Fitch Ratings

05 MAR 2024

Fitch Affirms Australia and New Zealand Banking Group at 'A+'; Outlook Stable

Fitch Ratings - Sydney - 05 Mar 2024: Fitch Ratings has affirmed Australia and New Zealand Banking Group Limited's (ANZ) Long-Term Issuer Default Rating (IDR) at 'A+'. The Outlook is Stable. Fitch has also affirmed the Short-Term IDR at 'F1', the Viability Rating (VR) at 'a+' and Government Support Rating (GSR) at 'a'.

Key Rating Drivers

Ratings Reflect Standalone Strength: ANZ's IDRs and senior debt ratings are driven by its VR, which is in line with the implied VR. The VR is underpinned by the bank's strong business profile and sound financial profile. The Stable Outlook reflects Fitch's view that ANZ has sufficient headroom in its financial metrics to maintain the current rating.

Economic Growth to Slow: We expect high inflation and interest rates to result in slower economic growth and higher unemployment in Australia and New Zealand, ANZ's two main markets, in 2024. However, the weakening should be manageable. We factor in high household leverage into our operating environment assessment, resulting in a score at the lower end of the 'aa' category. We do not use a blended approach for ANZ's operating environment score despite its higher international exposure than peers, as a large portion of the exposures are to the sovereign and financial institutions.

Strong Market Positions: ANZ is Australia's fourth-largest bank, accounting for around 13% of system assets at end-September 2023. It also operates the largest bank in New Zealand, ANZ Bank New Zealand Limited (A+/Stable/a), which has around 30% of total system assets. The strong market positions drive the 'aa-' business-profile score, which is above the implied 'a' category score.

Improved Non-Financial Risk Management: The positive outlook on the risk-profile factor score of 'a+' reflects the steady improvement in management of non-financial risk over the past few years. We may raise the score if historical non-financial risk issues are substantially dealt with, which may be reflected in the removal of the AUD500 million operational risk charge. We regard ANZ's underwriting and risk controls as sound and consistent with that of domestic peers.

Modest Asset-Quality Weakening: Elevated interest rates and an increase in unemployment as economic growth slows are likely to result in weaker asset quality in 2024. We expect the stage 3 loan/gross loan ratio to remain below 1.5% through this period. The assigned score of 'aa-' is above the implied 'a' category score to reflect the high level of collateral held over the loan book.

Earnings Headwinds: We expect ANZ's earnings to face continued pressure in 2024. The net interest margin is likely to contract as the cash rate stabilises, funding costs rise and competition for loans remains intense. Impairment charges are likely to normalise from very low levels currently, while inflation and high investment expenditure will continue to weigh on expenses.

Sound Capital Buffers: We expect ANZ's common equity Tier 1 (CET1) ratio, at 13.3% in the financial year ended September 2023 (FY23), to remain comfortably above regulatory minimums. The ratio is likely to fall by about 120bp to around 12% if the acquisition of Suncorp-Metway Limited (A/Rating Watch Positive) is completed. We expect further moderation as this level would be above our expected operating range of 11.0%-11.5% over the longer term. In the shorter term, we believe ANZ will continue to carry higher capital levels as there are downside risk to the operating environment and asset quality.

The Australian capital framework retains a level of conservatism relative to the global rules, even under the implementation of final Basel III standards, meaning the CET1 ratio appears modest compared with some international peers. We consider other metrics in addition to the CET1 ratio when assessing ANZ's capitalisation to compensate for this.

Stable Funding Profile: We expect ANZ's loan/customer deposit ratio, our core funding and liquidity metric, to modestly weaken over the next two years due to slowing deposit growth. Notwithstanding this, we believe ANZ's core metric likely to remain slightly stronger than peers' over the next two years. We view ANZ's good liquidity management as supporting the funding and liquidity profile.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

ANZ's Long-Term IDR and VR could be downgraded if the operating environment weakens sharply, resulting in a reassessment of the 'aa-' operating environment score into the 'a' category and probably a reassessment of most other factors. We believe a downgrade is unlikely but could occur if inflation remains high, requiring the cash rate to remain higher for much longer than our forecast, resulting in a much sharper decline in GDP growth and a rapid increase in unemployment.

The ratings may also be downgraded even if the operating environment score remains unchanged if a combination of the following occurs:

- the four-year average of stage 3 loans/gross loans is likely to be sustained around or above 2.0% (FY20-FY23: 0.8%);

- the four-year average of operating profit/risk-weighted asset ratio falls below 1.5% for a sustained period (FY20-FY23: 2.1%);

- ANZ's CET1 ratio falls to around 10.5%, or the equivalent under the Australian Prudential Regulation Authority's (APRA) final Basel III framework, without a credible plan to raise it back above 11.0% (FY23: 13.3%).

Any downgrade of ANZ's Long-Term IDR would be limited to one notch unless the Government Support

Rating (GSR) of 'a' is also downgraded.

A weakening in the authorities' propensity to provide support may result in Fitch lowering ANZ's GSR. However, this appears unlikely.

A change in the ability of the authorities to provide support is likely to be reflected in a downgrade of Australia's sovereign rating (AAA/Stable). However, this may not automatically result in a downgrade of the GSR if we believe the strength of the propensity to provide support offsets the lower ability to provide the support. Any change in the GSR would not directly affect ANZ's Long-Term IDR, which is driven by its VR.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

ANZ's Long-Term IDR, VR and senior debt ratings may be upgraded if a combination of the following occurs:

- the four-year average of the operating profit/risk-weighted asset ratio is likely to improve to above 3% on a sustained basis;

- ANZ commits to maintaining capitalisation at levels consistent with higher-rated peers, possibly reflected in the CET1 ratio above 12.5%, or the equivalent under APRA's final Basel III framework.

The GSR may be upgraded if Australian authorities provide additional, explicit statements of support for domestic systemically important banks, including ANZ, or otherwise provide greater certainty that support would be provided if needed.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Short-Term IDR: The Short-Term IDR of 'F1' is the lower of the two options available at a Long-Term IDR of 'A+', as the funding and liquidity score of 'a' is not high enough to support the higher option; the threshold is a score of at least 'aa-'.

Senior Unsecured Instruments: ANZ's senior unsecured debt ratings are aligned with the IDRs, consistent with the baseline approach outlined in Fitch's Bank Rating Criteria for markets like Australia where there is no developed resolution regime with a realistic prospect of senior debt bail-in and no full depositor preference.

Tier 2 Instruments: ANZ's subordinated Tier 2 debt is rated two notches below its anchor rating - the VR - for loss severity, with non-performance risk adequately captured by the VR. The point of non-viability for these instruments is at the discretion of the regulator. None of the reasons for alternative notching from the anchor rating as described in the criteria are present.

Additional Tier 1 Instruments: ANZ's Additional Tier 1 hybrid capital instruments are rated four notches below the anchor rating - the VR - consistent with the base case in the Bank Rating Criteria. The four notches comprise two notches for loss severity and two notches for non-performance risk to reflect discretionary coupon-skip risks. Conversion of these instruments occurs at the point of non-viability, which is at the regulator's discretion, or if the CET1 ratio falls below 5.125%. None of the reasons for alternative notching are present.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Short-Term IDR

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

A downgrade of the Short-Term IDR is unlikely, as this would require the Long-Term IDR to be downgraded by at least two notches to 'A-' as well as Fitch lowering the funding and liquidity score by at least one notch to 'a-'.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

The Short-Term IDR would be upgraded if the Long-Term IDR is upgraded. It may also be upgraded without an upgrade of the Long-Term IDR if we lift the funding and liquidity score by two notches to 'aa-'. This appears unlikely, as it would require ANZ's loan/customer deposit ratio to fall well below 100%.

Senior Unsecured Instruments

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

The senior unsecured instrument ratings will be downgraded if ANZ's IDRs are downgraded.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

The senior unsecured instrument ratings will be upgraded if ANZ's IDRs are upgraded.

Tier 2 and Additional Tier 1 Instruments

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

The Tier 2 and Additional Tier 1 instrument ratings will be downgraded if ANZ's VR is downgraded. The instrument ratings may also be downgraded if any of the reasons for higher notching outlined in Fitch's Bank Rating Criteria apply, although we view this as unlikely to occur.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

The Tier 2 and Additional Tier 1 instrument ratings will be upgraded if ANZ's VR is upgraded. The instrument ratings may also be upgraded if any of the reasons for lower notching outlined in Fitch's Bank Rating Criteria apply, although we view this as unlikely to occur.

VR ADJUSTMENTS

The business profile score of 'aa-' has been assigned above the 'a' category implied score for the following adjustment reason: market position (positive).

Sources of Information

The principal sources of information used in the analysis are described in the Applicable Criteria.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

ANZ has an ESG Relevance Score of '3' for Exposure to Social Impacts, above the bank sector default score of '2', due to the ongoing scrutiny of the conduct and practices of Australia's largest banks by consumers and authorities. This scrutiny has only a minimal impact on ANZ's business profile and ratings.

The highest level ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3'means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Australia and New Zealand Banking Group Limited	LT IDR	A+	Affirmed		A+
	ST IDR	F1	Affirmed		F1
	Viability	a+	Affirmed		a+
	Government Support	a	Affirmed		a
• junior subordinated	LT	BBB	Affirmed		BBB
• senior unsecured	LT	A+	Affirmed		A+
• subordinated	LT	A-	Affirmed		A-
• senior unsecured	ST	F1	Affirmed		F1

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Bank Rating Criteria (pub.01 Sep 2023) (including rating assumption sensitivity)

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Endorsement Status

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