Question and Answer

Andrew Bowden

Why don't we take a question from John Springer[ph] .

Analyst

Just on the cost side of the equation, it looks like a very good cost performance. Just if I could get some understanding of the drivers there, of the St. George and this coming through and also what we can expect for the organic costs coming through? And I think at the last result, you mentioned that there was potentially some stuff coming out this year. Just if you can give an update as to how that's tracking and what the numbers are in that category?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

I really am happy with our cost performance. If you'll recall, the productivity update that we gave towards the end of last year where we outlined a number of initiatives to do with productivity, which we run in conjunction with our strategic investment program, so as to help facilitate the investment that's part and parcel of that program. So there are a number of activities going on. And certainly, the usual sorts of things that you do with programs of the sort where you look to remove duplication. So we've had a second look at the merger and a second look at areas where there's duplication and being really clear where things get done centrally and get done once to support the different brands. And that's resulted in some cost savings for us. We've also done quite a bit in the way of process improvement and that's taken people out because we've taken steps out of processes, we've reduced rework, we've reduced waste, we've reduced duplication and really try to align processes across the group. Because as you can imagine, the way a home loans are handled different in St. George and different in Westpac. So aligning those to a common approach, getting best practice and taking off duplication. That means that our front-line people have had more capacity to spend time with customers. Within our back-office or operational areas, we've actually been able to take people out. So as you can see in our first quarter, we've reduced numbers of people by about 400. So there'll be further people reductions coming in the second half. We haven't given a specific number to that, we tend to manage that quite tightly. We try and use attrition respectably as we can so that we don't actually have to use redundancy situations. So we try and sort of think in advance about where we're working, where we expect savings to come and use attrition as much as we're able. Phil, I don't know if you'd like to add to that a bit?

Phillip Matthew Coffey
Former Chief Financial Officer

I think the three points as you've made, synergies became the run rate, and if it has synergies and so that's helped FTEs lower in salary and wages. Obviously, sort of flattish in the quarter. But that will increase as we go into the second quarter. So I think as we look forward, the amortization of course of their investment spend will pick up, but with the productivity benefits that Gail has talked to, and so that's what we've talked to when we gave an update in October around looking to ensure that we're able to manage the investment spend and that's tracking as we would have hoped.

Analyst

Is it fair to assume that the cost trajectory is not really going to change a lot as it gets through the year? X the salary and wages that you're always kicking in the second quarter?

Phillip Matthew Coffey
Former Chief Financial Officer

Look I think what we've tried to say and indicated, expenses were slightly lower in the quarter. You shouldn't expect that we're going to keep having a negative expense picture, but we do think that we're managing that cost growth well, and we are keen to continue to invest for opportunities. And so, you should expect that we'll see some modest cost growth but it will be disciplined and in line with what we think revenue upside is.

Operator

Next call from Jarrod Martin [Crédit Suisse].

Jarrod Martin
Crédit Suisse AG, Research Division

Last quarter has seen some quite interesting changes within the mortgage market. First of all, we're now offering to pay your expertise, as well as CBA. And then I think you responded overnight by increasing your discount, as well as lowering your application fee. A couple of questions on that. First of all, is part of this a reaction to a realization that business credit growth is probably not going to pick up as early as what was maybe anticipated six months ago and therefore, to really get some balance sheet growth, you need to focus on mortgages? And then secondly, we've seen in the past that historically, price wars tend to -- actually on the resulting lower industry profitability and I'm just wondering whether this actually looks like the beginning of the price war? And ultimately, we're just going to lower industry profitability?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Jarrod, I think what we're seeing is signs of excellent competitive intensity in the mortgage markets, and I think you'd expect that in a low-growth environment. You'd expect that kind of intensity and we welcome competition and we think it's very healthy overall. From my point of view, we have a really clear-strategic position and we're delivering on that strategic position. Our strategy is certainly one that's focused on customers and it's focused on depths of relationship. And I think you know if you look at the facts of our Westpac region and business bank, you can see the uplift that we're beginning to see come through, and this of course, still early days in there. But I mean the facts are, we've grown our market share in the Westpac region and mortgage retail and business bank over the past two years, more than any other bank. We've grown it from 14.2 to 16.5 so we've grown it by 2.3 percentage points over two years. And that's after the decline in the past in prior 10 years and before that point. But really importantly, it's actually being on the back of improving the depths of relationship with customers. So we've significantly increased the wealth penetration that we have with our customers, our attrition levels have been really low. So we're all about depths of relationship, quality service, delivery. And that's what our investment and our bank managers' approach is actually being about our investment in local. We put in the past two years, well over $200 million investment into people and the capability, with 616 bank managers, the 444 Business Banking managers, opening the city with new branches, the refurbishment of the branches, the uplifting capability build. All of that's the investments that we've made in the last couple of years, and you'll expect to start to see that paying off, and it is now. We've got a strong overall service proposition and it's about depths of customer relationship. And so the offer that we've come out with overnight, really speaks to that depths of relationship where the package offer includes credit cards, transaction accounts and our very strong insurance proposition. So this is not a single product play. It's about a packaged approach, depths of customer relationships. So that's our way of competing and from time to time, you have tactical approaches, and instantly, that's good for our people. It gives them extra real result to actually compete in the marketplace. We've invested in the distribution. We give them every now and then a tactical campaign to work with. On the mortgage, on your first point, which is, is this to sort of compensate for lower business credit? I don't think so. I think mortgage market is going to be competitive anyway. We came through the 2009 year, where a lot of players simply fell away and really do is earning ourselves and the CBA, who are actually out there being prepared to actually provide learning support for customers in the mortgage market. In 2010, as you know, we deliberately wound back our growth, just need to grow at or around system growth, a little more than system growth. And we achieved it. We retained the customers, all the customers that we put on during this 2009 year. For lower credit growth environment now, we are really happy with our funding position. So we happen to dial it up a little. And I think that would happen, whatever what's happening with the business lending side.

Andrew Bowden

Next question please from Craig Williams [Citigroup].

Craig Anthony Williams
Citigroup Inc, Research Division

A bit of a continuation to Jarrod's question, in terms of volumes not coming through. What's in fact happening in terms of mortgage volumes so far this year? That appears according to comments I've read from IFG and sort of picked up from CBA that volumes have fallen away within January, and most are happening there and so far, in the February period?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Well the volumes have been quite soft, and I think there was the effect of the interest rate rises that came through and we've just seen consumer caution. We've seen that in lack of spending in stores as well. So just a general consumer caution. And the general concern around half prices as well has all led to softer growth in the overall mortgage environment. And no doubt, the Queensland floods and the devastation that's occurred there has contributed further to that caution. Although I have just seen some economist reports coming out just yesterday, the producer that loan growth is a little stronger just recently, than had been predicted. So I think we'll start a see it pickup, and so far, in the year-to-date has been relatively soft but from an overall system point of view. I think we still stand by our original forecast for system growth at around 7% for the full year '11, but probably a little stronger in the second half of it.

Craig Anthony Williams
Citigroup Inc, Research Division

Presumably, that will have the same as first quarter results, you're comfortable enough that if volumes don't come through, you'll get the sort of volume margin trade-off in terms of revenue impact?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

We've been really focused on that, as you've seen in this first half, really making, and I mean I think the hard work we did last year in restructuring and getting more business through our first part is paying off well in Q2. We did that both in George and in Westpac. So sort of reduced about 10 percentage points, the share of business we get through our first party relative to our third party. So that's an example of the way in which we've been focusing on the volume margin trail.

Jarrod Martin
Crédit Suisse AG, Research Division

Had a question from Jon Mott please [UBS].

Jonathan Mott
UBS Investment Bank, Research Division

On the Pillar 3, and then so again on the mortgage topic. But just picked up a couple of interesting things where the mortgage exposure at default picked up by about $7 billion to $358 billion, and the regulatory expected loss also rose, but the risk weighted assets for the mortgage book came down pretty materially during the period. So if you could kind of explain what's going on in that book at this stage? And also, just a second question, at the half, you saw some gains on St. George derivative revaluations, which led to a pretty material release of Tier 1 capital. Have you got any update on that? Are there any further gains coming through there?

Phillip Matthew Coffey
Former Chief Financial Officer

I'll pick up the Pillar 3 question, John. What you're seeing in the mortgage book in the Pillar 3 is two factors. One, that we've had some increase in delinquencies. And that's both kind of in the shorter buckets, 30 and 60 days and in the 90-day bucket and that has tended to increase the rate-expected loss and exposure default. Obviously, we've had the growth as well in the book, which has increased mostly the exposure default picture. And then the reason that it doesn't flow through -- if you say it flow through into the risk-weighted asset picture, is that as the book seasons, as the actual level of maturities, sort of the overall book lengthens because we're obviously doing less new business in the front book because of the lower system, that leads to a lower risk weighting that we can apply and that leads to a lower risk weighting calculation overall for residential mortgages.

Jonathan Mott
UBS Investment Bank, Research Division

Hasn't that any assumptions on half prices or anything like that has been changed?

Phillip Matthew Coffey
Former Chief Financial Officer

No, nothing like that has come through.

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Is there anyone to pick up the second around the derivative contract? Revalued derivative contract, St. George still would be [indiscernible] relationship.

Phillip Matthew Coffey
Former Chief Financial Officer

Yes, we called out at the end of the year that there were still some quite a material maturity of contracts that had yet to mature that we would yet to reach an agreement with the Australian tax office. And that was largely because we're now dealing with under the new regime. And as a consequence, we haven't managed to reach agreement with the ATO. And when we do, we'll be able to update you, but that's still in discussion with the tax office.

Jonathan Mott
UBS Investment Bank, Research Division

Is that something that would be potentially first half or that would be later in the year?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

It could be either.

Andrew Bowden

A question please from Victor Gervin[ph] .

Analyst

Just two very brief questions from me. One is, it sounds like from your response to us earlier that you're tracking well to achieve positive George in this year. Is that correct interpretation?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

We started out with positive George. I think you heard Phil say that expense growth will pick up from its current position. But I'm hoping the revenue growth will pick up further too. So my intent is to finish the year with a positive George situation, but I'd like to say that we will continue to focus on investing where we need to invest as well. So that's really important for us. We have a very significant strategic investment program underway and that investment cost, we're really offsetting with the productivity benefit that we're getting through our productivity work. But overall intention is to finish off the year with a positive George.

Phillip Matthew Coffey

Former Chief Financial Officer

If I might just add, I think that, whether you call it underlying profit or core earnings, I mean that's what you're really trying to drive here. And obviously, positive George contributes to that but you'll still get a better result if you are able to draw the top line faster. And so we're definitely focused on that underlying profit and whether that leads to positive George or narrower George, but with a higher top line, it's that core earnings that we're focused on.

Analyst

And also, just a small question, capital. So we've seen about 10 basis points improvement, and I think Gail highlighted that you had the slightly lower DRP participation. Excluding the DRP impact, if you were able to isolate it, what was the capital generation in the quarter? Are you able to give us a number there?

Phillip Matthew Coffey
Former Chief Financial Officer

Look, I think DRP cost us about 10 basis points in terms of tier one capital. You can see in the Pillar 3 that interest rate risk in the banking book also had a pretty material lift in terms of its impact on capital. And you can back solve that, it comes in at about seven basis points as well. So they were the two major negative drags on our overall capital ratio.

Company Speaker

A question from Brian Johnson [CLSA] please.

Brian D. Johnson
CLSA Limited, Research Division

I just had a question on the Pillar 3 as well. Which have the safe mark for you Phil. So if we have a look at Page 11 and all the narrative sense to talk about in the corporate world, things are getting better but the kind of residual areas of risks are in the smaller business space. But when I have a look at Page 11, I'd see a few things. I see that the total impaired assets keeps on going up. I see the past 90 days is going up. If I just focus on the impaired, I see it's gone up by $138 million over the quarter. But when I have look at the corporate book, that's up $185 million. The specialized lending is actually up $110 million. Isn't that kind of telling us that we're still seeing it rise in the corporate sector as opposed to the SMEs?

Phillip Matthew Coffey
Former Chief Financial Officer

Look, I think what we're saying there and what we've said in the media release, Brian, which hopefully I can help clarify, is that we're seeing the existing stressed assets that we've had in the books in corporate land. Some are being regretted and some are migrating down into impaired. And that's a reality. In the case of specialized lending, most of those assets have got a lot of securities supporting them. And so the increased requirement for impairment charge is pretty low and notwithstanding the fact that they go from sort of semi-performing into impaired. But that's not where we're seeing new problems come into the book, it's the way we are seeing new problems, it's tending to be in the smaller customers across quite a broad range of industries as we struggle with some of the environmental issues around higher interest rates, higher Australian dollars and those sort of things. If you think of late we're seeing in real asset to kind of resolve some of these impaired assets, certainly from some of the banks selling down things like Centro[ph].

Brian D. Johnson
CLSA Limited, Research Division

If you look at that, the gross impaired, still sitting at $4.7 billion is very elevated. Can you give us an outline of when we're going to see the exposures basically fall down, the underlying assets realized?

Phillip Matthew Coffey
Former Chief Financial Officer

Look, I think the reality is that because we've got such a strong capital position, we don't feel obliged to be selling these things at fire-sale prices that we might have done back in the early '90s, when we really needed to reduce that kind of overhang. And so, we'll be considerate in terms of how we sell those assets down, we won't be giving them up, that's what we've considered is an appropriate price. It's not because we don't think we're fully covered, it's really around executing this in a way that optimizes the value for the shareholder. I don't think Brian, you should be thinking that, that number is going to change rapidly over the course of the next one or two quarters.

Brian D. Johnson
CLSA Limited, Research Division

I think the chart you've got within our media release probably really explains the circumstance where you can see that overall expense exposures have declined. But that the mix has moved and you can see in that chart if you look sort of closer that impaired asset is up little bit, but the watch list and the substandard is quite a bit lower, as you say and the company's migrating down.

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

I mean institutionally, I think you'd see probably more upgrades than downgrades in terms of the dollar terms, but probably much pretty even if you look at the true numbers of accounts going upgrades and downgrades. But at the smaller end, in your commercial end, there's still more downgrades than there are upgrades.

Andrew Bowden

Next question from Ben Sucre [ph].

Analyst

I just wanted to ask a bit more around your comments on margin and Gail, you mentioned stable to slightly improving in the next quarter or so. Just wondering how confident you are about sort of outcome in the second half of the year as well, and you also mentioned positioning for likely deposit competition? I just wanted to understand better what your thoughts are around your positioning in deposits and preparing for that?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

If you go back towards the end of last year, we reflected that we saw a trend for margins there's a stabilization and pleased to see that, that sort of played out. And we've seen some small improvements this first quarter. So that's three basis points pick up. The exit rates at the end of the quarter, the margin was higher than the average of the quarter. So that does bode well for the second quarter. And really, even into the third quarter. Obviously, there were a couple of elements that came towards the end of that first quarter. The standard variable increase in interest rates and then also the roll over of the term deposits that we're really happy with how we performed there and the rate at which those have been reset. So that helps support the margin going into the second quarter. And fairly even into the third quarter. But we're also dealing with rise in average funding cost. They're still very much a phenomenon that's actually out there. Deposit cost, difficult to know really. It's good to see that it's moderated somewhat. But it is a competitive market and we wouldn't want to predict how that's going to play out. So we wouldn't want to forecast for the second half. But I think, is to aim to manage that volume margin mix to try and keep it as stable as we can into the second half, into a rising cost environment.

Analyst

And so assuming, I mean you've made observations around credit growth and business credit growth and the like that, that may start to pick up second half. But if it is fairly projected as you say to, you're probably assuming that I would've thought deposit competition and the like remains -- I supposed reasonably consistent?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

A good point you make about business credit picking up. I mean if business credit picks up in the second half, and we actually write the volumes on our balance sheet early on, that really should helps a little bit with the mix benefit, because we'd be writing higher margin business and at the moment, of course, most of the business that's been written is in mortgages, which carries a lower margin. So that would help with regard to the overall margin story. But we're not baking that in. I think all along, we've been quite conservative about winning this top line will actually translate into activity. When that happens, it could happen quite quickly. It's often a function of confidence. At the moment, there's still cautious consumer sentiment, clearly, the floods and the cyclone and the devastation there will dampen confidence. It will over-pickup. I mean we're going to see the reconstruction activities begin to pickup into the second half. And we might find that there's quite a rebound quite quickly. We predict that more into the second half. And then I got pretty lost in the second part your question, Ben. Do you want to say it again?

Analyst

Just the deposit competition, beginning on the funding.

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Deposits, we think deposits will remain high. In other words, growth will remain quite strong into the second half as well. And that's obviously really important for us in terms of our overall funding mix and we're well positioned for that. Again, our distribution network has been reset or reshaped in order to prioritize deposit gathering. So it's no longer just focused on lending. It's focused on all the relationships. Consumer sentiment will remain, we think, quite subdued. But there's improving income and all of that I think will mean that deposit growth from system point of view will remain reasonably strong. Difficult to know how the actual computer intensity will clear off.

Company Speaker

Question from Ben Tu [ph] please.

Analyst

A question on the institutional runoff. Can you give us a feel for how that's actually trending towards in the quarter or whatever you've seen in January? Is that typically continuing at such a strong pace or is it same to slide down? And I guess just the second follow-up question, with the margin impact that you flagged from the establishment fees, how material is that? And you said something that you've been expecting in the subsequent quarters over into something that you think will affect during this quarter?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

We're certainly seeing, we had quite a bit of deleveraging going on in the first quarter. I think with something like $2.5 billion deleveraging in the first quarter. That's definitely slowed down and in fact, there may even be a little pick up from there. We'd be expecting to get some growth in that book. I think on the establishment-fees side, I don't think we're going to see that same impact going forward. I think that was a first quarter effect.

Analyst

How material is that?

Phillip Matthew Coffey
Former Chief Financial Officer

It certainly helped with margins quite a bit, particularly as it was adding to interest income at the same time as the actual outstanding assets were falling. I don't know. I think that's probably added circa one basis point to our overall margin story in the quarter. That will be a rough estimate, I think.

Andrew Bowden

A question from Richard Wiles [Morgan Stanley] please.

Richard E. Wiles
Morgan Stanley, Research Division

I just want to follow-up on Ben's question regarding margin. Gail, all the comments you've made seem to have a positive bias, and I would've thought would offset the high cost of funding. So at the same, some margin outlook should be more positive at the Group level in the second half. I'm wondering, are there any divisions where you actually expect there to be significant margin pressure in the second half or in the remainder of the year? Are there any divisions where you think the margins will go down?

Phillip Matthew Coffey
Former Chief Financial Officer

I can answer that. This is I mentioned to Ben, Richard, we'd expect margins to be lower in the second half for two reasons. One, we won't get that benefit of the establishment fees being booked. But secondly, we would hope that we'll start to see that book stabilize and grow, and that will also have an impact on margin. And thirdly, I think at the top-end of the margin, we are seeing a more competitive environment with some of the globals looking to utilize their balance sheet, as well as obviously, the domestic banks all being pretty competitive. And in that environment, there's three combinations we would expect to see some negative impact on margins in the institutional bank.

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

I mean there is still quite an increase in term funding costs, average funding cost. I mean we shouldn't think that, that is over. I mean we still today, are replacing money that we put on before the crisis at more expensive levels. We're looking forward to 2012, I think we may start to see some stabilization there. Obviously, we've got a big chunk of maturities coming through that we put on in 2009. And clearly, we'd be hoping to replace that with cheaper funds at that time, although comps to debt we have to mention that we'll be extending the term, too. So we'll be rolling that into longer-term maturities, five, seven, nine years sort of maturities. So that will counterbalance getting the funds in at the cheaper level. I'm really looking forward, I should add, to something like 2013 and '14 because we've the five-year money that we put in, in 2014. As to 2009, and that rolls off, and that was very expensive money at the time, so really looking forward to that time. And then you'll see quite a significant reduction actually in cost and it will be great to be able to pass some of that benefit on to customers.

Company Speaker

A question from Bethlam Israel[ph] .

Analyst

Andrew, or Phil, can you comment on how we can expect to see the CP to perform as the stress exposures continue to fall? For example, should there be an accelerated decline in the CP as stress exposures decline?

Phillip Matthew Coffey
Former Chief Financial Officer

Certainly, on the interest[ph] , you should expect that, that provisioning requirement as we stress exposures decline and in particular, the decline is as we start to see a much bigger ratio of upgrades to downgrades. The requirement to hold a greater provision, based upon the better grade will reduce. So as we said, that overall provision should come down. Now, at this stage, we're not required to hold it at PICO[ph] deduction by April [ph] because their provisions are already more than required. At some point, that will suffice [ph] and you'll get some requirements for that starting to capture some of the benefits. So you'll get a better P&L, but it will all drop into capital. It's got to be at some point in this cycle, that you will definitely see that provisioning coming down.

Analyst

Would I be right in thinking that the CP should reduce a faster rate than the stress exposure?

Company Speaker

There will be a function of the extent to which that's happening out of the worst rate of credits being remediated versus -- for example, we grade things A to H, A being the best. If something is after it, it's already got reflective [ph] provision, which is pretty substantial again. If that gets back to fully performing, you'd see a big recovery and collective. If it was rated E, you wouldn't get as bigger recovery. So it will depend on the kind of mix of recovery that we see flowing through there.

Operator

Have a question from Scott Manning [JP Morgan Chase] please.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Just wanted to further explore the comments on St. George, a little bit disappointing on the growth there. If you could elaborate on that with previously raised issues like geography and growth, I guess things like that? Is there anything fundamentally with the business that you're looking at addressing?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

As I mentioned in my overall remarks, 2010 was a year we really tried to use that opportunity, while we're busy restructuring the balance sheet also to restructure the St. George business and really take it back to kind of its regional roots of being a regional bank. We've got a national major bank in Westpac and St. George as part of our multi-brand stablers is really playing a regional bank role. And of course, it's heartlands in New South Wales and through Bank SA in South Australia. So structured more for that. We know because we've done a lot of empirical work on this that there's a very significant fit of customers that prefer to bank with a bank that is regional, a bank that is local, a bank that isn't a major bank. So that gives us the opportunity to win and attract and support customers with that sort of preference. So that was the first restructuring element. The second was, really wanting to reduce the reliance on third-party brokers. Now, that's particularly of course in New South Wales and South Australia where we have very strong distribution for St. George and there's no reason why there should be the reliance on brokers to the extent to which being in play. So about 10%, I think it moved from about 50% coming through brokers to now about 40% coming through brokers. So that's a good shift. And then the last one, as you know, the Group as a whole has been moving to reduce our concentration on commercial property. We've taken overall from the Group point of view, something like $10 billion reduction in commercial property exposure over the course of the past 18 months or so, and St. George is very much part of reducing that commercial property exposure and concomitantly, increasing the expertise and focus on other industry segments. So those are three big structural changes that we've brought about in 2010. Having said that, I really was disappointed that the mortgage growth fell away as quite as sharply as it did. We were keen to continue to grow at least the system growth in New South Wales and South Australia, and we really should've been able to do that with the strength of footprint that we have there. But it fell away more than I would've liked it. So Rob Chapman is now in charge and he's really got his hands to the tiller, if that's the right expression. And he's growing the momentum. He's got great experience and track record in sales, service and delivery. So I'm very confident that we're going to see the momentum pickup in terms of leading indicators in home lending in the second quarter. And you'll see that translate into balance growth into the second half. On business credit, we're comfortable now from a point of view of commercial property exposure overall. We've got to the level that we're comfortable in and we're happy to grow there. So not just with St. George but for Westpac as a whole, you can expect to see some growth in commercial property but growth in those other industry sectors as well. That's a little bit of a story of St. George. Feel free to ask me a follow up question if you'd like.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

I was just going to ask on reinvigorating the business to get back to the system levels of growth now that the break of utilization has been adjusted? Recent advertising around 1% off the standard variable rate for the first year that you come across. Is there anything apart from just a prospect kind of strategy that gets those volumes up from where they are?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

That's really about sales discipline and a whole approach with regard to our physical footprint and our distribution forces. So there's a lot there with regard to what we measure, what we track, how we reward, how we run sales meetings and Rob Chapman does that very, very well. So it's all about depth of customer relationships. Again, it's not just about the mortgage, we're measuring and tracking and I'm holding Rob accountable, but deepening customer relationships, it's about getting the insurance cross sells, it's about getting the Super for Life cross sells, it's about getting the transactional banking as well. So it's not just about the mortgage. We're no longer interested in just getting a mortgage. So it's a whole of relationship approach, bringing in the sales discipline and changing the model to support that. It's always good to have a tactical campaign here and there because it helps put some momentum behind it. But that's all it is.

Operator

Question from Ts Lynn [ph].

Analyst

For St. George, lending has been below expectations. Is this right across the country? And my second question is are you concerned about the fact that maybe customers can differentiate between St. George and Westpac now? And they think of St. George as a major bank and therefore turning away?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

No. Across the country, we need to think about St. George differently in its different regions. And its primary regions are New South Wales and South Australia. So it really doesn't make sense to measure St. George from a national system point of view. We should be measuring St. George and will be doing this in providing you with the information. We're measuring St. George and homeland performance relative to New South Wales systems. And there, we'd expect to grow that system. And so we should. And similarly in South Australia, with Bank SA, we'll be expecting to grow our system and so, we should. Obviously in Queensland and in Victoria and in West Australia, it's a different situation because we have less physical distribution, less of our own people on the ground. And as we re-weight it away from third-party brokers, you wouldn't expect to grow a systems growth until such time as we build out those networks. Then we have plans to do that overtime in both Queensland and in Victoria. So that's the point around the geography for St. George. So look at the performance to know how it's tracking from a health point of view, primarily in a relative new system in New South Wales and South Australia. And then as we roll our infrastructure and physical footprint, you can look at Queensland and Victoria as well. There's no evidence at all that the customers are confused about Westpac and St. George. They do stand for fundamentally different propositions and there's remarkably little overlap between customers who joined St. George, this is particular in the consumer side, and Eastern East side. Customers are joining St. George and customers who join Westpac. If we're all St. George customers', who else is on their consideration list, Westpac doesn't feature. And similarly, if we ask Westpac customers who else is on their consideration list, in terms of other banks that they would consider, St. George doesn't feature. So we've really learned through the research that we've done detailed research, that there's a whole different set of customers that prefer a regional bank, that isn't a major bank. And so we think through our multi-brand strategy, we have access to a whole customer set, that most of our competitors don't have access to because they don't have regional banks in the way we do.

Company Speaker

We'll take a question from Yohan Bandelook[ph] .

Analyst

First of all, with respect to the net interest margin new Zealand's, would you be able to provide a bit more color around the sort of importance of the roll out for lower spreads fix-rate mortgages to variable? You seem to be growing your market share there. So the implicit question is, what can we expect for the second half to come from New Zealand in terms of NIM contribution?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Phil can answer this, perhaps more fully for he's the Director of the New Zealand business is particularly well-placed to answer' this question. But as one of our peers have seen, the shift from fixed to variable does have an improvement in the margin. I wouldn't want overstate it from an impact in the overall group point of view. But we have seen that shift occur. So something like -- being shipped to something like 40% now in variable, up from about 30% a year or two ago. So it's that kind of shift that's actually occurred into variable loans out of fixed loans. But Phil, you might want to talk about the impact that you see into the second half?

Phillip Matthew Coffey
Former Chief Financial Officer

I think as you said Gail, that shift and it's also just some of them more finely priced, fixed deals also have been rolled over. The timing of when the margin impact, and the size of the margin impact, obviously is also a function of your volume. And so having a better balance sheet growth, pictured in some of their peers has probably meant that we haven't got as much margin pickup. But we had about a 10 basis point margin improvement half-on-half last year in New Zealand. And that kind of the growth rate, looks like it's continuing at least for another half. And then obviously, what it will be after that, will be a function of kind of as the market develops, what kind of volume we see and the like. Let's say at the moment, conditions in New Zealand still feel pretty subdued.

Analyst

And could we assume that this sort of relative order of the bullet points, with respect to the NIM is also -- the order of magnitude of the three basis points improvement?

Phillip Matthew Coffey
Former Chief Financial Officer

What was three basis point improvement? I think you're talking about a period in which actually, have a different story.

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Without...

Phillip Matthew Coffey
Former Chief Financial Officer

Are you saying now [indiscernible]...

Analyst

I'm just simply looking at the five bullet points that you listed. So New Zealand is fourth there, it doesn't mean that it's the fourth most important contributor just to get a feel for the different mix there, that the two to three basis points?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

No, we haven't [indiscernible] I mean I wouldn't have put the mortgage distribution for proprietary as being first and most important to be honest. It's probably the improving spreads on the deposits and the repricing on the assets would be -- that certainly outweigh the other one. The most impact from the Group, overall.

Analyst

My final question is could you provide some color around the impairment charges? I mean you do say that it's lower than the average for the first half, but is it also lower than the $277 million that I've got here for the fourth quarter of last year?

Phillip Matthew Coffey
Former Chief Financial Officer

We said it was about $290 million and that's what it was.

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

And that includes the $40 million additional overlay that we took in December for the flood.

Operator

We will take our final question from Bryan Whitland [ph] please.

Analyst

Just a question around St. George, if I could. Just on the commercial property side, you're calling out the rightsizing of that book. I know it hasn't appeared as one of the points that are in the margin that you see. But was there any impact from sort of rolling off sort of higher margin commercial property on the margin this quarter?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

I wouldn't say so much this quarter but it has been an impact over the past year or so, because clearly, commercial property carries higher risk as we all know, but it also carries a bit of margin. It will have an impact over the whole period, I wouldn't call it out as a particular effect for this last quarter.

Analyst

One follow-up question on funding. You're talking about sort of the wholesale funding requirement potentially being a bit lower. One of your peers kind of funded themselves with deposits last half. Are we sort of heading towards continued improvements in loan to deposit ratio, I don’t know if the calculation by definition, will see that. But I mean do you see that as a sort of structural trend that's emerging?

Phillip Matthew Coffey
Former Chief Financial Officer

I think obviously, it's a function of the growth rates of both and where we start from. And it's been a particularly good period because we've had modest line growth and strong deposit growth. As Gail mentioned, we think that deposit growth will stay reasonably robust for a while because incomes are pretty strong and employment's quite strong. And that's normally two of the big drivers for deposit growth. But as credit growth starts to reemerge later in the half, obviously, we'll get back to a more balanced kind of picture. So yes, in the short term, but probably no, as we move into 2012.

Andrew Bowden

That's all the question on the line, but we can try and get back to you later on today. Thank you very much for attending and good morning.

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Thanks, everyone.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may all disconnect.