the Australian Prudential Regulation Authority's (APRA) minimum regulatory capital requirement of 8%, including the domestic systemically important banks (D-SIB) buffer of 1.0% and capital conservation buffer of 2.5%, and above the CET1 target of 10.5% for "unquestionably strong."

In our view, ANZ will continue to maintain its CET1 ratio at about its current level above APRA's indicated target CET1 ratio. This is despite the regulatory forbearance APRA announced in March 2020 indicating that it would show tolerance for banks not meeting its indicated CET1 ratio, in the timeframe it set out, provided the banks were meeting the minimum regulatory capital requirements. Furthermore, APRA indicated that the banks may utilize some of their current large buffers--over the minimum regulatory requirements--to facilitate lending to support the economy. We note that because of credit risk migration in a COVID-19 environment ANZ's regulatory capital ratios will be pro-cyclical and that this will have an impact on capital management decisions going forward.

ANZ remains well placed to meet the final capital requirements that the Reserve Bank of New Zealand (RBNZ) announced on Dec. 5, 2019, for its New Zealand subsidiary, ANZ Bank New Zealand Ltd., particularly given the seven-year transition period, that the RBNZ has delayed by one year due to the COVID-19 outbreak and containment measures, now starting July 1, 2021. We believe ANZ has significant flexibility to strengthen its regulatory capital ratio further, if needed, through a combination of retaining capital following business sales currently underway, reduced dividend payout, increased dividend reinvestment, or new capital injection.

We forecast that ANZ will maintain an RAC ratio of 10.5%-11.0% in the next two years. Our baseline forecast takes into consideration our view that the slowdown in house prices and credit growth has reduced some of these risks that built up in the preceding year, although somewhat offset by our expectation for increased credit losses due to COVID-19.

We currently see a one-in-three possibility that the economic impact of the COVID-19 outbreak and containment measures for the Australian banking sector could be significantly more severe or prolonged than our base case. In that scenario, we expect to assess our economic risk score within our BICRA for Australia to have worsened by one category, and consequently apply higher risk weights in our capital analysis. In that case, we could form a view that ANZ's RAC ratio is likely to remain below 10%, and consequently, the bank's capital level is no longer strong.

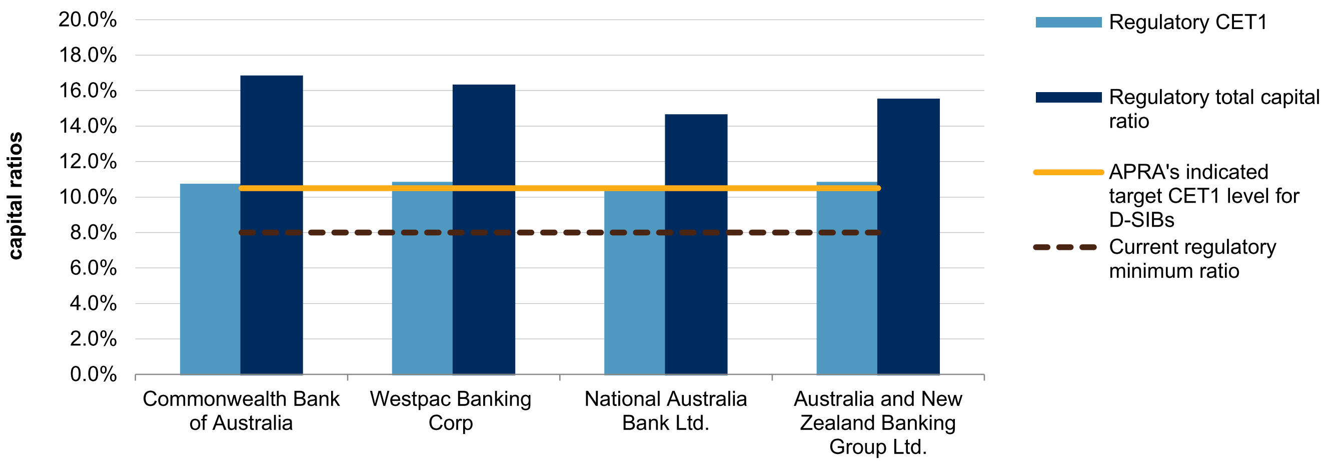
We assess ANZ's capital and earnings assessment on a forward looking basis and key elements of our assessment include:

- Modest loan growth over the forecasting period, shadowing our estimates for system level growth.
- Our estimate for loan growth in 2020 takes into consideration slower loan growth in institutional loans as volume growth moderates following a strong spell in the 2020 first half as a result of companies drawing down on committed facilities.
- Net interest margin will remain under pressure driven by intense competition and a lower earnings rate on deposits, mortgages, and capital in a low interest rate environment.
- Lower fee income driven by the Royal Commission outcome and COVID-19 concessions.

- Credit losses to peak at around 85 basis points (bps) as a result of COVID-19 in 2021, thereafter to revert back to normalized credit loss levels at around 50 bps.
- Future dividend decisions will take into consideration capital pro-cyclicality.

Chart 2

Australian Majors Are Strongly Capitalized

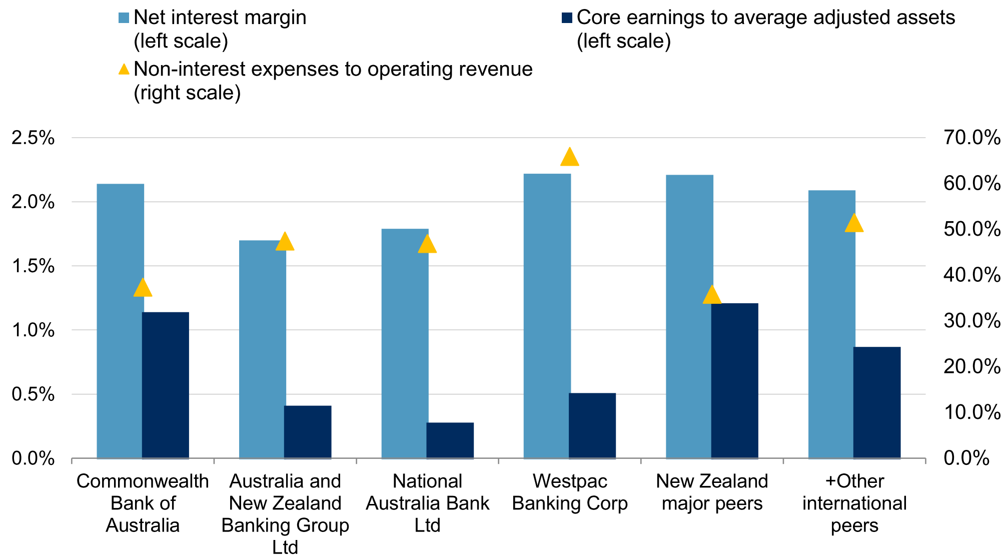


CET1--Common equity tier 1. D-SIBs--Domestic systemically important banks. APRA's--Australian Prudential Regulation Authority's. Source: S&P estimates and regulatory disclosures as of March 2020.

Our sensitivity analysis shows that ANZ earnings have headroom for a severe downside scenario, and would be able to withstand a significant rise in credit losses in combination with a decline in operating income. In our base-case scenario, we estimate that ANZ's gross operating income will decline by about 8% but that ANZ's earnings would remain sufficient to absorb a significant rise in credit losses relative to rising to about 10x those in 2019. Consequently, we do not currently foresee a reduction in the absolute amount of capital held by ANZ, although its net income and dividend payouts will be substantially lower.

Chart3

Profitability Of Majors Is In Line With International Peers



+ Other international peers include Toronto dominion Bank (AA- / Stable / A-1+), Bank of Montreal (A+ / Stable / A-1), Bank of Nova Scotia (A+ / Stable / A-1), DBS Bank (AA- / Stable / A-1+), Nordea Bank Abp (AA- / Stable / A-1+), Banco Santander S.A. (A /Negative / A-1) and Banco Bilbao Vizcaya Arentaria S.A. (A- / Negative / A-2). Source: S&P estimates year to date metrics.

ANZ, along with other Australian major banks, remains marginally more reliant on hybrid capital instruments, compared with a number of other banks internationally. We expect ANZ to continue to show strong earnings, despite continued competitive pressures on net interest margins. The remainder of the bank's capital base consists mainly of common share capital and retained earnings.

Table 3

Australia and New Zealand Banking Group Ltd. Capital And Earnings

		--Year-ended Sept. 30--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Tier 1 capital ratio	12.5	13.2	13.4	12.6	11.8
Adjusted common equity/total adjusted capital	86.0	85.3	85.1	82.9	81.5
Net interest income/operating revenues	74.4	76.9	70.6	70.5	68.8
Fee income/operating revenues	12.1	13.8	18.2	19.2	21.3
Market-sensitive income/operating revenues	11.3	6.9	8.1	6.8	3.3
Noninterest expenses/operating revenues	47.4	48.2	49.9	48.2	52.3
Preprovision operating income/average assets	1.0	1.0	1.1	1.2	1.2

Table 3

Australia and New Zealand Banking Group Ltd. Capital And Earnings (cont.)

		--Year-ended Sept. 30--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Core earnings/average managed assets	0.4	0.6	0.7	0.7	0.6

*Data as of March 31.

Table 4

Australia and New Zealand Banking Group Ltd.--Risk-Adjusted Capital Framework Data

(Mil. A$)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Credit risk					
Government & central banks	228,429	6,915	3	6,830	3
Of which regional governments and local authorities	0	0	0	0	0
Institutions and CCPs	105,191	22,146	21	19,255	18
Corporate	422,298	205,988	49	323,036	76
Retail	431,744	137,661	32	160,902	37
Of which mortgage	380,553	107,579	28	116,216	31
Securitization§	13,468	2,142	16	2,694	20
Other assets†	7,331	4,997	68	13,012	177
Total credit risk	1,208,461	379,849	31	525,729	44
Credit valuation adjustment					
Total credit valuation adjustment	--	7,445	--	9,679	--
Market Risk					
Equity in the banking book	0	0	0	0	0
Trading book market risk	--	7,102	--	11,894	--
Total market risk	--	7,102	--	11,894	--
Operational risk					
Total operational risk	--	47,902	--	36,847	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	450,309	--	584,148	100
Total Diversification/ Concentration Adjustments	--	--	--	(50,049)	(9)
RWA after diversification	--	450,309	--	534,099	91
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		56,295	12.5	59,624	10.2
Capital ratio after adjustments‡		56,295	12.5	59,624	11.2

Table 4

Australia and New Zealand Banking Group Ltd.--Risk-Adjusted Capital Framework Data (cont.)
*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Sept. 30 2019, S&P Global Ratings.

Risk position: Sizable headroom in earnings to absorb increased COVID-19-related credit losses.

We believe the COVID-19 outbreak will not increase the risk appetite of banks. Australia's major banks (including ANZ) will likely remain cautious, especially given the uncertain operating conditions and the backdrop of the Royal Commission, which cast a shadow over banks' lending practices.

Following the advent of the COVID-19 outbreak, we now forecast that, consistent with the Australian banking system as a whole, ANZ's credit losses in the year to Sept. 30, 2021, will rise to about 85 bps of gross loans and advances (totaling about A$5.6 billion), nearly 8x the historic low in fiscal 2018.

We believe that the full extent of losses will take some time to materialize, as a number of businesses and households are likely to struggle to meet their financial obligations once the restrictions to contain the coronavirus outbreak are lifted, when the moratorium on debt servicing ends, and the government reduces fiscal support.

We forecast ANZ's credit losses will ease to about 50 bps in fiscal 2022--broadly in line with our expected long-term average for the Australian banks--on the back of improving economic growth and falling unemployment. Nevertheless, we see significant risks. Credit losses could rise well above our base case if the economic downturn becomes significantly more prolonged or severe than our forecasts. We expect business loans (in particular to small and midsize businesses related to travel and tourism, hospitality, and retail sectors) to drive the increase in credit losses.

We believe ANZ, consistent with its major bank peers, has sizable headroom in its earnings to absorb our forecast increase in credit losses and a large contraction in interest spreads and fee income. ANZ announced a new A$1.7 billion overlay provision to account for potential impacts of COVID-19. Furthermore, we expect that the major Australian banks, including ANZ, would increase the absolute amount of capital they hold to maintain their regulatory capital ratios, which would be otherwise weakened due to credit transitions within the banks' internal ratings-based capital models.

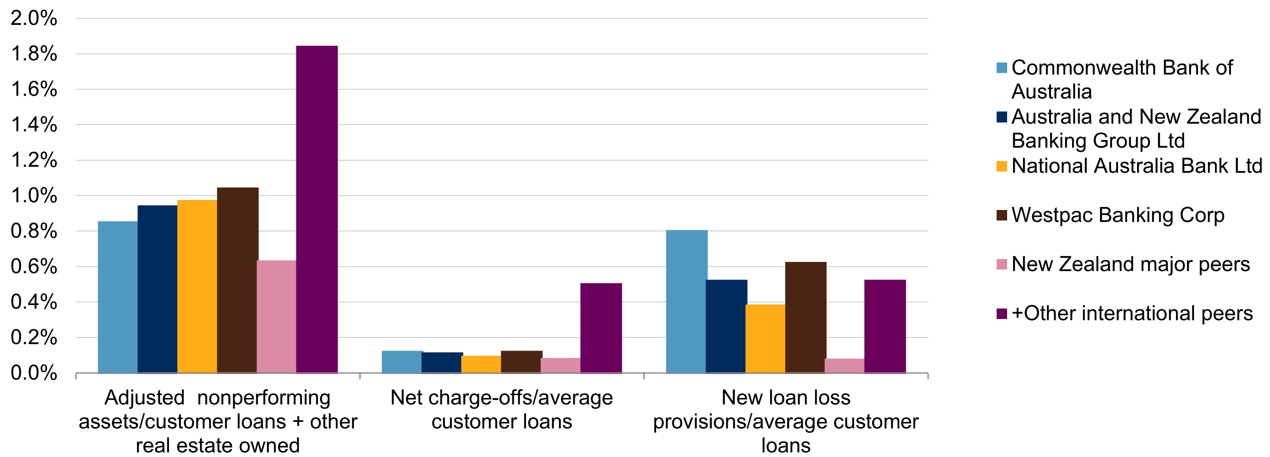
We note that in response to the COVID-19 outbreak ANZ raised its cost of equity hurdle rate by around 300 bps. This will result in an improvement in risk adjusted returns for new institutional business and will also spill over to the existing institutional back book. Anecdotally we note that ANZ benefitted from a "flight to quality" as other international active banks reduced their exposures outside their home markets.

We expect house prices to fall by about 10% before resuming modest growth around the middle of calendar 2021. In the short term, restrictions on auctions and inspections are likely to curtail the volume of home sales. In addition, we expect demand for housing will not be as buoyant as in the past several years as immigration will likely remain nonexistent for some time due to travel restrictions. At the same time, we expect the large fiscal stimulus from the government to reduce the severity in home price falls. Similarly, the moratorium on home loan repayments should restrict distressed sales by homeowners.

We believe that ANZ's lending and underwriting standards are conservative, as evidenced by low loan-loss provisions and nonperforming assets, which are at levels broadly comparable with its Australian major bank peers (see chart 4). In recent years, ANZ's credit losses have been significantly below our expectations through the cycle, though Australian banks benefited from a long run of benign economic conditions.

Chart 4

Strong Asset Quality Relative To International Peers



+ Other international peers include Toronto dominion Bank (AA- / Stable / A-1+), Bank of Montreal (A+ / Stable / A-1), Bank of Nova Scotia (A+ / Stable / A-1), DBS Bank (AA- / Stable / A-1+), Nordea Bank Abp (AA- / Stable / A-1+), Banco Santander S.A. (A /Negative / A-1) and Banco Bilbao Vizcaya Arentaria S.A. (A- / Negative / A-2). Source: S&P estimates year to date metrics.

Residential mortgage prices are expected to stabilize in line with our forecast rebound in economic activity and employment in calendar 2021. We also expect immigration driven population growth to resume during this time. Reduced construction of new homes in recent months is likely to persist in the next 12 months, which should amplify the persistent gap between demand and supply for housing--especially in Melbourne and Sydney, which attract most migrants. Finally, interest rates are likely to remain low, which should also support price growth when economic conditions improve.

ANZ's lending portfolio is expected to remain well diversified by geography, customers, and industry. About 60% of ANZ's lending in Australia is to the housing sector, which is broadly in line with the concentration shown by ANZ's Australian major bank peers. Furthermore, banking activities are diversified across retail, commercial, and institutional banking. We believe that the banking activities are relatively simple and exposures to higher-risk activities are relatively low.

In our view the ongoing simplification of ANZ's business portfolio with greater focus on retail and commercial banking within Australia and New Zealand has reduced the bank's exposure to relatively risky geographies and businesses. Within Asia, ANZ is now focusing mainly on institutional banking. Recently new impaired assets within the institutional banking division increased and related primarily to 1) a single name exposure based in Singapore and 2) an adjustment to nonlending equity accounted assets where the value in use calculations did not support the carrying value of the assets. The quantum of the increase in these new impaired assets are still within our tolerance levels for ANZ at the current rating level.

Compared with its peer Australian major banks, ANZ also has a larger proportion of its assets in New Zealand, a banking system we consider to be marginally riskier than that in Australia. Following its reductions in Asian exposures and ongoing sale of wealth management and insurance businesses, ANZ's growth appetite appears to be conservative and broadly in line with system trends.

ANZ's public disclosures, such as its annual report and Pillar 3 reports, provide transparency into the group's underlying risk-management practices, structures, positions, and earnings generation, in our view. We believe that ANZ's on- and off-balance sheet exposures are not dominated by complex products such as derivatives, securitizations, and structured credits that could result in an undue buildup of risk.

In our opinion, ANZ is addressing the governance, accountability, and culture shortcomings that have been highlighted across the Australian banking industry over the past three years, including by the Royal Commission. We expect the implementation of the Royal Commission recommendations and the heightened social and media attention on governance issues should strengthen the risk culture of Australian financial institutions, including ANZ. Stronger risk management should help offset any pressure on ANZ's credit profile because of lower earnings due to more rigorous governance and regulation and subdued credit growth.

In our view, a strong regulatory framework supports ANZ's risk-management practices, such as the regulator's push to ensure that prudent underwriting standards are applied. The bank will remain focused on well-understood products and sectors, in our opinion. ANZ's overall risk position is comparable with that of its major bank peers. The smaller banks show one or more of the following characteristics: material concentration by industry, geography, or sector; key-person dependency; aggressive growth appetite; and focus on risky business segments or customer groups. At the same time, we consider that business and operations of ANZ and other major Australian banks are more complex but their risk-management framework is better resourced. We believe that ANZ is not exposed to any material risks that are unique to the bank in Australia, or are not adequately captured within our assessment of the bank's capital and earnings.

Table 5

Australia and New Zealand Banking Group Ltd. Risk Position

		--Year-ended Sept. 30--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Growth in customer loans	13.7	1.7	4.2	0.7	2.4
Total managed assets/adjusted common equity (x)	22.5	20.7	20.4	21.7	23.0
New loan loss provisions/average customer loans	0.5	0.1	0.1	0.2	0.4
Net charge-offs/average customer loans	0.1	0.1	0.2	0.3	0.3
Gross nonperforming assets/customer loans + other real estate owned	0.9	0.9	0.8	0.9	1.0
Loan loss reserves/gross nonperforming assets	75.1	60.8	68.7	71.2	71.2

*Data as of March 31.

Funding and liquidity: Monetary support from the central bank has allayed funding and liquidity risks due to dislocation of financial markets.

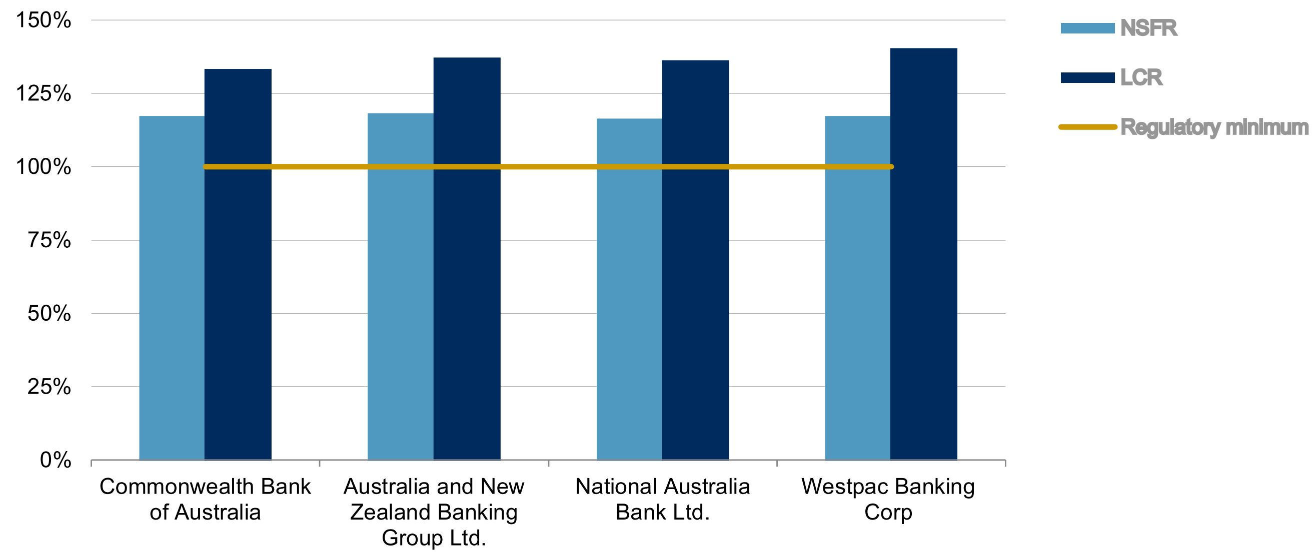
We believe the substantial monetary support package from the RBA has allayed funding and liquidity risks for ANZ from financial market dislocation following the COVID-19 outbreak. We expect ANZ to be able to adequately manage these challenges. The RBA Term Funding Facility of about A$12 billion will provide the group with flexibility to manage refinancing risk and matched the term funding maturities for the remainder of fiscal 2020, further a substantial portion of the group's 2020 wholesale funding requirement was raised early on and should alleviate immediate funding pressures.

In our opinion, ANZ adequately manages its funding and liquidity risks, notwithstanding the structural funding weaknesses that are inherent in the Australian banking system. Along with the other Australian major banks, ANZ's share of funding received from core customer deposits has improved and the tenor of its wholesale funding has lengthened. ANZ's wholesale funding is diversified by investors, geography, and maturities, which should help the bank to maintain access to funding if there is a disruption to one of these sources.

ANZs funding metrics are broadly in line with those of the other Australian major banks. We note that ANZ's funding ratios are weaker than those of smaller Australian banks and a number of international peers with similar issuer credit ratings, reflecting systemwide structural weaknesses in Australia. Nevertheless, we believe that the Australian major banks adequately manage their funding risks in the context of the nation's banking industry, and their funding ratios are broadly comparable with banks in Sweden and Norway--countries with banking industry profiles similar to Australia.

Chart 5

Australian Majors Have Adequate Buffer In Regulatory Funding Metrics



NSFR--Net stable funding ratio. LCR--Liquidity coverage ratio (three-month average).
Source: Regulatory disclosures as of March 2020.

The Australian major banks' strong funding franchises domestically and internationally support their funding stability, in our view. Indeed, we expect that if the Australian banking sector experiences a systemic funding problem, its impact on the Australian major banks would be partly mitigated by a likely "flight to quality" to these banks. ANZ reported its Basel III net stable funding ratio of 118.4% as of March 31, 2020, compared with the regulatory minimum of 100%, which came into effect on Jan. 1, 2018.

Since the COVID-19 market volatility emerged, ANZ experienced strong deposit inflows and in particular from the group's corporate and institutional customer base as customers utilized their committed facilities and placed the monies back on deposit with ANZ.

ANZ's liquidity is adequate in our opinion and we believe that the bank should be able to survive at least a six-month period of funding disruption. Its liquidity metrics, along with those of the other Australian major banks, compare unfavorably relative to many international peers, partly due to the limited availability of government debt in Australia. This is reflected in a relatively modest ratio of broad liquid assets to short-term wholesale funding of 1.18x as of March 30, 2020, according to our estimates. Qualitatively, however, we factor into our assessment the liquidity available to these banks from the Reserve Bank of Australia's committed liquidity facility (CLF), which is backed by eligible assets. Under a stressed scenario, we expect that the undrawn portion of CLF would operate in the same way as any other high-quality liquid assets. Based on ANZ's Pillar 3 report, we understand that ANZ had access to undrawn CLF of an average of A$35.7 billion during the quarter ended March 31, 2020. In our opinion, access to this facility should boost the estimated on-balance sheet broad liquid assets of A$236.5 billion as of March 30, 2020, if needed.

ANZ regularly conducts stress tests for liquidity risk management, and this should enhance the bank's ability to deal with such risks by identifying likely issues that could emerge in such scenarios. ANZ's liquidity coverage ratio stood at a quarterly average of 139% as of March 31, 2020, well above the regulatory minimum of 100%.

Table 6

Australia and New Zealand Banking Group Ltd. Funding And Liquidity

		--Year-ended Sept. 30--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Core deposits/funding base	64.3	66.4	64.9	65.3	63.4
Customer loans (net)/customer deposits	115.9	120.2	124.8	125.6	128.5
Long-term funding ratio	78.7	81.0	81.6	81.0	79.8
Stable funding ratio	99.5	96.7	94.0	92.4	95.7
Short-term wholesale funding/funding base	22.8	20.6	20.0	20.6	21.9
Broad liquid assets/short-term wholesale funding (x)	1.2	1.1	0.9	0.9	1.0
Net broad liquid assets/short-term customer deposits	6.3	1.9	(2.2)	(4.2)	0.6
Short-term wholesale funding/total wholesale funding	62.3	59.3	55.2	57.2	57.8

*Data as of March 31.

Environmental, Social, And Governance (ESG)

We see ESG factors for ANZ to be broadly in line with those for industry and domestic peers. In our view, ANZ has a comprehensive, well-developed risk management and governance framework across the group's activities. We expect ANZ's strong business franchise and financial strength to help it absorb potential financial penalties and customer remediation costs associated with governance shortfalls that have emerged in the practices and operations of major Australian banks in the past three years. Many Australian banks faced criticisms for issues such as overcharging customers, non-adherence to responsible lending standards, or failure to timely report suspicious transactions to the financial crimes regulator. We believe policymakers have increasingly called for greater penalties for such lapses, at least partly on the basis that these profitable banks must meet community expectations. ANZ, along with other Australian banks, have offered moratoriums on home and business loan repayments to borrowers that face hardship from COVID-19 and its containment measures. We consider these measures could help the bank rebuild trust within the community. Significant costs to remedy past lapses have affected earnings of ANZ and the other major Australian banks. Continued governance failures could make ANZ and its domestic peers less attractive to the equity and debt investors that are more sensitive to the ESG factors, in our view.

We see environmental factors as less relevant (than social and governance factors) to the creditworthiness of ANZ. The mining sector accounts for only about 1% of the total domestic lending by the Australian banking sector. Still, we believe ANZ is indirectly exposed to the environmental factors because it operates in an economy where the commodities sector is significant. Evolution of domestic and global environment standards and legislations, and changing customer preferences leading to a transition toward less carbon intensive forms of energy could weaken the broader economy and consequently the bank's lending portfolio.

Support: Expected timely financial support from the Australian government enhances creditworthiness.

Our issuer credit rating on ANZ is two notches above the bank's SACP, reflecting our view that the bank is highly likely to receive timely financial support from the Australian government, if needed. This reflects our view that:

- ANZ is of high systemic importance to the Australian economy and financial system because it is one of the four pillar banking institutions in Australia that control a total of more than three-quarters of the country's banking assets and customer deposits. ANZ has a material market share in Australia of about 13% of customer deposits, 14% of housing loans, and 15% of loans to nonfinancial corporations. In our view, the bank plays a material role in sourcing offshore funding that supports economic activity in the country, and it is strongly interconnected with the three other major banks in Australia.
- The Australian government remains highly supportive of the private sector banks in the country. We believe that government support is unlikely to diminish in the next two years following APRA's recent announcement that it is proceeding with its plan to strengthen Australian banks' loss absorbing capacity. Our view of the Australian government's supportiveness factors in a well-developed institutional framework that should facilitate a timely and coordinated response as well as a track record of proactive and prompt support for the banking system through measures such as guarantees for funding during the global financial crisis. We believe that the government's existing legislation, policy, and relationships with supranational agencies do not hinder it from assisting the banking system.

Additional rating factors:

We notch our ratings on ANZ and its core banking subsidiaries' hybrid and nondeferrable subordinated debt instruments off ANZ's group SACP of 'a'. This is because we expect that any financial support for any of the major Australian banks, if needed, is unlikely to extend to these instruments. In addition, we believe that Australia's legal and regulatory framework could allow authorities to instigate restructuring of a failing bank to the detriment of nondeferrable subordinated debt. In this context, we note that increasing regulatory capital requirements could result in a one-notch higher group SACP, though it is unlikely to occur in the next two years.

The issue ratings on ANZ's Basel II nondeferrable subordinated debt are 'A-', or one notch below ANZ's group SACP, reflecting subordination to the senior debt in liquidation. The issue ratings on ANZ's Basel III nondeferrable subordinated debt are 'BBB+', or two notches below ANZ's group SACP; the additional notch is because such instruments contain a contingency clause that requires mandatory conversion into common equity or a write-down of principal on the activation of a nonviability trigger.

The issue ratings on ANZ's Basel III-compliant hybrid capital instruments are 'BBB-', or four notches below the group SACP, reflecting one notch for subordination in liquidation, two notches for the risk of partial or untimely payment, and one notch for a contingency clause that requires the mandatory conversion of such instruments into common equity on the activation of a nonviability trigger.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings, Oct. 24, 2013
- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	**3**	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	**bbb+**	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of August 7, 2020)*

Australia and New Zealand Banking Group Ltd.	
Issuer Credit Rating	AA-/Negative/A-1+
Certificate Of Deposit	
Foreign Currency	AA-/A-1+
Commercial Paper	
Foreign Currency	A-1+

Ratings Detail (As Of August 7, 2020)*(cont.)	
Junior Subordinated	BBB-
Senior Unsecured	A-1+
Senior Unsecured	AA-
Subordinated	A-
Subordinated	BBB+
Issuer Credit Ratings History	
07-Apr-2020	AA-/Negative/A-1+
09-Jul-2019	AA-/Stable/A-1+
07-Jul-2016	AA-/Negative/A-1+
Sovereign Rating	
Australia	AAA/Negative/A-1+
Related Entities	
ANZ Bank New Zealand Ltd.	
Issuer Credit Rating	AA-/Negative/A-1+
Certificate Of Deposit	
Local Currency	AA-/A-1+
Preferred Stock	BBB-
Senior Unsecured	A-1+
Senior Unsecured	AA-
ANZ New Zealand (Int'l) Limited (London Branch)	
Senior Unsecured	AA-
Australia and New Zealand Bank (China) Co. Ltd.	
Issuer Credit Rating	A+/Negative/A-1
Australia and New Zealand Banking Group Ltd. (London Branch)	
Junior Subordinated	BBB-
Senior Unsecured	AA-
Australia and New Zealand Banking Group Ltd.(New York Branch)	
Senior Unsecured	AA-
UDC Finance Ltd.	
Issuer Credit Rating	BBB+/Watch Neg/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.