MEDIA RELEASE

Further margin declines forecast for Australian banks

Sydney, 8 June 2012 - East & Partners' and Macquarie Equities Research's latest predictive research paper has highlighted the difficult outlook for business margins among the major retail banks due to lack of business repricing, coupled with rising funding costs. Macquarie and East & Partners also expect less than three percent credit growth over the next year which, coupled with margin pressure, is likely to see net interest income in the business sector under pressure.

Over the four years since April 2008, total market planned borrowings have increased 0.5 per cent. This number gives a slightly skewed version of events however as the institutional segment is the only area of the market with an increasing proportion of companies looking to borrow. Both the Corporate and SME segments intentions to borrow are down 2 per cent and 3.9 per cent respectively over the same time period.

The commonly held view is that the banks are not that exposed to the miners. A particularly surprising angle of the research, contrary to that view, is that the banks 'peripheral' exposure in other mining/energy state industries had increased substantially, with total mining/energy state lending now accounting for 34 per cent of all business bank lending. Compounding the impact on earnings was higher repricing levels and frequency in the mining/energy states. This led to the surprising finding that business banking earnings from the mining/energy states appear to have doubled over the last 4 years.

Mike Wiblin, Macquarie Equities Research's Banking Analyst said: "With rising funding costs and relatively little repricing in the business space we believe the risk is to the downside for business banking margins over the coming 6 to 12 months.

"The analysis has also shown the substantial tailwind from volume and repricing in mining/energy states the banks have experienced over the last four years. Moderation of the mining/energy boom remains a risk, which could represent a further relative drag on bank earnings. Of the banks, we believe NAB is best placed to offset these headwinds, particularly given its leadership position in SME and corporate lending."

Paul Dowling, East & Partners Principal Analyst noted: "These key connections between customer behaviour and financial performance in banking are proving a powerful predictor for both the banking sector and individual bank stocks. The headroom left for continued repricing of the lending book is becoming constrained as business borrowers' ability to pay drops. The business market, post-GFC, is conservatively geared, however, and with margin compression being predominantly managed through deposit pricing strategies in the near term, we don't see a follow through into climbing delinquencies or provisioning levels."

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About Macquarie Equities Research

With more than 2,200 stocks under coverage around the world, Macquarie Equities Research is a top 10 global equities research house providing comprehensive research analysis of equities, economics, commodities and ESG. Research is available to permissioned institutional clients via email, secure access online, smartphone apps, and select third-party channels (Bloomberg, Factset, Thomson, Capital IQ, TheMarkets.com).

About East & Partners

East & Partners is Asia-Pacific's leading specialist business banking market research and analysis firm. East & Partners delivers both bespoke and multi-client research programs and consulting services to client banks and financial services providers across the institutional, corporate, SME, business, investment and financial services markets.

About the Macquarie and East & Partners Business Banking Series

This is the second report in the inaugural Macquarie and East & Partners Business Banking series. The series links East & Partners' demand-side content with observable outcomes to deliver strong insights into the business banking segment. This approach is a world-first initiative in helping investor outlook and expectations for the bank sector.