



Australian Banks: 2025 Q2

Decent conditions, but priced for more.

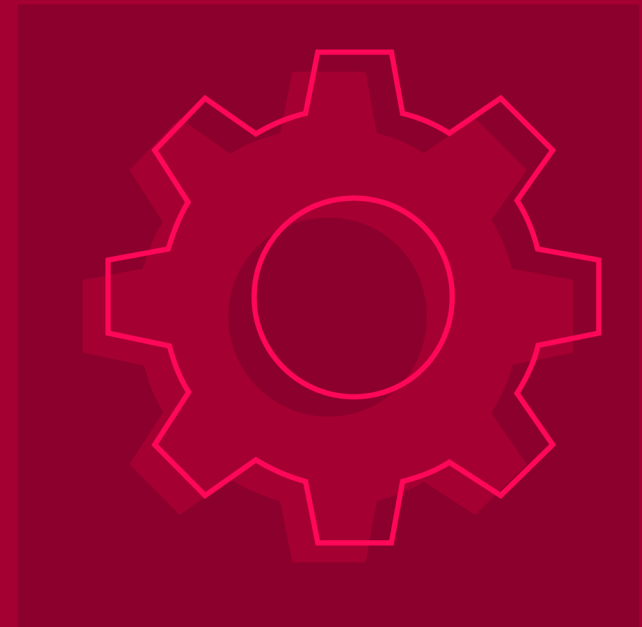


Table of Contents

Executive Summary: Frothy Valuations Disregard Fundamentals	3
Valuation: Stretched, Unless Growth Surprises Materially on the Upside	6
Credit Growth: Rising Despite Sluggish Economy	9

Interest Margins: Held up by Lower Deposit Rates	15
Capital and Credit Risk: In a Good Spot	20
Top Picks and Coverage: Limited Opportunities	24

Morningstar Equity Research

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Important Disclosure

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Executive Summary

Frothy valuations disregard fundamentals.

Resilient Earnings, but Bank Shares Are Expensive

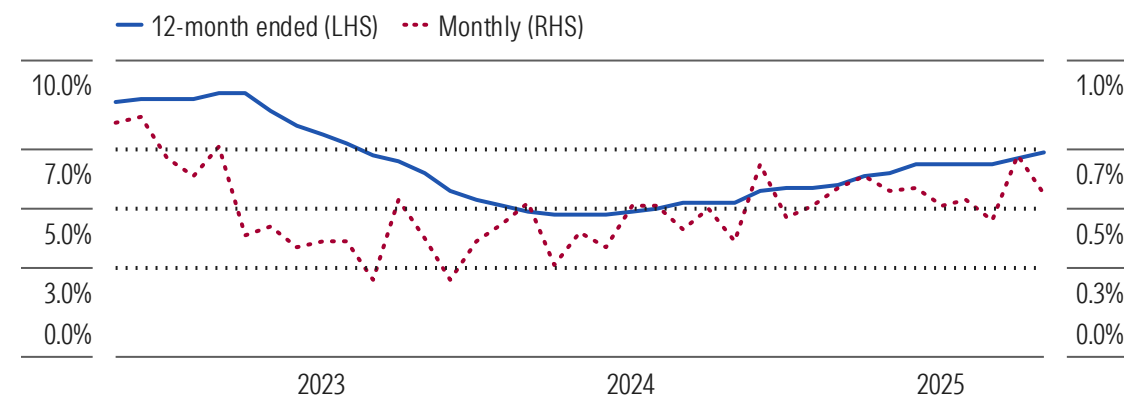
Most bank share prices have run ahead of the fundamentals, especially Commonwealth Bank, priced for much more than the mid-single-digit earnings growth we expect. Under new management, ANZ has integration and governance risks hanging over it, but presents the best value.

Credit growth is healthy, with total growth on an annualized basis of 6.9% in the three months to May 2025. It is well supported by public investment, population growth, and solid house prices. If cash rates are lowered further in 2025, as futures markets predict, growth could accelerate as borrowing capacity increases. But the Reserve Bank of Australia's low economic growth forecast out to 2027 underpins our expectation that credit growth slows to 4% to 5% per year in 2026.

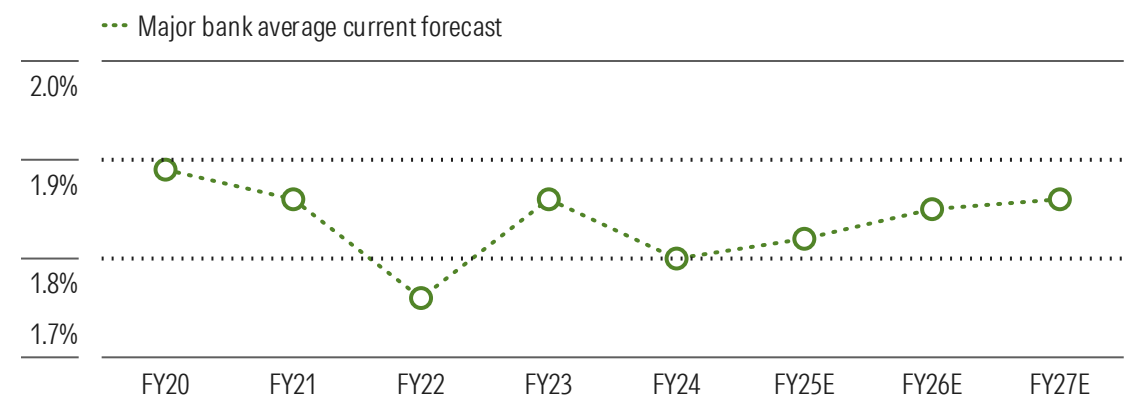
Bank net interest margins are softening due to competition for mortgages and the lingering impact of customer switching from transaction accounts to more expensive deposit products. Over time, we expect competitive intensity to ease as nonmajor banks look to lift subpar returns on equity. Low bad debt expenses are helping soften the hit to earnings and are likely feeding into the more favorable rates for customers. Low unemployment, a tight rental market, large equity buffers, and rising house prices support low loan losses for banks.

Banks are nearing the end of announced on-market buybacks, but still hold surplus capital, which supports the outlook for modest dividend growth.

Credit Growth: Lower Cash Rate a Short-Term Tailwind



Net Interest Margins: Repricing Loans and Deposits to Protect Margins

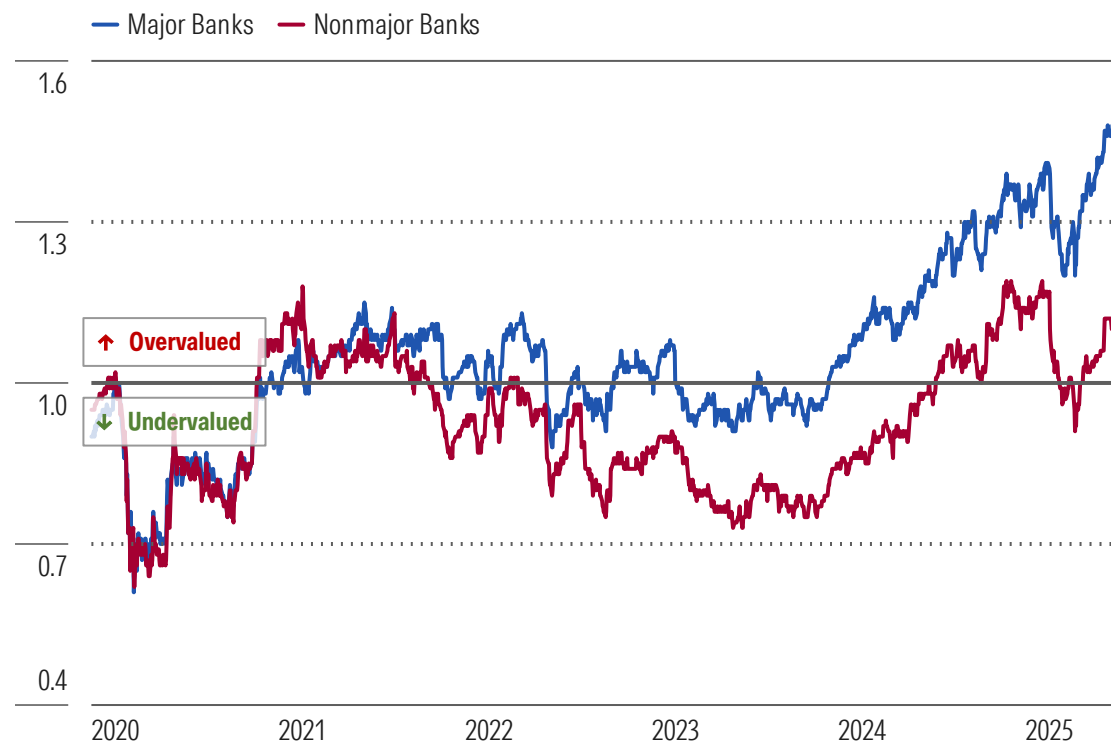


Valuations Stretched Given Benign Earnings Growth Outlook

The major banks ended the quarter with a weighted average price/fair value estimate of 1.50, and 1.11 for nonmajor banks. These metrics are up from 1.27 and 1.01 at the end of March. The increase is entirely due to higher share prices, with fair values unchanged.

Most Australian Banks Overvalued

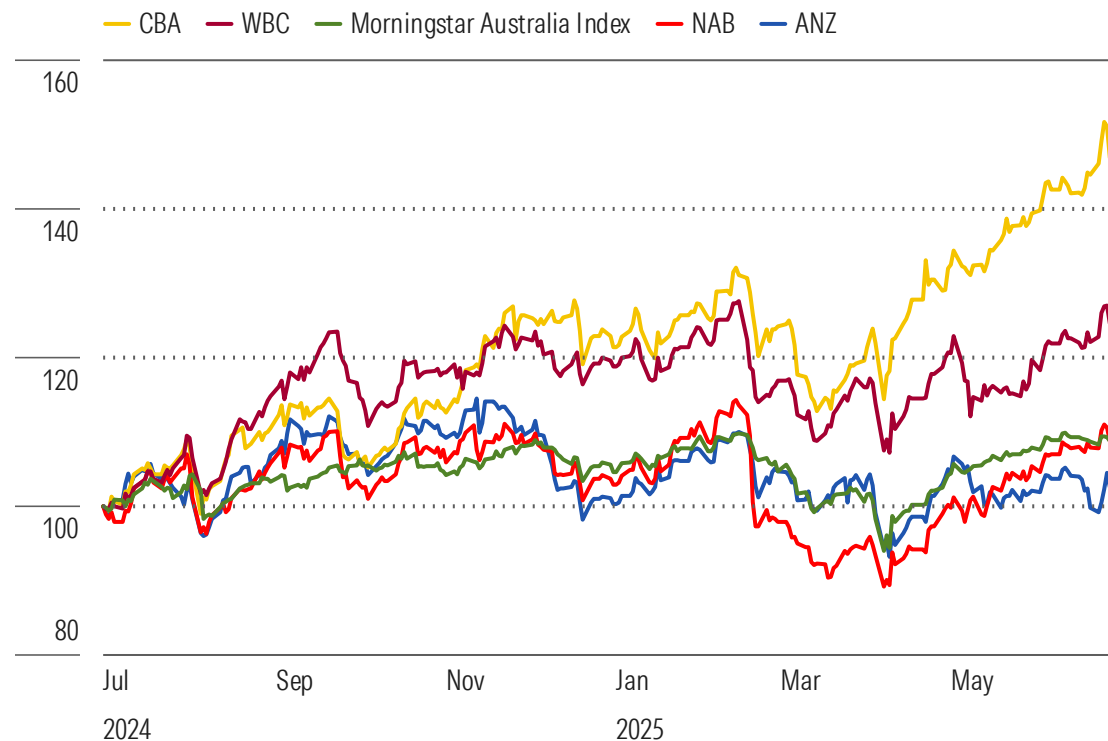
Weighted average price/fair value.



Major bank performance was positive across the board in the past 12 months, though the contrast between Commonwealth Bank and ANZ is stark. We don't think any economic or industry data explains the recent surge in prices.

Share Price Rally Out of Sync With Outlook for Modest Earnings Growth

Bank share prices compared with Morningstar Australia Index over the past 12 months.



Source: Morningstar (left). PitchBook, Morningstar Australia Index (right). Data as of June 30, 2025.

See Important Disclosures at the end of this report.

Valuation

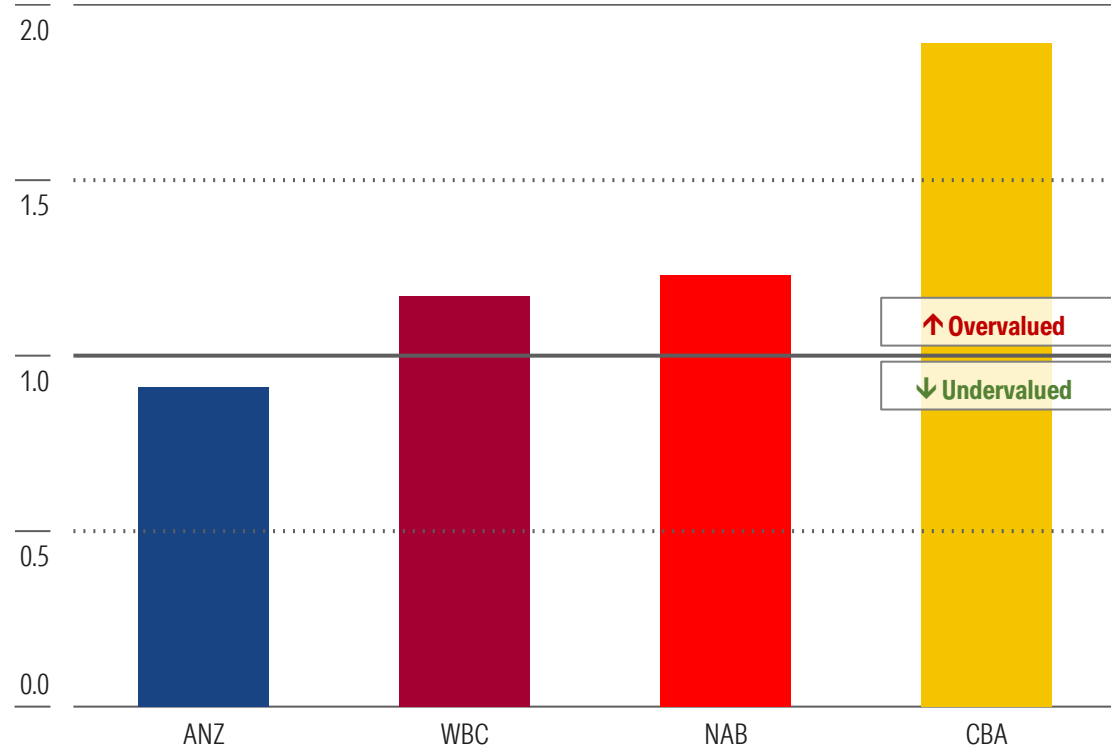
Stretched unless growth surprises materially on the upside.

Better Value in ANZ Group and Nonmajors

ANZ Group offers upside from improved operating efficiency and successful integration of Suncorp Bank. Commonwealth Bank, near all-time highs, is most expensive, on a forward P/E of close to 30 times and a fully franked dividend yield under 3%.

Major Banks Mostly Overvalued

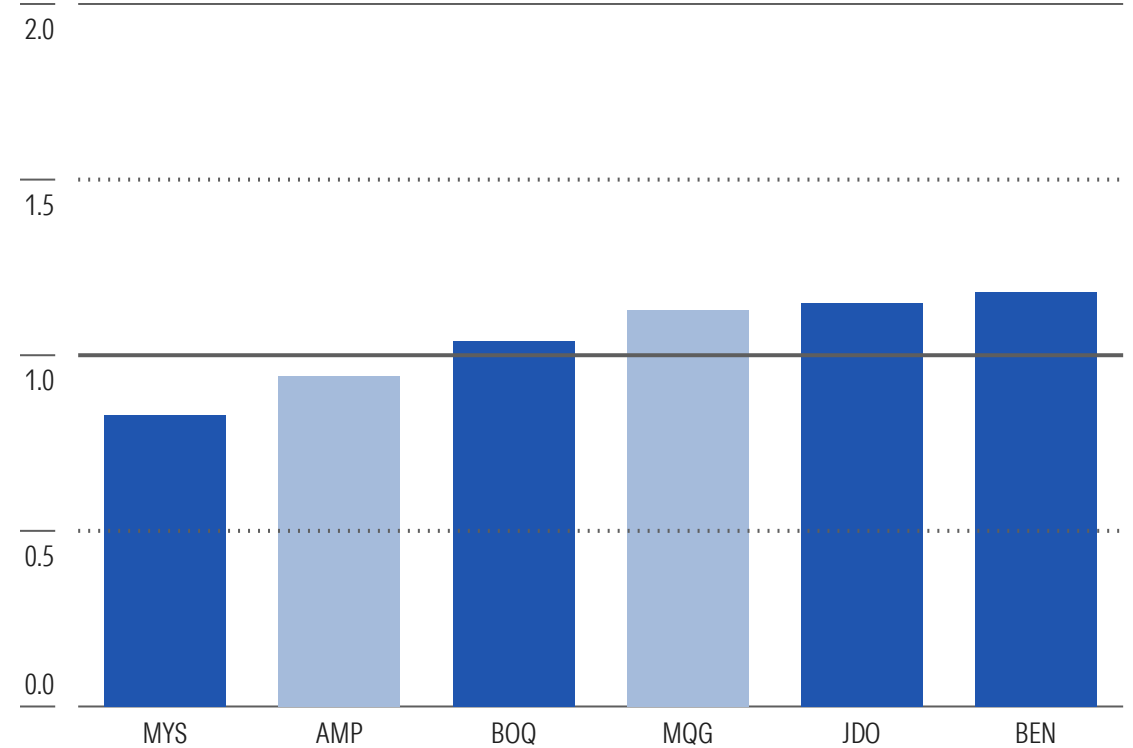
Price/fair value.



Nonmajors Bank of Queensland and MyState Bank have relatively weak funding positions, but industrywide loan and deposit repricing is beneficial, and should see both become more competitive again in the medium term.

Nonmajor Banks Are Lower Quality, but Not Priced for Perfection

Price/fair value includes diversified financials—AMP and Macquarie.



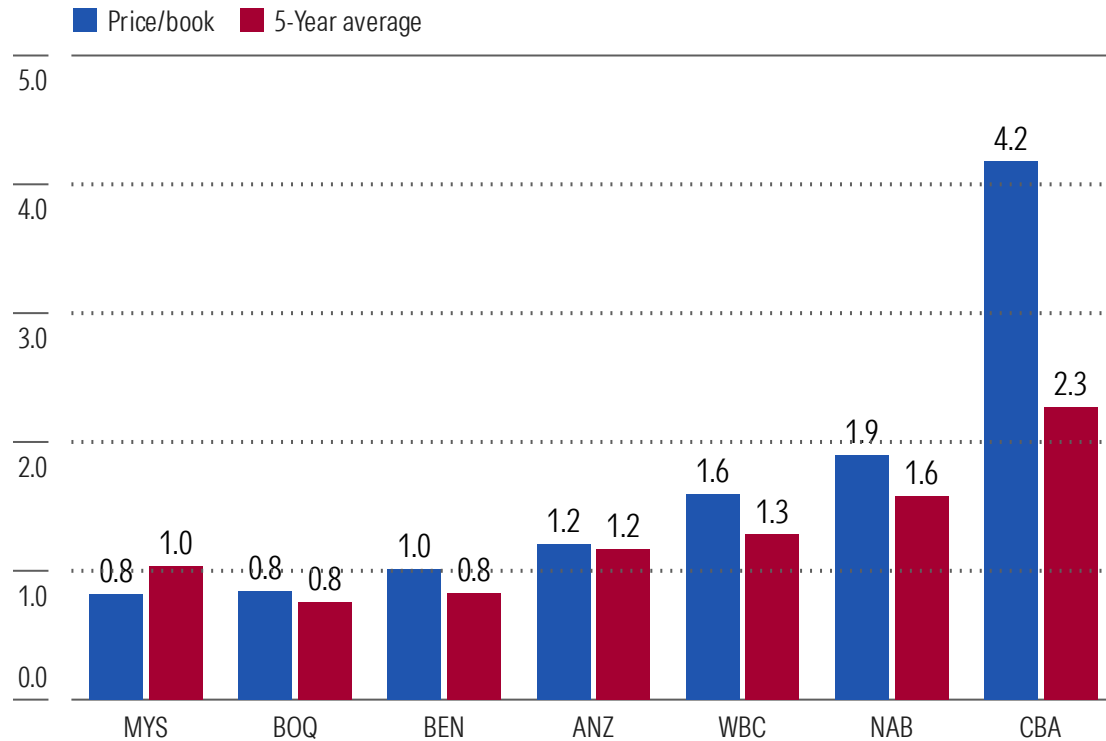
Commonwealth Bank Is an Outlier; Dividend Yields Reasonable

The valuation divergence between Commonwealth Bank and its peers continues to widen, and in our view, is unjustified. Price/book discounts could unwind, particularly for ANZ Bank if it can deliver similar earnings growth, but on a cheaper P/E.

With average dividend payout ratios of 75%, major bank dividends can grow in line with earnings. With a small surplus capital buffer, ANZ is at greatest risk of lowering dividends, but the risk is already reflected in the share price.

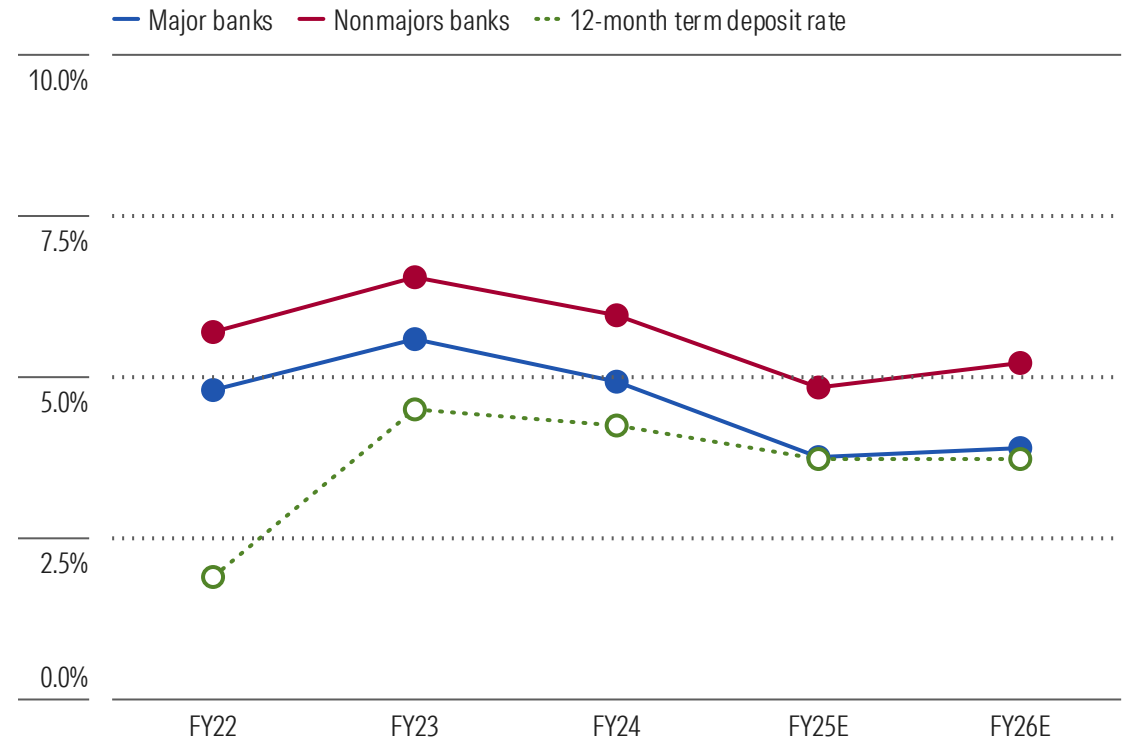
Price/Book Above Long-Term Averages for Major Banks

Five-year average is market-cap weighted.



Mostly Fully Franked Dividend Yields Look Reasonable and Maintainable

Forecast term deposit is based on the average of major banks' advertised rates.



Credit Growth

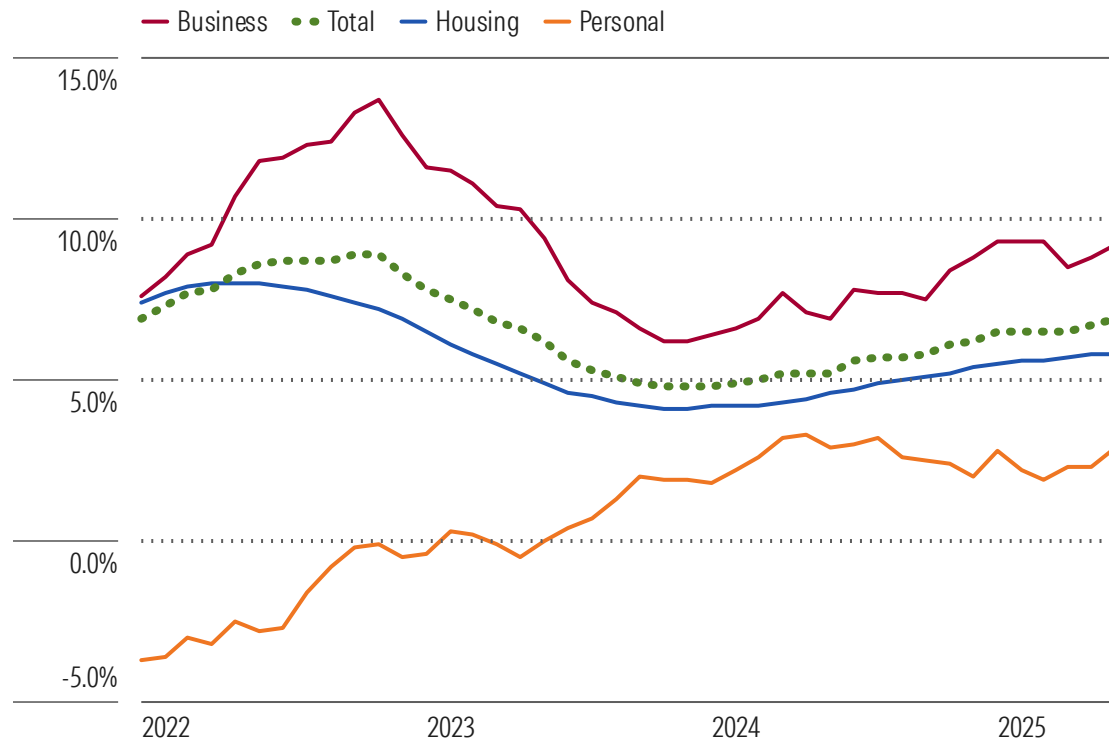
Rising despite sluggish economy.

Easing Household Pressure Is Supporting Credit Growth

Housing credit grew 5.8% over the 12 months to the end of May 2025, with steady month-on-month growth in the past six months. Higher wages and strong population growth are tailwinds, with recent interest rate cuts also increasing borrowing capacity.

Trade Wars Pose a Risk to Economic and Credit Growth

Australia credit growth by sector-12 months ended May 2025.

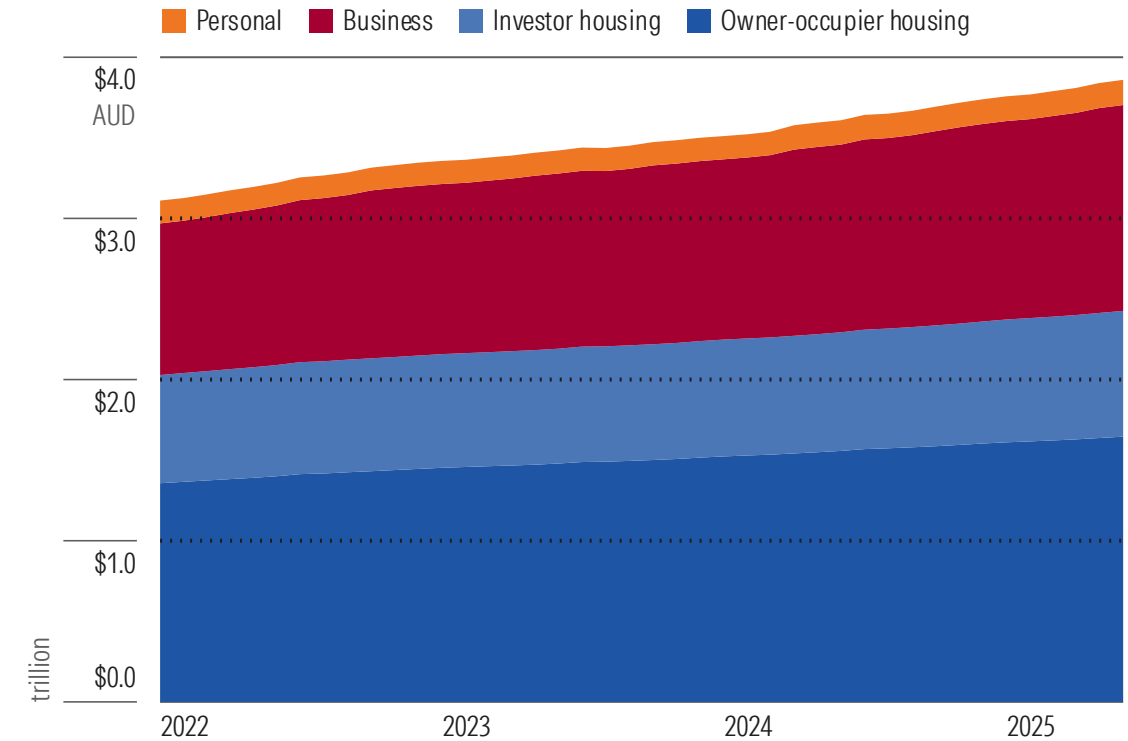


Source: Reserve Bank of Australia. Data as of May 31, 2025.

Business lending makes up around a third of total credit and has benefited from growing optimism of demand across many sectors, helped by falling inflation and rate cuts. We expect growth to slow, especially as US tariffs add economic uncertainty.

Housing Is Almost Two-Thirds of Outstanding Loans

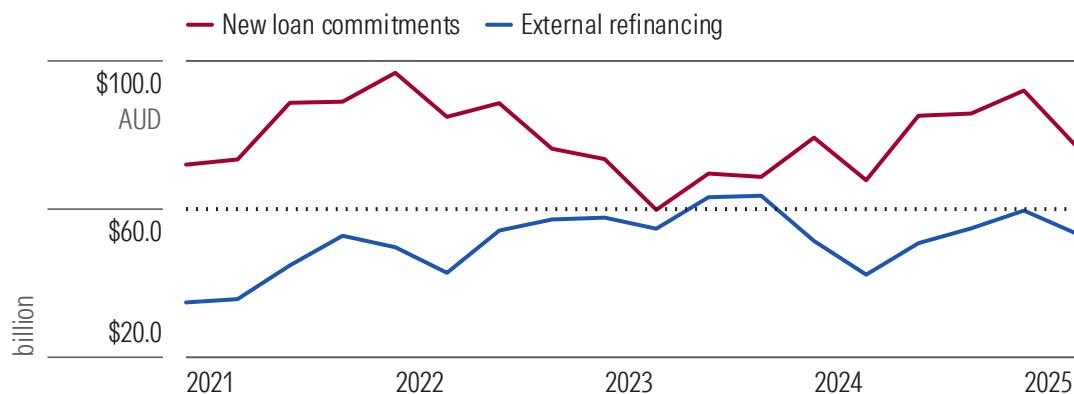
Australian credit by sector.



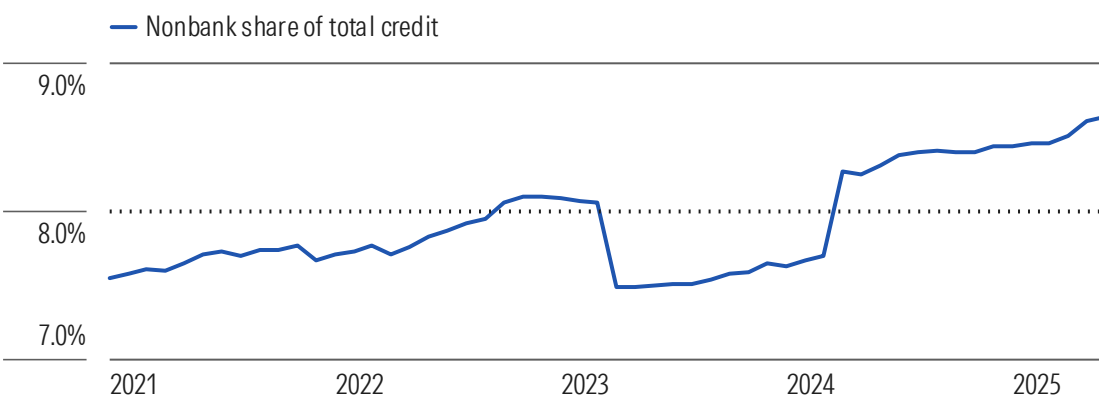
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Loan Demand Influenced by Cash Rate Moves

New Lending Growth Expected to Outpace Refinancing



Higher Rates Hurt Nonbank Lenders, Pushing Them Into Riskier Segments



Modest Loan Growth Expected

New home loan commitments are expected to remain on a positive trajectory, supported by population growth, rising house prices, and lower interest rates.

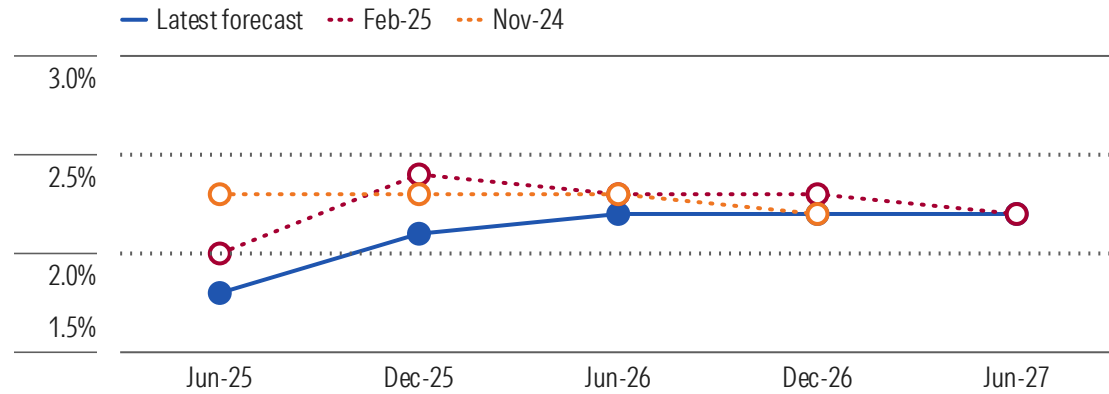
We expect refinancing activity to be broadly flat in 2025. In a falling rate environment, borrowers are less inclined to look for a better deal compared with an environment where rates are rising. When banks compete for a modest pool of new loans and fight to retain existing customers, competition for lending is usually higher. Banks discounted aggressively in recent years, so many borrowers are already paying interest rates in line with offers to new borrowers, hence negating an incentive to refinance.

Nonbank Lenders Can Boost Credit Growth

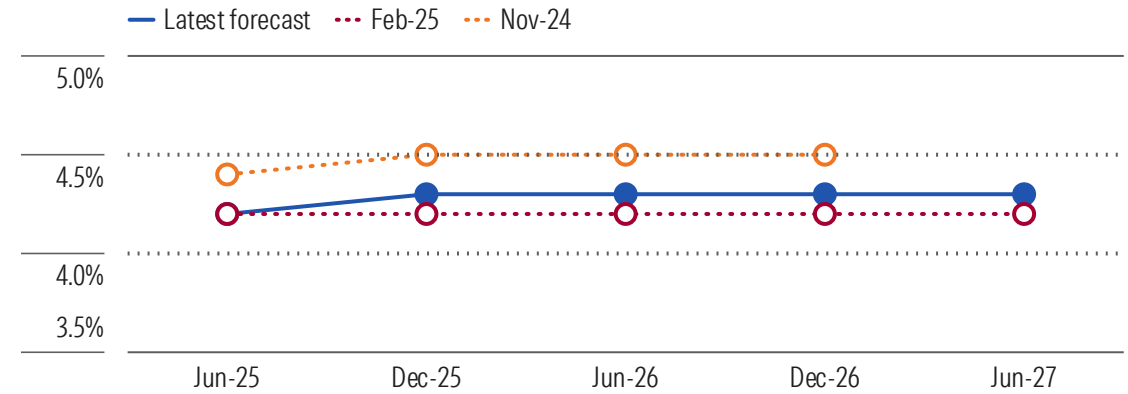
Nonbank lenders make up 8.6% of total credit, the highest in a decade. In the 12 months to May 2025, nonbank credit was up 11.2%, compared with bank credit growth of 6.6%. Based on the results of ASX-listed nonbank lenders, market share gains are likely outside of mortgages. Despite relying on more expensive wholesale funding, nonbanks can take share by lending to higher-risk borrowers or sectors not well served by banks. This can be because of onerous capital requirements, risk appetite, or efforts to streamline loan application processes. Nonbank lenders are compensated by charging a higher lending rate. Nonbanks are active in low-documentation lending, which major banks no longer offer. These potentially higher-risk loans remain a modest risk to the system overall.

Economic Backdrop Decent for Banks, but Tariffs Still Pose a Threat

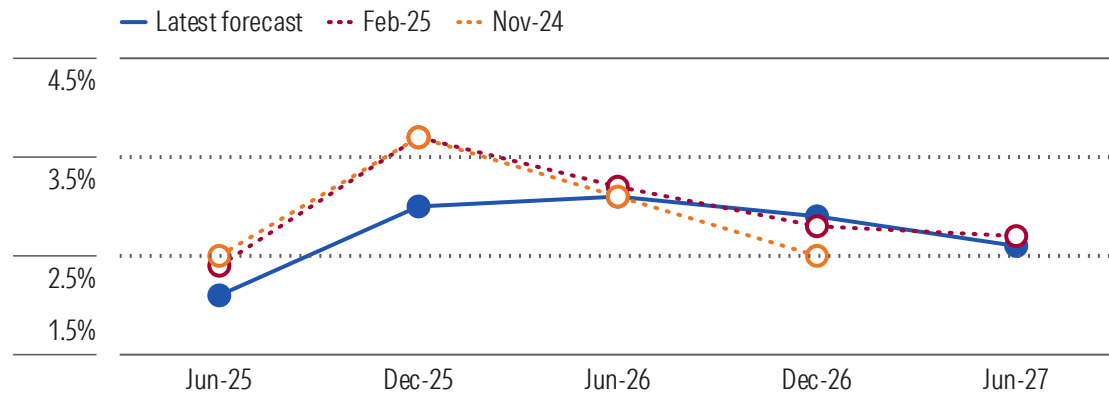
Tariffs Could Hurt Moderate GDP Growth Forecasts



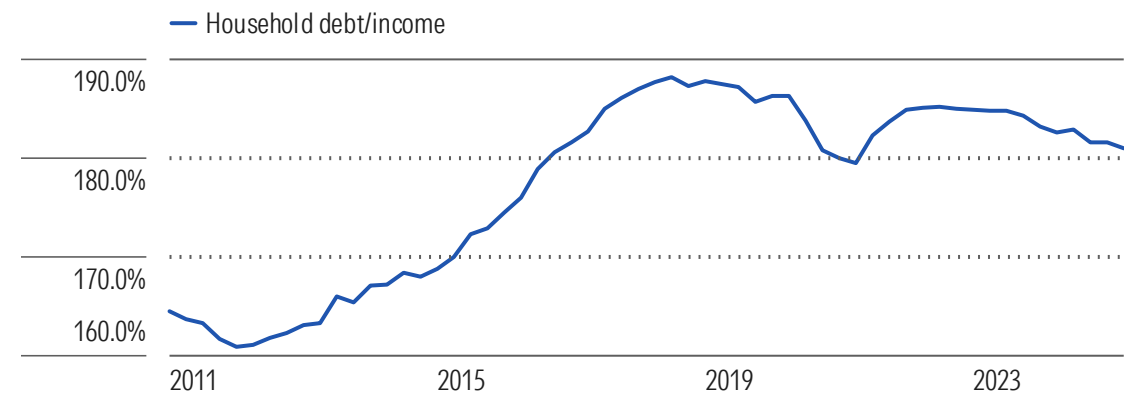
Unemployment: Not Expected to Jump; Bank Credit Quality Sound



Inflation: Falling and Providing Headroom for Monetary Stimulus



Household Debt/Income: Material Increase in Leverage Unlikely

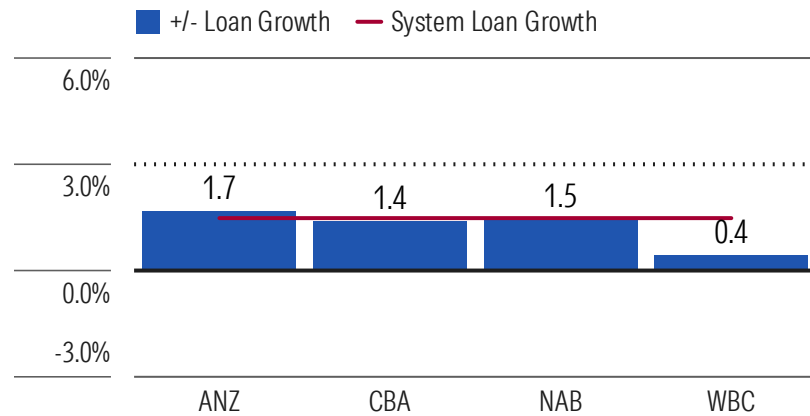


Source: Reserve Bank of Australia. Data as of May 31, 2025 (top left, top right, and bottom left). Data as of March 31, 2025 (bottom right).

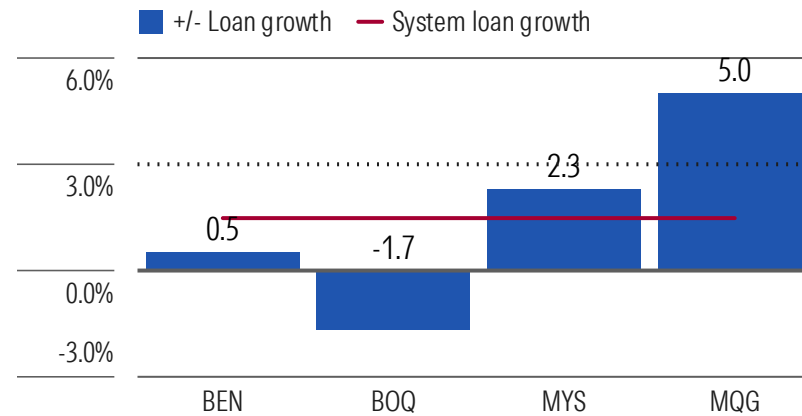
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Housing Loans: Major Banks Hold Their Ground; Macquarie Gains Eventually Expected to Slow

Majors' Housing Loan Growth Over Past Three Months*

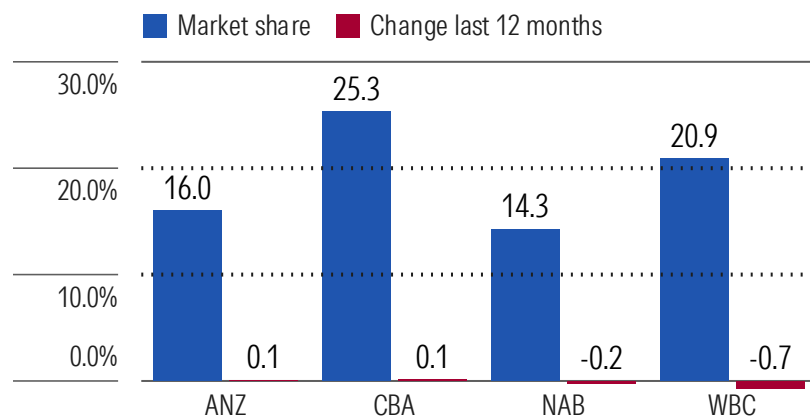


Nonmajors' Housing Loan Growth Over Past Three Months*

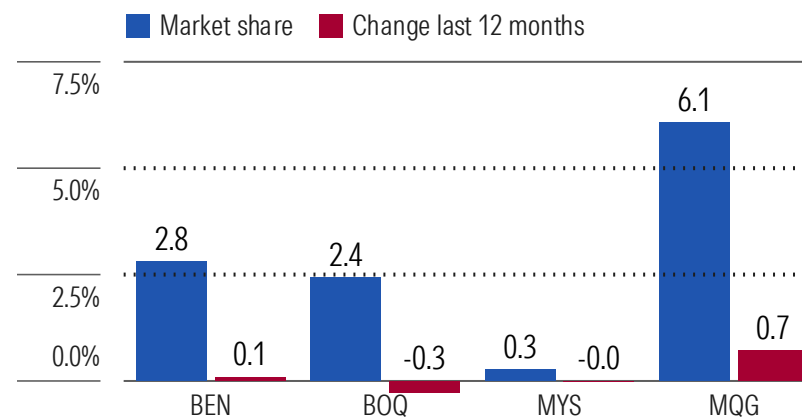


Based on Australian Prudential Regulation Authority data, home loan balances grew 1.5% in the quarter to May 2025 or 5.9% annualized. Recent rate cuts and market expectations of more to follow appear to be strengthening borrower confidence and increasing borrowing capacity. Wage growth, tax cuts, and lower inflation are also helping. Investor demand strengthened late in 2024, with positive momentum continuing in 2025.

Major Banks' Market Share



Nonmajor Banks' Market Share*



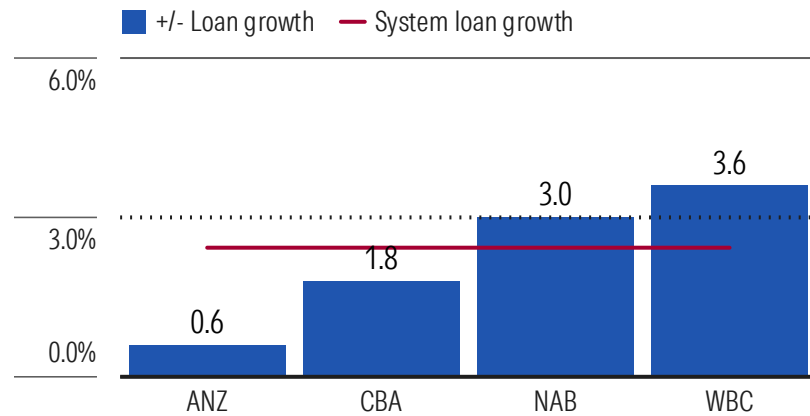
Major banks appear to be pricing to hold market share, with Westpac hit by the closure of its broking business, RAMS Financial Group. Macquarie's market share gains are beating our expectations, growing around three times faster than the market. We expect this to slow, given a likely internal need for higher returns. Macquarie's operating cost savings have impressed and offset net interest margin pressure recently, but we expect this to become harder to achieve in the future.

Source: Australian Prudential Regulation Authority, Morningstar. *Data for period ended May 31, 2025. Note: ANZ Group is adjusted to include ANZ and Suncorp Bank in the previous corresponding period.

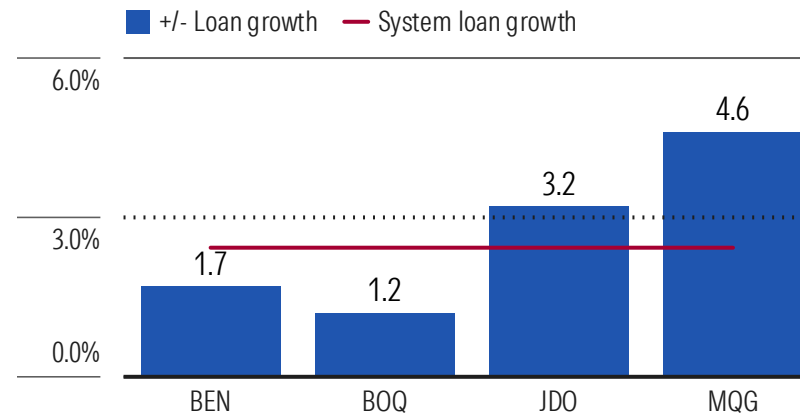
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Business Loans: Steady Growth

Majors' Business Loan Growth Over Last Three Months*

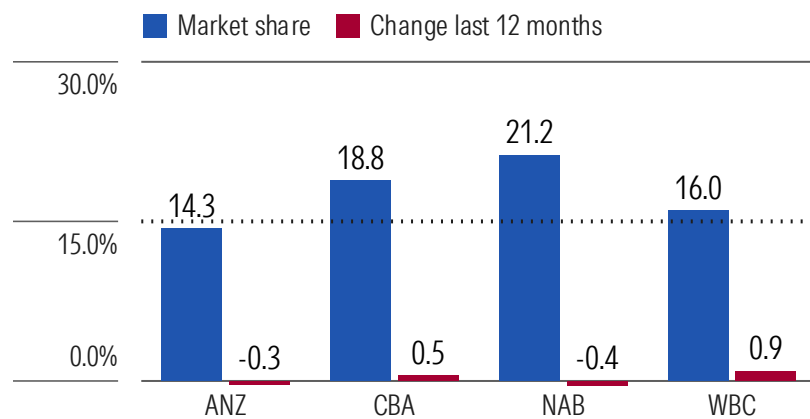


Nonmajors' Business Loan Growth Over Last Three Months*

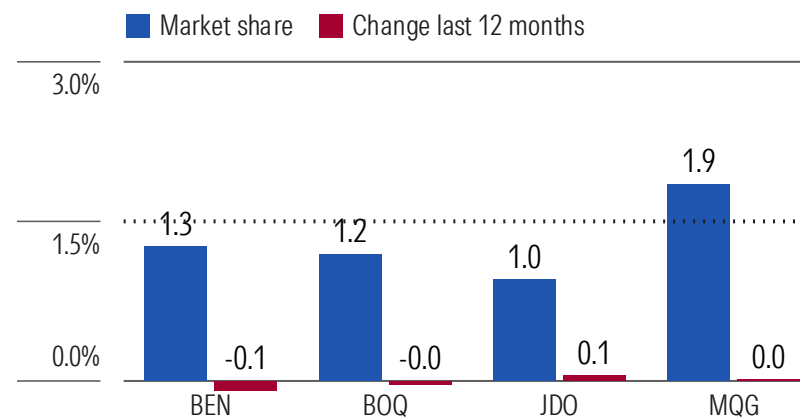


Business loan balances grew 2.4% in the quarter to May 2025, an annualized rate of 9.7%. We expect moderation closer to 5% in 2025, with US tariffs potentially prompting businesses to pause new investment. Manufacturing businesses appeared increasingly optimistic about a recovery in demand as consumer pressures ease, with capacity expansion bringing investment in buildings and plant and machinery, which is lumpy.

Major Banks' Market Share



Nonmajor Banks' Market Share*



We expect Judo Capital's focus on customer service offerings, including a dedicated banker and fast approvals, to be the nonmoatworthy point of difference to win share. News that employees responsible for bringing in a material amount of loans are leaving to compete is a short-term headwind as they poach customers. Macquarie is unlikely to undercut peers on price as it needs to cover additional expenses and the investment it is making to speed up approval times.

Source: Australian Prudential Regulation Authority, Morningstar. *Data for period ending May 31, 2025. Note ANZ is adjusted to include ANZ and Suncorp Bank in the previous corresponding period.

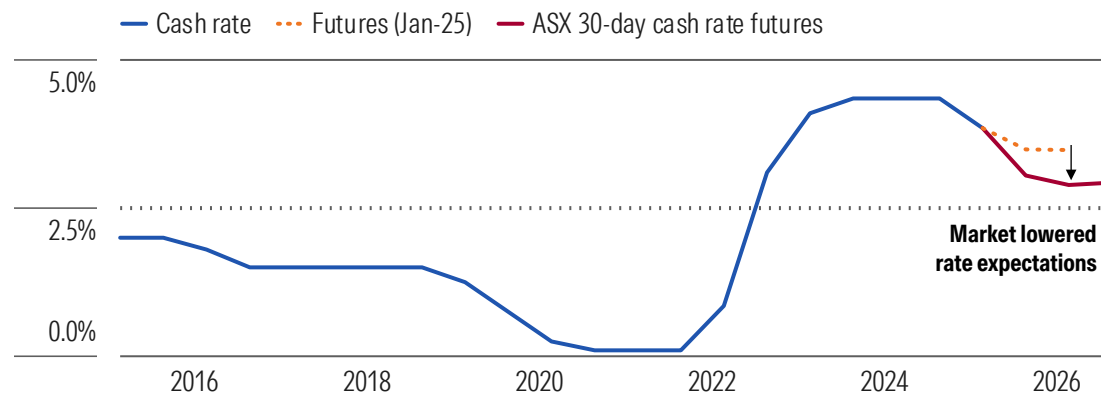
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Interest Margins

Held up by lower deposit rates.

Easing Inflation Supports Expectations of More Rate Cuts

RBA Cash Rate: Easing Cycle Has Begun

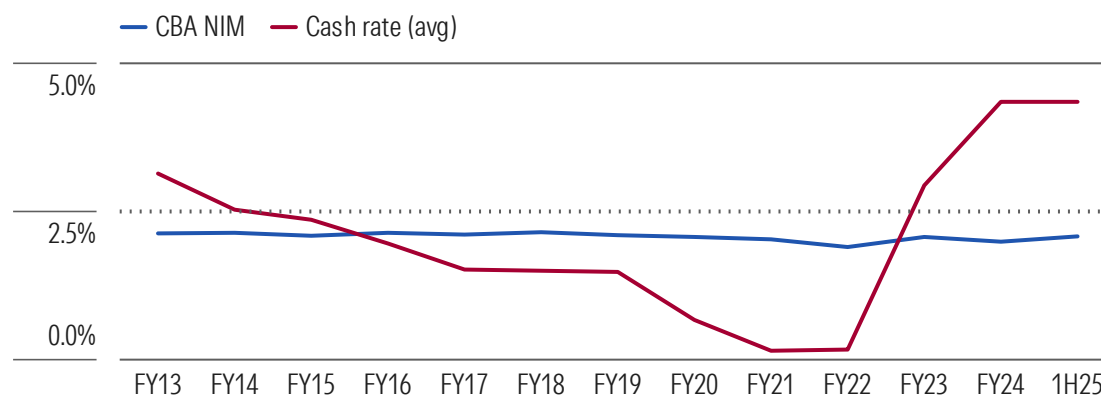


Rate Cuts Continue as Restrictive Stance Relaxes

The RBA's cash rate target currently sits at 3.85%, with no change in July 2025 after 0.25% cuts in February and May.

With inflation continuing to ease and now in the banks' target range, more rate cuts are possible, especially if a boost to household demand is needed to support economic growth. ASX 30-day futures point to a cash rate around 2.9% by June 2026, essentially another four 0.25% cut over the next 12 months. The impact of President Donald Trump's tariffs on the global economy remains uncertain, but major bank economists are broadly in agreement with the market for an average rate forecast of 3.1% by June 2026.

Competition Mostly Drives NIMs, Not Cash Rate

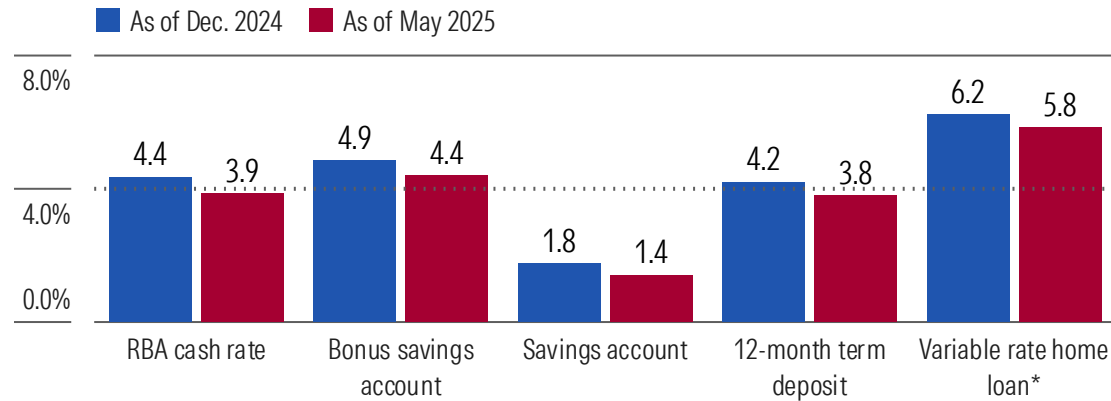


Higher Rates Are Generally Favorable for Margins

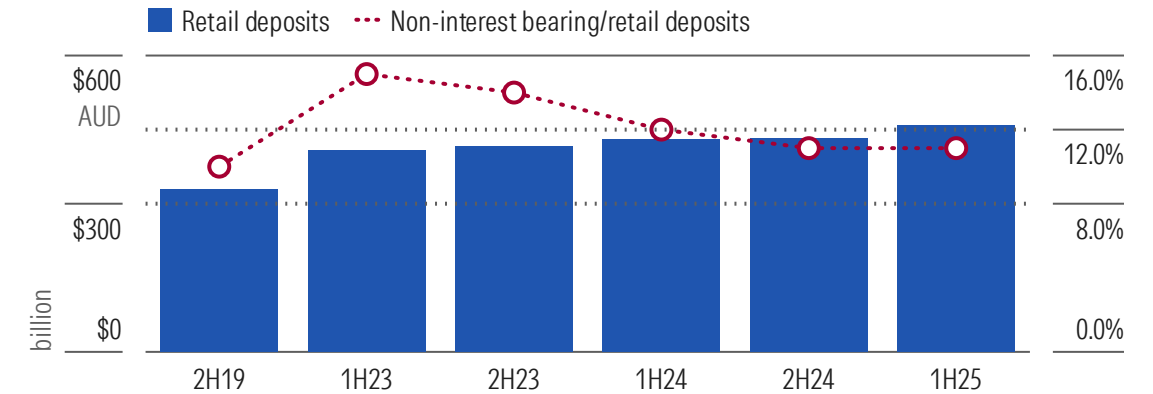
With some funding costs not increasing by as much as lending rates, such as low-rate savings and transaction accounts, higher rates are positive for bank margins, all else equal. However, the intensity of competition is an important variable. Banks aim to manage lending and deposit rates to ensure a NIM sufficient for an adequate return on equity.

Banks Benefit From Cheap Deposits, but Customers Seek Higher Rates

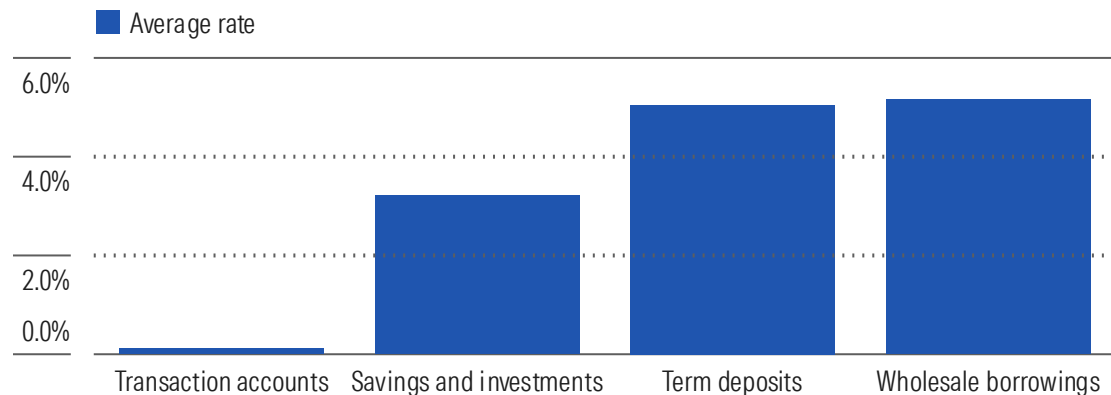
Rates: Average Deposit Rates Moderating After Outpacing Rises in Lending Rate



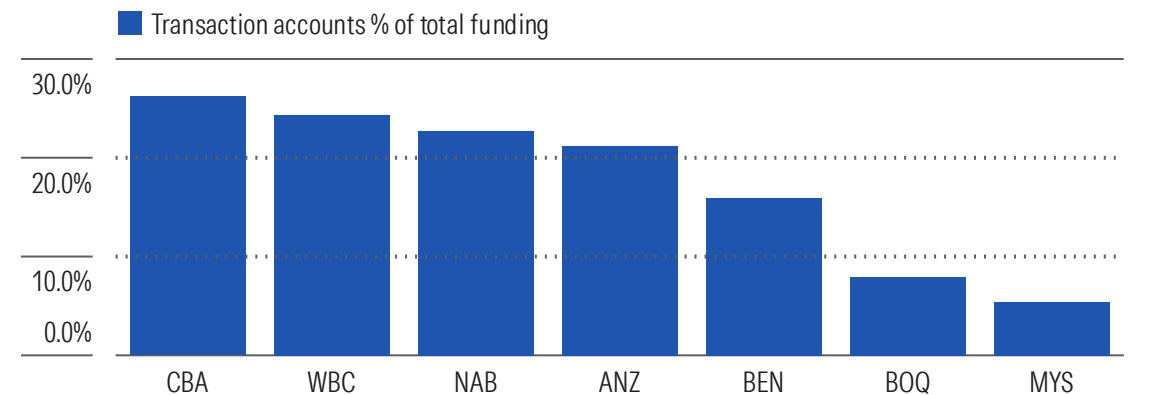
Switching: Moves Out of Commonwealth Bank Transaction Accounts Slowed



Funding Costs: Banks Reliant on Term Deposits Face Most Margin Pressure



Deposit Funding: Banks With Low-Cost Deposits Best Placed to Compete



Source: Reserve Bank of Australia, Morningstar. Data as of May 31, 2025. (top left). *Variable rate for new home loans. Commonwealth Bank result presentation—retail deposits. Morningstar. Data as of Dec. 31, 2024. (top right). Bendigo Bank result presentation, Morningstar. Data as of Dec. 31, 2024. (bottom left). Company reports, Morningstar. CBA, BEN, MYS as of Dec. 31, 2024, BOQ as of Feb. 28, 2025, compared with March 31, 2025, for other major banks. (bottom right).

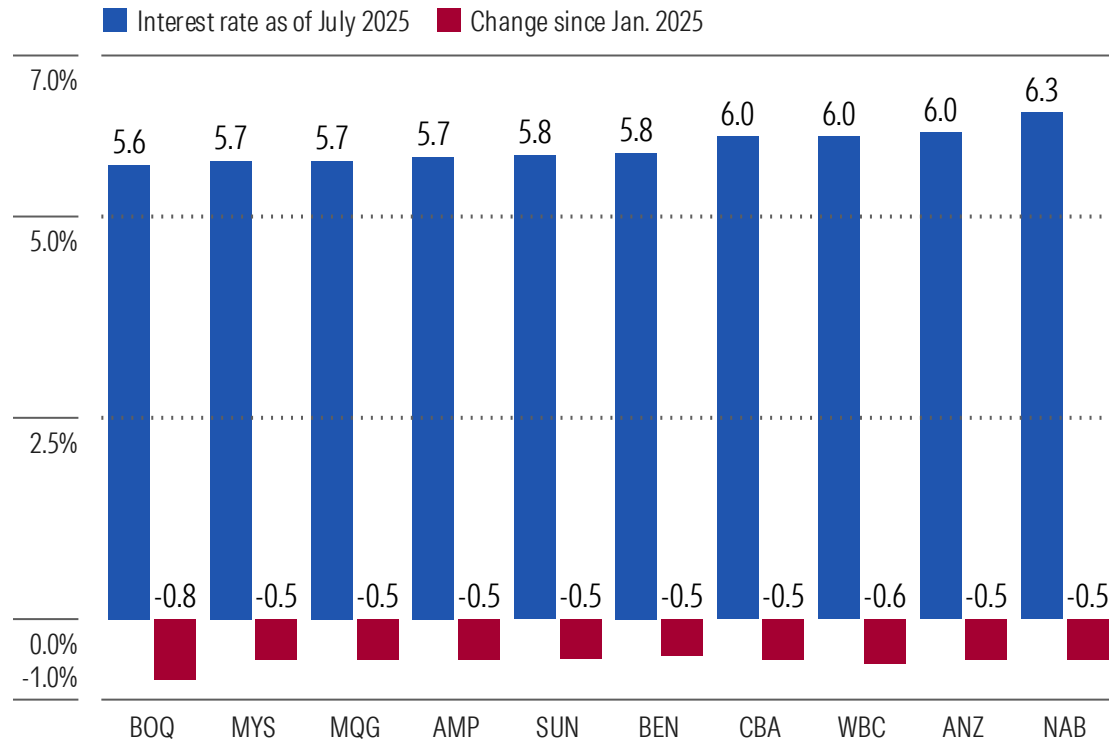
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Home Loan Rates Coming Down With Cash Rates

Competition is intense, with the RBA's 0.5% of rate cuts in 2025 passed on in full to existing borrowers and reflected in advertised rates. The major banks remain focused on margins, with an average lending rate around 0.4% higher than nonmajor banks.

Major Banks Advertise Highest Owner-Occupier Variable Rates

Variable rate: owner-occupier—principal and interest—loan/value ratio below 80%.



The spread between rates on outstanding loans and new loans has narrowed, after a period of heavy discounting to existing clients when refinancing activity was high.

Discounts for New Borrowers Have Shrunk

Rate differences for outstanding and new variable owner-occupier housing loans.



Source: Company websites, Morningstar. Data as of July 1, 2025 (left). Reserve Bank of Australia, Morningstar. Data as of May 31, 2025 (right). Note: ANZ charges an additional AUD 10 per month for an offset account.

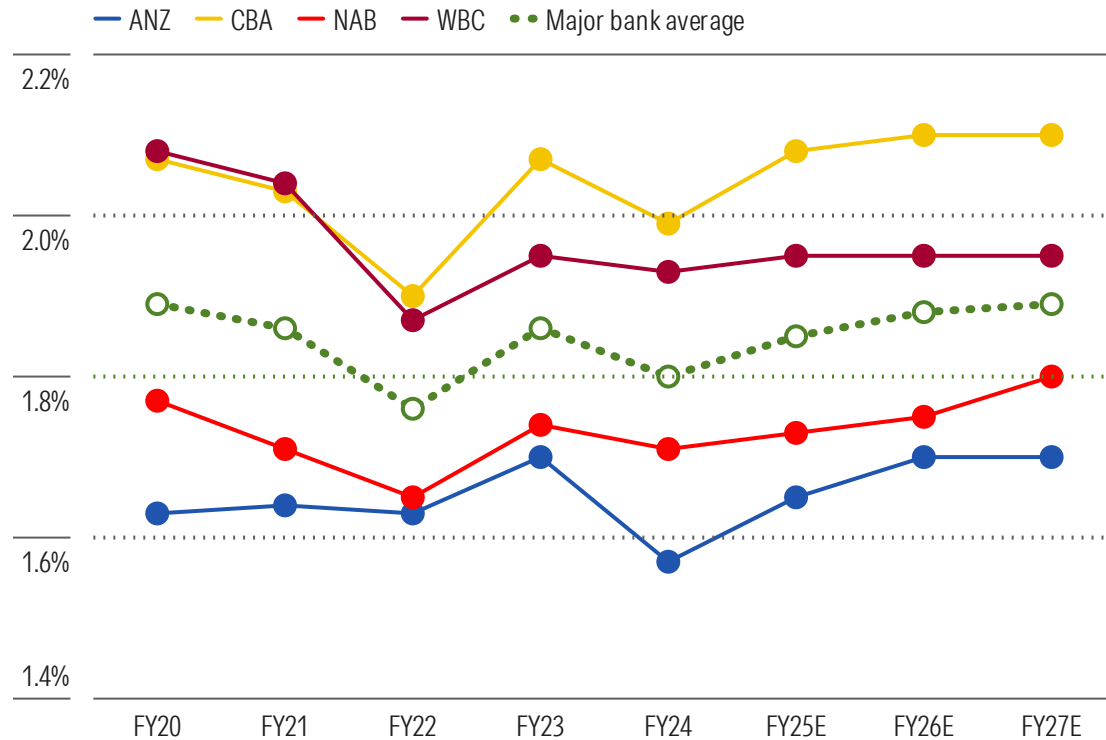
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Bank Profits Showing Resilience

Margins could soften in the short term as cash rates fall, but we expect a modest improvement in the medium term. We expect banks to gradually lower rates on savings and term deposits relative to the cash rate, and discount new home loans less.

NIM Rebound Likely to Flatten Out

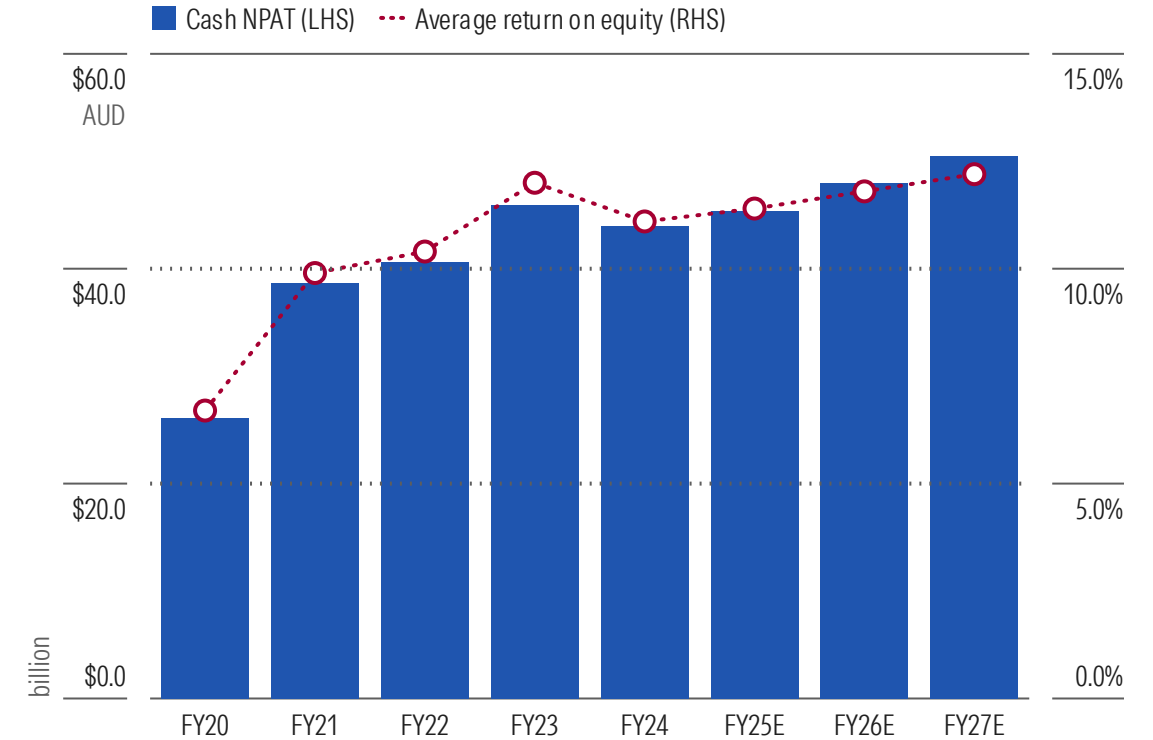
Morningstar NIM forecasts based on fiscal period.



With higher NIMs and low-single-digit loan growth, we forecast 5% net interest income growth per year to fiscal 2029. Net interest income is 80%-85% of revenue. While bad debts are likely to rise, cost-containment should see cash profits grow with revenue.

Net Interest Income Growth Key to Our Profit Forecasts

Sum of net interest income and profits for major banks.



Source: Company reports, Morningstar estimates. Data as of June 30, 2025. Note: NPAT = net profit after tax.

See Important Disclosures at the end of this report.

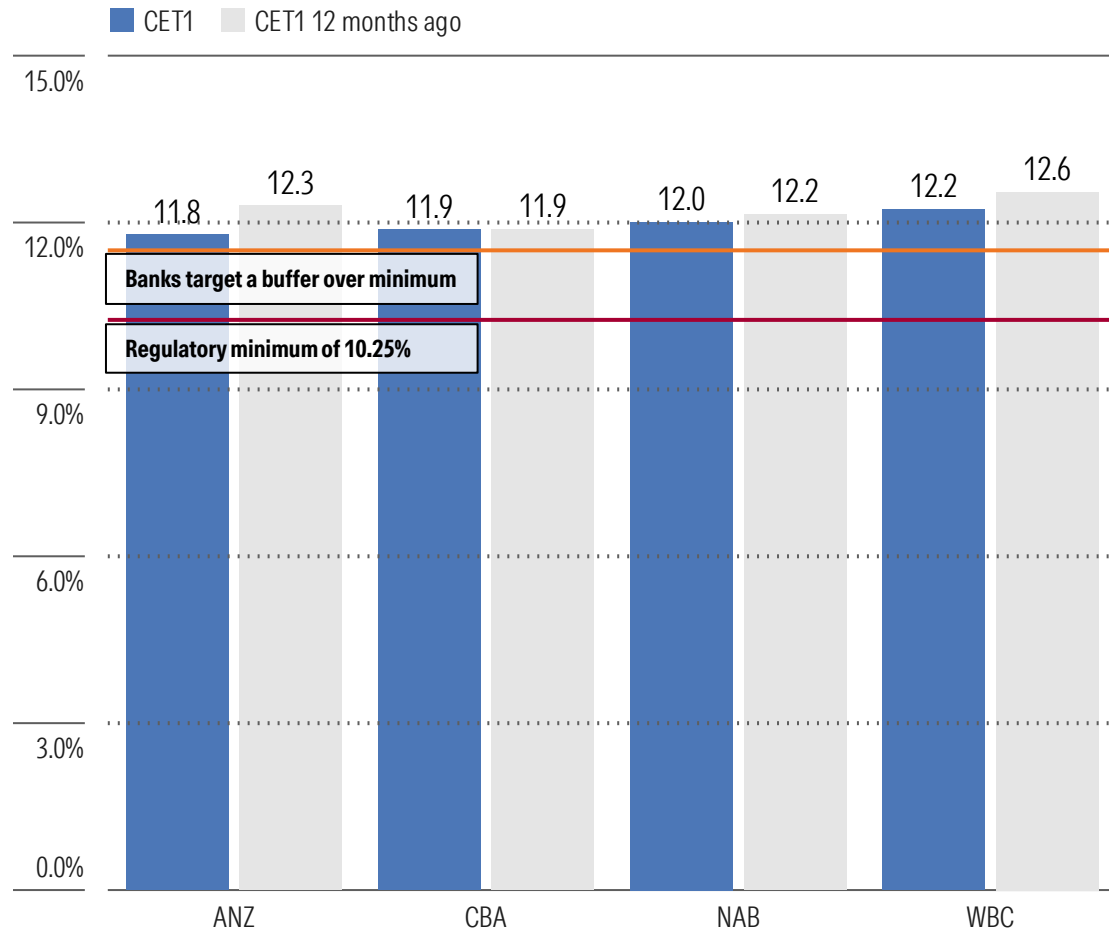
Capital and Credit Risk

In a good spot.

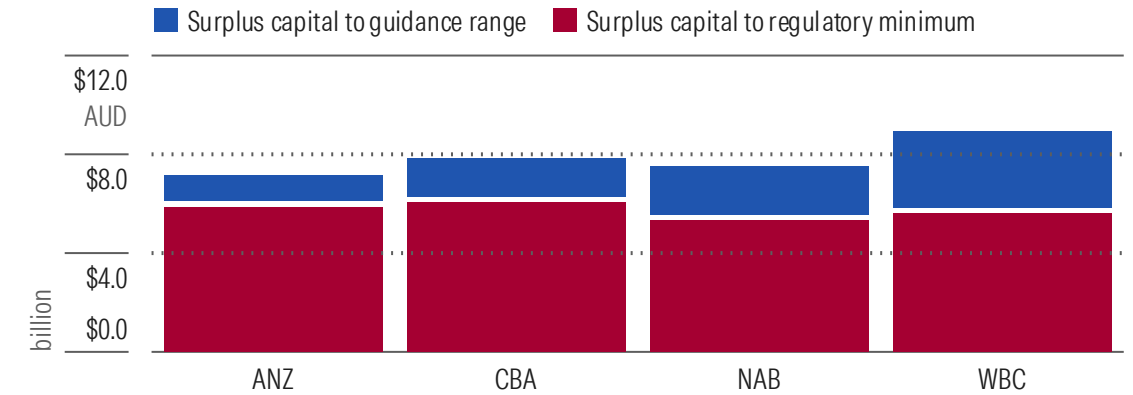
Bank Balance Sheets Are Sound and Providing Comfort

Major Banks Comfortably Exceed Regulatory Capital Requirements

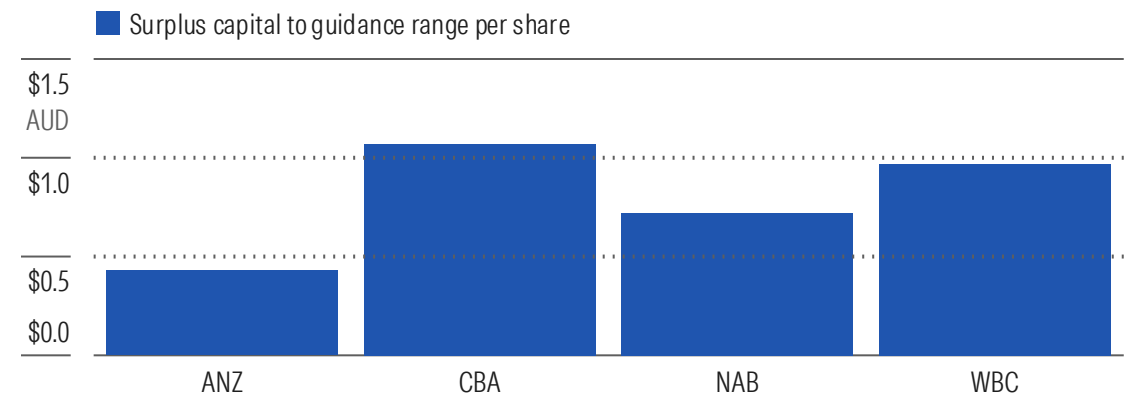
Common equity Tier 1 ratio compared with 12 months prior.



Substantial Surplus Capital Over Minimum Requirements



Surplus Capital Supports Dividends

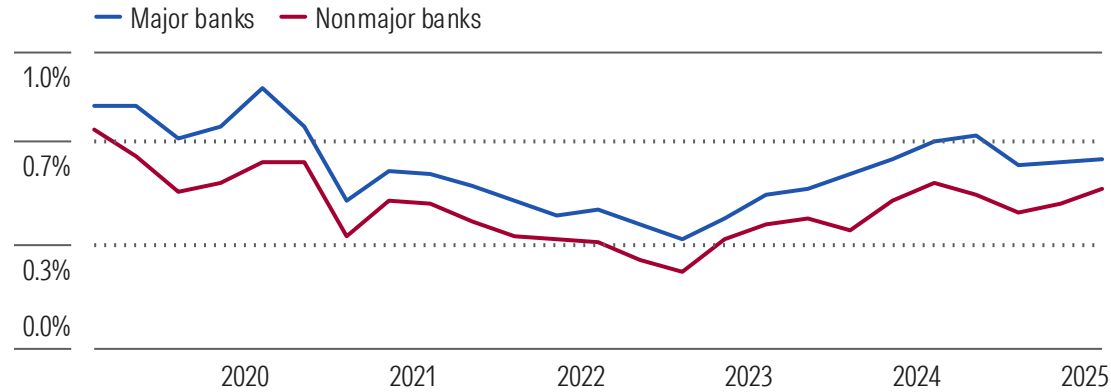


Source: Company reports. Morningstar. Data as of March 31, 2025. Surplus to guidance range based on top of bank target ranges of 11.0%-11.5%.

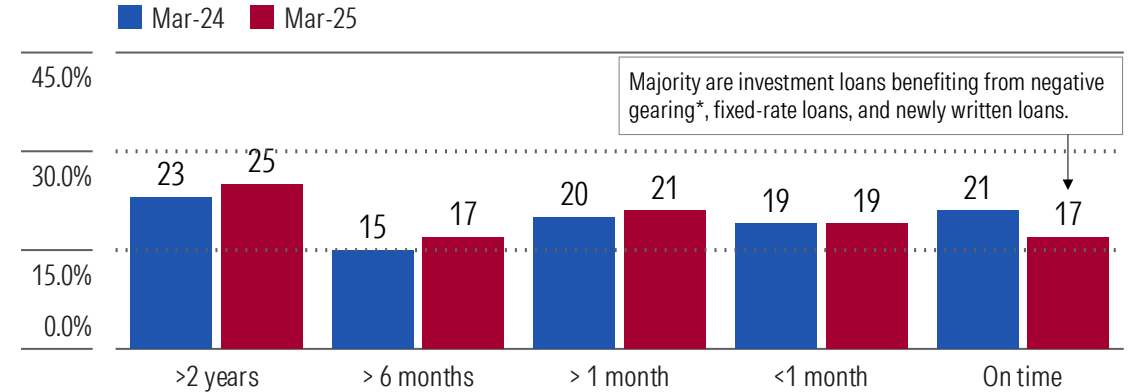
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Equity Buffers Derisk the Potential for Large Loan Losses

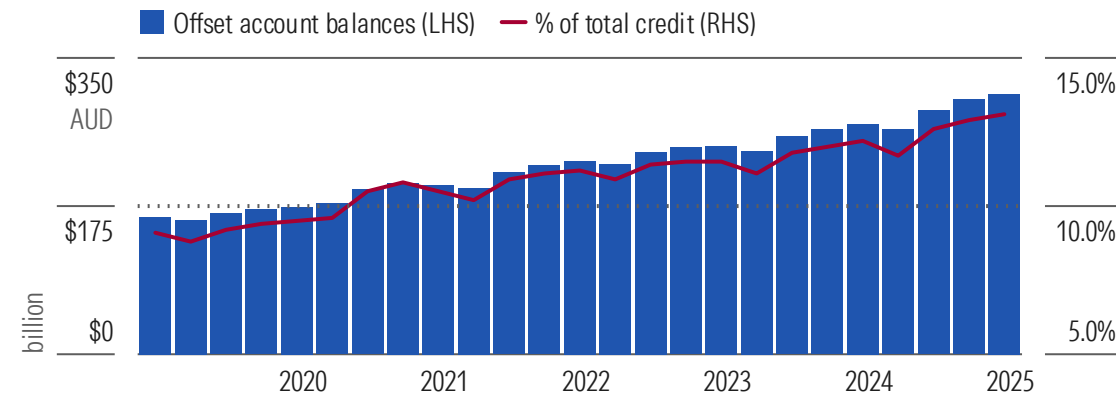
Home Loan Arrears: Tax Cuts Likely Helped Pause Upward Trend



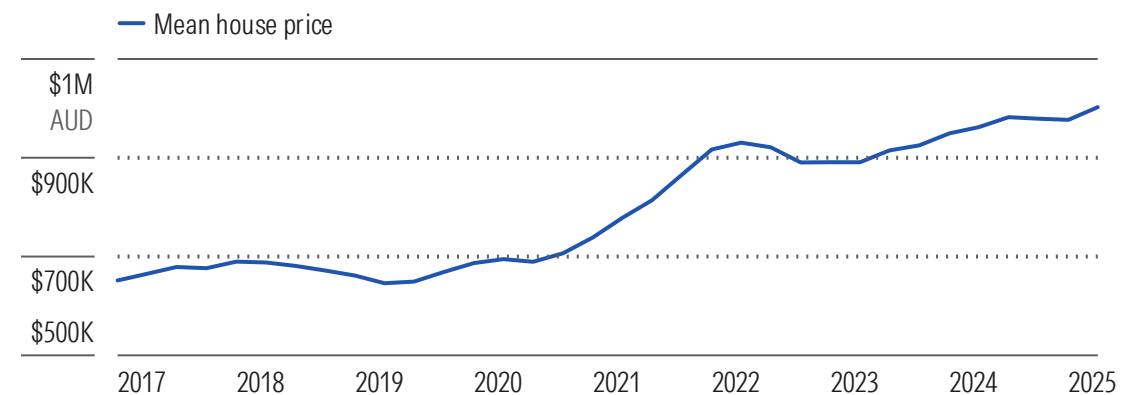
Payments in Advance: More Equity Supports Lower Loan Losses



Offset Accounts: Rising, but Likely on Loans, Which Are Already Lower Risk



House Prices: Expand Equity Buffers and Limit Bank Losses



Source: APRA. Data as of March 31, 2025 (top left and bottom left). Westpac, Morningstar. Data as of Mar. 31, 2025 (top right). Australian Bureau of Statistics. Data as of Mar. 31, 2025 (bottom right).

*Negative gearing occurs when the costs of an investment property exceed the income it generates, creating a tax loss, which can be offset against other taxable income.

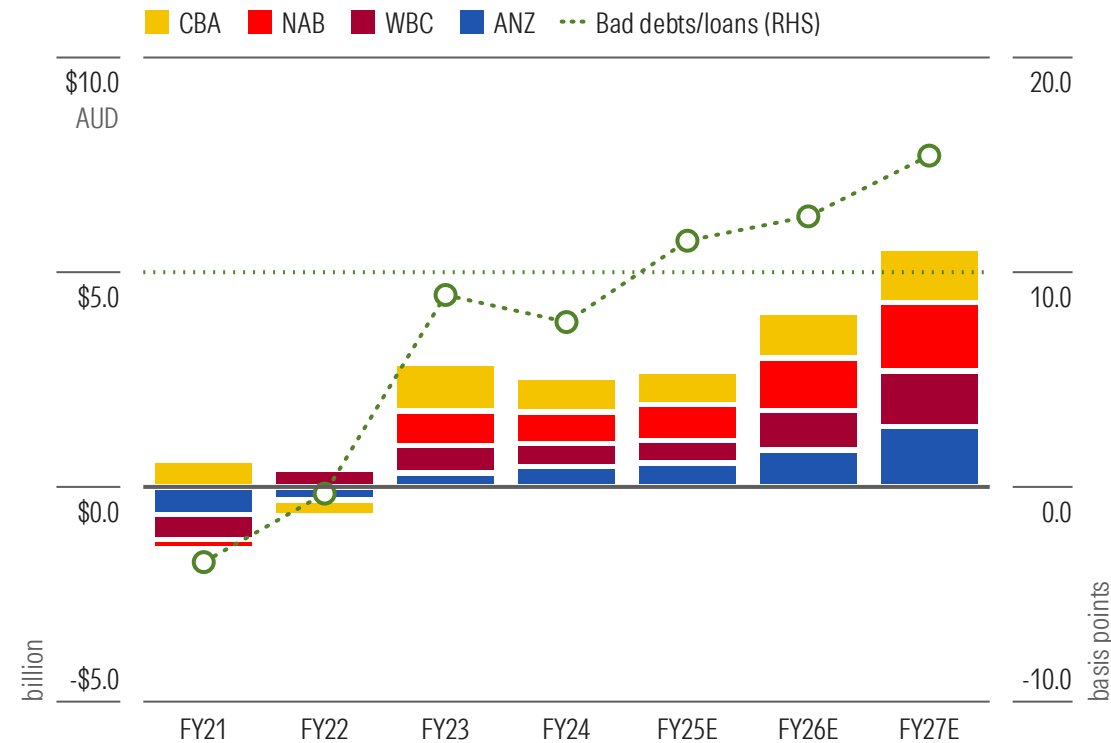
Well Provisioned, but Higher Bad Debts an Earnings Headwind

Low unemployment, borrower equity buffers, and loans written, assuming borrowers can meet repayments if interest rates increase by 3%, make a loan-loss spike well above long-term averages unlikely. Conservative provisioning is likely to unwind by fiscal 2027.

Provisions as a percentage of credit risk-weighted assets are well above 2019 levels. Banks are cautious about how businesses and households manage higher rates, along with the outlook for economic growth and employment.

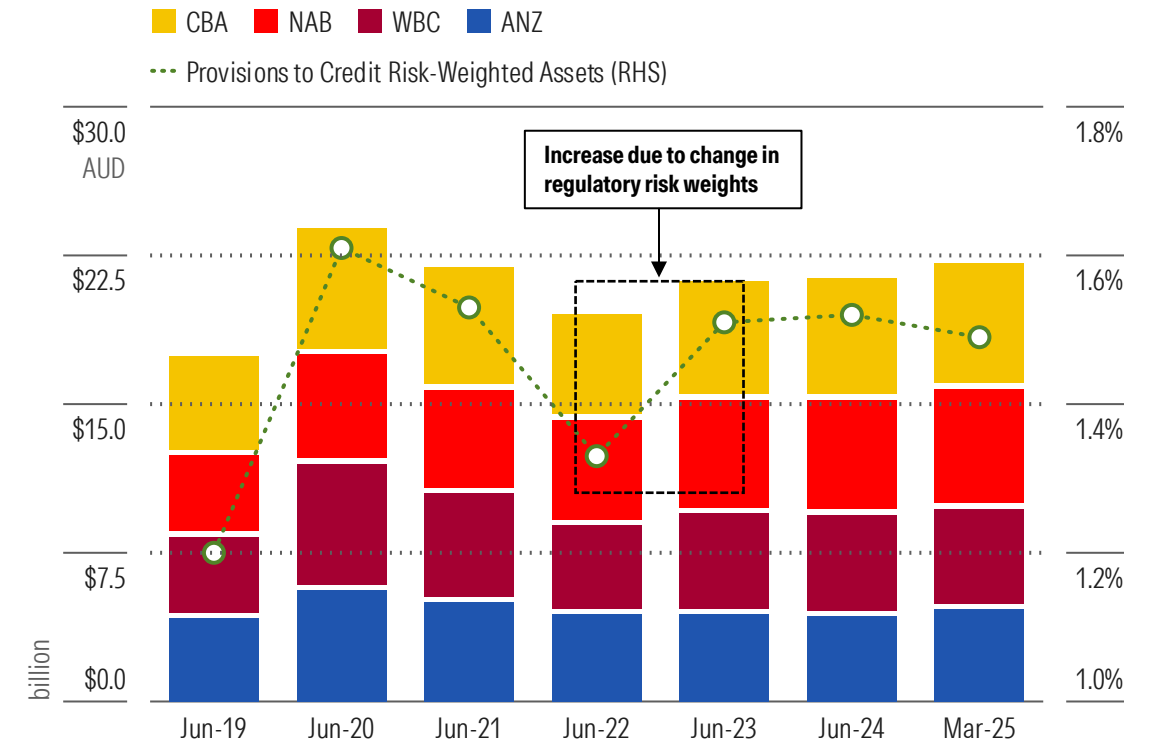
Major Banks' Bad Debts Set to Normalize, Not Spike

Bad debts (LHS) include incurred losses and changes to provisions.



Bank Provisions Are Earnings Buffer, Which Are Welcome Given Macro Uncertainty

Provisions (LHS) include collective and specific provisions.



Source: Company reports, Morningstar. Data as of March 31, 2025.

See Important Disclosures at the end of this report.

Top Picks and Coverage

Limited opportunities.

Upside in ANZ and MyState With Margin Fears Overstated

Australian Major Bank

	Company (Ticker)	Market Cap	Rating	Last Close	FV Est.	Moat
P/FV	ANZ Group (ANZ)	AUD 86.5 bn	★★★	29.2	31.0	Wide
1.75	<p>ANZ Group is the smallest of the wide-moat major banks in Australia, and while not as large as peers, cost advantages support our expectation of above cost of equity returns over the long term. ANZ resorted to discounting and cashbacks to arrest lost home loan market share, but we expect investments in process and digital offerings to make the bank more competitive in the future. While this comes with added costs, it should help drive earnings growth and returns on equity. We expect the acquisition of Suncorp Bank to improve bank efficiency modestly, increasing its funding from low-cost transaction accounts and leveraging its investment in technology, but the drawn-out integration and associated costs make it unlikely to be materially value-accretive.</p>					
1.50						
1.25						
1.00						
0.75						
0.50						
0.25						

Australian Nonmajor Bank

	Company (Ticker)	Market Cap	Rating	Last Close	FV Est.	Moat
P/FV	MyState (MYS)	AUD 0.7 bn	★★★★	4.2	5.1	None
1.75	<p>MyState commands a tiny 0.3% share of the Australian home loan market, but with investment in its digital offerings and an expanded sales team, has demonstrated an ability to profitably grow loans. We expect market share gains to be more difficult, with cost inflation and higher wholesale funding costs affecting smaller banks more than major banks. MyState margins fell more than major banks due to a greater reliance on term deposits, but means the small bank could benefit more as deposit pricing falls. MyState focuses on lower-risk owner-occupier borrowers with a loan/value ratio below 80%. The merger with Auswide Bank looks reasonable given potential cost synergies.</p>					
1.50						
1.25						
1.00						
0.75						
0.50						
0.25						

Higher-Quality Banks Attracting the Bigger Valuation Premiums

Company (Ticker)	Market Cap (AUD billion)	Moat Rating	Uncertainty Rating	Last Close	Fair Value	Star Rating	P/FVE	P/E	Yield	3-Mth Return	1-Year Return
ANZ Group (ANZ)	86.5	Wide	Medium	29.2	32.0	★★★	0.91	12.3	5.7%	-1.6%	+3.3%
Westpac Banking (WBC)	115.7	Wide	Medium	33.9	29.0	★★	1.17	16.4	4.5%	+6.2%	+24.3%
National Australia Bank (NAB)	120.2	Wide	Medium	39.4	32.0	★★	1.23	16.8	4.4%	+15.2%	+8.6%
Commonwealth Bank of Australia (CBA)	308.9	Wide	Medium	184.8	98.0	★	1.89	29.3	2.7%	+22.8%	+45.0%
Major Banks (average)							1.30	18.7	4.3%	+10.6%	+20.3%
MyState Bank (MYS)	0.7	None	Medium	4.2	5.1	★★★★★	0.83	15.0	5.0%	+8.2%	+12.6%
Bank of Queensland (BOQ)	5.1	None	Medium	7.8	7.5	★★★	1.04	13.4	4.6%	+14.7%	+33.9%
Judo Capital (JDO)	1.7	None	High	1.6	1.4	★★	1.16	22.4	0.0%	-16.3%	+24.2%
Bendigo & Adelaide Bank (BEN)	7.2	None	Medium	12.6	10.8	★★	1.17	13.9	5.0%	+18.1%	+10.0%
Nonmajor Banks (average)							1.05	16.2	3.6%	+6.2%	+20.2%
Liberty Financial Group (LFG)	1.0	None	High	3.3	4.5	★★★★★	0.74	7.1	9.6%	-6.2%	-11.2%
AMP (AMP)	3.2	None	High	1.3	1.35	★★★	0.93	11.5	3.2%	-1.6%	+15.1%
Macquarie Group (MQG)	87.2	Narrow	High	228.7	195.0	★★★	1.17	21.8	3.0%	+12.4%	+11.7%
Diversified Financials (average)							0.95	13.5	5.2%	+1.6%	+5.2%

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