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Australia's Four Major Banks Should Weather Expected Mild Downturn; Ratings Affirmed With Stable Outlooks

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MELBOURNE (Standard & Poor's) July 1, 2009--Standard & Poor's Ratings Services said today that it had affirmed its 'AA/A-1+' ratings on Australia's four major banks: Australia and New Zealand Banking Group Ltd., Commonwealth Bank of Australia, National Australia Bank Ltd., and Westpac Banking Corp. The outlooks on the long-term ratings of all the four banks remain stable. At the same time, the ratings on the core subsidiaries of these banks were affirmed with stable outlooks.

"The rating affirmation reflects our expectation that the global economic downturn is likely to have a fairly benign impact on the Australian economy, resulting in only a mild and short recession in the country," Standard & Poor's credit analyst Sharad Jain said. "Furthermore, we believe that the Australian banking sector's less fiercely competitive environment relative to some of the global peers has contributed to less risky lending standards, reflected in lower loan-to-value ratios in the residential mortgage sector. Consequently, we believe that earnings pressures and impairments or credit losses for the Australian major banks are likely to remain significantly lower than those experienced by some international peers." We expect that new loan loss provisions are likely to increase in fiscal 2010, but only slightly from the levels recorded in the first half of fiscal 2009, before starting to

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decrease in fiscal 2011. (For further details of our expected credit loss rates, please see "Criteria | Financial Institutions | General: Credit Stress Testing Asia-Pacific Banks", published on June 16, 2009.)

A key factor underpinning the affirmation of the 'AA' ratings is our belief that the more "traditional" retail and commercial banking model adopted by these banks supports their income stability. The contribution of trading income or losses to the Australian major banks' earnings is small, as the major Australian banks undertake very limited proprietary trading and hold insignificant amounts of trading securities, which are subject to volatile mark-to-market movements.

Standard & Poor's acknowledges that the major Australian banks are likely to face significant challenges in the next two years due to the global economic downturn and potentially further financial-market volatility. Despite these challenges, the rating outlooks remain stable because we believe the risk of a rating downgrade is lower than a "one-in-three" chance threshold that would apply to a negative outlook. Our view is supported by our expectations of the major banks' continued satisfactory earnings, credit losses remaining well under control, adequate capitalization, well-managed funding and liquidity (notwithstanding the Australian major banks' dependence on offshore wholesale funding), and conservative risk appetite.

The ratings on the major banks are likely to come under pressure if credit losses increase materially, combined with additional stress in factors such as access to wholesale funding. A key review trigger would be if our expectations of credit losses moved to a level closer to the current downside scenario from the current base-case scenario outlined in our stress test article. Credit losses could significantly rise due to a deeper, more rapid, and longer economic recession than our current expectations, or even a worse-than-expected impact from a benign economic recession. Ratings could also be lowered due to any material negative developments such as adverse investor sentiment, M&A activity, and the banks pursuing riskier business models due to aggressive growth or earnings strategies.

Although these banks are similar to each other in many ways, we believe the existing differences in their strategies could be affected by broad market developments that could consequently impact the individual rating or outlook to different extents. Standard & Poor's will examine the impact of market developments on the individual banks and the resulting implications on the rating or outlook on a case-by-case basis.

Standard & Poor's will be publishing a Credit FAQ on Australia's four major banks soon. The article compares the performance of Australia's four major banks with some of their international peers.

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