MORNINGSTAR

Australian Banks: 2026 Q2

Modest earnings growth under threat; valuations remain elevated.

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Executive Summary

Rate hikes and tax changes leave borrowers hesitant.

Loan Growth Slows, Losses Mount—but Banks Stand on Solid Ground

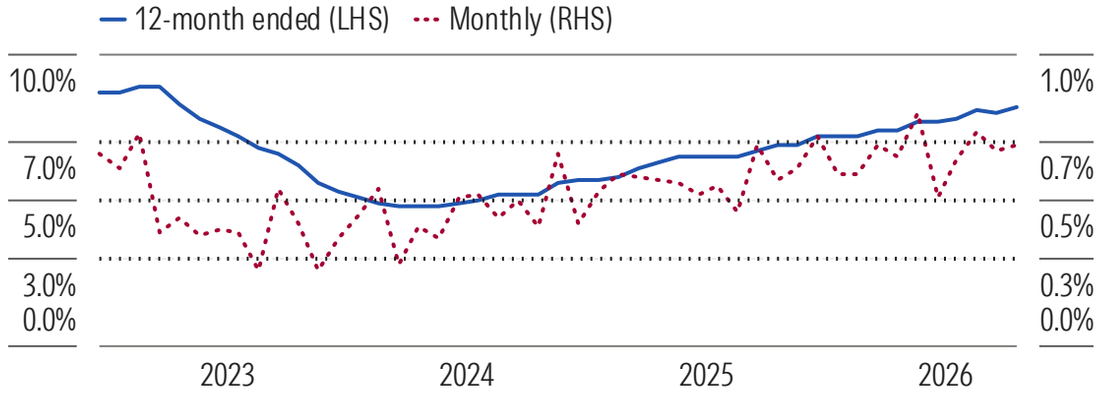
Australian major bank share prices weakened, first as banks increased provisions as the Iran war hit fuel security and costs, and then as higher cash rates and proposed tax changes clouded the outlook for consumers and housing. Total credit ran hot, with total growth on a year-ended basis of 8.2% to May 2026, but higher cash rates, economic uncertainty, and less appealing tax breaks cloud the outlook for houses and businesses.

We cut our fiscal 2027 and medium-term profit forecasts for the majors around 5%, with slower credit growth and a modest reduction to net interest margins. Competition for a smaller pool of new loans is likely to fuel discounting to keep and win customers. Our fair value estimates for ANZ, National Australia Bank, and Westpac were lowered 3%.

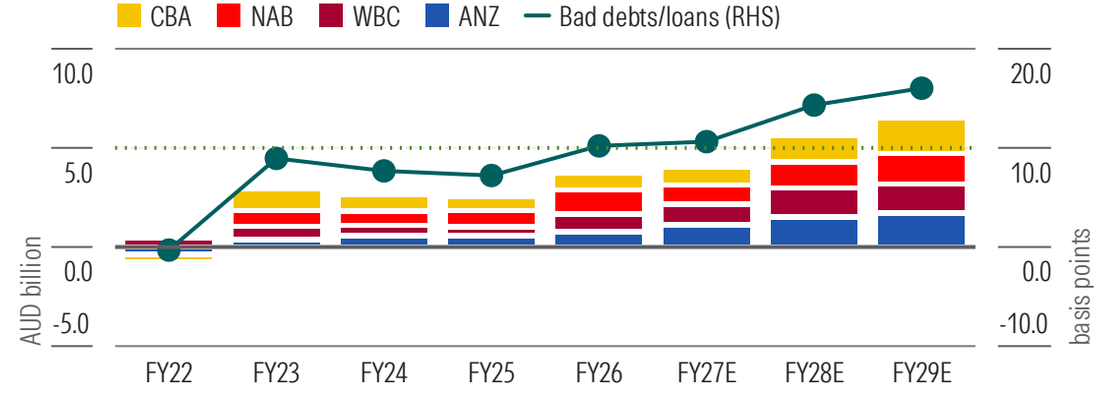
Moving into a period of higher rates, combined with tax changes potentially stifling investor demand, house price growth could moderate at the same time as unemployment is on the rise. Large household equity buffers and healthy bank provisioning balances should prevent a spike in bad debts, but an increase in losses is likely. Surplus capital also provides comfort. The majors hold AUD 12 billion above their targets. This is not as big as the AUD 18 billion surplus held two years ago, though, meaning this is less of a buffer to absorb losses and support dividends.

Typically, unemployment, medical issues, or relationship breakdowns trigger defaults. We don't expect lower house prices to materially worsen bad debts. The market is dismissing the risks, though, and the major banks are still overvalued.

Credit Growth: Upswing Likely Coming to an End



Bad Debts: Expected to Rise From Low Levels



Source: Reserve Bank of Australia. Data as of May 31, 2026 (top). Company reports, Morningstar. Data as of Dec. 31, 2025 (bottom). Commonwealth Bank, CBA. National Australia Bank, NAB. Westpac, WBC. ANZ Group, ANZ.

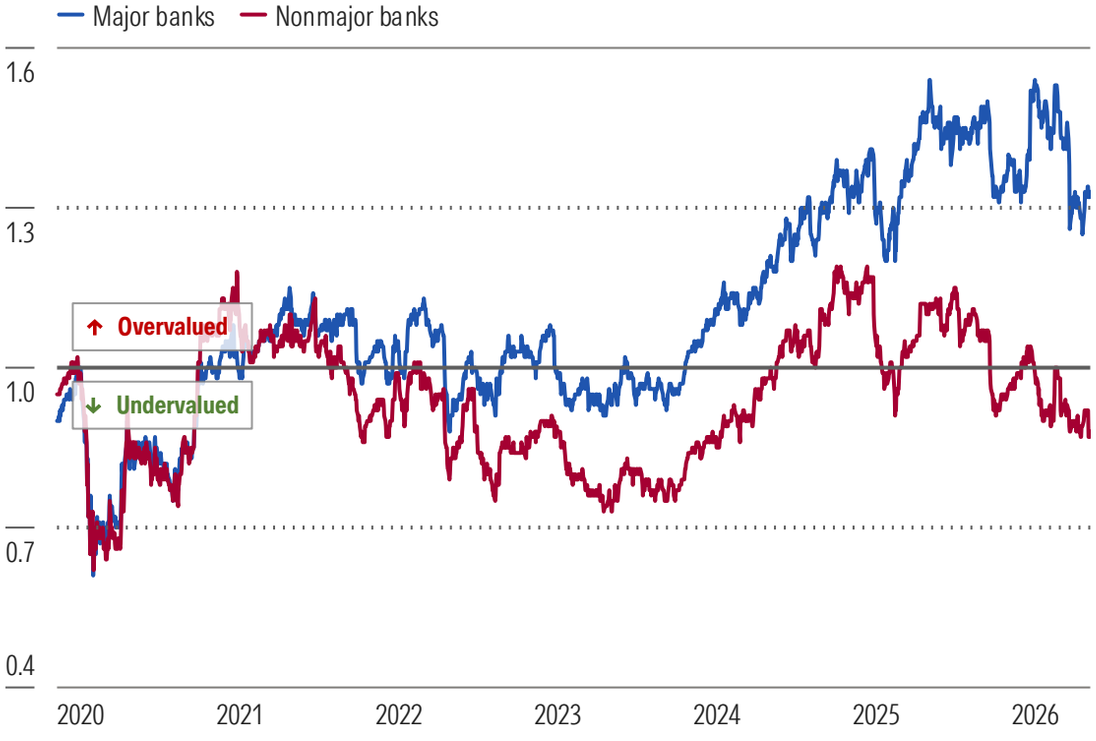
Shares Have Further to Fall to Match Earnings and Risks

The major banks' weighted-average price/fair value estimate fell to 1.33 from 1.41 in the previous quarter. Nonmajors ended the quarter at 0.88, steady with the previous quarter, with the higher interest rate environment hurting their competitive position.

Despite trailing peers over the past 12 months, Commonwealth Bank has outperformed so far this year. As the largest and most profitable bank, it is likely viewed as the safest option as uncertainty around loan losses rises.

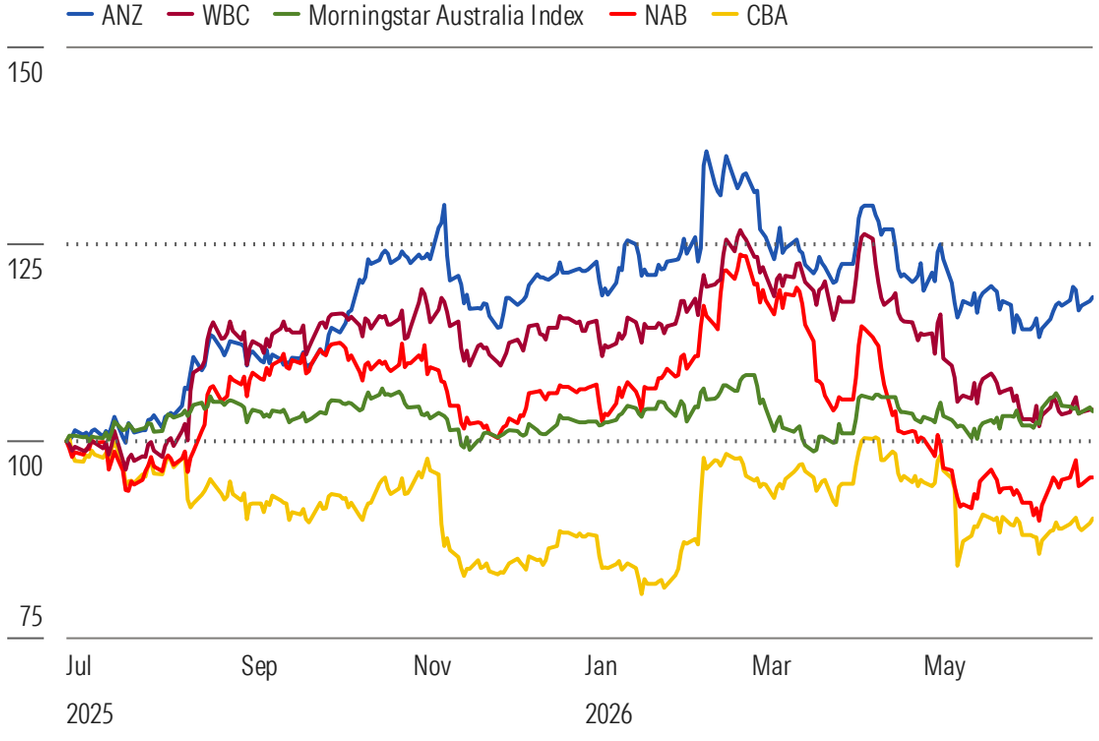
Most Australian Banks Are Overvalued

Weighted average price/fair value.



Potentially Higher Credit Stress in Commercial Lending Weighs Most on NAB

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, 2026.

Valuation

Majors look pricey; lower-quality names offer better value.

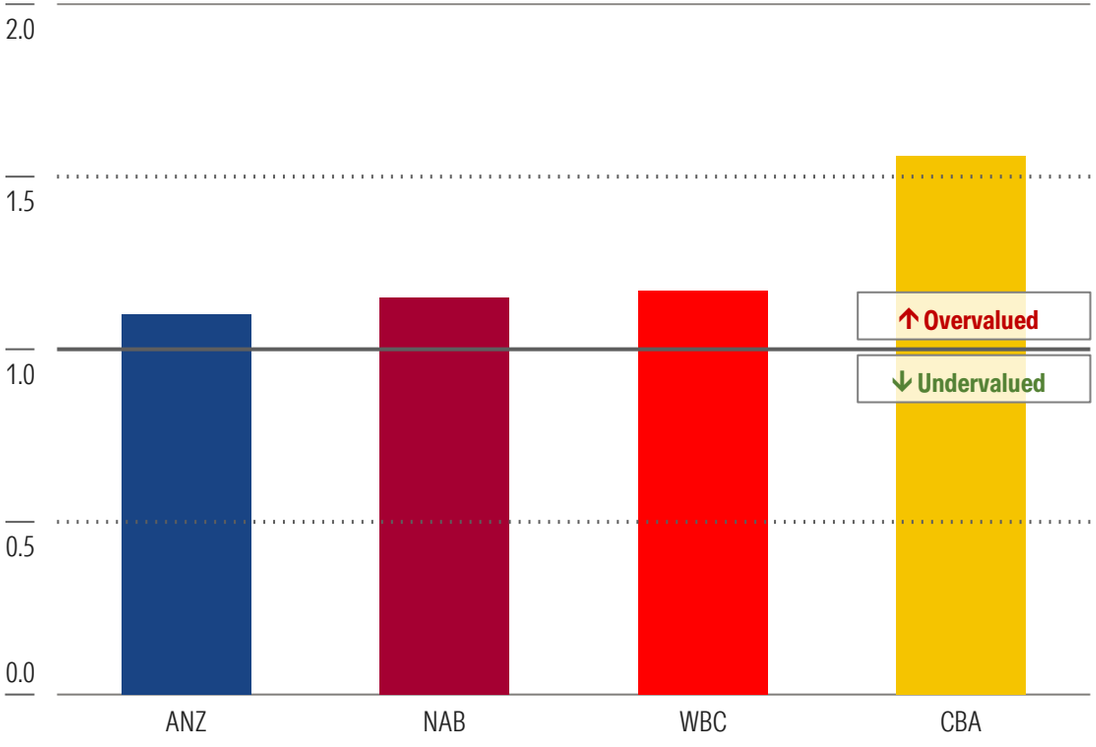
Best Relative Value in ANZ Group and Nonmajors

While no longer cheap, ANZ Group offers the most relative value among major bank peers, with improving operating efficiency. Commonwealth Bank is most expensive on a forward P/E of 25 times and a fully franked dividend yield of around 3%.

Weaker economic conditions are pushing bad debts higher for business lender Judo, but its selloff is overdone. A handful of exposures where the probability of losses has risen is not enough for us to infer that lending standards are inadequate.

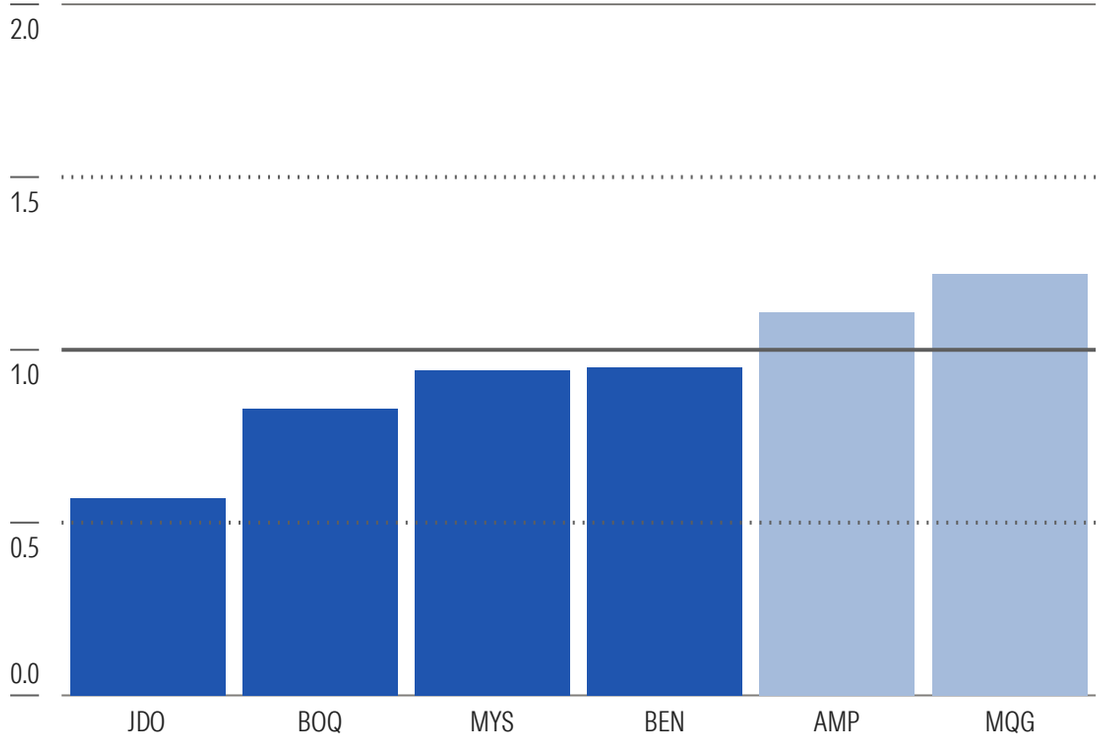
Major Banks Overvalued

Price/fair value.



Nonmajor Banks Are Lower-Quality but More Than Priced In

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



Source: Morningstar. Data as of June 30, 2026.

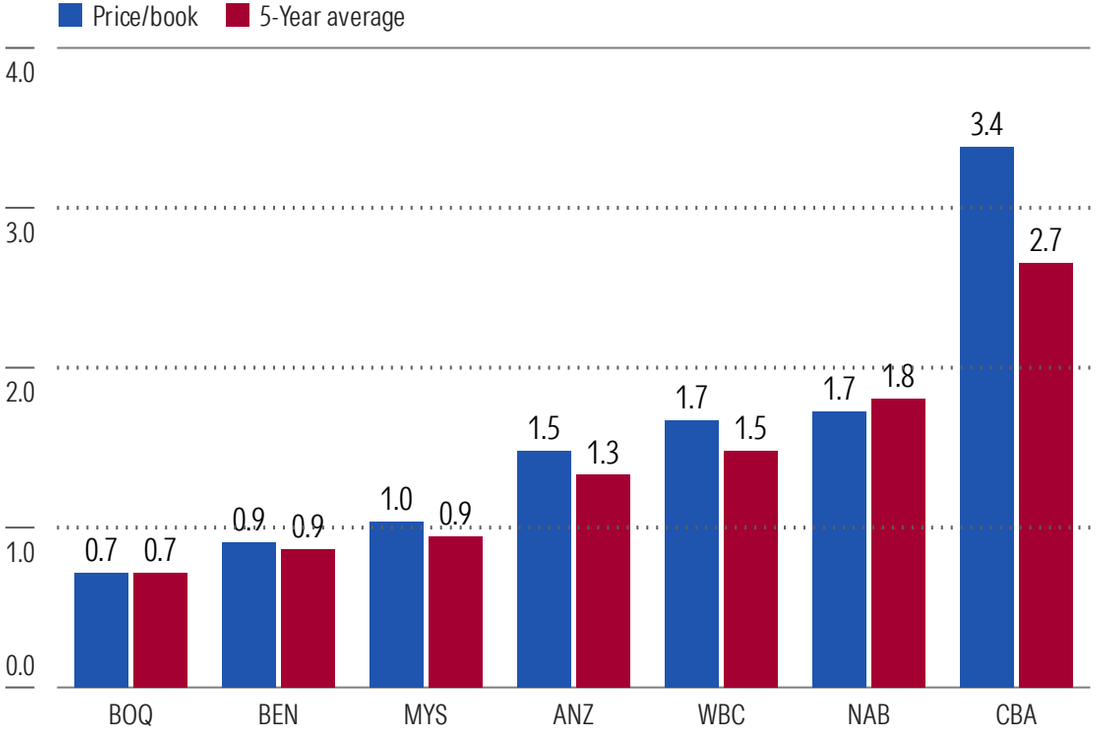
Major Bank Multiples Hard to Justify as Economic Headwinds Build

The valuation divergence between Commonwealth Bank and its peers is unjustifiably wide. If ANZ Bank can deliver similar earnings growth at a cheaper P/E, we expect its discount to peers to shrink.

With average dividend payout ratios of 75%, major bank dividends can grow in line with earnings. Yields on nonmajor banks are more appealing; investors are compensated for their lower quality and lack of moat.

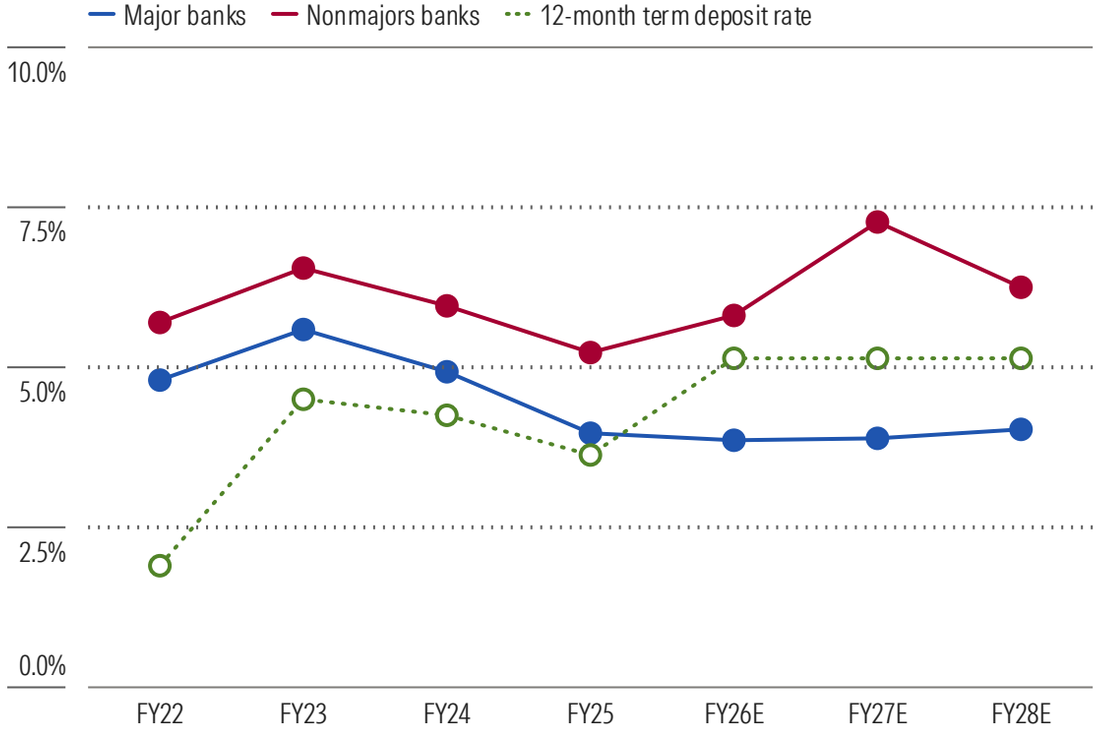
Price/Book Above Long-Term Averages for Most Banks

Five-year average is market-cap-weighted.



Major Bank Yields Less Appealing as Term Deposits Rise*

Bank dividend yield versus 12-month term deposit.



Source: Reserve Bank of Australia. Data as of May 31, 2026. *Nonmajors dividend yield includes Bank of Queensland paying a special dividend after selling equipment finance loans to Challenger.
Note: Forecast term deposit rate is based on the average of major banks' current advertised rates.

Credit Growth

Set to cool rapidly.

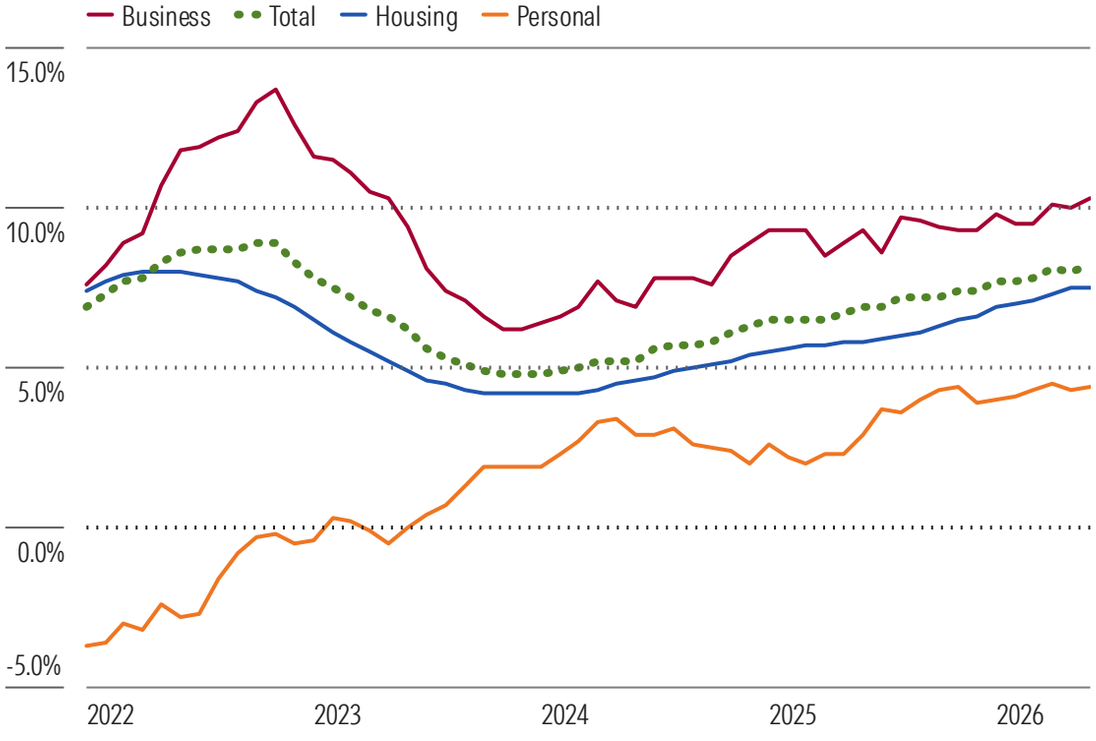
Battling Inflation and Housing Affordability Makes for a Tough Backdrop for Credit Expansion

Housing credit grew by 7.5% over the 12 months to the end of May 2026. Investor lending was particularly strong at 10.3%, but lower borrower confidence and capacity following rate hikes and changes to tax benefits are expected to materially slow growth.

Business lending accounts for around a third of total credit and has benefited from growing optimism about demand across many sectors. But with inflation remaining above target, rate hikes could damp confidence and slow growth.

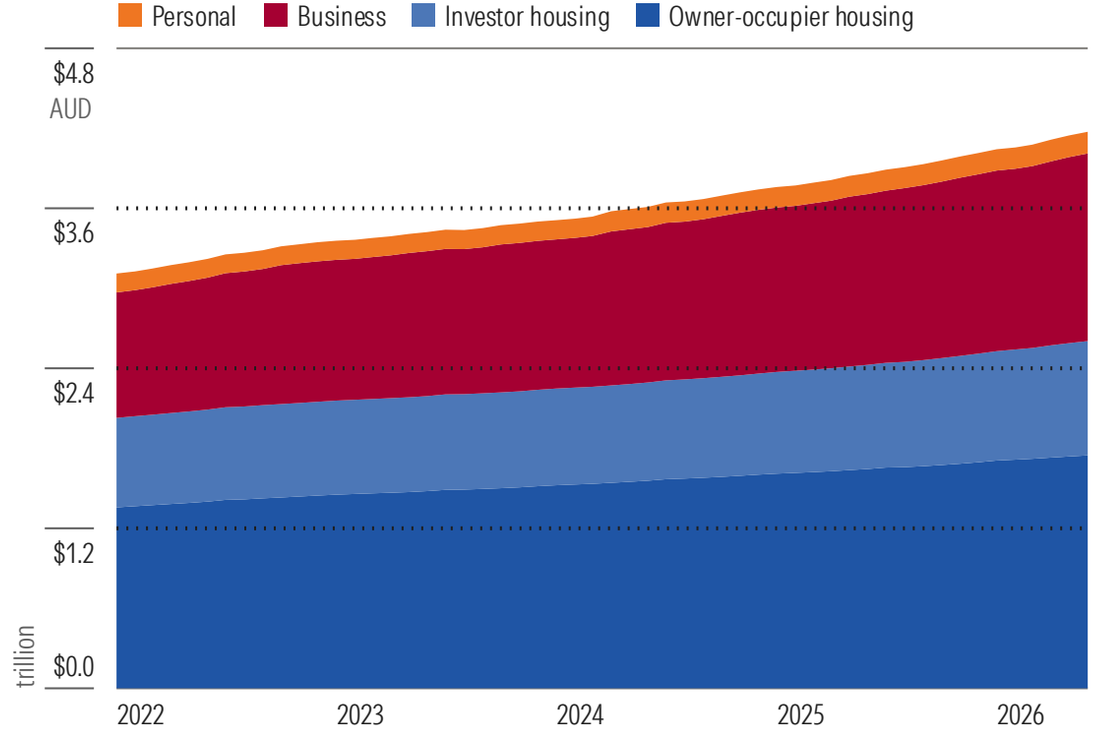
Credit Growth to Slow From Buoyant Levels

Australian credit growth by sector—12 months ended May 2026.



Business Lending Is Big Enough to Move Dial on Overall Credit Growth

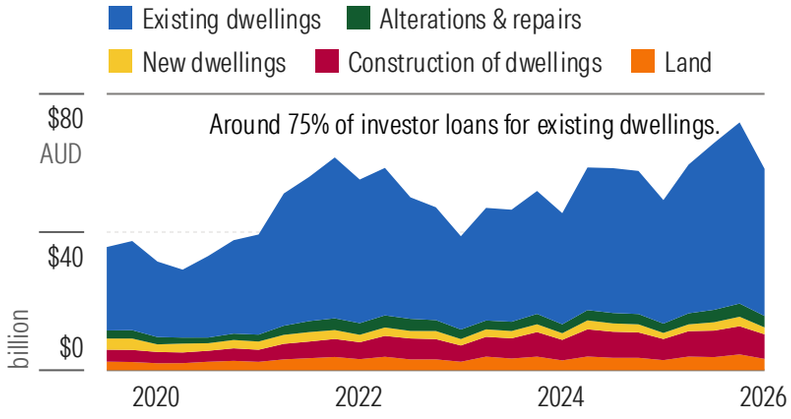
Australian credit by sector.



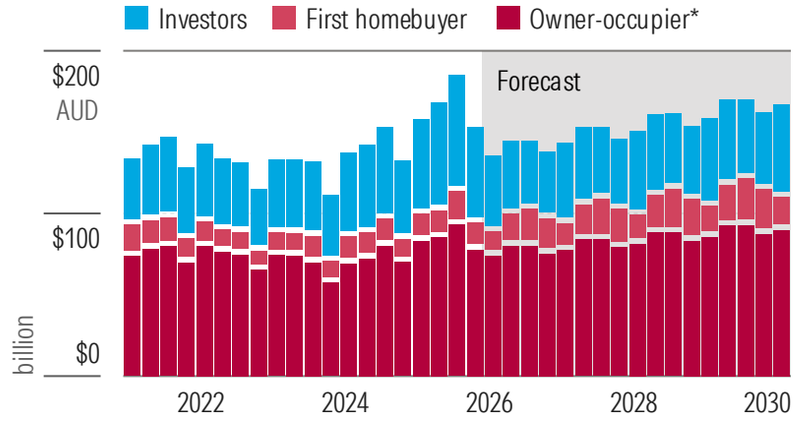
Source: Reserve Bank of Australia. Data as of May 31, 2026.

Tax Changes to Curb Investor Credit Growth

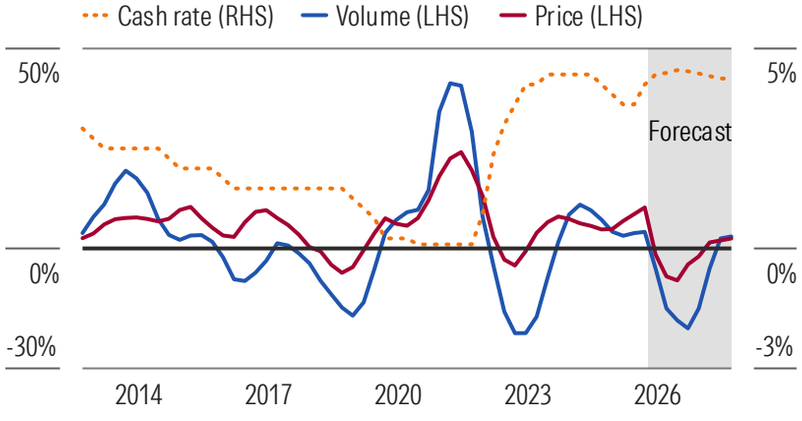
Investment Into Existing Dwellings Disincentivized



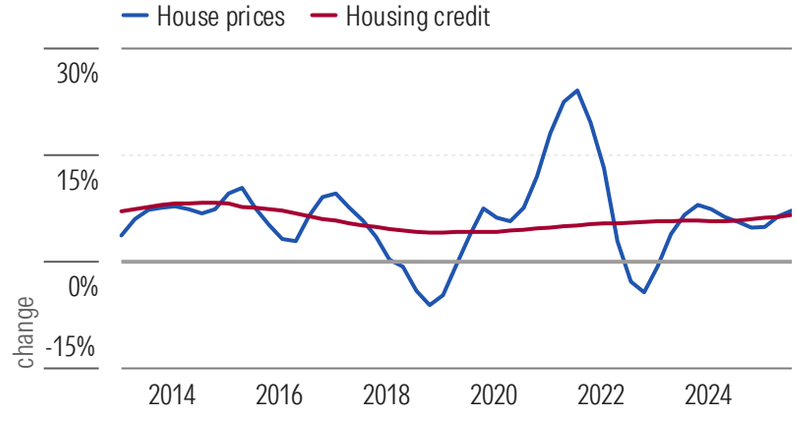
And Likely Slows New Lending



Lower Sales Volumes and House Prices Expected



But House Prices Are Not the Key to Credit Growth



Fewer Investors to Slow Growth

We forecast credit growth of around 2.5% in 2027. This is based on investor lending falling around 30% and a modest increase in first-time homebuyer activity. Weak consumer confidence and soft house prices cause hesitancy from buyers and sellers, and a fall in turnover and prices is likely, as in previous downturns. High construction costs for new dwellings and no oversupply are expected to support prices of existing dwellings.

Population and Wages Growth Matter More

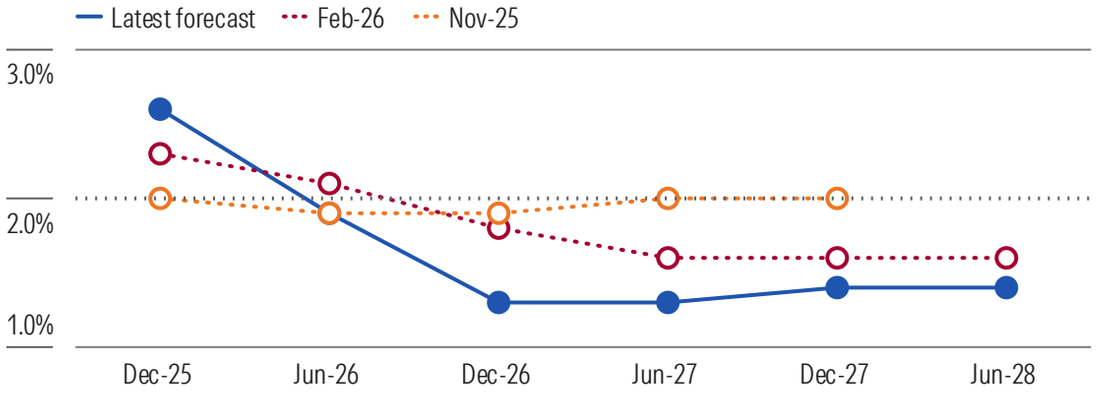
House prices influence the size of individual loans but are more a symptom than a cause of credit growth overall.

Population and wages growth, plus borrowing capacity, which is influenced by rates, are the key drivers. Every 0.5% interest rate rise reduces borrowing capacity by roughly 5%-7%.

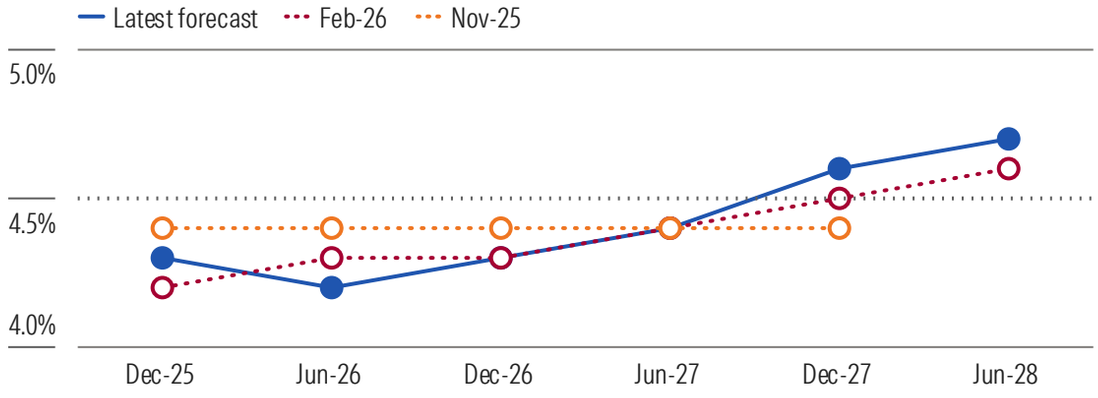
Source: ABS, Morningstar (top left and right). RBA, ABS, Cotality, Morningstar (bottom left). RBA, Cotality (bottom right). Data as of March 31, 2026.
*Owner-occupiers excluding first homebuyers.

Economic Backdrop Softening, but Still Decent for Banks

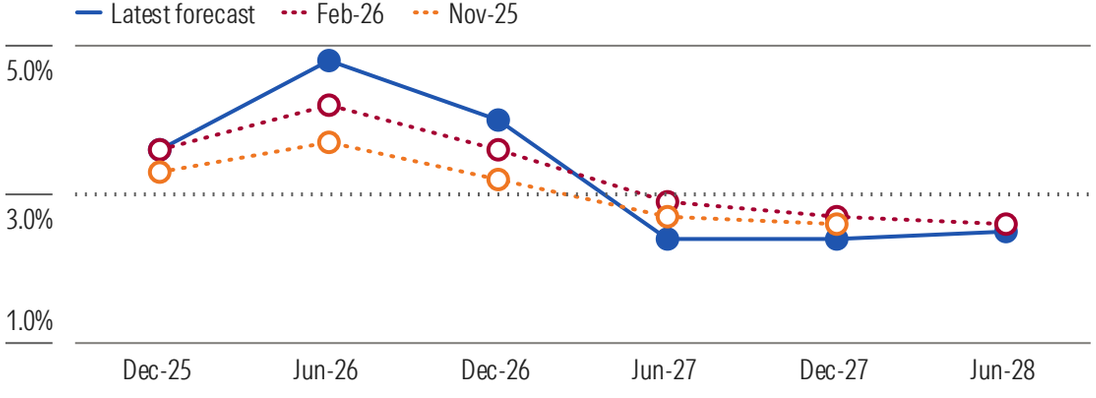
GDP: Sticky Inflation and Weaker Housing Weigh on Economic Growth Prospects



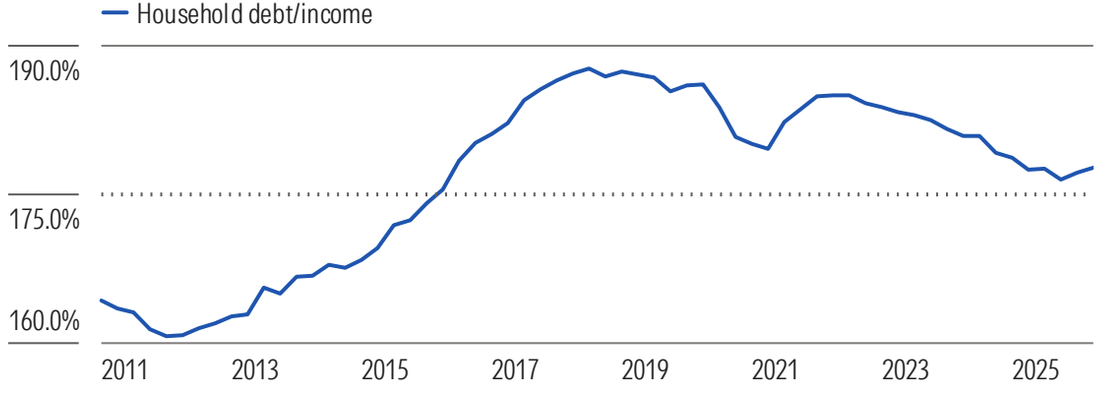
Unemployment: Expected to Rise, but Bank Credit Quality Sound



Inflation: Getting Back to 2%-3% RBA Target Proving Difficult



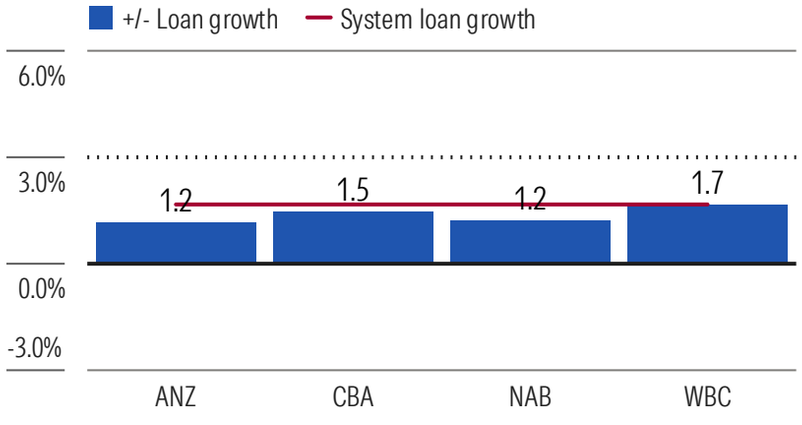
Household Debt/Income: Material Bounce in Leverage Unlikely



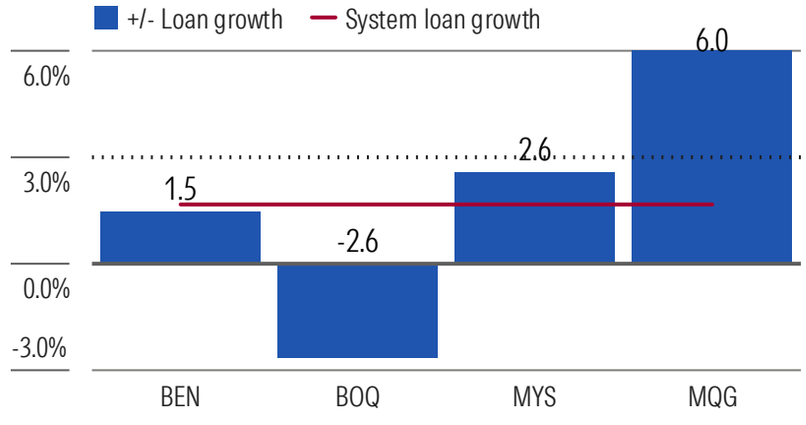
Source: Reserve Bank of Australia. Data as of May 31, 2026 (top left, top right, and bottom left). Data as of March 31, 2026 (bottom right).

Housing Loans: Macquarie Continues to Needle the Big Banks in the Home Loan Race

Majors' Housing Loan Growth Over Past Three Months*

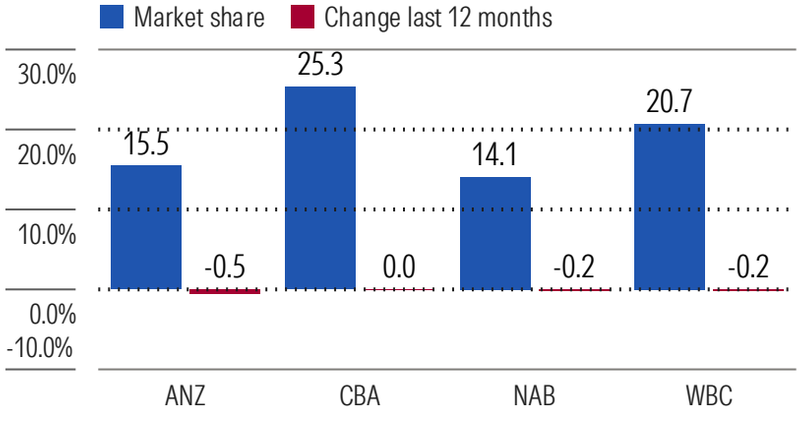


Nonmajors' Housing Loan Growth Over Past Three Months*

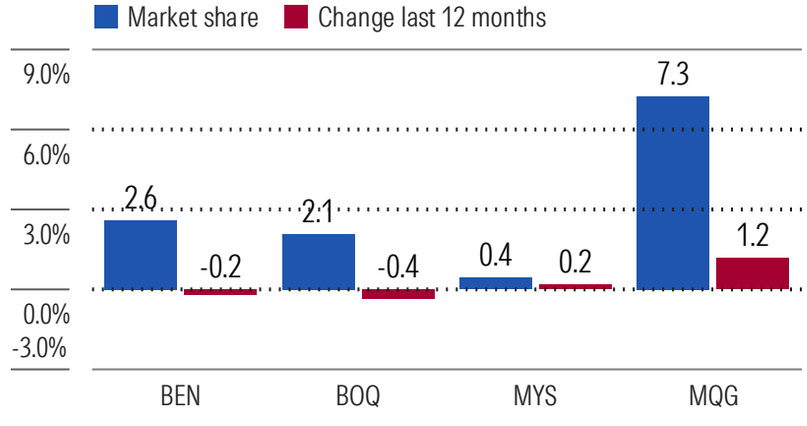


Based on Australian Prudential Regulation Authority data, home loan balances grew 1.7% in the quarter to May 2026, or 6.7% annualized. Rate cuts during 2025 strengthened borrower confidence and increased borrowing capacity. Wage growth, tax cuts, and lower inflation also helped. But recent rate hikes, an oil supply shock, and the government's changes to tax incentives for residential investors are likely to slow growth for the remainder of the year and into next year.

Major Banks' Market Share



Nonmajor Banks' Market Share*

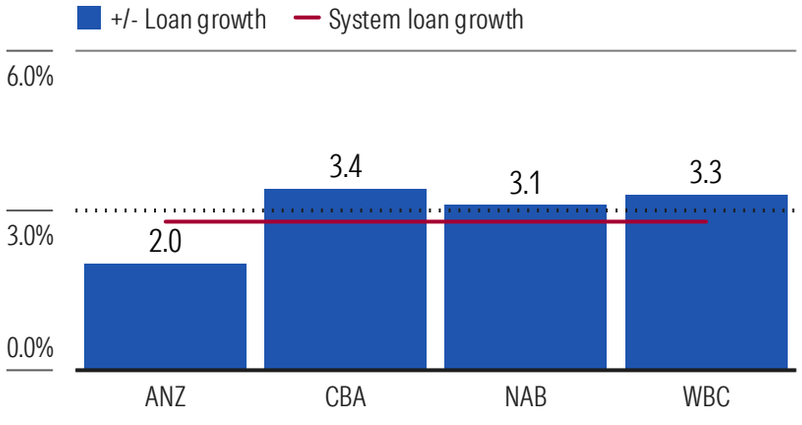


Major banks are broadly holding share, with ANZ's reluctance to compete on price costing it ground. Macquarie has been the standout, accelerating share gains largely at the expense of broker-dependent smaller lenders—though this looks set to fade as rivals lift their broker offerings and rising interest rates give transaction deposit-rich banks greater room to compete on price.

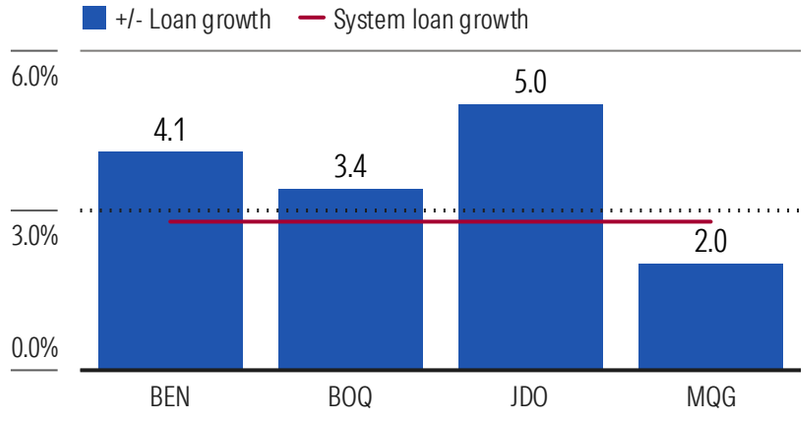
Source: Australian Prudential Regulation Authority, Morningstar. *Data for period ended May 31, 2026. Note: MyState housing loan growth adjusted for Auswide Bank merger.

Business Loans: Solid Growth, Softer Outlook

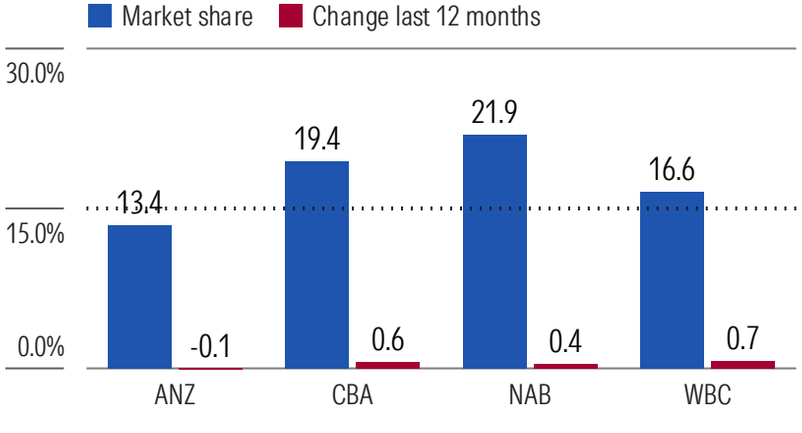
Majors' Business Loan Growth Over Past Three Months*



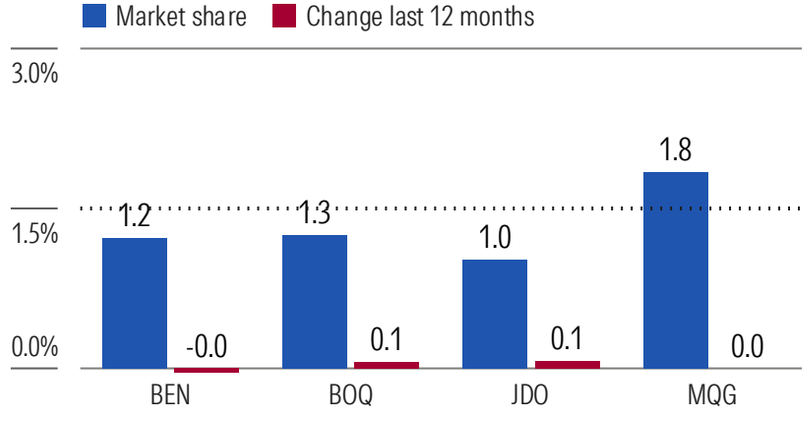
Nonmajors' Business Loan Growth Over Past Three Months*



Major Banks' Market Share



Nonmajor Banks' Market Share*



Business loan balances grew 2.8% in the quarter to May 2026, an annualized rate of 11.2%. We expect growth to moderate to around 5% in the second half of 2026, reflecting an outlook for muted economic growth. Businesses are likely to become more cautious, as uncertainty around consumer demand weighs on investment intentions. ANZ-Roy Morgan and Westpac-Melbourne Institute consumer sentiment readings are among the weakest in their history.

Major banks are investing in growth by adding new bankers and digitizing more of the approval process. Some selective discounting persists, though banks generally view this as a more effective use of capital than competing through the mortgage broker channel. We expect Judo Capital's model—centered on dedicated relationship bankers and fast approvals—to remain a meaningful point of difference in winning business lending share.

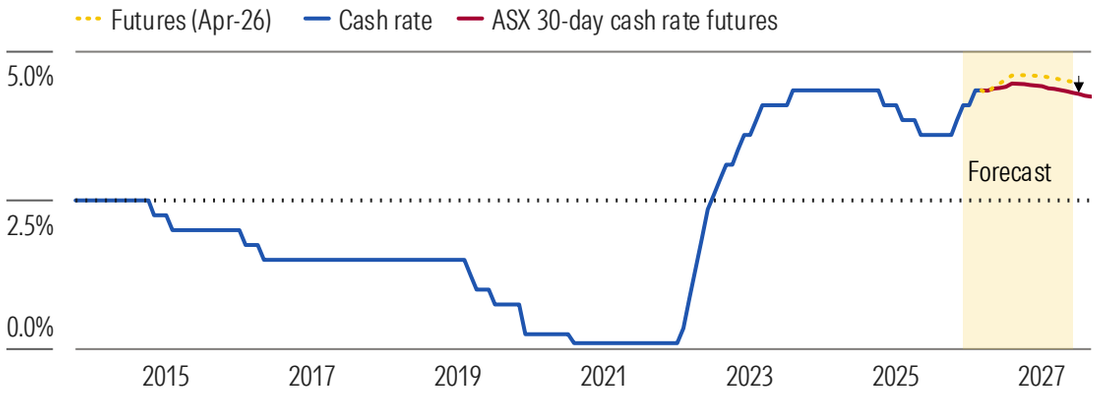
Source: Australian Prudential Regulation Authority, Morningstar. *Data for period ended May 31, 2026.

Interest Margins

Slower growth sharpens competition on price.

Rising Rate Risk Collides With Household Stress

RBA Cash Rate: Brief Period of Easing Gives Way to Tightening Cycle

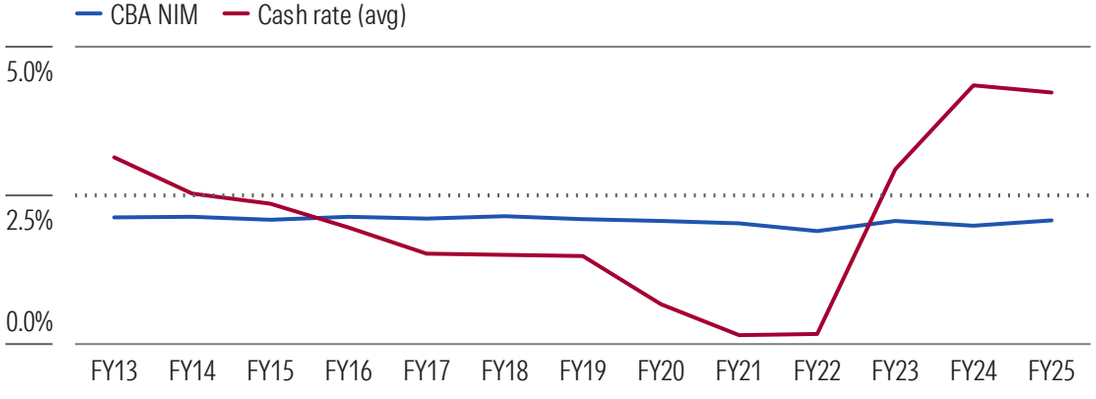


RBA Tackles Inflation Despite Household Headwinds

The RBA's cash rate target currently sits at 4.35%. Monetary easing saw the rate fall 0.75% in 2025, but inflation continued to break away from the target range and pushed the RBA to reverse course. Three 0.25% rate hikes so far in 2026 focused on combating homegrown inflationary pressures, with the Middle East conflict and oil prices only adding uncertainty.

ASX 30-day futures point to a cash rate around 4.45% by December 2026, pricing in a small chance of a rate hike. This is above the restrictive 4.35% level of late 2023 and 2024. Major bank economists are broadly in agreement with the market.

Competition Mostly Drives NIMs, Not Cash Rate



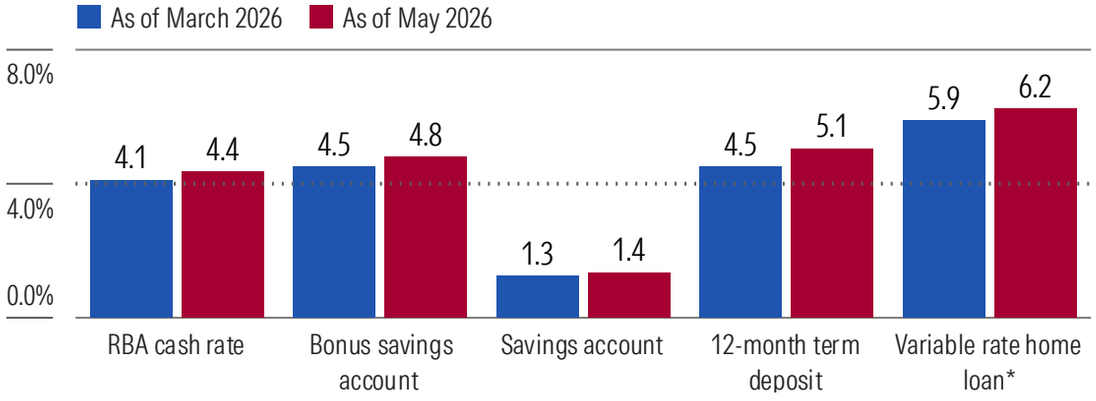
Higher Rates Are Generally Favorable for Margins

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 the key variable, and we expect the upside will be competed away. Banks aim to manage lending and deposit rates to ensure a net interest margin sufficient for an adequate return on equity.

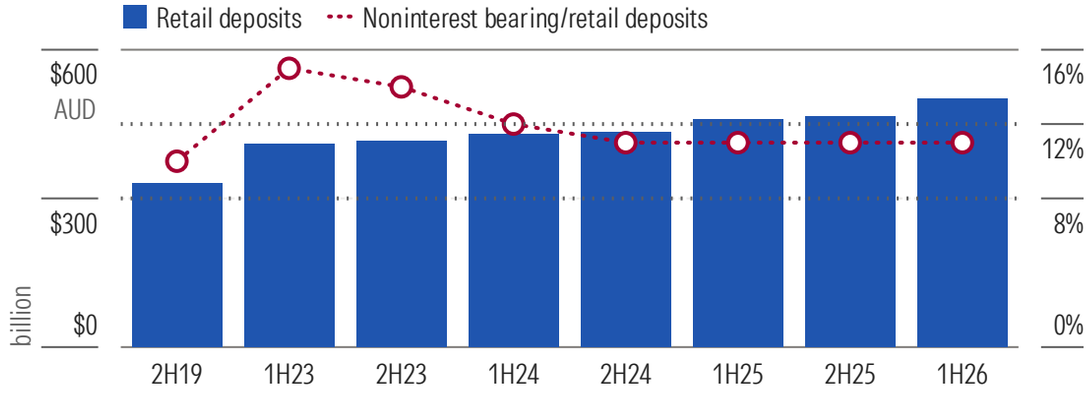
Source: Reserve Bank of Australia. Data as of June 30, 2026 (top). Commonwealth Bank, RBA, Morningstar. Data as of June 30, 2025 (bottom).

Banks With Cheaper Deposits Better-Placed, Aided by Customer Inertia

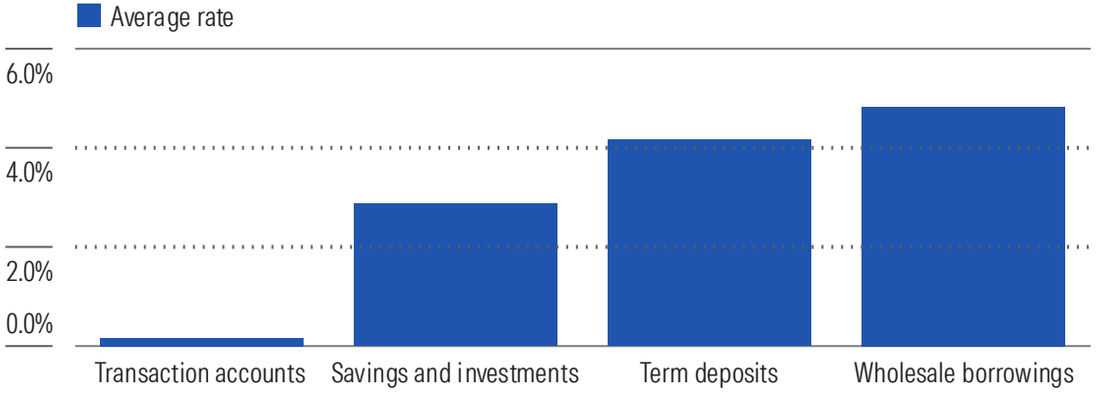
Rates: Rate Asymmetry to Temporarily Widen Bank Margins



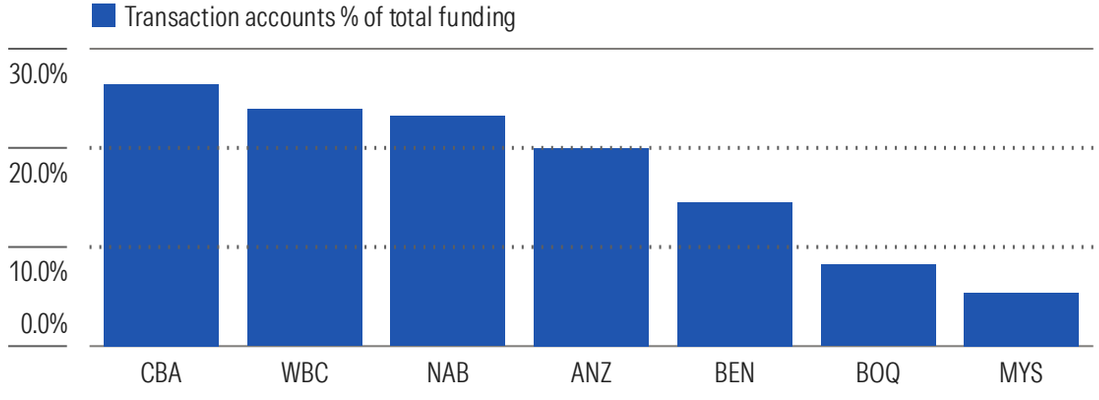
Switching: Deposit Mix Stable for Commonwealth Bank



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, 2026. *Variable rate for new home loans (top left). Commonwealth Bank result presentation—retail deposits. Morningstar. Data as of Dec. 31, 2025 (top right). Bendigo Bank result presentation, Morningstar. Data as of Dec.31, 2025 (bottom left). Company reports, Morningstar. CBA, BEN, MYS as of Dec. 31, 2025; BOQ as of Feb. 28, 2026; compared with March 31, 2026, for other major banks (bottom right).

See Important Disclosures at the end of this report.

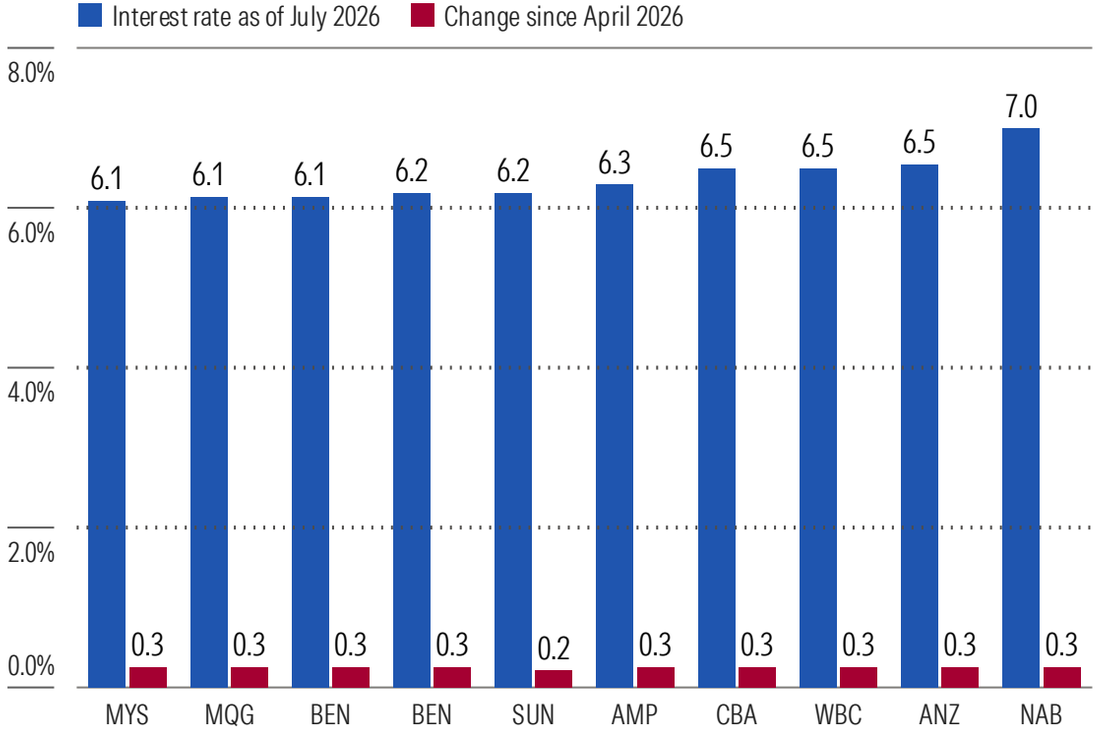
Rate Rises Squeeze Home Borrowers

The RBA's recent rate hikes have been passed on in full, partially unwinding the 0.8% fall in advertised lending rates during 2025. Major bank average advertised lending rate is 0.40% higher than nonmajor banks.

The spread between outstanding and new loan rates is currently tight. However, as rising rates expand bank margins, the additional headroom could fuel competitive discounting and widen the differential again.

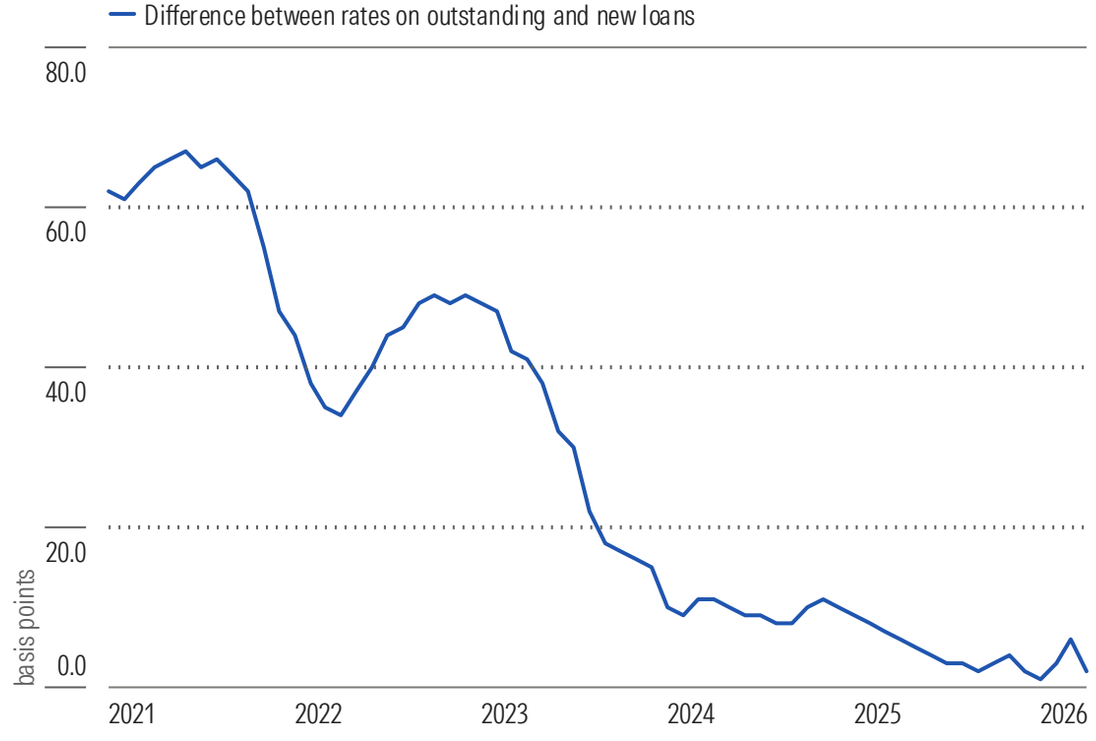
Major Banks Advertise Highest Owner-Occupier Variable Rates

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



Less Aggressive Discounting for New Borrowers

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



Source: Company websites, Morningstar. Data as of July 1, 2026 (left). Reserve Bank of Australia, Morningstar. Data as of April 30, 2026 (right). Note: Some banks charge additional fees for offset accounts.

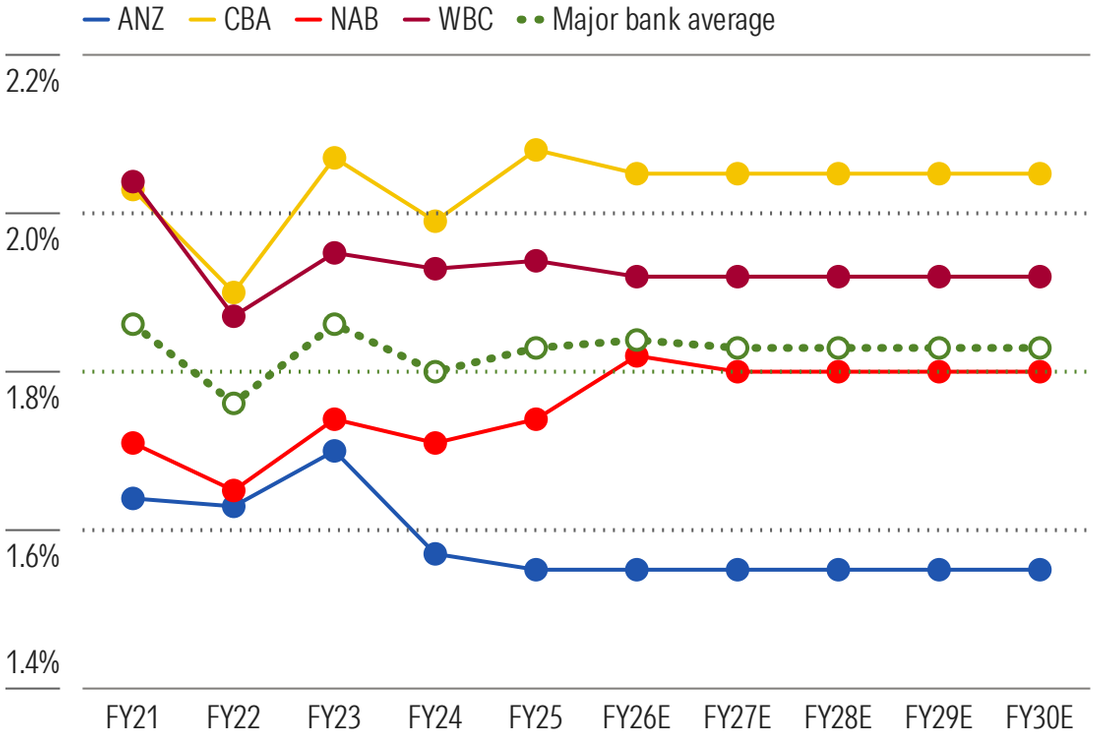
Modest Loan Growth and Cost Discipline Drive Bank Profit Growth

We expect intense competition and soft credit growth to expunge potential upside from higher cash rates. We expect banks to lift rates on savings and term deposits broadly in line with changes to the cash rate and to discount home loans more.

On flat NIMs and low-single-digit loan growth, we forecast 4% net interest income growth per year to fiscal 2030. Net interest income is around 85% of revenue. Bad debts are likely to rise, but cost containment sees cash profits grow with revenue.

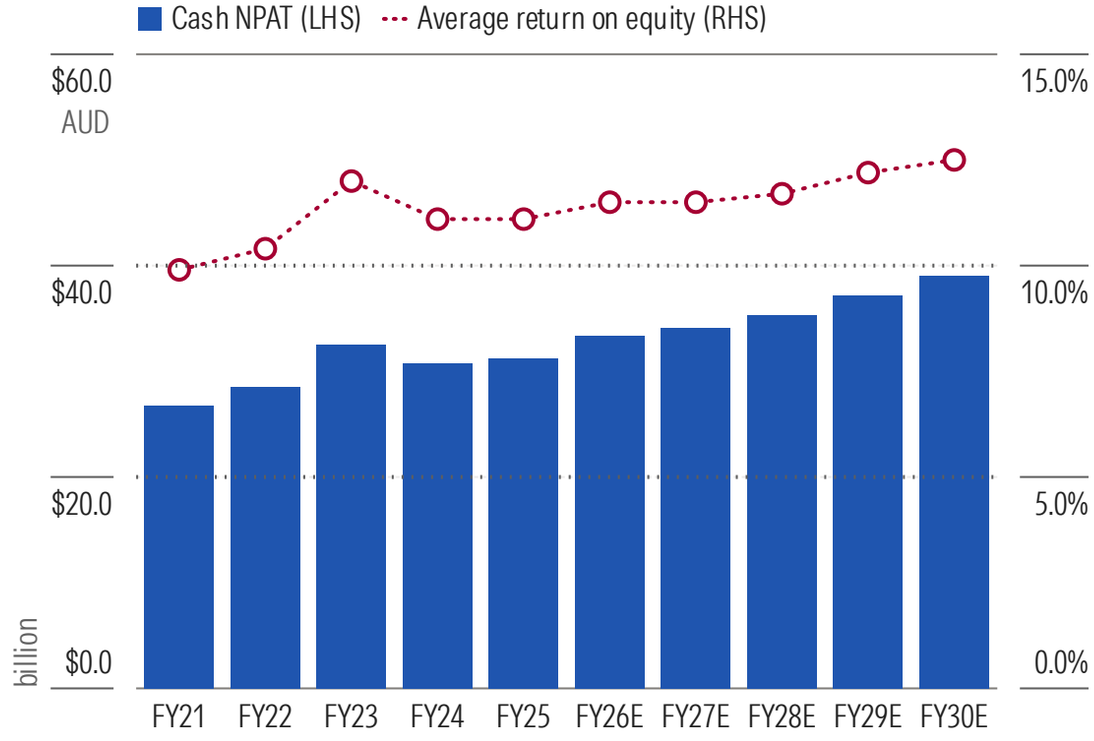
NIM to Flatten Out

Morningstar NIM forecasts based on fiscal period.



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, 2026. Note: NPAT = net profit after tax.

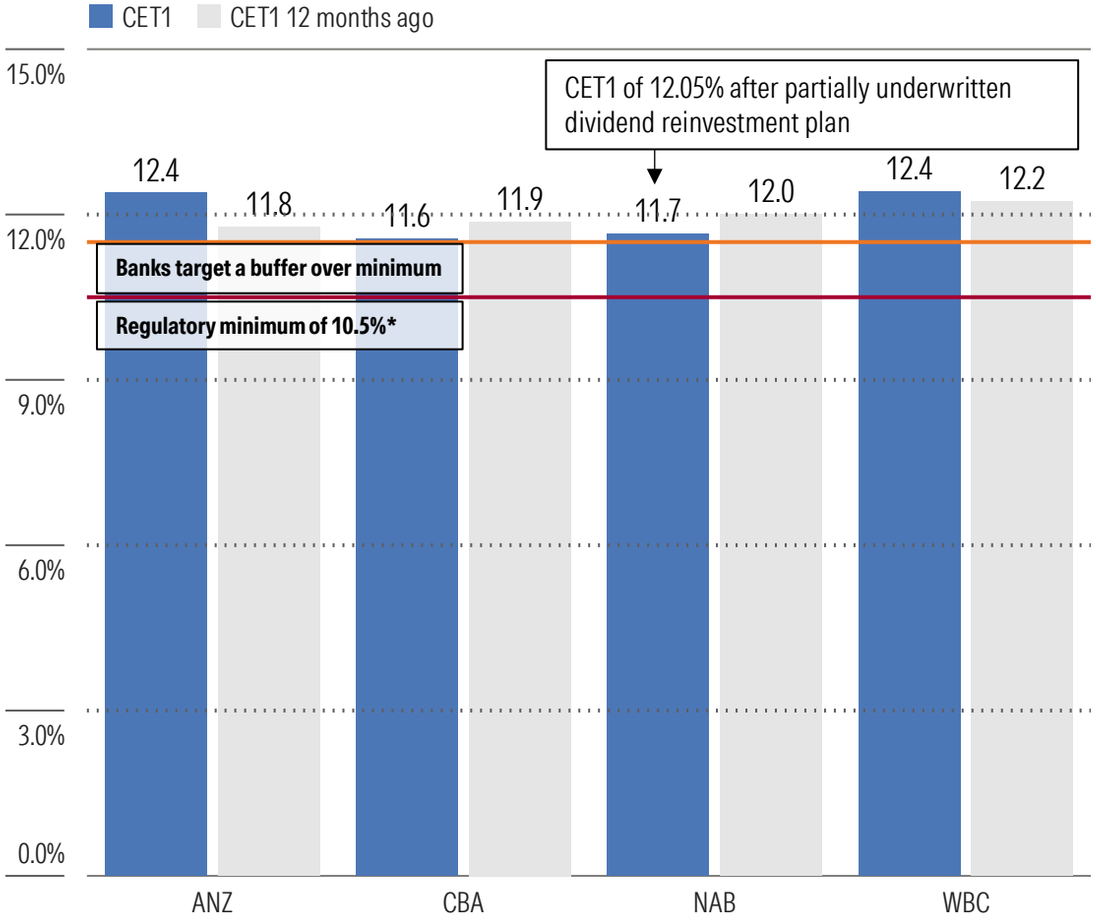
Capital and Credit Risk

Clouded outlook sets up toughest test in years.

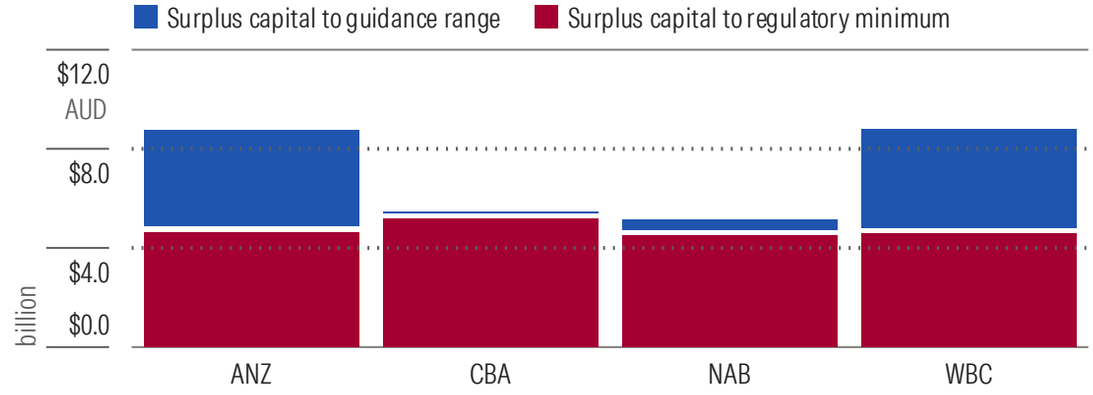
Sound Balance Sheets, but Risk Surplus Erodes if Economy Stalls

Major Banks Comfortably Exceed Regulatory Capital Requirements

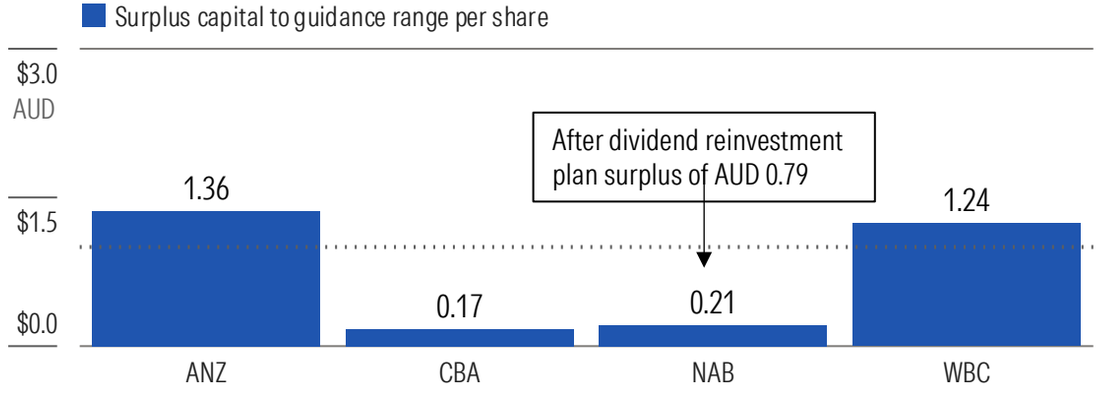
Common equity Tier 1 ratio compared with 12 months prior.



Limited Scope to Reduce Surplus Capital



But Enough to Support Dividends and Credit Growth

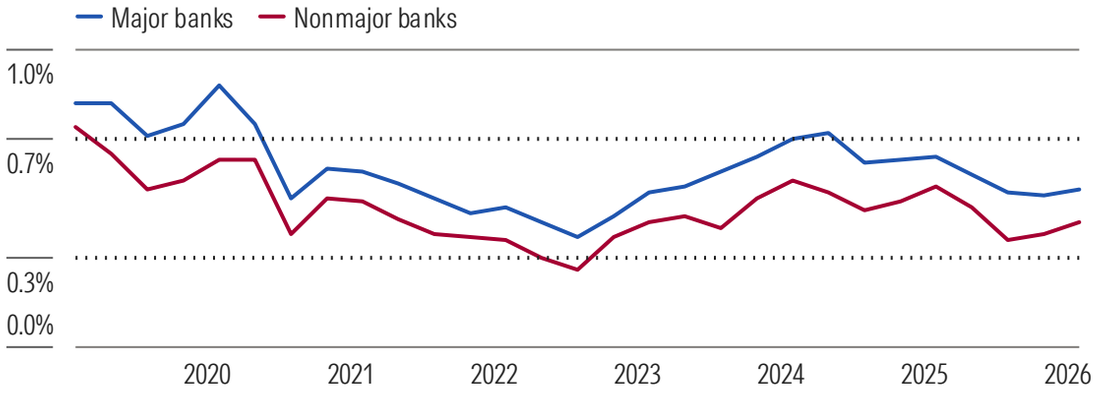


Source: Company reports. Morningstar. Data as of March 31, 2026. Surplus to guidance range based on top of bank target ranges of 11.0%-11.5%. *Current regulatory minimum of 10.25% increases to 10.50% from January 2027.

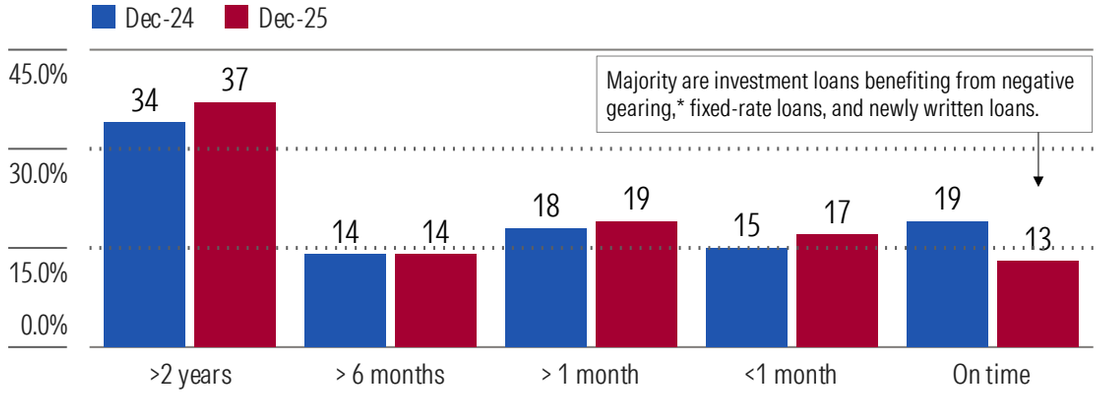
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Strong Equity Buffers Cushion Against Large Loan Loss Risk

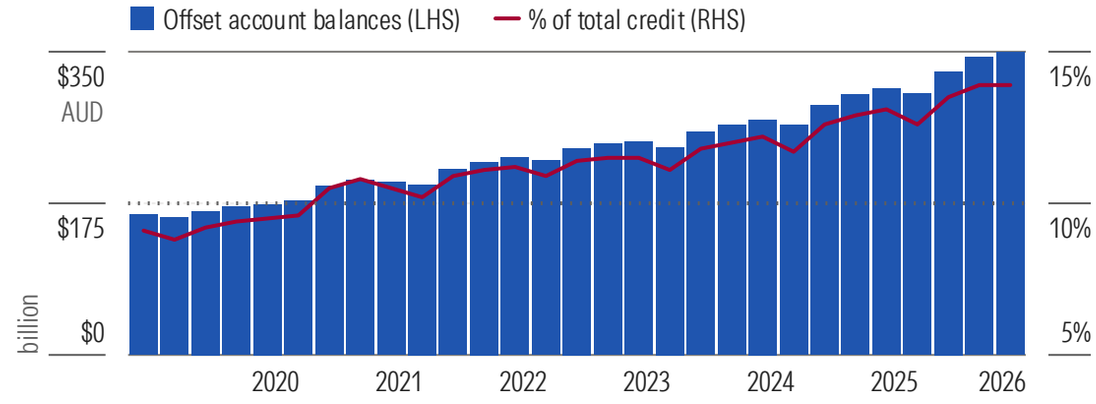
Home Loan Arrears: Uptick Likely on Rate Hikes, Inflation, and Softer House Prices



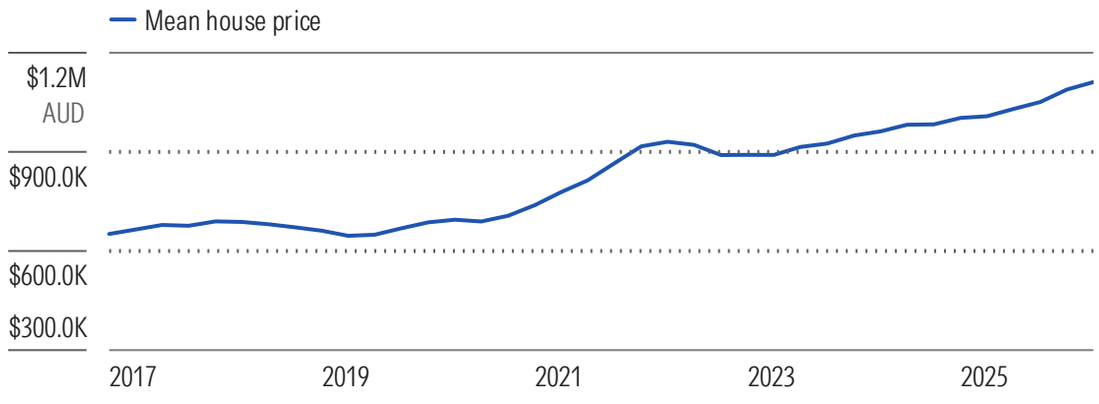
Payments in Advance: More Equity Supports Lower Loan Losses



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



House Prices: Past Gains Strengthen Capital Cushions and Ease Default Concerns



Source: APRA. Data as of Dec. 31, 2025 (top left and bottom left). Commonwealth Bank, Morningstar. Data as of Dec. 31, 2025 (top right). Australian Bureau of Statistics. Data as of Dec. 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.

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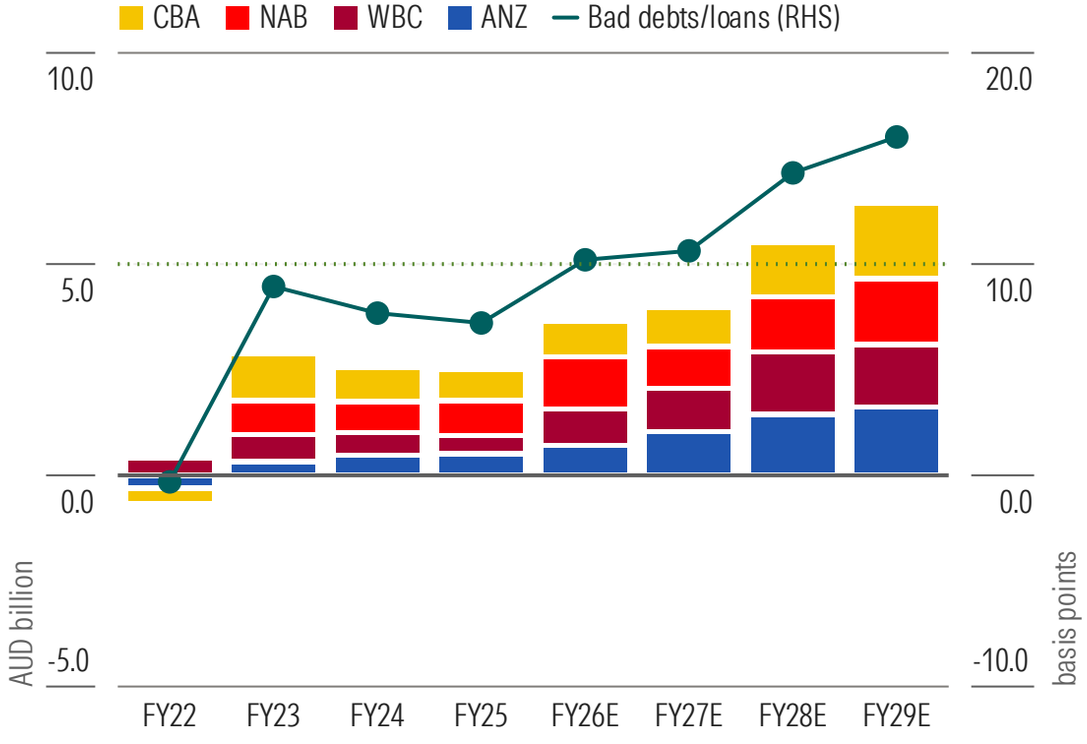
Bad Debts Expected to Climb Off a Historically Low Base

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.

Provisions as a percentage of credit risk-weighted assets are well above 2019 levels. Banks are cautious about how businesses and households navigate global economic uncertainty, as well as its implications for inflation and employment.

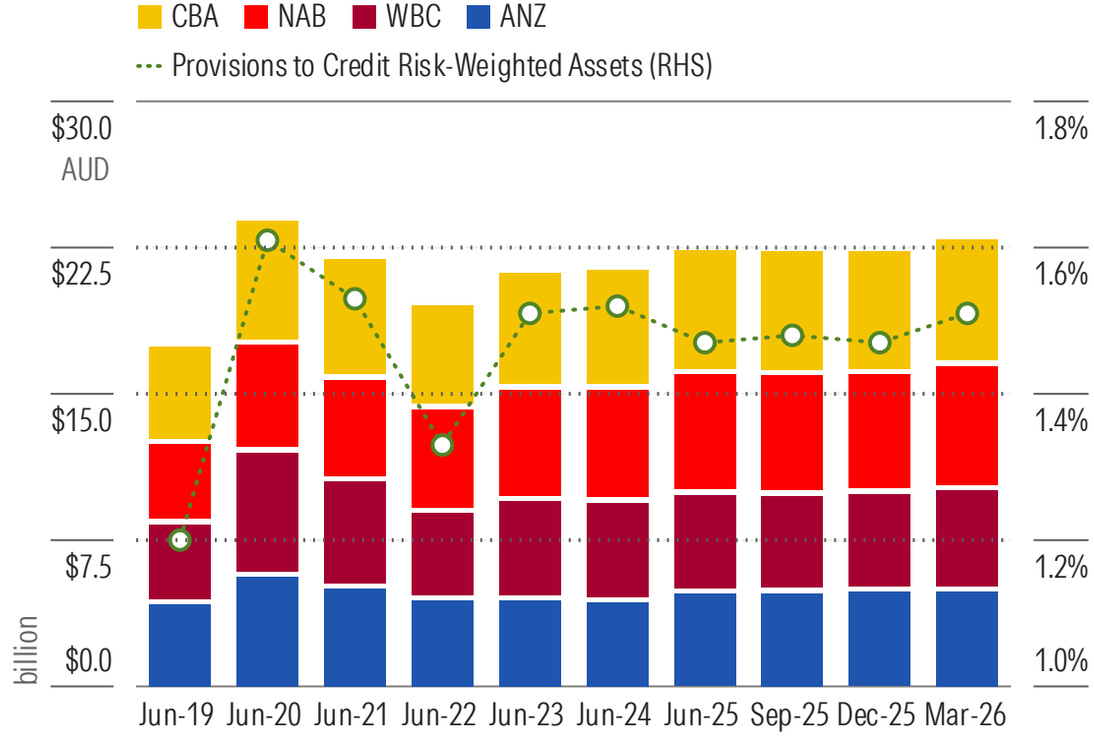
Major Banks' Bad Debts Set to Normalize, Not Spike

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



Bank Provisions Are a Welcome Earnings Buffer Given Macro Uncertainty

Provisions (LHS) include collective and specific provisions.



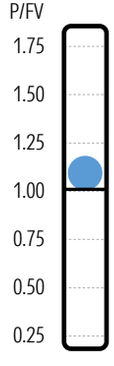
Source: Company reports, Morningstar. Data as of June 30, 2026.

Top Picks and Coverage

Opportunities remain even with the sector looking expensive.

Judo Priced for Elevated Loan Losses; ANZ Best Relative Value Among Expensive Majors

Australian Major Bank



Company (Ticker)	Market Cap	Rating	Last Close	FV Est.	Moat
ANZ Group (ANZ)	AUD 105 bn	★★★	35.0	32.0	Wide

ANZ Group is the smallest of the wide-moat major banks in Australia and benefits from cost advantages that 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 wide-moat bank more competitive. Management is reviewing strategic priorities to cut costs and lower nonfinancial risks, which should help drive earnings growth and returns on equity. We expect the Suncorp Bank acquisition to modestly improve bank efficiency, increasing its funding from low-cost transaction accounts and leveraging technology investment.

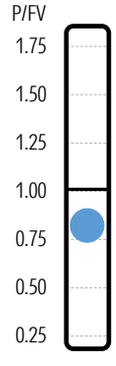
Australian Nonmajor Bank



Company (Ticker)	Market Cap	Rating	Last Close	FV Est.	Moat
Judo Capital (JDO)	AUD 0.8 bn	★★★★★	0.9	1.6	None

Judo is a no-moat, specialist business bank carving out share in Australia's SMB lending market through a relationship-led, dedicated-banker model — high-cost, but genuinely differentiated. Judo lends where the majors won't, charging above-market rates for the risk. Shares crashed after a trading update in which higher credit stress drove a 10% downgrade to fiscal 2026 pretax profit guidance. We see this as idiosyncratic, not systemic — a handful of one-off exposures, not broader loan book deterioration — and don't expect elevated losses to persist long-term. On a single-digit forward P/E, the market has pushed risk/reward too far to the downside.

Australian Nonmajor Bank



Company (Ticker)	Market Cap	Rating	Last Close	FV Est.	Moat
Bank of Queensland (BOQ)	AUD 4.1 bn	★★★★	6.2	7.5	None

We expect Bank of Queensland's medium-term earnings recovery to be driven by the bank extracting cost savings from consolidating banking platforms and digitizing more processes, and it putting the bank on a stronger footing to compete for loan. The bank failing to reignite volume growth in the mortgage broker channel is a key risk. Bad debts are almost certain to rise, but we take comfort that recent loan growth is not from compromising on lending standards. Increased exposure to home loans outside of Queensland is also helping to diversify risk. Our long-term bad debt/loans forecast of 12 basis points is below the 10-year average of 16.0 basis points, driven by changes in the mix of loans.

Source: Morningstar. Data as of July 6, 2026.

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)	105.4	Wide	Medium	35.3	32.0	★★★	1.10	13.8	4.7%	-3.7%	+16.3%
National Australia Bank (NAB)	118.3	Wide	Medium	38.6	33.0	★★	1.17	15.9	4.4%	-7.7%	-1.5%
Westpac Banking (WBC)	120.5	Wide	Medium	35.7	30.0	★★	1.19	16.8	4.3%	-10.4%	+6.1%
Commonwealth Bank of Australia (CBA)	275.3	Wide	Medium	165.0	105.0	★	1.57	25.2	3.1%	-4.5%	-7.3%
Major Banks (average)							**1.26**	**17.9**	**4.1%**	**-6.6%**	**+3.4%**
Judo Capital (JDO)	1.0	None	High	0.9	1.6	★★★★★	0.55	8.8	0.0%	-33.8%	-45.5%
Bank of Queensland (BOQ)	4.1	None	Medium	6.2	7.5	★★★★	0.82	10.8	6.5%	-9.1%	-21.1%
MyState Bank (MYS)	0.8	None	Medium	4.6	4.9	★★★	0.94	13.9	5.2%	+3.4%	+8.0%
Bendigo & Adelaide Bank (BEN)	5.9	None	Medium	10.4	11.0	★★★	0.95	11.3	6.1%	+2.9%	-18.6%
Nonmajor Banks (average)							**0.81**	**11.2**	**4.4%**	**-9.2%**	**-19.3%**
Liberty Financial Group (LFG)	1.0	None	High	3.4	4.4	★★★★	0.77	6.9	8.8%	-5.6%	-5.3%
AMP (AMP)	4.1	None	High	1.7	1.4	★★	1.23	15.6	2.3%	+33.5%	+20.4%
Macquarie Group (MQG)	96.2	Narrow	High	251.7	205.0	★★	1.23	24.0	3.0%	+22.4%	+9.8%
Diversified Financials (average)							**1.08**	**15.5**	**5.5%**	**+16.8%**	**+8.3%**

Source: Morningstar. Data as of July 6, 2026. Note: P/E and yield are one-year forward.

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