KPMG

FIPS

Financial Institutions Performance Survey

March 2016 Quarterly Results

Executive summary

Strong results delivered by a well-capitalised New Zealand banking sector leaves the sector in a good position for uncertain times ahead.

The March 2016 quarter has seen profits increase for the banking sector from $1.11 billion in December 2015 to $1.20 billion in March 2016 despite increased volatility seen in the global financial markets during the period. The increase in non-interest income has played a significant role in the increase of profits for the banking sector with an increase of $196.19 million which more than offsets the increases in operating expenses up by $40.29 million and the impaired asset expense increase of $20.35 million. Interest margins continue to be squeezed with all participants but one experiencing a reduction in net interest margins driven mainly by continued competitive pressures for residential mortgage lending and the low interest rate environment. The interest margin for the March quarter was 2.17% compared to 2.21% in December 2015. Funding costs continue to be low despite increased volatility in offshore financial markets with the average cost of funds decreasing from 3.50% in December to 3.21% in the March quarter.

Asset growth continues to gain momentum

Once again, the banking sector managed to set a new record high with total assets increasing by 4.16% from $443,014 million in December 2015 to $461,455 million in March 2016. Lending momentum continues with all survey participants increasing their loan books. Gross loan and advances increased by $6.6 billion during the March quarter. The continued high demand for residential mortgages and the rising Auckland, Christchurch (and now Hamilton and Tauranga) property markets, continue to play a significant part in the increase in lending. The prolonged low dairy prices which continue to put farmers under cash-flow pressure, as farmers are facing a third consecutive season of below break-even prices also contribute to the lending growth. Reserve Bank of New Zealand (RBNZ) data at May 2016 showed total year-on-year growth for agriculture lending of 7.3%, business lending of 6.4% and housing lending of 8.5%. The housing lending growth is the fastest annual growth rate since June 2008.

The banking sector managed to set a new record high for total assets.

Economic outlook

With much of the focus being on China's slower economic growth and the normalisation policy by the US Federal Reserve in the earlier part of the year, the attention of the global stage was most recently shifted to Europe with the referendum concerning the UK's continued membership within the EU. The

unexpected result of the poll which favoured the exiting of the UK from EU membership (or Brexit), though not legally binding, caused immediate wide spread panic amongst investors in the global financial market. This sparked a global sell-off of major indices across the US, Europe and Asia. It is estimated that the sell-off cost global investors more than US$2 trillion in a single day, a feat not seen even during the GFC[1]. Since then, the global market has been slow to recover those losses as investors dip back into the market with much caution.

Australia is New Zealand's biggest market for goods and services. The current political instability and the stalled election results in Australia could weigh heavily on New Zealand's economy[2]. Any negative impact on the Australian economy as a result of the election outcomes will directly affect the New Zealand economy as well. The developments across the Tasman will be something to watch, in particular how smoothly and quickly they can be resolved.

The banking sector continues to be well-capitalised beyond minimum regulatory levels.

In response to the escalating global uncertainty, the banks are beginning to take precautionary steps to help mitigate and reduce their exposure to global financial volatility. One such example is the move by all four of the major banks in New Zealand to completely stop real estate lending activities to foreigners and non-residents where the loan is supported by foreign income, while also significantly reducing the maximum loan to income ratio on foreign income for New Zealand citizens and permanent residents. This recent move aligns the four majors with what is also taking place at the parent level in Australia as well.

Despite global concerns, the banking sector continues to be well-capitalised beyond minimum regulatory levels and even in comparison to other global banks.

In the latest government figures, dairy exports fell to $11.13 billion for the year ended 31 May 2016. This is a 10% decline from the year prior, and it was very much expected given the downward pressures in milk prices during the 2nd half of 2015. Although the latest Global Dairy Trade auction showed prices dropped by 0.4% since the previous auction, the second quarter of 2016 has shown some signs of recovery and by the end of June 2016 quarter the GDT Price Index was nearly 11% higher than it was a the end of the first quarter for 2016 and 3.4% higher than the index 12 months ago[3]. In the last Financial Stability report, the RBNZ has commented that the level of non-performing loans have only 'ticked up modestly', with the banking sector's exposures to dairy debt rising to approximately $40 billion[4] and that the increase is due to the banks providing dairy farmers with working capital.

In other developments, the New Zealand Stock Exchange (NZX) recently launched NZ milk price futures to add to its product offerings in order help dairy farmers better manage price volatility risks. However, it will take some time before these futures gain traction and volume, allowing dairy farmers to benefit from their use. NZX also announced that the market could also expect the launch of NZ milk price option-contracts to follow shortly.

Regulation

Following the release of the first consultation paper on the review of the outsourcing policy for registered banks, the RBNZ issued a second consultation paper with some changes to its initial proposal. These include extending the transitional period to five years, retaining the existing threshold for the outsourcing policy at NZ$10 billion in liabilities (net of related party), and the requirement for banks to have a crisis management plan for the functions they want to outsource instead of an exhaustive list of functions they are prohibited from outsourcing. The RBNZ expects a final version of the outsourcing policy to be released by the end of the year.

In April, the RBNZ announced that New Zealand's financial system would be undergoing an extensive review by the International Monetary Fund (IMF), focusing on key areas such as the resilience of the finance sector to withstand shocks, quality of the RBNZ's regulatory and supervisory framework, and the RBNZ's ability to respond effectively to a financial crisis. This review comes as part of the Financial Sector Assessment Programme undertaken by the IMF to monitor the financial stability of its members. The results of this review are expected to be published by the IMF in early 2017.

In June, the RBNZ issued a consultation paper on the dual registration for small foreign banks that have not been deemed to

1. Global selloff after Brexit
2. New Zealand economic impact
3. Global dairy trade price index
4. Rising dairy debt

be systematically important to New Zealand's financial stability. This consultation proposes to allow such banks to register as both a branch and a subsidiary of their overseas parent. In doing so, this could allow such banks to better manage their capital and liquidity levels on a consolidated basis, while expanding lending operations and reducing costs arising from local capital and regulatory requirements. However, the RBNZ is concerned about the reduction in oversight and regulatory powers related to foreign banks that set up as a branch structure and will monitor whether the overseas parent is based in a jurisdiction that has comparable oversight, governance, and accounting and transparency standards with those of the RBNZ.

In its May 2016 *Financial Stability Report*, the RBNZ continued to raise its concerns over the overheated Auckland housing market and the serious threat this poses to financial stability. The much needed relief provided by the new loan-to-value ratio (LVR) restrictions was short-lived, with the RBNZ commenting that they are beginning to see housing price pressures re-emerge once again, and the government has not ruled out imposing new debt-to-income restrictions.

In July the RBNZ released a paper showing that it was serious about the house price issue indicating it will be moving property investors LVR ratios to 40% and clarifying the other LVR ratio applications. This was followed shortly after by a number of parties ranging from bankers, politicians, ex-RBNZ economists and journalists all commentating the seriousness of the current situation. The most noted that being the well-reasoned and balanced commentary from the CEO of the ANZ Bank David Hisco.

TABLE 1: Movement in Interest Margin	31 Mar 16 Quarter Ended (%)	Movement During the Quarter (bps)	Movement for the 6 Months (bps)	Movement for the 12 Months (bps)
ANZ Banking Group	2.18%	-4	-5	-5
Bank of New Zealand	2.21%	0	-9	-13
Commonwealth Bank of Australia	2.09%	-3	-4	-4
Heartland Bank[6]	4.58%	-60	19	13
Kiwibank Limited	1.98%	-9	-15	-14
Southland Building Society	2.61%	-2	-6	-32
The Co-operative Bank	2.61%	-10	-16	-19
TSB Bank Limited	2.03%	-5	-11	-12
Westpac Banking Corporation	2.11%	-6	-17	-15
Average	**2.17%**	**-4**	**-8**	**-9**

TABLE 2: Movement in Impaired Asset Expense/ Average Gross Loans	31 Mar 16 Quarter Ended (%)	Movement During the Quarter (bps)	Movement for the 6 Months (bps)	Movement for the 12 Months (bps)
ANZ Banking Group	0.08%	-1	2	1
Bank of New Zealand	0.23%	1	-15	-3
Commonwealth Bank of Australia	0.17%	3	8	3
Heartland Bank[6]	0.41%	7	-9	3
Kiwibank Limited	0.10%	3	2	2
Southland Building Society	0.67%	34	5	-12
The Co-operative Bank	0.05%	-3	1	0
TSB Bank Limited	0.31%	23	178	27
Westpac Banking Corporation	0.06%	7	5	-1
Average	**0.13%**	**2**	**2**	**0**

What else is happening?

On 30 June, Moody's retained New Zealand's Aaa credit rating, citing a strong economy, low government debt, a strong banking sector and a strong fiscal framework and political consensus on targeting balanced budgets together with low debt.[5]

Last month the Co-operative Bank announced an offer of up to $30 million of unsecured, subordinated, Tier 2 regulatory capital debt securities to New Zealand investors with a rating of BB given by Fitch. The securities have a proposed term of 10 years and offer a 6% return for investors.

5. Moody retains New Zealand's rating

6. See footnote 10 on page 15.

Quarterly analysis

An increase in profits for the New Zealand banking sector despite increased volatility in global financial markets

The banking sector continues to deliver strong results with net profit after tax (NPAT) up by 7.96% from December 2015 to reach $1.20 billion in March 2016, albeit this is still down on record highs shown during the September quarter of $1.27 billion.

1 SEE FIGURE 1 – PAGE 5

ANZ and BNZ were the front runners of this quarter, with increases in net profits of $69 million and $67 million, respectively, with ANZ reporting a NPAT of $416 million and BNZ reporting a NPAT of $259 million for this quarter. These two banks reported a combined $242 million increase in non-interest income, which was the key driver behind overall profitability for the banking sector for this quarter. Overall, non-interest income increased by $196.19 million; this has significantly reversed the previous quarter reduction in non-interest income of $249.36 million.

12 SEE FIGURE 12 – PAGE 16

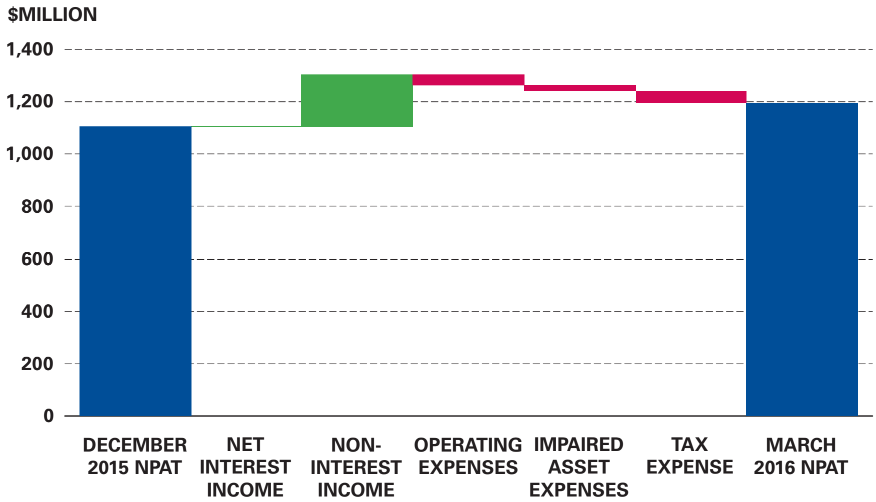
Leading the way, ANZ reported a $177 million increase in non-interest income, which has almost undone the $178 million decline reported in the previous quarter. This was mainly attributable to an $88 million favourable fair value movement in hedging derivatives and a $55 million increase in net fund management and insurance fee income. BNZ showed a similar trend, reporting a $65 million increase in non-interest income attributable to fair value revaluations of financial instruments. Meanwhile, for CBA, the $37 million reduction in non-interest income was comprised of a $21 million downward movement in fair values of financial instruments and a $16 million reduction in other operating income.

15 SEE FIGURE 15 – PAGE 17

TABLE 3: Analysis of Gross Loans	Quarterly Analysis			Annual Analysis		
	31 Mar 16 Quarter Ended $Million	31 Dec 15 Quarter Ended $Million	% Increase	31 Mar 16 Quarter Ended $Million	31 Mar 15 Quarter Ended $Million	% Increase
ANZ Banking Group	118,289	116,573	1.47%	118,289	109,906	7.63%
Bank of New Zealand	71,608	70,039	2.24%	71,608	66,601	7.52%
Commonwealth Bank of Australia	74,004	72,644	1.87%	74,004	67,881	9.02%
Heartland Bank[6]	3,040	2,951	3.02%	3,040	2,792	8.89%
Kiwibank Limited	16,489	16,402	0.53%	16,489	15,420	6.93%
Southland Building Society	2,888	2,813	2.67%	2,888	2,410	19.82%
The Co-operative Bank	1,804	1,757	2.65%	1,804	1,566	15.18%
TSB Bank Limited	3,849	3,745	2.80%	3,849	3,290	16.99%
Westpac Banking Corporation	72,537	70,959	2.22%	72,537	67,569	7.35%
Total	**364,508**	**357,883**	**1.85%**	**364,508**	**337,435**	**8.02%**

6. See footnote 10 on page 15.

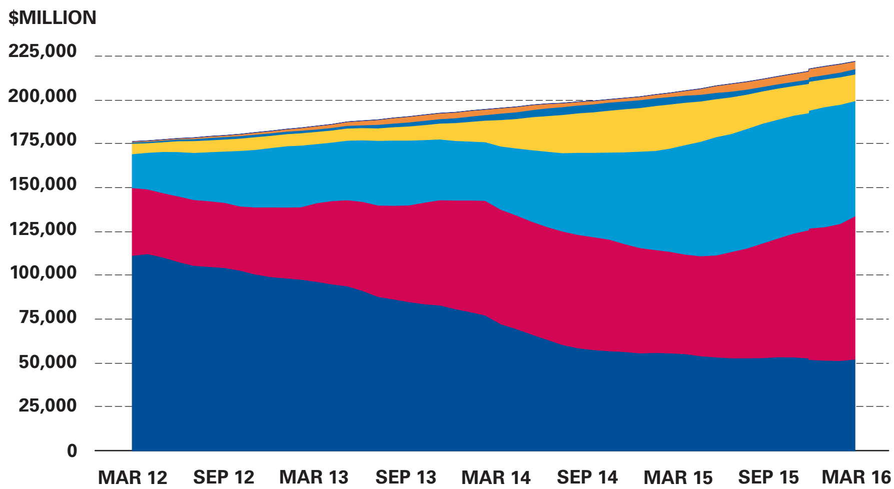
1 MOVEMENT IN NET PROFIT AFTER TAX



2 RESIDENTIAL MORTGAGE LOANS MATURITY PROFILE

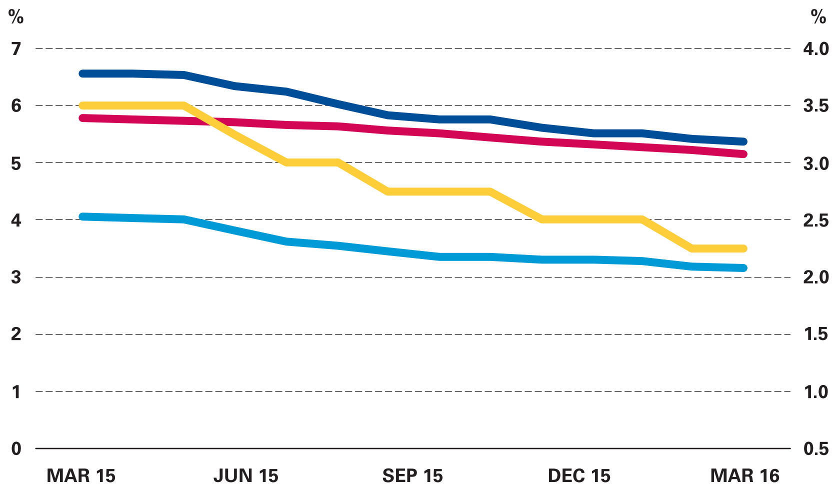
- FLOATING
- < 1 YEAR
- 1>2 YEARS
- 2>3 YEARS
- 3>4 YEARS
- 4>5 YEARS
- 5 YEARS +

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS



3 RETAIL INTEREST RATES ON LENDING AND DEPOSITS

- EFFECTIVE FLOATING MORTGAGE RATE (LHS)
- EFFECTIVE FIXED MORTGAGE RATE (LHS)
- SIX-MONTH TERM DEPOSIT RATE (LHS)
- OCR RATE (RHS)



Westpac's NPAT was down by 4.78%, having reduced by $12 million this quarter to $239 million. The main drivers were a softer net interest margin, down by 6 basis points (bps) to 2.11%, which resulted in a $6 million reduction in net interest income, combined with an $11 million increase in impaired asset expense.

13 SEE FIGURE 13 – PAGE 16

Kiwibank reported a $9 million or 23.68% reduction in NPAT, which was mostly due to a softer net interest margin, down by 9 bps to 1.98% resulting in $3 million less net interest income, combined with a $3 million decrease in non-interest income. For TSB, the $2.65 million or 20.77% reduction in NPAT was largely due to a $2.26 million increase in impaired asset expense.

Fair value movements on financial instruments continue to contribute to profit or loss volatility for the banks, as ongoing global uncertainties, currency volatility and sizeable shifts in swap curves continued to feature over the course of this quarter and to present times.

A summary of financial performance of the survey participants is as follows:

- net interest income improved slightly by 0.04% or $0.90 million;
- non-interest income increased by 34.77% or $196.19 million;
- operating expenses increased by 3.37% or $40.29 million;
- impaired asset expense increased by 20.63% or $20.35 million; and
- tax expense increased by 11.78% or $48.33 million.

Margins continue to be under pressure

The overall net interest margin eased by 4 bps from 2.21% in December down to 2.17% in March (see Table 1 – page 3). The 1.85% growth in gross loans, although amounting to $6.63 billion, did not translate into a much higher net interest income which at $2.25 billion showed only a marginal $0.9 million increase on the previous quarter. The net interest margin has continued to decline every quarter for the past four consecutive quarters, down by a total of 14 bps from 2.31% in June 2015 to 2.17% in March 2016, attributable to the continued competitive pressures felt by the survey participants and the prevailing low interest rate environment with customers continuing to prefer lower margin fixed rate loans.

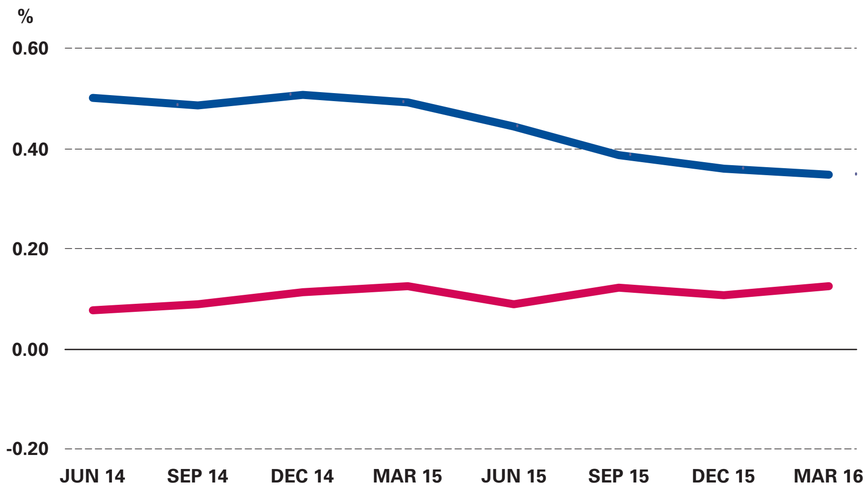
Effective floating and fixed mortgage rates fell at a greater pace than the fall experienced in average interest margins, down by 24 bps and 23 bps respectively since December, meaning that the banking sector enjoyed some relief on the funding side that caused the overall margin fell less than it otherwise would have.

3 SEE FIGURE 3 – PAGE 5

Of the major banks, Kiwibank reported the largest decline in the net interest margin of 9 bps down to 1.98%, followed by Westpac with a decline of 6 bps, down to 2.11%, ANZ with a decline of 4 bps during this quarter to 2.18%, and CBA with 3 bps down to 2.09%. Decreases in net interest margins were reported across all survey participants except BNZ, which managed to maintain its margin at 2.21%. As the NZD swap curve shifted downwards over the course of the March quarter, both the overall interest income relative to average interest earning assets fell by 30 bps from 5.26% to 4.97%, and the overall interest expense relative to interest bearing liabilities fell by 29 bps to 3.21%.

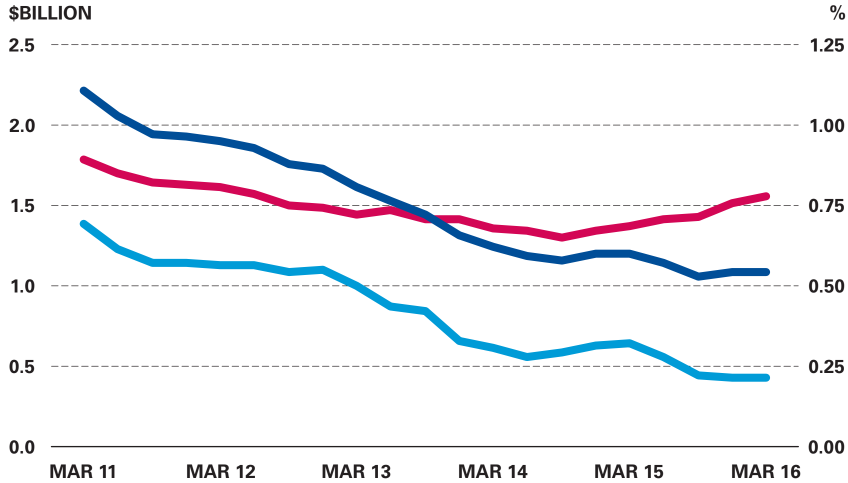
Since the end of March, through to early July, the NZD swap curve has become flatter at the three year and longer durations, possibly indicating that interest rates are now expected to stay lower for longer. However, global uncertainties continue to dominate financial markets, with the recent Brexit vote exasperating the situation overseas, leading to declines in commodity and equity markets as investors flee to safer assets such as US Treasuries and Sovereign debt, in turn adversely impacting global liquidity and credit spreads. The current outlook is an extended period of uncertainty for the global financial markets, while the UK Government has yet to invoke the legal process of leaving the EU.

4 MAJOR BANKS: GROSS IMPAIRED VS IMPAIRED ASSET EXPENSE



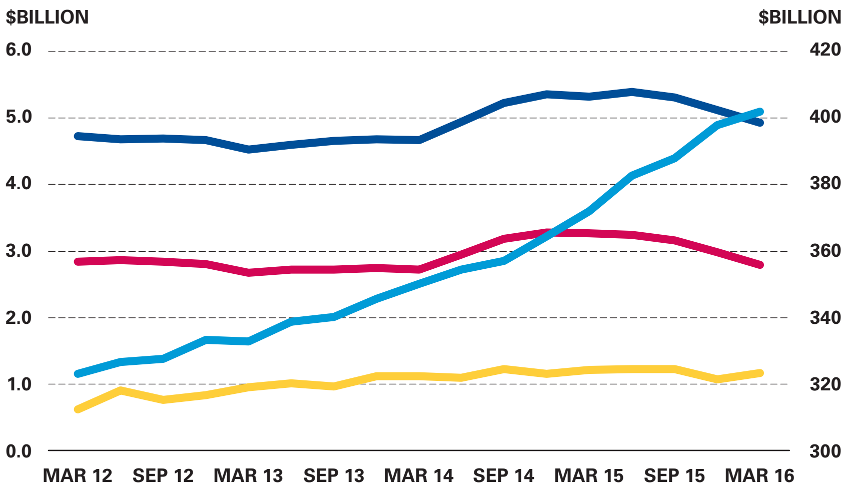
GROSS IMPAIRED LOANS/GROSS LOANS AND ADVANCES
IMPAIRED ASSET EXPENSE/AVERAGE GROSS LOANS AND ADVANCES

5 MOVEMENT IN PROVISIONING



TOTAL PROVISION FOR DOUBTFUL DEBTS/ GROSS LOANS AND ADVANCES (RHS)
COLLECTIVE PROVISION (LHS)
INDIVIDUAL PROVISION (LHS)

6 MAJOR BANKS: INTEREST EARNING ASSETS COMPARED TO INTEREST INCOME AND EXPENSE



INTEREST INCOME (LHS)
INTEREST EXPENSE (LHS)
INTEREST EARNING ASSETS (RHS)
NET PROFIT (LHS)

Favourable funding conditions continue despite volatility in financial markets

Participants continue to report reduced funding costs across the board, for the second consecutive quarter, with overall interest costs relative to average interest bearing liabilities down by 29 bps from 3.50% to 3.21% in March driven mainly by lower deposit rates. The four major banks reported reductions ranging between 30 bps by BNZ to 26 bps by ANZ, closely followed by Kiwibank with 23 bps. TSB reported the smallest reduction of 4 bps to 3.38%, followed by Co-operative Bank's reduction of 6 bps to 3.87%.

7 SEE FIGURE 7 – PAGE 9

Heartland continues to report the highest funding costs, with interest costs at 3.95%[6] relative to average interest bearing liabilities. However, this was compensated with relatively higher interest income compared to the other survey participants to produce a net interest margin of 4.58%[6] for the March quarter. Remaining participants reported margins from 1.98% by Kiwibank to 2.61% by both Southland Building Society and Co-operative Bank.

Costs of funding derived from short-term local deposits continued to decrease this quarter, with RBNZ data released for April showing a further 14 bps drop in six-month deposit rates, down to 3.17%.

The Core Funding Ratio for the banking sector strengthened from 86.1% in March to 86.6% in April, and remains well above the regulatory minimum of 75%, still leaving plenty of room to seek alternative sources of funding.

In the latest Official Cash Rate (OCR) move on 9 June, the RBNZ has left the OCR unchanged at 2.25%, in their press release stating that inflation was expected to strengthen reflecting the accommodative stance of monetary policy, expected increases in fuel

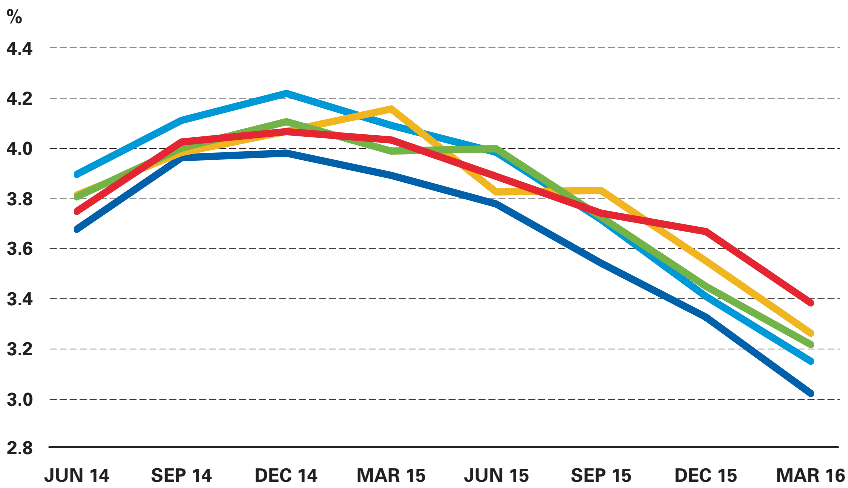
TABLE 4: Movement in Over 80% LVR Lending (On and Off Balance Sheet)

	Quarterly Analysis				Six Month Analysis			
Quarterly Analysis	**31 Mar 16 $Million**	**31 Dec 15 $Million**	**Movement During the Quarter $Million**	**% Change**	**31 Mar 16 $Million**	**30 Sep 15 $Million**	**Movement During the Six Month Period $Million**	**% Change**
ANZ Banking Group	8,166	8,286	-120	-1.45	8,166	8,650	-484	-5.60
Bank of New Zealand	3,251	3,201	50	1.56	3,251	3,304	-53	-1.60
Commonwealth Bank of Australia	7,505	7,688	-183	-2.38	7,505	8,013	-508	-6.34
Heartland Bank[6]	23	22	0	2.20	23	17	6	33.44
Kiwibank Limited	1,862	1,943	-81	-4.17	1,862	1,858	4	0.22
Southland Building Society	316	325	-10	-2.96	316	392	-77	-19.54
The Co-operative Bank	196	186	10	5.38	196	184	12	6.60
TSB Bank Limited	383	388	-5	-1.30	383	381	2	0.61
Westpac Banking Corporation	7,664	7,722	-58	-0.75	7,664	7,855	-191	-2.43
Total	**29,366**	**29,762**	**-396**	**-1.33**	**29,366**	**30,655**	**-1,289**	**-4.20**

6. See footnote 10 on page 15.

7 MAJOR BANKS: AVERAGE COST OF FUNDING

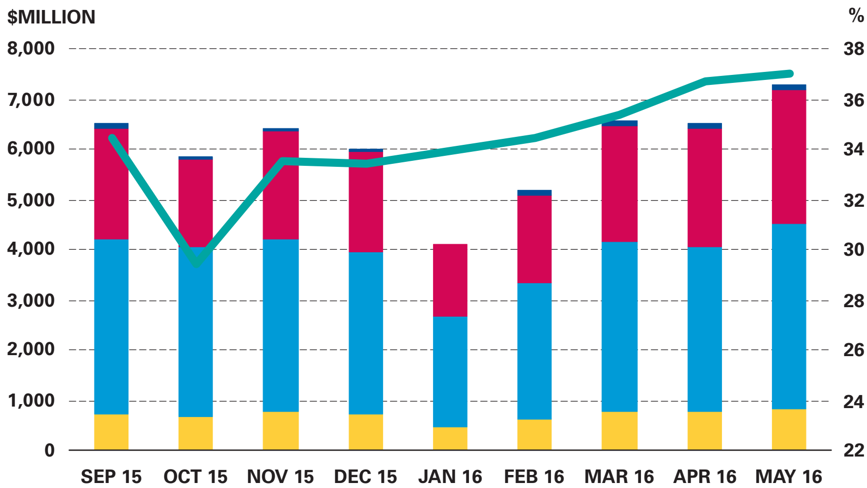
- ANZ
- BNZ
- CBA + ASB
- KIWIBANK
- WESTPAC



8 NEW MORTGAGE LENDING BY BORROWER TYPE

- BUSINESS PURPOSES
- INVESTOR
- OTHER OWNER OCCUPIER
- FIRST HOME BUYER
- INVESTOR LENDING (%)

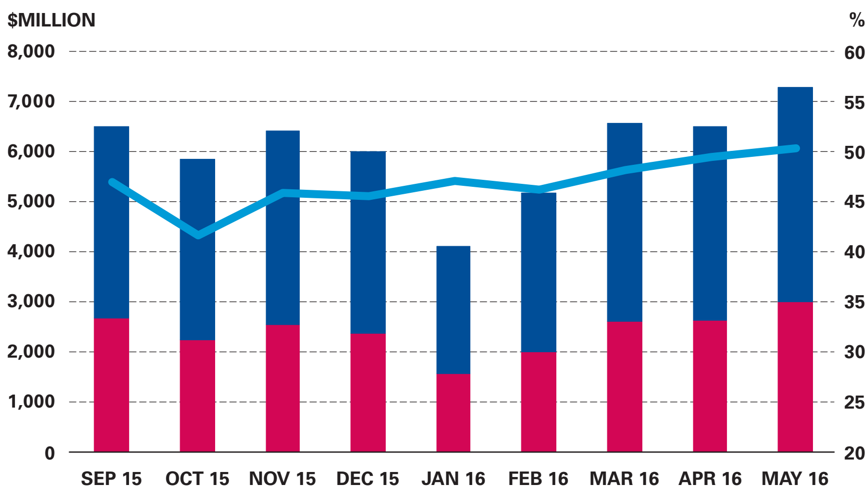
SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS



9 NEW LENDING BY PAYMENT TYPE

- PRINCIPAL AND INTEREST
- INTEREST ONLY (INCLUDING REVOLVING CREDIT)
- PROPORTION OF NEW LENDING INTEREST ONLY – INVESTOR

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS



and other commodity prices, an expected depreciation in the NZD and some increase in capacity pressures. In addition, the RBNZ would have been worried about the effect that a reduction of interest rates would have had in an already overheated Auckland property market. However, the RBNZ also said that monetary policy will continue to be accommodative and further policy easing may be required to ensure that future average inflation settles near the middle of the target range.

3 SEE FIGURE 3 – PAGE 5

Global events have had a direct impact on OCR forecasts here in New Zealand, with the major banks commenting on downward pressures to the OCR ahead of the next announcement due in August, but the position remains far from clear. As global economic developments continue to unfold, this will be the space to watch ahead of the next OCR announcement in August.

With lower swap rates, credit margins still form a substantial component of funding costs and continue to pose concerns for banks. Recent bond issuances include $700 million five-year bonds with a 3.795% coupon issued by Westpac in April, $200 million three-year floating rate bonds with a 1.15% margin issued by Kiwibank in May, and $250 million seven-year bonds with a 4.102% coupon issued by BNZ in June.

Lending growth continue to increase at a fast pace

Lending growth continues to gain momentum, with the four major banks accounting for 93.93% of the $6.63 billion total growth in lending. Of the major banks, BNZ achieved the greatest percentage growth at 2.24% or $1.57 billion, closely followed by Westpac with 2.22% or $1.58 billion. BNZ noted that the success behind the strong volume growth in housing lending was driven by a number of strategies put in place to gain market share through a range of channels, including re-entering the broker market and expanding the mobile mortgage workforce. ANZ achieved the smallest percentage increase among the big four banks at 1.47%, however, this still translated to the largest dollar increase at $1.72 billion due to the relative size of its existing loan book. ANZ has also noted that investing in new digital capabilities making banking easier for their customers had a big part in the growth of housing and small business lending.

14 SEE FIGURE 14 – PAGE 16

Heartland achieved the highest percentage growth rate of the survey participants at 3.02% or $88.98 million, in its first quarter operating as the newly formed amalgamated entity post 31 December 2015. Whilst the smallest incremental percentage increase was reported by Kiwibank at 0.53% or $87 million (see Table 3 – page 4).

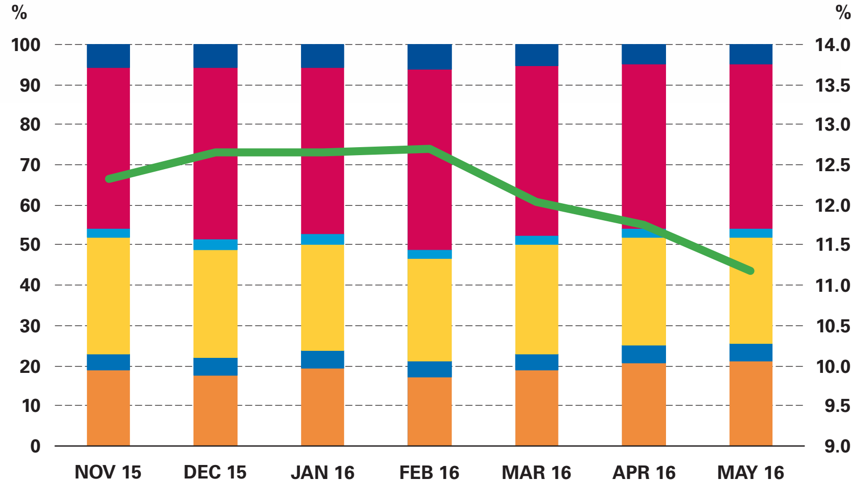
RBNZ data released in May shows some recovery in business lending growth rates. These were reported at 6.4% in May after showing some signs of slowing down when they dipped from 7.6% in January down to 5.5% by March. Growth rates in agriculture lending continued on a downward trend, easing from a peak 9.3% in September to 7.3% in May, with the proportion of lending to the agricultural sector slowly shrinking from 8.49% in December to 8.41% in May, pointing to the banks' continued caution around their exposure to this sector. It appears lessons have been learnt from the last dairy downturn in 2009 as banks continue to be proactive managing their dairy exposures and continue to work with their customers in these tough times for dairy prices. Agriculture lending reached $59.99 billion, while business lending reached $91.92 billion in May.

Mortgage lending continues to dominate the banks' loan books, reaching a new high of $227.7 billion, up by 3.91% or $8.4 billion since December. The housing market continues to be buoyant, with the latest REINZ statistics showing the median national sale price jumping to $506,000 in May, an all-time high, while sales volumes rose 14% to 9,075. With the median prices for five regions hitting all-time highs, the Auckland market is no longer the sole driver behind house price growth, with Auckland's median price rising slower than the national median price, having increased by 7.5% to $805,000 in May, and Auckland's share of sales based on numbers over the past two years falling from 40% to 34%. The latest

10 COMPOSITION OF LENDING BY LVR SPEED LIMITS

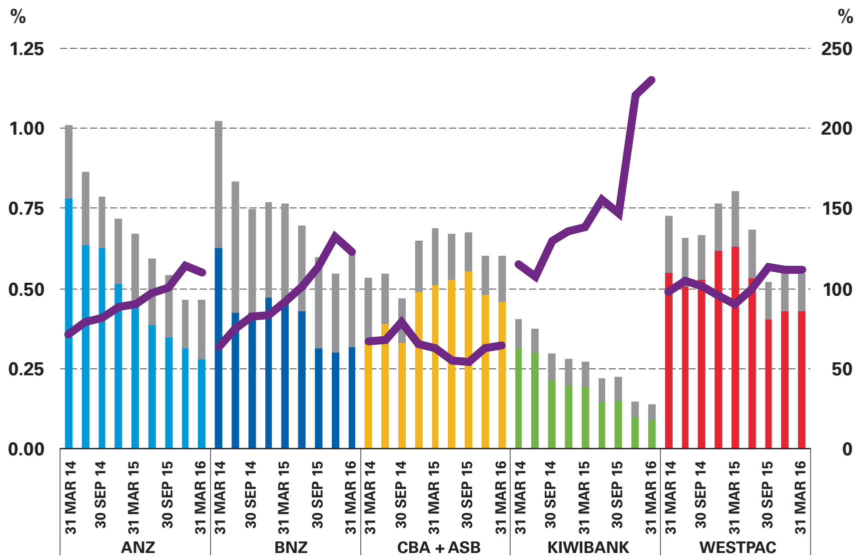
- NON-AUCKLAND LVR > 80% ($MILLIONS)
- NON-AUCKLAND LVR < 80% ($MILLIONS)
- AUCKLAND OWNER-OCCUPIER LVR > 80% ($MILLIONS)
- AUCKLAND OWNER-OCCUPIER LVR < 80% ($MILLIONS)
- AUCKLAND INVESTOR LVR > 70% ($MILLIONS)
- AUCKLAND INVESTOR LVR < 70% ($MILLIONS)
- TOTAL LENDING OUTSIDE LVR SPEED LIMITS/TOTAL LENDING

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS



11 MAJOR BANKS: PAST DUE AND GROSS IMPAIRED ASSETS VS GROSS LOANS AND ADVANCES

- GROSS IMPAIRED/GROSS LOANS AND ADVANCES (LHS)
- PAST DUE/GROSS LOANS AND ADVANCES (LHS)
- TOTAL PROVISIONS/PAST DUE AND GROSS IMPAIRED ASSETS (RHS)



Quotable Value (QV) report also shows nationwide residential property values increasing by 13.5% over the past year reaching an average value of $590,909 with values being 42.6% above the previous market peak of late 2007. These increases are mainly driven by strong investor demand, low interest rates, continued buoyant market conditions in Auckland and strong net migration. The Auckland average value was $974,087 according to QV. QV also reports a surge in investor activity in recent times due to the RBNZ signalling that they may introduce further restrictions to property investors later this year.

RBNZ data on new mortgage lending as at May 2016 showed that it had reached $7.3 billion, an increase of $1.3 billion in lending since December 2015. The movement is mainly driven by investor lending which increased by $692 million or 34.50%, followed by owner occupiers, which includes first home buyers with $562 million or a 14.26% increase, and an increase of $32 million for business purposes. Further assessment of the increase in new mortgage lending by payment type shows an increase of 18.37% in principal and interest and 26.09% in interest-only loans. The share taken up by the investors increased to 50.36% of all interest-only loans in May, up from the previous peak of 45.57% in December.

8 SEE FIGURE 8 – PAGE 9

9 SEE FIGURE 9 – PAGE 9

The Auckland property market is no longer the sole driver behind lending growth, the $7.3 billion mortgage lending is made up of $3.95 billion Auckland lending and $3.34 non-Auckland lending, which increased by 67% and 33% since December, respectively.

By the end of May, borrowers' preference has markedly shifted towards one-year fixed mortgages, reaching 39.75% of mortgages written (up from 34.41% in December). Meanwhile, the proportion of two-year fixed mortgages and floating mortgages shrunk by 335 bps down to 27.47%, and by 70 bps down to 23.17%, respectively.

5 SEE FIGURE 5 – PAGE 7

Looking further into the detail, the impaired asset expense relative to average gross loans and advances increased marginally by 2 bps to 0.13% in March (see Table 2 – page 3). Collective provisioning rose slightly by 1 bp to 0.43% relative to gross loans and advances, while individual provisioning improved by 54 bps to 33.26% of gross impaired assets.

17 SEE FIGURE 17 – PAGE 17

The banking sector has reported a marginal improvement in gross impaired assets, down from 0.36% to 0.35% relative to gross loans and advances, mostly driven by solid lending growth this quarter. However, the overall levels of past due assets relative to gross loans and advances have increased, with this ratio up by 8 bps to 0.18%. ANZ, BNZ and CBA reported the largest increases in past due assets of $43 million, $40 million and $17 million, respectively, pushing up their ratios of past due assets to gross loans and advances by 3 bps, 5 bps, and 2 bps, respectively. Among the major banks, BNZ reported the highest percentage of past due assets relative to the size of its loan book at 0.29%, compared to the next highest at 0.19% reported by ANZ.

4 SEE FIGURE 4 – PAGE 7

11 SEE FIGURE 11 – PAGE 11

The outlook for the dairy sector continues to be of a concern for all banks with some banks reporting increases in collective provisioning to reflect the increased risk of deterioration of certain dairy loans. BNZ reported that its collective provision increased by $38 million as at 31 March 2016 compared to the previous year, mainly driven by an increase in the provisioning for dairy loans due to prolonged lower dairy prices and also due to the fact that the bank is an earlier adopter of IFRS 9 Financial Instruments meaning that they are recognising the provisions sooner than they would under the old standard.

According to the latest Financial Stability Report published by the RBNZ in May, the "total non-performing loans (NPLs) for the banking sector have continued to fall from their post-GFC peak of 2.2% in 2011, down to $2.1 billion in March, representing around 0.5% of the total stock of lending. Falling NPLs were driven by declines in most sectors, reflecting the relatively strong domestic economic performance."

The RBNZ reported that the recently implemented LVR speed limits appear to have taken some of the heat out of the Auckland market, with nationwide high-LVR lending declining from 21% in 2013 to 13% by the end of 2015. Based on new statistics published by the RBNZ, it can be observed that between the months of November 2015 and May 2016, the high-LVR lending further reduced from 12.3% to 11.2% (see Table 4 – page 8).

10 SEE FIGURE 10 – PAGE 11

Operating costs ratio

The banking sector has improved its operating costs ratio, reporting a 145 bp reduction, down to 41.07% this quarter. The $197.08 million increase in operating income was largely attributable to the $196.19 million increase in non-interest income, which included $242 million in fair value movements and net trading gains reported by ANZ and BNZ, while net interest income remained broadly the same at $2.25 billion this quarter. On the other side of this ratio, overall operating costs increased by 3.37% or $40.29 million, to reach $1.24 billion mainly due to the continued investment in digital services as customers' preferences continue to evolve. When looking at operating costs relative to the more recurring interest income, there appears to be some deterioration in operating cost efficiencies, as this ratio has increased by 164 bps to 23.97%.

16 SEE FIGURE 16 – PAGE 17

ANZ has improved its operating costs ratio, with the $174 million uplift in operating income more than making up for the $66 million increase in operating costs. ANZ New Zealand said its increase in operating expenses is associated with an accounting change to the application of the ANZ group's software capitalisation policy which means bringing forward the recognition of software expenses resulting in lower amortisation charges in future years. BNZ has achieved the largest reduction in operating costs, down by $14 million or 6.25%. Among the other banks, the more notable operating cost reductions were achieved by Heartland Bank at $4.57 million or 20.25%, and Southland Building Society at $3.44 million or 16.81%.

As a result of the current low interest rate environment, coupled with prevailing competitive pressures in the lending market, continuing customer demand for new digital services and ongoing regulatory developments, operating cost management continues to be one of the key priorities for banks this year.

Major banks - Quarterly analysis

Entity	Size & Strength Measures							
	30 Jun 14	30 Sep 14	31 Dec 14	31 Mar 15	30 Jun 15	30 Sep 15	31 Dec 15	31 Mar 16
	Total Assets[9] ($Million)							
ANZ[7]	132,422	135,074	135,290	140,253	150,664	152,038	152,289	160,801
BNZ	75,845	79,522	79,658	81,926	85,657	86,629	86,819	89,913
CBA + ASB[7]	72,077	73,483	74,149	76,994	80,147	81,321	81,785	86,012
Heartland Bank[10]	2,368	2,431	3,112	3,148	3,308	2,825	3,290	3,334
Kiwibank	16,590	16,882	17,064	17,948	18,228	18,686	18,858	19,227
Southland Building Society	2,786	2,825	2,826	2,858	3,094	3,163	3,286	3,408
The Co-operative Bank Limited	1,664	1,704	1,770	1,795	1,838	1,896	1,971	2,029
TSB Bank Limited	5,655	5,736	5,908	5,908	5,991	6,208	6,299	6,424
Westpac[7]	80,392	80,963	82,442	82,087	87,455	88,203	88,416	90,309
Total	**389,799**	**398,619**	**402,219**	**412,917**	**436,382**	**440,968**	**443,014**	**461,455**
	Increase in Gross Loans and Advances (%)							
ANZ[7]	1.30	1.31	1.53	1.75	3.60	0.86	1.51	1.47
BNZ	1.45	0.93	1.16	1.57	1.01	1.72	2.35	2.24
CBA + ASB[7]	0.96	1.87	1.19	2.75	2.04	2.29	2.53	1.87
Heartland Bank[10]	3.77	3.15	33.06	1.55	3.65	-16.53	22.19	3.02
Kiwibank	1.85	0.66	2.20	2.04	1.50	2.24	2.51	0.53
Southland Building Society	-0.53	-0.10	2.88	2.50	11.34	2.71	2.04	2.67
The Co-operative Bank Limited	2.58	2.74	2.93	2.19	3.24	4.28	4.23	2.65
TSB Bank Limited	0.94	0.20	3.04	1.73	5.27	3.39	4.57	2.80
Westpac[7]	0.95	1.24	1.67	1.51	1.57	1.99	1.38	2.22
Average	**1.22**	**1.30**	**1.68**	**1.88**	**2.34**	**1.51**	**2.09**	**1.85**
	Capital Adequacy (%)							
ANZ[7,8]	12.10	12.70	11.80	12.60	12.50	13.30	13.30	13.70
BNZ	11.82	12.04	12.28	12.90	12.59	12.67	13.26	12.58
CBA + ASB[7]	12.00	11.10	12.70	12.10	12.70	13.30	14.10	13.70
Heartland Bank[10]	14.39	14.09	13.76	13.36	12.86	12.85	14.46	14.01
Kiwibank	13.00	13.20	13.30	12.40	13.40	12.80	12.80	12.90
Southland Building Society	15.64	16.02	16.07	15.61	14.59	14.21	14.27	13.76
The Co-operative Bank Limited	16.80	16.80	16.50	16.50	16.30	16.20	15.80	15.80
TSB Bank Limited	14.77	14.98	13.48	13.85	13.71	15.77	14.86	14.52
Westpac[7,8]	11.70	12.30	11.60	12.10	12.40	13.30	13.90	14.00
	Net Profit ($Million)							
ANZ[7]	390	468	425	452	427	467	347	416
BNZ	205	252	232	270	295	241	192	259
CBA + ASB[7]	191	227	214	218	212	234	243	220
Heartland Bank[10]	10	10	14	13	12	10	15	14
Kiwibank	26	35	36	29	27	33	38	29
Southland Building Society	4	6	5	4	6	4	5	6
The Co-operative Bank Limited	2	2	3	2	2	3	3	2
TSB Bank Limited	16	12	-18	16	13	25	13	10
Westpac[7]	281	242	244	247	266	249	251	239
Total	**1,125**	**1,254**	**1,154**	**1,251**	**1,261**	**1,266**	**1,107**	**1,195**

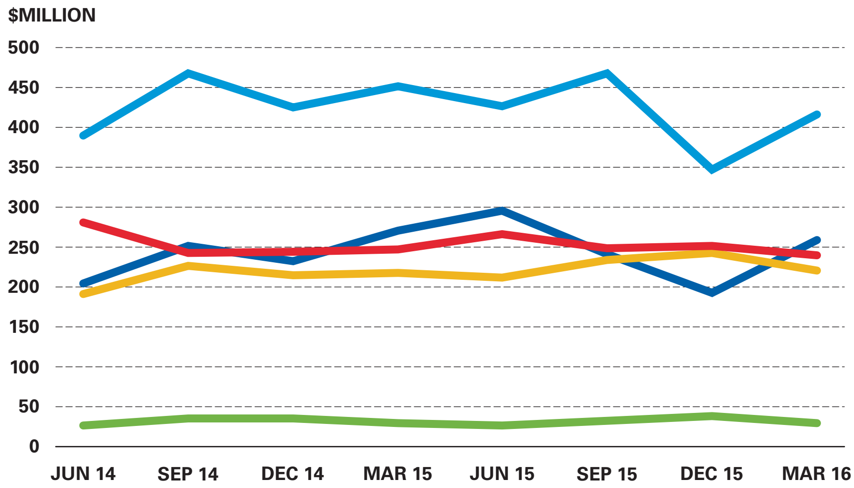
7. The results for Australia and New Zealand Banking Group, Commonwealth Bank of Australia and Westpac Banking Corporation relate to the total New Zealand operations of these entities.
8. The capital adequacy ratio's reported are for the overseas banking group.
9. Total Assets = Total Assets - Intangible Assets.

Entity	Profitability Measures							
	30 Jun 14	30 Sep 14	31 Dec 14	31 Mar 15	30 Jun 15	30 Sep 15	31 Dec 15	31 Mar 16
	Interest Margin (%)							
ANZ[7]	2.27	2.32	2.33	2.23	2.21	2.23	2.22	2.18
BNZ	2.37	2.28	2.28	2.34	2.36	2.30	2.21	2.21
CBA + ASB[7]	2.29	2.40	2.40	2.13	2.35	2.13	2.12	2.09
Heartland Bank[10]	4.94	4.99	5.46	4.45	4.43	4.39	5.18	4.58
Kiwibank	1.96	2.13	2.17	2.12	2.07	2.13	2.07	1.98
Southland Building Society	2.81	2.97	2.97	2.93	2.86	2.67	2.63	2.61
The Co-operative Bank Limited	2.85	2.95	2.90	2.80	2.81	2.77	2.71	2.61
TSB Bank Limited	2.17	2.30	2.15	2.15	2.12	2.14	2.08	2.03
Westpac[7]	2.18	2.23	2.28	2.26	2.32	2.28	2.17	2.11
Average	**2.28**	**2.32**	**2.34**	**2.26**	**2.31**	**2.25**	**2.21**	**2.17**
	Non-interest Income/Total Tangible Assets (%)							
ANZ[7]	0.73	1.00	0.79	0.90	0.76	0.80	0.33	0.77
BNZ	0.53	1.06	0.63	0.94	0.97	0.83	0.42	0.71
CBA + ASB[7]	0.64	0.58	0.63	0.70	0.39	0.66	0.77	0.57
Heartland Bank[10]	0.45	0.33	0.87	0.53	0.64	0.36	0.89	0.45
Kiwibank	0.58	0.72	0.73	0.57	0.57	0.59	0.62	0.55
Southland Building Society	0.77	0.93	0.96	1.03	0.98	0.95	1.03	0.97
The Co-operative Bank Limited	1.17	1.14	1.13	0.24	1.00	0.99	1.02	0.64
TSB Bank Limited	0.33	0.38	0.35	0.40	0.24	0.38	0.20	0.21
Westpac[7]	0.73	0.78	0.73	0.66	0.73	0.69	0.63	0.62
Average	**0.66**	**0.86**	**0.71**	**0.80**	**0.71**	**0.74**	**0.51**	**0.67**
	Impaired Asset Expense/Average Gross Loans and Advances (%)							
ANZ[7]	0.07	0.04	0.05	0.07	0.10	0.06	0.09	0.08
BNZ	0.11	0.12	0.02	0.26	0.10	0.38	0.22	0.23
CBA + ASB[7]	0.16	0.10	0.29	0.14	0.08	0.09	0.14	0.17
Heartland Bank[10]	0.46	0.36	0.54	0.38	0.62	0.50	0.34	0.41
Kiwibank	-0.11	0.08	0.16	0.08	0.03	0.08	0.07	0.10
Southland Building Society	0.51	0.35	0.43	0.79	0.31	0.62	0.33	0.67
The Co-operative Bank Limited	0.07	0.08	0.07	0.05	0.16	0.04	0.08	0.05
TSB Bank Limited	0.11	0.85	6.06	0.04	0.07	-1.47	0.08	0.31
Westpac[7]	0.01	0.13	0.12	0.07	0.08	0.01	-0.01	0.06
Average	**0.08**	**0.10**	**0.17**	**0.13**	**0.09**	**0.11**	**0.11**	**0.13**
	Operating Expenses/Operating Income (%)							
ANZ[7]	39.85	37.81	39.02	36.61	38.03	36.34	43.30	42.41
BNZ	41.67	43.07	39.67	32.91	34.47	35.81	42.26	34.94
CBA + ASB[7]	38.15	37.66	37.04	37.60	41.19	37.73	36.76	37.98
Heartland Bank[10]	47.98	49.15	50.77	48.02	50.35	49.94	49.59	43.96
Kiwibank	70.19	56.78	54.10	62.07	67.52	59.84	59.35	62.39
Southland Building Society	63.33	62.83	66.27	62.82	60.39	67.73	70.22	57.43
The Co-operative Bank Limited	81.97	82.85	77.95	78.63	80.40	77.65	73.38	81.41
TSB Bank Limited	36.91	38.20	37.95	43.59	44.68	42.50	47.83	51.65
Westpac[7]	39.64	37.70	38.97	37.89	38.95	43.11	40.48	40.80
Average	**41.51**	**40.20**	**40.04**	**37.92**	**39.84**	**39.52**	**42.52**	**41.07**

10. Operating income for Heartland includes net interest income, net operating lease income, other income and fee income. Heartland Bank Limited's amalgamation with one of its wholly owned subsidiaries was effective from 31 December 2015. Data and ratios on September 2015 and its prior year comparative that have been used for the purpose of analysis do not reflect the amalgamation as September 2015 restated financials are not publicly available. Ratios calculated in this Survey may differ if September 2015 and its prior year comparative had been used for the purpose of analysis.

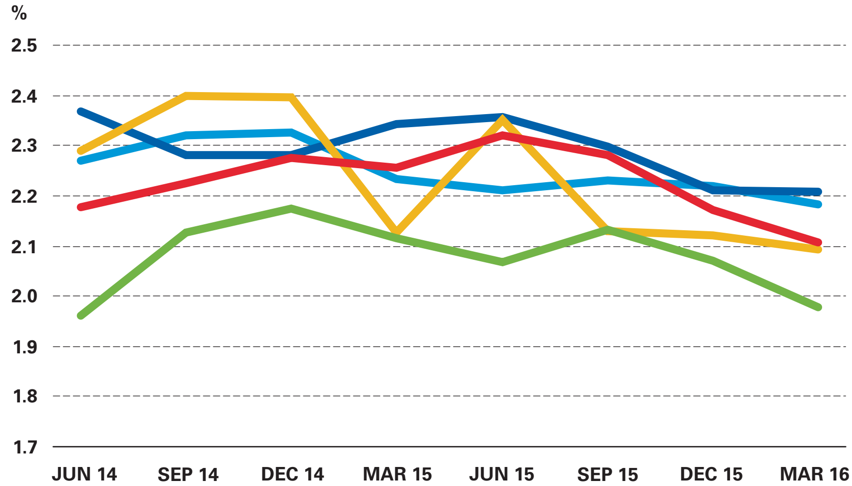
12 MAJOR BANKS: NET PROFIT

- ANZ
- BNZ
- CBA + ASB
- KIWIBANK
- WESTPAC



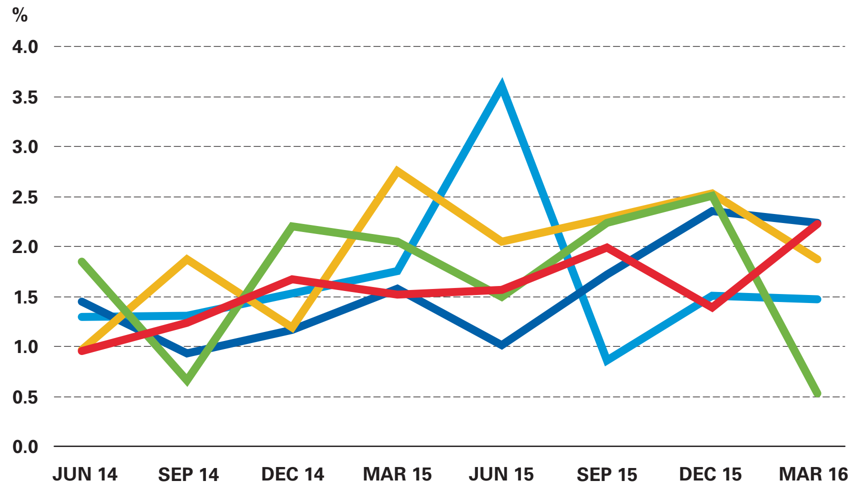
13 MAJOR BANKS: INTEREST MARGIN

- ANZ
- BNZ
- CBA + ASB
- KIWIBANK
- WESTPAC



14 MAJOR BANKS: INCREASE IN GROSS LOANS AND ADVANCES

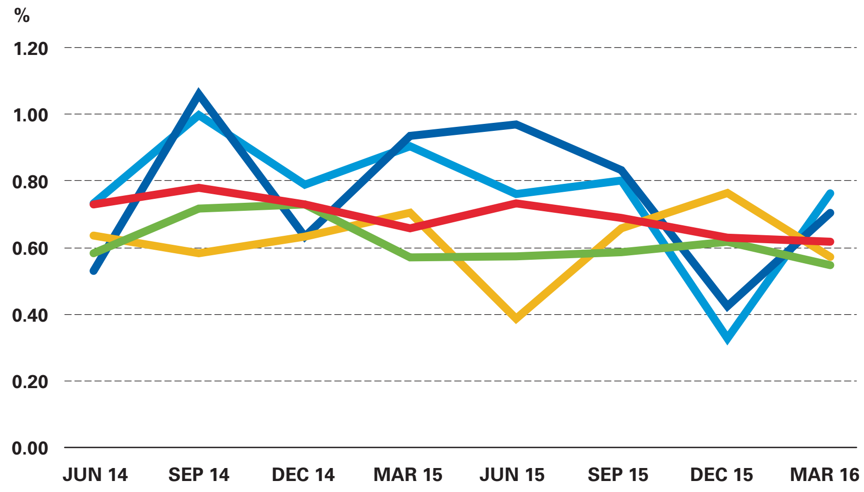
- ANZ
- BNZ
- CBA + ASB
- KIWIBANK
- WESTPAC



15

MAJOR BANKS: NON-INTEREST INCOME/ AVERAGE TOTAL ASSETS

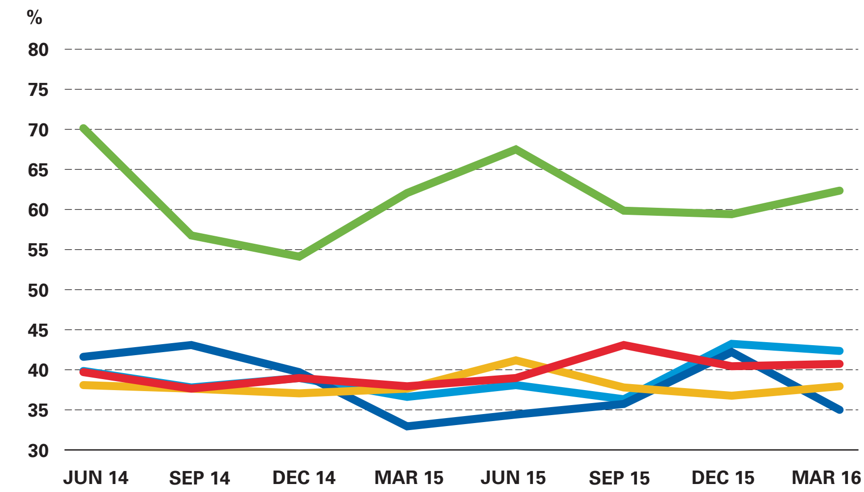
ANZ
BNZ
CBA + ASB
KIWIBANK
WESTPAC



16

MAJOR BANKS: OPERATING EXPENSES/ OPERATING INCOME

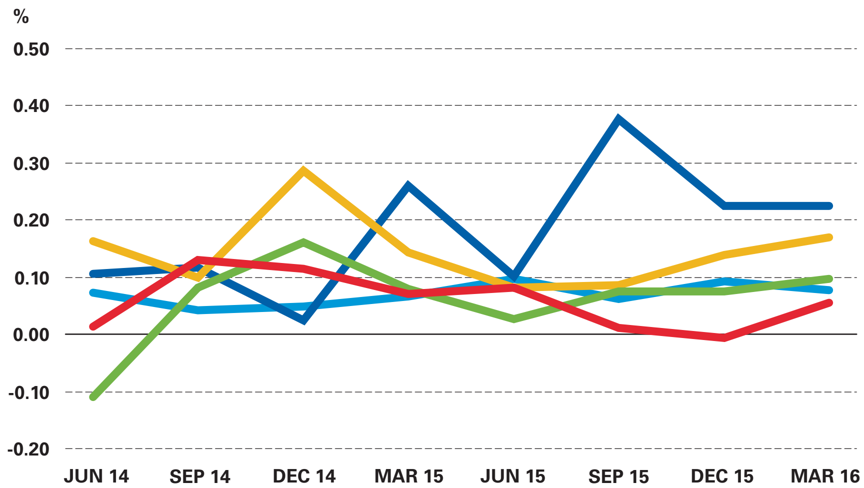
ANZ
BNZ
CBA + ASB
KIWIBANK
WESTPAC



17

MAJOR BANKS: IMPAIRED ASSET EXPENSE/AVERAGE GROSS LOANS AND ADVANCES

ANZ
BNZ
CBA + ASB
KIWIBANK
WESTPAC



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