MOODY'S
INVESTORS SERVICE

Rating Action: Moody's takes action on Australian banks

Global Credit Research - 19 Jun 2017

NOTE: On June 22, 2017, the press release was corrected as follows: The list of affected credit ratings accessible via hyperlink from this press release was corrected to include the ratings for Westpac Banking Corporation Senior Unsecured Commercial Paper Program (Foreign Currency). Revised release follows:

Sydney, June 19, 2017 -- Moody's Investors Service has today downgraded the Baseline Credit Assessments (BCAs), long-term ratings and Counterparty Risk Assessments (CRAs) of 12 Australian banks and their affiliates, reflecting elevated risks in the household sector which heighten the sensitivity of the banks' credit profiles to an adverse shock. These elevated risks have been captured in Moody's Macro Profile for Australia, which has been lowered to "Strong +" from "Very Strong --".

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At the same time, Moody's has affirmed the BCAs, long-term ratings and CRAs of another six Australian banks and their affiliates, reflecting the balance sheet buffers and resilience to potential shocks for these banks.

Following these actions, the rating outlooks of 16 banks are now stable, while two remain negative.

Moody's has also downgraded the insurance financial strength rating of one lenders mortgage insurer, and placed the insurance financial strength rating of another on review for downgrade.

The banks and their affiliates that have been downgraded are: Australia and New Zealand Banking Group Limited (ANZ), Commonwealth Bank of Australia (CBA), National Australia Bank Limited (NAB), Westpac Banking Corporation (Westpac), Bendigo and Adelaide Bank Limited, Heritage Bank Limited, Members Equity Bank Limited, Newcastle Permanent Building Society, QT Mutual Bank Limited, Teachers Mutual Bank Ltd., Victoria Teachers Mutual Bank and Credit Union Australia Limited.

Specifically, the long-term ratings of Australia's four major banks, ANZ, CBA, NAB and Westpac, were downgraded to Aa3 from Aa2, their BCAs downgraded to a2 from a1, while their short-term ratings were not changed and affirmed at P-1.

The long-term ratings of Newcastle Permanent Building Society and Bendigo and Adelaide Bank Limited were downgraded to A3 from A2, with the remaining banks downgraded to Baa1 from A3.

The banks and their affiliates with ratings remaining unchanged and which have been affirmed are: AMP Bank Limited, Bank of Queensland Limited, HSBC Bank Australia Ltd, Citigroup Pty Limited, Suncorp-Metway Limited and Macquarie Bank Limited.

The rating outlooks for the following banks have been revised to stable from negative: ANZ, CBA, NAB, Westpac and Members Equity Bank Limited.

The rating outlooks for the following banks remain unchanged at stable: Bendigo and Adelaide Bank Limited, Citigroup Pty Limited, Heritage Bank Limited, Newcastle Permanent Building Society, QT Mutual Bank Limited, Teachers Mutual Bank Limited, Victoria Teachers Mutual Bank and Credit Union Australia Limited, Bank of Queensland Limited, Suncorp-Metway Limited and Macquarie Bank Limited.

The rating outlooks for AMP Bank Limited and HSBC Bank Australia Ltd remain unchanged at negative, as a result of the negative rating outlooks for their parents.

Moody's has also downgraded the insurance financial strength rating of Westpac Lenders Mortgage Insurance Limited (WLMI) to A1 from Aa3, and revised its rating outlook to stable from negative. WLMI is a mortgage insurance subsidiary of Westpac. The subsidiary's rating incorporates Moody's assumption of affiliate support from Westpac, and the rating action reflects the change in the rating and outlook of its parent.

Moody's has also placed the A3 insurance financial strength rating of Genworth Financial Mortgage Insurance Pty Ltd on review for downgrade.

Please click on this link http://www.moodys.com/viewresearchdoc.aspx?docid=PBC_196157 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

RATINGS RATIONALE

Please click on this link http://www.moodys.com/viewresearchdoc.aspx?docid=PBC_196157 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and provides, for each of the credit ratings covered, Moody's disclosures on the following items:

Principal Methodologies

MACRO PROFILE CHANGE

Under Moody's bank rating methodology, the first stage of the rating agency's credit analysis for banks starts with the Macro Profile, which is an assessment of the macro environment within which a bank operates. This reflects Moody's view that bank failures are very often associated with systemic crises driven by macroeconomics rather than idiosyncratic factors. Moody's country level analysis focuses on economic strength, institutional strength, susceptibility to event risk, credit conditions, funding conditions and industry structure. In today's action, Moody's has changed its assessment of Australia's Macro Profile to "Strong + "from "Very Strong -". This change was driven by the rating agency's view that the credit conditions in Australia have deteriorated. High levels of debt and rapid credit expansion can signal credit quality problems that emerge later. High and rising household debt in the context of low nominal wage growth has led to very high levels of household leverage, thereby increasing the household sector's and, by extension, the banking sector's sensitivity to a potential shock. In assessing a given country's credit conditions, Moody's considers the level of private-sector debt to GDP and the growth in private sector debt.

RATIONALE BEHIND THE DOWNGRADE OF BANK RATINGS

In Moody's view, elevated risks within the household sector heighten the sensitivity of Australian banks' credit profiles to an adverse shock, notwithstanding improvements in their capital and liquidity in recent years.

While Moody's does not anticipate a sharp housing downturn as a core scenario, the tail risk represented by increased household sector indebtedness becomes a material consideration in the context of the very high ratings assigned to Australian banks.

Specifically, Moody's notes the following:

Latent risks in the housing market have been rising in recent years, because significant house price appreciation in the core housing markets of Sydney and Melbourne has led to very high and rising household indebtedness. The rise in household indebtedness comes against the backdrop of low wage growth and structural changes in the labour market, which have led to rising levels of underemployment. Whilst mortgage affordability for most borrowers remains good at current interest rates, the reduction in the savings rate, the rise in household leverage and the rising prevalence of interest-only and investment loans are all indicators of rising risks.

In Moody's assessment, risks associated with the housing market have risen sharply in recent years. Rising house prices during 2013-17 have been accompanied with an elevated proportion of lending to residential property investors, raising some concerns over the negative impact on financial stability. Australia also exhibits very high levels of household debt, with the ratio of household debt to disposable income rising to 188.7% at end-2016. This situation is particularly concerning, against the backdrop of low nominal income growth experienced in Australia over the past few years. Whilst unemployment remains low — at 5.5% as at May 2017 — rising levels of underemployment indicate spare capacity within the labor market, which could constrain wage growth over the medium term.

The household sector's resilience to weaker employment levels and/or rising interest rates has materially reduced. Any increase in household sector stress would have the potential to weaken consumer confidence and consumption, creating negative second and third order impacts on overall economic activity and, accordingly, bank balance sheets.

Whilst capital adequacy is likely to strengthen further — as a result of regulatory action — and macro prudential measures will alleviate a further build-up of risks, the very high level of household sector indebtedness will take a considerable period of time to unwind.

The resilience of household balance sheets and, consequently, bank portfolios to a serious economic downturn has not been tested at these levels of private sector indebtedness.

RATIONALE BEHIND THE AFFIRMATION OF BANK RATINGS

Despite the elevated risks and rising sensitivity to potential shocks, Moody's has affirmed the banks' ratings where, in Moody's opinion, buffers against those risks are already appropriately reflected in their ratings.

Specifically, bank ratings have been affirmed where the strength of the banks' capital adequacy and the likely trend in asset quality are in line with Moody's expectations for the rating level.

GOVERNMENT SUPPORT REMAINS AN IMPORTANT RATING CONSIDERATION

The Aa3 stable senior unsecured debt ratings of ANZ, CBA, NAB, and Westpac continue to incorporate two notches of uplift, reflecting Moody's expectation of a "very high" probability of government support, in case of need.

The A2 stable senior unsecured debt rating of Macquarie Bank Limited incorporates Moody's "high" public support assumption.

The senior unsecured debt ratings of Bank of Queensland Limited (A3 stable), Bendigo and Adelaide Bank Limited (A3 stable) and Suncorp-Metway Limited (A1 stable) incorporate Moody's "moderate" public support assumptions, which result in a one-notch uplift.

WHAT COULD CHANGE THE RATINGS UP

Moody's does not expect any upward pressure on the ratings of the affected institutions in the medium term.

However, bank outlooks could be revised to positive if the operating environment in Australia improves, with a stabilization in household leverage, nominal income and house price metrics, and/or the banks further improve their capitalization and funding/liquidity profiles.

WHAT COULD CHANGE THE RATINGS DOWN

The ratings could be lowered if credit conditions in Australia continue to deteriorate. In particular, further material increases in the credit-to-GDP ratio and household debt-to-income ratio would be credit-negative.

The banks' ratings could also be downgraded if their financial fundamentals deteriorate significantly. If all other rating factors are kept constant, the BCAs of the banks would come under adverse pressure if the banks report significantly increased problem loan ratios or significantly reduced profitability.

Moody's will also monitor the extent to which any weakening in asset quality and profitability is balanced by higher buffers, notably in the form of core capital and improved funding structures.

RATIONALE BEHIND THE REVIEW FOR DOWNGRADE FOR GENWORTH FINANCIAL MORTGAGE INSURANCE PTY LTD

The review for downgrade of Genworth Financial Mortgage Insurance Pty Ltd's A3 insurance financial strength rating is similarly driven by the elevated risks in the household sector and the rising sensitivity to potential shocks. As a mortgage insurer, there is potential for higher losses emanating from residential mortgage loans with higher loan-to-value ratios.

Moody's review will focus on the company's portfolio loss development and potential for deterioration as a consequence of the elevated risks in the household sector, its capital adequacy in light of these risks, and the sustainability of its business franchise, given the change in lender behaviour toward the retention of a greater level of risk on their own balance sheets, as well as competition from foreign-based firms.

AMP Bank Limited is headquartered in Sydney, Australia, with total assets of AUD 19.01 billion (USD 13.77 billion) as at 31 December 2016.

Australia and New Zealand Banking Grp. Ltd. is headquartered in Melbourne, Australia, with total assets of

AUD 896.51 billion (USD 683.91 billion) as at 31 March 2017.

Bank of Queensland Limited is a regional bank based in the Australian state of Queensland with total assets of AUD 50.96 billion (USD 39.18 billion) as at 28 February 2017.

Bendigo and Adelaide Bank Limited is a regional bank based in the Australian state of Victoria, with total assets of AUD 70.95 billion (USD 51.37 billion) as at 31 December 2016.

Citigroup Pty Limited is headquartered in Sydney, New South Wales, Australia, with total assets of AUD16.06 billion (USD 11.63 billion) as at 31 December 2016.

Commonwealth Bank of Australia is headquartered in Sydney, Australia, with total assets of AUD 971.72 billion (USD 703.62 billion) as at 31 December 2016.

Credit Union Australia Limited is headquartered in Brisbane, Queensland, Australia, with total assets of AUD 12.9 billion (USD 9.6 billion) as at 30 June 2016.

Heritage Bank Limited is headquartered in Toowoomba, Queensland, Australia, with total assets of AUD 8.82 billion (USD 6.39 billion) as at 31 December 2016.

HSBC Bank Australia Ltd is headquartered in Sydney, New South Wales, Australia, with total assets of AUD31.1 billion (USD 22.52 billion) as at 31 December 2016.

Members Equity Bank Limited is headquartered in Melbourne, Australia, with total assets of AUD 24.59 billion (USD 17.81 billion) as at 31 December 2016.

National Australia Bank Limited is headquartered in Melbourne, Victoria, Australia, with total assets of AUD 790.23 billion (USD 602.83 billion) as at 31 March 2017.

Newcastle Permanent Building Society is headquartered in Newcastle, New South Wales, Australia, with total assets of AUD 9.77 billion (USD 7.28 billion) as at 30 June 2016.

QT Mutual Bank Limited is headquartered in Fortitude Valley, Queensland, Australia, with total assets of AUD1.43 billion (USD 1.07 billion) as at 30 June 2016.

Suncorp-Metway Limited is a regional bank headquartered in Brisbane, Australia with total assets of AUD 64.06 billion (USD 46.39 billion) as at 31 December 2016.

Teachers Mutual Bank Ltd. is headquartered in Homebush, New South Wales, Australia, with total assets of AUD 5.54 billion (USD 4.13 billion) as at 30 June 2016.

Victoria Teachers Mutual Bank is headquartered in Hawthorn, Victoria, Australia, with total assets of AUD2.16 billion (USD 1.61 billion) as at 30 June 2016.

Westpac Banking Corporation is headquartered in Sydney, New South Wales, Australia, with total assets of AUD 839.99 billion (USD 640.79 billion) as at 31 March 2017.

REGULATORY DISCLOSURES

Please click on this link http://www.moodys.com/viewresearchdoc.aspx?docid=PBC_196157 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and provides, for each of the credit ratings covered, Moody's disclosures on the following items:

• Releasing Office

• Person Approving the Credit Rating

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The below contact information is provided for information purposes only. Please see the ratings tab of the issuer page at www.moodys.com, for each of the ratings covered, Moody's disclosures on the lead rating analyst and the Moody's legal entity that has issued the ratings.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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