Question and Answer

Andrew Bowden
Head of Investor Relations

Thanks, Peter. We've got a slightly different process here. I'll call out your name and company. And if you got hold of it, we'll do some analysts first, and then we'll have time for the media. [Operator Instructions]

So I might take the first call from Jonathan Mott from UBS, please.

Jonathan Mott;UBS;Analyst

My question relates to Slide 9. And you give us the breakdown there between Stage 1, Stage 2 and Stage 3 collective provisions as well as your individual provisions. But what we can see here is that the Stage 1 and Stage 2 have started to come down pretty quickly. So two parts to the question.

Firstly, do you expect if the economy continues to recover at the rate you're talking about and the vaccine works that those Stage 1 and Stage 2 provisions will eventually revert to where they were back in September last year -- or 2019, I should say?

And also the Stage 3, can you just talk through how that will progress? Just as a timing perspective, does that come down more slowly? And therefore, should we expect more provision releases to come down as these Stage 1, Stage 2 and Stage 3 start to reverse?

Peter Francis King
CEO, MD & Director

Yes. Jonathan, thanks. The way I think about that is credit quality of the portfolio is the fundamental piece that drives provisioning. So look at that stress chart on business and delinquencies and then the PD buckets within the Pillar 3. So the speed of that improving is one of the fundamental pieces.

And then the other piece relates to the economic forecast. So they're on that slide as well. And you can see how much we have seen economic forecasts improve, say, in '22 with employment down from 6.7% in our previous forecast to 5.2%. So that's -- it's both of those. Probably, just I’ll mention it for you, half of the move in the cap were related to the economic outlook changes. So that was a big driver.

And really, if there's no further improvement in economic forecast, you're back to the fundamentals of the book. On the IAPs. Yes, on the IAPs, that's just a factor of companies that really get into trouble. And we've had a pretty low quarter in terms of IAPs and whatnot.

Jonathan Mott;UBS;Analyst

So the changes in the economic forecast, that really drove that Stage 1 and Stage 2 recoveries that you're seeing coming through there. Is that correct?

Peter Francis King
CEO, MD & Director

And the underlying improvement in credit quality. So it's both this quarter.

Andrew Bowden
Head of Investor Relations

I'll take a question from Jarrod Martin from Crédit Suisse, please.

Jarrod Martin
Crédit Suisse AG, Research Division

Andrew, nice to hear Westpac talking more positively. Just a question on expenses. So your first quarter expenses are annualizing at $10.3 billion. Obviously, you're flagging timing with project expenditure, et cetera. Second half '20 expenses annualized at $10.5 billion. Should we be thinking that FY '21 expenses will be able to be managed within that sort of additional envelope from $10.3 billion to $10.5 billion? Or is there additional investment that's going to be required for your sort of cost program?

Michael Rowland
Chief Financial Officer

So Michael Rowland here. The way we think about expenses, we are managing our expenses very tightly. We're very conscious of the environment we live in. But as we indicated at the full year, our Fix agenda does require us to increase our expenses in FY '21. So that's why we've said that we don't expect the quarter to be replicated. So there will be a phasing -- there is a phasing issue with the quarter's expenses, and we do expect a little bit more from the Fix agenda that we've got in the final 3 quarters of the year.

Peter Francis King
CEO, MD & Director

And Jarrod, Michael is also spending a lot of time on the 3-year plan. So it's not only this year, but we're very focused on the 3 years as well, and we'll have more to say about that at the half year.

Jarrod Martin
Crédit Suisse AG, Research Division

So what I sort of read into that comment that there's a potential that this year's expenses will be above $10.5 billion?

Peter Francis King
CEO, MD & Director

No. We'll give you an update at the half year, mate. And it's only a quarterly.

Andrew Bowden
Head of Investor Relations

We'll take a question from Victor German from Macquarie, please.

Victor German
Macquarie Research

Andrew, could I just ask a question on margins? I appreciate, Michael, you pointed that there are some headwinds coming in the second half. But given very favorable deposit spreads, would you be able to provide us a little bit of perhaps color in terms of how much benefit you got from deposits in the quarter. And do you think that, that benefit could continue in the second quarter given that deposit spreads continue to decline in January?

Michael Rowland
Chief Financial Officer

Yes. Look, I think there's a lot at play in the margin walk, if you like. So yes, deposit spreads were favorable. So that gave us a couple of basis points. We're still getting some benefit from lower funding costs. But we're suffering, as we indicated at the full year, on the lower tractor as that rolls through with lower rates.

And also, we'd point out that asset competition remains very fierce in the market, particularly in the mortgage book, as I'm sure you're aware. So you've got all those things at play. We are very -- we did manage the margin very tightly. That was a conscious decision we made. How much more we can get out of the second half? Deposits are pretty lowly priced. We're pretty close to the floor. So I'm not sure that there's a lot more in the second half, but we can assure you, we'll continue to manage that margin as tightly as we can.

Andrew Bowden
Head of Investor Relations

I'll take a question from Matthew Wilson from Evans & Partners.

Matthew Wilson
Evans & Partners Pty. Ltd., Research Division

I wonder if you could just walk us through the Pillar 3 data. If we compare you to peers, your gross impaired at 90 days past due is 40 basis points higher or 70 basis -- 70% higher. Your provision cover is half that of your peers, 50% lower, yet your credit risk-weighted assets to exposure at default has stepped down to be sector leading at 32%. And your write-back $635 million of provisions. The sort of the pillar 3 data doesn't seem to sort of all gel, particularly when you compare it to peers and also try and square the circle with what's happened to credit risk-weighted assets versus what's happening to your impaireds.

Peter Francis King
CEO, MD & Director

Yes, Matt, what I'd say on that is on the risk-weighted asset side, the change in RWA density is really reflecting the credit movement, the credit quality improvement. And I think that's broad-based. It also reflects a little bit of a reduction in volumes. You look at credit cards as an example, over the year, it's come down quite a lot.

On the coverage, we're all using different models. So we look at our CAPs to RWA. And yes, that came down, but for the similar reasons that we spoke about, the economic forecast changes and then the credit quality moves, but we think that the provisioning is fine from that perspective. So -- and then if -- I think the other thing was sort of the impaired piece. I haven't got that analysis in front of me, but certainly, yes, we did see the 90-day trends in unsecured and mortgages actually come down a little bit in the quarter.

Matthew Wilson
Evans & Partners Pty. Ltd., Research Division

Okay. Obviously, the models are different, and it's difficult. But even when you do it on to gross loans, you are sort of 40 basis points below where some of your peers are or maybe 30 basis points are where some of your peers are. It's a more optimistic outlook in your provisioning.

Peter Francis King
CEO, MD & Director

Yes. I think that's right. Because I think, as David said, they -- we didn't change the scenario weight. So we moved those last half to be further weighted to the downside. But as we've said, the forecast now, we're looking at are more positive, so we haven't moved the weightings. And so we've also -- we've got that impact of both the forecast outlooks in the models and the credit quality. And stepping back, the new accounting standard is more volatile. That's what we expected. It was volatile on the way up, increased pretty quickly and with these new forecasts, that's to come out a little bit.

Andrew Bowden
Head of Investor Relations

We'll take a question from Brian Johnson from Jefferies, please.

Brian D. Johnson
Jefferies LLC, Research Division

Congratulations on the big improvement. I'm just interested, should we -- given that you've had this great asset quality outcome and the scenarios have changed, has this change the procyclical rise in the credit risk weightings that we're expecting? I mean CommBank have basically taken them out because their provision cover is so strong, and they basically haven't done the big net write-backs. What should we be thinking on yours -- do we -- have you kind of like exploited that capital by writing it back so you still got the procyclical rise in the credit risk-weighted assets? Can you just update us on that, please?

Peter Francis King
CEO, MD & Director

Yes. Well, we haven't put updated estimates, but I'd say what we've disclosed historically is based off a modeled scenario. And what we're looking at in terms of the forecast is a much better picture of the forecast than what we used in the model. So procyclicality won't be what we set out historically.

Brian D. Johnson
Jefferies LLC, Research Division

Will it be 0 though, Pete, potentially?

Peter Francis King
CEO, MD & Director

Well, you got it -- for it to be 0 from here, you got to say there's no further step down in the economy or whatnot. So that will just depend on your view of the forecast.

Brian D. Johnson
Jefferies LLC, Research Division

Sorry, just to labor the point, though, Pete, is that like when we have a look at CommBank, their provisioning is strong, but it's so strong that they're telling you they're more than covered for their base case. You guys have written back your provision. I'm just trying to get a feeling, is there still -- in the base case at this stage, do you think there would still be a rise in the procyclical capital weight? Or should we just take that out?

Peter Francis King
CEO, MD & Director

I think based on the forecast, it's improving from here. I can't -- each bank is at a different position. They've got different credit quality. They've got different growth settings and activities in the market. So you can a look at each bank on how they're running the business, where they're growing and then what the credit quality looks like.

Brian D. Johnson
Jefferies LLC, Research Division

Okay. The next one, Pete, if I may, is just where are we up to on shrinking that institutional business? How much risk-weighted assets is to go? Or has it already all happened?

Michael Rowland
Chief Financial Officer

So Michael here. So look, we're a reasonable way through that. There's still a little bit more to go in the half, but we're well progressed.

Andrew Bowden
Head of Investor Relations

We'll take a question from Brendan Sproules from Citi.

Brendan Sproules
Citigroup Inc., Research Division

I just got a question on some of the improved mortgage momentum that you referred to on Slide 2. Is that sort of momentum in applications expected to drive credit growth in mortgages in the second quarter? And could you tell us how your momentum is going in the Business Bank?

Peter Francis King
CEO, MD & Director

Yes. So on mortgages, we've seen a few months now of positive growth in the mortgage portfolio. So that's a turnaround from the shrinkage that we saw for the majority of the second half. And I think you can see that in the stats that come out in APRA. So that's -- that lead -- the lead measure for us is the apps from that has turned into mortgage growth. And that has been predominantly in our consumer business. The next phase for us is to also get that flowing through into small business where we still got improvements in process that we can put through there.

Andrew Bowden
Head of Investor Relations

We'll take a question from Richard Wiles from Morgan Stanley, please.

Richard E. Wiles
Morgan Stanley, Research Division

Couple of questions, please. It sounds like the Treasury and markets income was up reasonably versus second half '20 average. What would the growth rate have been in the income and noninterest income if you exclude that benefit?

And secondly, just to follow-up Brendan's question on the mortgages. You obviously -- we see the APRA data. You're seeing the applications. What's happening in the investor book? Are you seeing a pickup in the investor lines?

Peter Francis King
CEO, MD & Director

Not at the margin on investors, Richard. So I wouldn't say we're -- we've seen them come back into the market yet, but conditions are looking like that's a possibility, I think.

Michael Rowland
Chief Financial Officer

Yes, Richard, Michael here. So yes, we're seeing a few growth in owner-occupied...

Peter Francis King
CEO, MD & Director

Treasury.

Michael Rowland
Chief Financial Officer

On Treasury. Okay. So Treasury, we're not -- this is only a quarter result, not a half. But we've had a good -- we did have a good result in Treasury. Underlying result, as I think we indicated in the pack, was relatively flat on noninterest income and a little bit up on interest income. So that's -- we'll stick with that.

Peter Francis King
CEO, MD & Director

Richard...

Richard E. Wiles
Morgan Stanley, Research Division

And that includes the Treasury benefit?

Peter Francis King
CEO, MD & Director

Yes. Treasury added 1 basis point to the margin, mate. So that's the -- that's on Slide 3.

Michael Rowland
Chief Financial Officer

Yes.

Andrew Bowden
Head of Investor Relations

Take a question from Brett Le Mesurier from Velocity, please.

Brett Le Mesurier
Velocity Trade Capital Ltd., Research Division

You talked about some troubles you were having with business lending. When I look in the Pillar 3, the business lending category hasn't changed that much in the last 3 months and down a bit over the past year, but the biggest decline is in the corporate category, which is down from $62 billion to $53 billion on balance sheet from December '19 to December '20. So that's larger exposures, isn't it?

Michael Rowland
Chief Financial Officer

Yes. So Michael, here, so that's both the WIB exposed trade finance roll off, but also non-mortgage business lending has -- so yes, and international, yes.

Brett Le Mesurier
Velocity Trade Capital Ltd., Research Division

How much of that -- sorry?

Michael Rowland
Chief Financial Officer

I was just going to say that part of the reducing the footprint offshore WIB will come through in that corporate line.

Brett Le Mesurier
Velocity Trade Capital Ltd., Research Division

How much of that $9 billion reduction is trade finance?

Michael Rowland
Chief Financial Officer

A little bit less than half.

Brett Le Mesurier
Velocity Trade Capital Ltd., Research Division

Okay. So your focus is more away from larger borrowers, I gather, and focusing more on small business because small business exposure haven't changed?

Peter Francis King
CEO, MD & Director

Yes. I wouldn't -- I'd say there's a bit of demand in there, Brett. So if you look at -- if I think about March last year, we had big drawdowns on unused lines as people took liquidity going into sort of that first phase COVID, that's come back. So you've got a bit of demand in there as well as choices we're making in terms of the portfolio. So I don't think it's right to say we're not -- yes, we're not growing in corporate. It's just how it's worked. And in fact, one of the interesting things is we're starting to see more activity in M&A interest and so that, if it does come through, will come through in that corporate line.

Andrew Bowden
Head of Investor Relations

Take a question from Andrew Triggs from JPMorgan, please.

Andrew Triggs
JPMorgan Chase & Co, Research Division

Peter, a question just to follow-up on deposit costs. We can obviously track retail deposit offerings quite closely. But just interested in the other bits and pieces in the deposit book, including institutional deposits and, I guess, more negotiated deposits for larger volumes. Have these come down more than what retail deposits has given just the surplus of liquidity and funding in the system? And then just another sort of follow-up on margins, I guess. Just interested how meaningful the cashback offers have become in terms of the NIM headwind that you quote on the mortgage growth, please?

Michael Rowland
Chief Financial Officer

Yes. So just on institutional deposits. They're quite volatile because it follows the government spending, government drawdown. So it has come off, particularly in the quarter, but that's more just a cyclical movement.

On the cashbacks, look, it's a very competitive market out there. And we're doing our best to compete and do the right thing for our customers. So different banks are doing different things. It's part of our broader proposition.

Andrew Triggs
JPMorgan Chase & Co, Research Division

Just to follow-up on that, Michael. So the timing of the cashback offers in the market, which has been around, obviously, for a while now, is that starting to -- when is it sort of the peak period for pressure from the amortization impact of that upfront cashback?

Michael Rowland
Chief Financial Officer

Well, that flows through the portfolio. So you'll just see it through the portfolio margin over time as you normally would with the -- as the loan tenure rolls through.

Peter Francis King
CEO, MD & Director

But the other thing going on in the mortgage market is fixed rates are much higher in terms of percentage of flow, probably historically around 20%, they're more 35% to 40%. So we've got the dynamic of fixed, variable. And what happens to 3-year swap rates will probably be the best indicator of fixed rate pricing, I think. So as usual, you've got lots of moving bits in the margin. We've got to manage all of them.

Andrew Bowden
Head of Investor Relations

Take a question from Andrew Lyons from Goldman Sachs, please.

Andrew Lyons
Goldman Sachs Group, Inc., Research Division

Peter, recognize it's just a quarterly, but hoping you could make some comments just around the thinking on dividends, a very strong capital result today, pro forma capital greater than 12%. And traditionally, Westpac thought about a consistent increase in the DPS. I'm just wondering, going forward, is this likely to remain the case? Or will the shift focus more towards the payout ratio?

Peter Francis King
CEO, MD & Director

Well, it's not really something I'm going to comment on today because we need to sit down at the half year with the full information with the Board and think about it. But I think you're right to say the conditions are better than what we thought last year. So it will be a good discussion to have at the half year.

Andrew Bowden

Head of Investor Relations

Take a question from Azib Khan from Morgans.

Azib Khan
Morgans Financial Limited, Research Division

Peter, so you've been looking to onshore parts of the mortgage process, particularly the loan doc prep that was being carried out in processing centers in the Philippines and in India. How much of that onshoring is now complete? And is that what's contributing to the improvement in your home loan turnaround times?

Peter Francis King
CEO, MD & Director

We've got about 300 of the 1,000 roles just over complete, so we're about 30%. And I would say, to quote our head of the mortgage line of business, he talks about 41%. So it's not a single big silver bullet solution. It's just going through and improving and renovating our process. We're really just stepping back and taking complexity out of it and looking at it from a customer perspective end-to-end. So it's not a -- it's not one thing. It's the 41% that he's doing.

Andrew Bowden
Head of Investor Relations

Okay. I'll take a question now from John Rolfe, please, from The Daily Telegraph.

John Rolfe;The Daily Telegraph

Peter, in your opening remarks, you mentioned you'd recently visited areas of Sydney and regional New South Wales, and people were positive. I'm wondering how positive were they, how surprised were you by that? And was it different in the bush to the burbs?

Peter Francis King
CEO, MD & Director

Yes. I think -- so I was out in the Riverina of New South Wales, and it's obviously been a very good season out there from a farming perspective. It was noticeably different in the region. So very, very positive off the back of a good season, but some quiet confidence about next period as well. They're talking about difficulties in getting housing, so similar to other regional areas.

So I think the regions are very positive, probably a little bit. And if I come back to the city, I think it's the CBDs are probably most challenged, and the suburbs are probably a little bit better. And certainly, as you go around and you look at activity in the CBDs, it's noticeably better this week, I must say. It does feel like there's been a lot more people come back into town this -- particularly this week. But it's still -- talking to small businesses, the activity is still well below what they had same period last year. That's not a surprise because the social distancing does impact how many people we can bring back into our large towers. It's just nowhere near what we had back in March this year.

So I think it's a very -- it's acknowledging the impact of those who are in areas that are in lockdown, but things are tending to swing back pretty quickly, and it's all about the social distancing requirement and how we're managing that. But yes, I was struck at how positive the regions were.

John Rolfe;The Daily Telegraph

Okay. If I could just ask a follow-up. What do you think will happen when JobKeeper goes? Are we no longer going to head off of a fiscal cliff?

Peter Francis King
CEO, MD & Director

Well, I think about it as we're really in steps. So I don't like this cliff analogy. We're in -- we're just going through stages, and I think they’re steps now. So we've managed, in aggregate, the transitions pretty well. If I reflect on my conversations with CEOs overseas, they're remarking on how well the Australian and New Zealand economies have managed this. In fact, I had one CEO ask me, "Are you sure the data is right that you guys are doing?" So I think that's the global context.

And then if you look at how we move forward, yes, we've got further changes coming with government stimulus, but we've got a banking system that's in great shape to help people through the period. We've got low interest rates which will help. We've got domestic activity, hopefully, continuing to pick up. So there's positive signs there. I think we do tend to focus on the negative a little bit too much. And so we've got to balance it up and talk about the positives as well.

Andrew Bowden
Head of Investor Relations

I'll take a question from Clancy Yeates from The Sydney Morning Herald.

Clancy Yeates;The Sydney Morning Herald

Peter, the Reserve Bank has sort of acknowledged there are -- things are improving, but there are also risks to financial stability from very low interest rates sort of driving people to take more leverage in property. What are your views on this issue? Are you concerned that ultra-low rates and the quickening rise in house prices could lead to sort of riskier borrowing behavior from your customers?

Peter Francis King
CEO, MD & Director

Well, I think if I just touch on the housing market, if I look at supply and demand of housing, one of the big drivers at the moment is there's no supply. There's not enough supply in the market. And so it's not a surprise that prices are going up because there's plenty of people that want to buy. So there is a bit of -- there's not enough stock in the market. At the moment, you're seeing the clearance rates at record highs. So they're interrelated.

In relation to borrowing, I just -- it's probably just worth a reminder that the banks all use interest rate floors in their capacity assessments. So we're not assessing people on 2% interest rates. It's more like 5%. And so that gives the ability for people to afford the mortgage at higher interest rates. And so that's an important thing. I'm sure that the regulators will continue to look at it. And if prices continue to go up, they may look at macroprudential, but that doesn't feel like it's close. And a lot of the price activity is actually driven by people that have already got cash. So it's not just people borrowing.

So all in all, I think it's being managed well at the moment. There's controls in the system, and we've just got to manage the COVID virus. And hopefully, we do well on the rollout of the vaccine in the second half.

Andrew Bowden
Head of Investor Relations

I'll take a question from James Frost from The Australian Financial Review.

James Frost;The Australian Financial Review

Peter, I'm just curious about the running off of deferrals. You seem to be lagging your peers a little bit. The APRA stats tend to indicate you're extending or entering into new deferrals at a higher rate than some of them. Can you tell us a little bit about some of the challenges you face there?

Peter Francis King
CEO, MD & Director

It's -- the simple answer is that it's timing based on our choice, James. So if I think about, at the 3-month point, so if you go back last year, our deferrals came back faster than the market because we chose to do check-ins as opposed to just rolling them. And then from right now, we chose not to have any contact with customers over the Christmas period. So we rolled the deferrals out to February and March effectively. So I don't read anything into the fact that we're a little bit higher at the moment. And as I said, I expect the majority of the deferrals to roll off post March -- pre March, sorry.

Andrew Bowden
Head of Investor Relations

Okay. I might -- I'll take the last question from Joyce Moullakis, please, from News Corp.

Joyce Moullakis;News Corp

I just wanted to ask -- I mean I know you're talking about focusing on the positives, but in terms of sporadic lockdowns in states, even if there's sort of short, sharp lockdowns, how are you factoring that into your thinking going forward?

And secondly, following up from one of the analysts on the cashback offers, they seem to be coming more of a feature in this market given the cheap funding that's available at the moment through the TFF. Are they a permanent feature, do you think, for 2021?

Peter Francis King
CEO, MD & Director

So on lockdowns, I think they're pretty tricky for people to manage. So I do reflect on the individual impacts they'd be in business or people. And the big thing is, for me, is certainly so people do well when there's certainty in terms of what's happening. So I think that's probably the biggest thing I think about is how do we get certainty. I'm not going to comment on the effectiveness of them. I think that's for government to work through how and what the right health response is. But I would highlight that when they come off, we do see rebound in activity pretty quick. So yes, we're probably going to have a few. No system is perfect in terms of containing a virus, so they'll probably be here, but they do bounce back quickly.

Just on cashbacks, they're just a feature of the market. I wouldn't link them to TFFs that they're a feature of competition, fixed rates, variable rates. That's a bigger feature in the market at the moment and cashbacks just will be here, I think. I don't think it's anything to do with TFF.

Andrew Bowden
Head of Investor Relations

I do have one more question from Richard Gluyas, please, from News Corp.

Richard Gluyas;News Corp

I'm just wondering in relation to those quite dramatic improvements in your economic forecasts between September and December, can you pinpoint 2 reasons, Peter, perhaps what drove that? What was going on in the economy that suddenly switched the course -- dramatically switched?

Peter Francis King
CEO, MD & Director

Well, I think it's 2 things. One is the actual economic performance was better than what we thought so probably a faster rebound that was built -- than was built in. And one of the stats I look at is actually the number of people that are employed. And we had about 13 million people employed back in March 2020, and we're back at 12.9 million people being employed now.

And what that says is that the -- it's not -- we're not exactly back there yet but the amount of employment in the economy has come back. So -- and I think that has, therefore, underpinned, obviously, income. Savings rates are higher. Spending has been a bit higher. And so the rebound has probably been a little bit faster than what people thought.

Now that's not saying that we know there's more people that are -- I think would like to work and they're unemployed, but that rebound was probably a bit faster than what we thought in previous forecasts.

Richard Gluyas;News Corp

And was there another -- you mentioned 2 factors. Is there another one?

Peter Francis King
CEO, MD & Director

Well, I think the actual economic outcome was the first one. So it was a bit better and then employment coming back. They're the 2 that I would point to.

Andrew Bowden
Head of Investor Relations
Okay. I think that's all we've got for today. So thank you -- I'd like to thank everyone for come -- dialing today, and we'll be around to take further questions during the day, if needed. Thank you very much, and good morning.