Question and Answer

Melanie Kirk
Head of Investor Relations

Great. Thank you, Matt. For this briefing, we'll be taking questions from analysts and investors. [Operator Instructions] We'll now take the first question from Andrew Lyons.

Andrew Lyons
Goldman Sachs Group, Inc., Research Division

Andrew Lyons from Goldman Sachs. Matt, just a question on expenses. For a long time now, CBA has been willing to grow costs above peers, and it has certainly delivered a better outcome for shareholders via better revenue growth. And your commentary today would suggest that that strategy will likely continue where you've said cost reductions are there but it's a long-term goal and you will continue to invest.

However, I'm just wondering how flexible do you think the organization's performance on costs can be if the revenue environment is such that even if you're still outperforming peers on costs, that's driving -- sorry, outperforming peers on revenue, that's driving a flat or a declining outcome on revenues over the medium term?

Matthew Comyn
CEO, MD & Executive Director

Thanks for the question. I mean from our perspective, there's a lot of work that goes into our cost management and the initiatives that we're going to deliver during the period, and not just this year but into future years. I think what we've indicated and very consistent with our approach for a number of years is we believe that the best interest of the ongoing success of the Commonwealth Bank is having a degree of flexibility around that. We start each period with the intent to reduce our operating costs. But as you said, we've seen opportunities in the last -- certainly the last several periods, either to respond in a way that we're supporting customers with some of the substantial resources we've put into financial assistance solutions, but also in this period $88 million of expenses in volume growth from operations to business bankers, which has delivered strong above-system growth. Clearly, we're comfortable with that.

We want to continue to invest in our technology. We believe that that's critical to the ongoing success of CBA. I think we see that reflected the technology actually assisting again in that above-volume growth. But we also have to be cognizant of that external environment. As you mentioned, it's a softer revenue environment, particularly given where low rates are. So between Alan and I and the rest of the team, we're always just trying to get the optimal outcome. And from our perspective, each period, talking about what we've done, the choices that we've made. And obviously we're comfortable with those choices, but we have to be able to retain sufficient flexibility to be able to continue to deliver the best overall outcome.

Melanie Kirk
Head of Investor Relations

Thank you, Andrew. We'll take the next question from Jon.

Jonathan Mott;UBS;Analyst

It's Jon Mott here from UBS. I just got two questions, if I could. The first one actually relates to the second quarter, and you did give us very detailed first quarter trading update back in November where you said revenue was flat, in particular, at around 5 -- just under $5.9 billion level. So if you backsolve out the revenue in the second quarter, especially if you add back some of the aircraft leasing, which technically is like an impairment charge, we saw extremely strong revenue growth in the second quarter, somewhere around 5% to 6%, depending on what exactly that flight number is, but very, very strong. And that came through a stronger NIM, better fee income, better trading income. Given that you've come out with your opening remarks that you've seen a marked turn in economic conditions, why shouldn't we be extrapolating that stronger December quarter out for the outlook from here, providing you've got the assumption that the economic conditions continue to improve? And then I've got a second question, if I may.

Matthew Comyn
CEO, MD & Executive Director

Why don't I start and Alan you add. I mean you're right, Jon, as far as second quarter was stronger. And a number of different drivers of that, many of which you've mentioned. I mean stronger volume growth across a number of businesses. I mean home lending, as I said, December with a net balance growth of just over $3 billion, very strong month. Similarly, business was strong throughout the half, but certainly in that second quarter. And as you said, fee income. I mean CommSec delivered a very strong performance, and as you'd expect during the sort of periods of ongoing volatility. Again, higher markets and trading income as well was significant, particularly in our sort of commodities area. That trading performance is obviously very hard to replicate period-on-period. That would be the main drivers from my perspective.

Alan Docherty
Chief Financial Officer

Yes. I mean the only thing I'd add to that, Jon, is there was some element of the aircraft impairment that we took in the first quarter of the financial year. So that wasn't all weighted towards the second quarter. We continually look at on a month-to-month basis how those discounted cash flow assumptions across that portfolio is looking. So we did take some provision, which would have held the first quarter revenue back a little bit relative to second quarter. So that -- but yes, other than that, yes, the momentum was strong in the second quarter.

Jonathan Mott;UBS;Analyst

And just a second question, if I could. On Slide 36, and this one is probably not as update, this is one of the charts we've been talking about for many years now, which is the MFI by age bracket. And providing the color scheme is right and I presume it is, it looks like you've seen a sharp decline in your MFI over the last 12 months, especially in the youth and up to the age 35 bracket. You're back to where you were in December 2015.

So I wanted to make sure, is that correct? And what's happened over the last 12 months, especially given your investment in technology or the positive talk you had through the presentation, that your MFI market share in the youth, Generation X and Generation Y has fallen back so dramatically over the last 12 months?

Matthew Comyn
CEO, MD & Executive Director

Yes. Thanks, Jon. And as you might anticipate, we've looked pretty closely at the results as provided by an external provider. The best causal explanation I've got is a significant reduction driven by migrants. We do extremely well in migrants, and obviously, there's been far fewer. So let's say, we've probably about a 40% share. I'm not entirely convinced that there's enough of a reduction in flow to impact the stock, but it's a survey-based results. I don't have a better answer. Certainly, we can't see anything beyond that that would indicate any degradation if we look at the way where -- in terms of share around both deposits, everyday banking, the way people are banking with us, home lending share means strong growth right across all of the ways that our customers bank with us. But I think the reasonable next question would be, well, on that basis, we'd like to see some recovery in that. Well, certainly, as international borders open, which, unfortunately, is probably still some time away. We'll certainly be looking for that. But I don't have a better explanation, but there's certainly nothing else other than that that we can see.

Melanie Kirk
Head of Investor Relations

Thank you, Jon. We'll take the next question from Brian.

Brian D. Johnson
Jefferies LLC, Research Division

Brian Johnson, Jefferies. First off, congratulations on a fantastic operational result. Two questions. The first one is that when we have a basis risk which was 3 basis points better over the period, can this actually get better going forward? Or should we be thinking that's now a neutral?

Alan Docherty
Chief Financial Officer

Yes. Yes, it was a big benefit in the sequential half, 3 basis points. And there's a couple of things going on there. Obviously, we had the, feel like, the bottoming out of the bill OIS spread that was around minus 2 basis points averagely over the 6-month period.

The other dynamic that's going on, and there is a volume dynamic, so effectively because of that very strong growth in the at-call deposit portfolio, we've effectively got much less structural exposure to basis risk. And so that reduction in the size of the balances that we're paying the bill rate on meant that there's a volume benefit embedded in that 3 basis points. So that was around half the benefit rate was the other half of the benefit.

I'd see that that sort of structural change, there's been a large move in it. I don't see a whole lot left in that move. And obviously, at minus 2 basis points, we'd say that from a rate perspective, that's bottomed out. So you'd see very much that's a temporary insulation in terms of the sequential move.

Brian D. Johnson
Jefferies LLC, Research Division

So Alan, the 7 basis points down is before any adverse movement that comes from basis risk?

Alan Docherty
Chief Financial Officer

Yes, that excludes basis risk. Yes.

Brian D. Johnson
Jefferies LLC, Research Division

Okay. I've got a lot of questions. But just the second one, if I may. Just when we have a look at Slide 71, the housing growth, we can actually see that -- from Slide 76, we can see that the average drawdown for home lending is actually shrinking. But I think what is more concerned is when we have a look at Slide 71, we can see new funding drawing down $65 billion but people repaying back $63 billion. And if I annualize the $63 billion, it's kind of telling me your book is only now lasting about 3.8 years, which, when you think about, kind of tells us the front book, back book accelerates. Could you just run us through what those dynamics that are coming through? Why are you getting such paltry growth? What does it mean for the margin? And what does it mean for basically holding the dominant market share?

Alan Docherty
Chief Financial Officer

Yes. I mean in terms of the weighted average life, actually, we're seeing -- that's actually held up very well in the context of lower rates and faster repayments. So we're seeing that flow to fixed rate home loans actually leading to an overall lengthening, a marginal lengthening in this period of the overall home loan behavioral term. For many years, we've talked about home loan behavioral terms of weight average of 6 years. Our expectation is that that's going to actually increase marginally over the next 6 to 12 months due to that greater share of flow into fixed rate home lending.

I mean partly in terms of the dollar rise in it. It's just a much larger stock of home loans that you're looking at that $63 billion runoff in the context. Also if you look at the $63 billion in the context of the larger stock relative to the last 6-month period, the runoff is only marginally higher than the rate that you would have seen 6 months ago due to that strong fixed rate flow.

Matthew Comyn
CEO, MD & Executive Director

Yes. I mean just to add to that, BJ, look, as you'd expect, those rates have come down. There's a couple of rate cuts during that period. The book does amortize more quickly. As Alan said, one of the things that we've looked at -- because those people have switched across the market to fixed rate loans, you do get a NIM compression from that. But actually the offset to that is actually the duration, as we're looking out, is improving. So we're certainly not seeing any change in and around the behavioral term.

I think it's unlikely we'll see the repeat of what we've had in the last period, which is if you break down how the housing market has actually grown, there's definitely been more sort of refinance splits going into fixed rates, just as rates have come down. And we've moved across the industry more people into fixed rate loans. I mean we probably would have peaked in the early 40% in terms of flow of fixed rate, which would be more than double what we would have otherwise seen in prior periods, but I think that's starting to slow.

And then compositionally, strong growth in first home buyer, owner occupier, investors still weak. And of course, those -- couple of those segments are segments that we do well in. As we've seen run-off repayments, refi, we've looked at that, they've grown, but actually fundings have grown more. But as Alan said, it's a very large book, so it does run off. And so there is absolutely an element of funding to be able to continue to grow. I mean our balance growth during that period and, particularly, in the second quarter was very strong.

Melanie Kirk
Head of Investor Relations

Thank you, Brian. We'll take the next question from Richard.

Richard E. Wiles
Morgan Stanley, Research Division

I'd like to ask questions on a couple of topics. The first is the dividend. I think you've explained pretty well why the payout ratio is below the long-term target range of 70% to 80%. But could you comment on whether you think your long-held practice of having a 45-55, first half, second half SKU is still appropriate? And could you also talk about the pros and cons of using your surplus capital for a multiyear increase in the dividend rather than a multibillion-dollar buyback?

In other words, why couldn't you -- with so much surplus capital, why couldn't you push your target payout ratio even higher for several years if you chose to use the capital that way rather than doing a buyback? And then I've also got a question on business banking, which I can come back to.

Matthew Comyn
CEO, MD & Executive Director

Sure. Why don't I start and Alan you add? I mean look, on the dividend -- overall, our principal to the dividend insofar as target payout ratio between 70% to 80% remains. As you know, typically, that's meant that we've paid in and around that 75%. There's been a slight differential between the first and second half. I mean broadly speaking, we're not intending on changing that. As you said, we're slightly below for the reasons that I think Alan well covered in terms of just some conservatism and being just cognizant of the risks that we face over the next period.

And then I guess on the capital side, I would like -- I'm not going to speculate on the differential between those. As you've seen in terms of the way we think about capital and certainly share count is an element that we think has been an important contributor to DPS growth over a sustained period of time. But there's a range of different capital options. That's clearly a discussion with the Board. And we'll go through a variety of different choices at the appropriate time and therefore make the announcement on that basis.

Richard E. Wiles
Morgan Stanley, Research Division

Okay. And then on Slide 12, you talk about the -- one of your strategic priorities being to build Australia's leading business bank. How are you going to measure that success? What does leading business bank mean? Is it Net Promoter Score? Is it size of the business bank? Is it profit of the business bank? How will you measure that objective?

Matthew Comyn
CEO, MD & Executive Director

Yes. Look, I mean, there's a range of different factors. And I'm trying to make the link in terms of where I think it's important economically for a pickup in business investment. I think financial institutions clearly have an important role to play there. We have a strong customer franchise in business banking. We've got, I think, the strongest share of business deposits in areas like merchants and in payments.

Typically, we've lagged in lending. We're not going to measure success based on our volume metric. As you'd expect, obviously, volume, pricing, credit quality, all important through the cycle.

In terms of -- in this period, we saw, as I said, diversified growth across a range of different sectors. We've added business bankers. We've broadened our sector and geography segmentation. We've improved the service offering, particularly some of the digitization and speed decisioning.

But ultimately, we'd be looking very much at a balanced set of metrics. That's an aspiration for us over the medium term. And we're pleased with the performance that we've had in the 6 months, but it's just that; it's 1 period. And we're very much going to measure our success or otherwise over multiple years across a number of the measures that I just mentioned.

Melanie Kirk
Head of Investor Relations

Thank you, Richard. We'll now take the next question from Andrew Triggs.

Andrew Triggs
JPMorgan Chase & Co, Research Division

Question relates firstly to -- 2 questions. The first one relates to investment spend. The half was annualizing at $1.7 billion for the year. Is this the new level we should expect for the near term, noting that much of the pickup came from productivity and growth?

And the second question relates to credit risk migration. So you actually saw a tailwind to capital in the half from positive credit risk migration. Can you perhaps update us on your thinking? I think previously you said that the central peak estimate in the base case was a 70-basis point impact, which clearly things are turning out much more favorable than that.

Alan Docherty
Chief Financial Officer

Yes. Thanks, Andrew. Yes. So on the investment spend. Yes, I mean, we took a decision this year to rebase upwards that overall level of investment spend. I mean you've seen a slight decline in the proportion of risk and compliance spend in terms of the overall envelope of the dollar amount of that spend is still relatively consistent on the same period last year. And given the amount of work that we wanted to do around continue to invest in the franchise and our technology agenda and digitizing the bank, we rebased the spend upwards. That's the annualized run rate of around $1.7 billion, and I think that -- the rebased level of investment spend commensurate with the change program that we've got across productivity, growth and obviously continue to invest from a risk and compliance perspective.

On the provisioning assumptions and credit risk-weighted asset migration, yes, I mean we've obviously been very pleased with the improvements in the risk-weighted asset intensity of the portfolio over the period. One of the side effects of the very strong support that we've seen as people -- as growth in mortgage offset accounts, people have got further ahead averagely in the repayments. That, along with some other improvements in the broader economy, have helped reduce the risk-weighted asset intensity relative to the level that we've seen back in June. And so we revised our assumption in terms of what happens to credit risk-weighted assets through a central scenario. And under a central scenario now, we wouldn't expect to see any material negative migration in credit risk-weighted assets.

We've retained a pretty cautious downside scenario. And so you can see in the disclosures, we've continued to assume a negative credit risk-weighted asset migration and the assumption that you see a pretty punitive downside scenario, but under a central scenario, we wouldn't expect to see any material deterioration in credit quality from here.

Melanie Kirk
Head of Investor Relations

Thank you, Andrew. We'll take the next question from Jarrod.

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Crédit Suisse. Just a follow-up on capital and just particularly around the dot points on Slide 30 about when your decision making, that's greater certainty regarding domestic economic performance and the ongoing assessment of the portfolio of credit quality. Could you give a bit more detail around what you're looking for? They're assuming that you're wanting to see the policy support measures come off such as JobKeeper and how that flows through to the economy. And what sort of time frame do you need to see those things come up before you feel that you have enough certainty to make that decision? Is it 1 month, 3 months, 6 months, 12 months?

Matthew Comyn
CEO, MD & Executive Director

Yes. Thanks, Jarrod. Look, I mean, it's a little hard to be specific on the time frame because realistically there's a number of variables which still need to play out. Certainly, as you said, that's one of the keys from our perspective is we think there's a lot of resilience in households with that surplus savings. But clearly, some of the income measures are going to be tapering over the next few months, how effective will the -- some of the other stimulus measures in terms of creating continued recovery in the labor market and investment.

So we certainly want to see that play through into the midyear, at least. I guess one part of that would be how the economy continues to perform during that period. And so I mean as we look domestically, even the continued management of the pandemic, a critical enabler of that, any interruptions in terms of vaccine or broader impacts from any constraints placed on the economy. So I think from our perspective, we can safely say that we'll be looking into that April or June quarter. But between now and then, there's also a number of other things that we'll be looking for, and we may change that view.

Alan Docherty
Chief Financial Officer

I mean just to add to that, the -- we're obviously also looking at very particular sectors of the economy, in particular exposures that we have in our portfolio that are going to be under -- they're under significant stress. So aviation, we've called out specifically, and a number of other vulnerable subsectors. So again, part of the -- one of the moving parts, I guess, in terms of how we think about our level of provisioning credit quality and the outlook is how those sectors perform and what the outlook is for those sectors. And each quarter that passes, we'll obviously have more information around how they're likely to fare over the period ahead, so that -- as well as the macro factors, we'll obviously be looking at those particular sectors that we've called out.

Melanie Kirk
Head of Investor Relations

Thank you, Jarrod. We'll take the next question from Victor.

Victor German
Macquarie Research

Victor German from Macquarie. I have 2 questions as well, one on expenses and one on margins. So the first question following up from what we discussed before on expenses. Matt, when you originally outlined your strategy around expenses, you had that chart, which I think at the time you kind of indicated you're probably going to regret putting in. But that chart indicated that you were hoping, excluding divestments, to achieve a reduction in the cost base. And at that point, it would have implied a cost base of less than $10 billion.

We're currently annualizing around $11 billion. I'm just interested in sort of your thought but clearly appreciate the fact that you're obviously seeing great opportunities to continue investing in the business. But do you think sort of vis-à-vis where we were sort of 2 years ago, that uplift in cost base is enough to absorb those opportunities? Or do you still feel that you need to see that cost base to continue to go up to capture all those opportunities that you want to do in the next 2 to 3 years?

Matthew Comyn
CEO, MD & Executive Director

Yes. Thanks, Victor. And look, I don't recall expressing regret at the time. I do recall you trying to work out what our core and noncore cost base was. And look, as you said, if we looked at, including divestments, our cost base has gone down, but that's a very low bar.

As we look at sort of our continuing operations of expenses, all of the expense growth over that period has been driven by risk regulation and compliance spend. We think that that's been necessary investments. Obviously, in the management of nonfinancial risk, it's been critical around the Remedial Action Plan, responding. We've added significant FTE to our management of financial crimes compliance. So probably in the order, just in that area alone of about 2,000 people over that time.

And then if I look at the rest of the expense base, we're flat, and flat on a nominal basis, which means we've absorbed both inflation and volume-related costs. So our commitment and our approach remains unchanged. Certainly, we accept the higher and elevated risk and compliance over that period. And then as I said earlier, in each subsequent period, we start with an intent to reduce our cost base but had some flexibility where we can see that there's opportunities to increase costs if it's in the best interest of creating value for our shareholders.

Melanie Kirk
Head of Investor Relations

Thank you, Victor. We'll take the last question from Brendan.

Brendan Sproules
Citigroup Inc., Research Division

Brendan Sproules from Citi. Just got a couple of questions on group margin on Slide 23. You've shown some asset price discounting evident in the quarter. I was wondering -- sorry, the half. I was wondering if you could talk to what is the competitive environment at the moment. And do you expect that discounting to increase over the next 6 months, given some of the pretty sharp deals that are available in the market?

And then secondly, on the deposit side, obviously transaction savings and investments were all drags in this particular period, but we've obviously seen TD and high interest savings account rates come down in the market. So wondering if you could talk about what we can expect in the next half on those.

Matthew Comyn
CEO, MD & Executive Director

Why don't I talk broadly about the housing market and then Alan if you want to add something either to that or on deposits. I mean as you'd expect, the housing market remains very competitive, which is obviously great news for customers. So I do think that we're going to continue to see a lot of price-based competition. Margins are still quite good. So as I said, we would expect that to continue. You do see some pressure from switching from variable to fixed rate. So there's a compression effect there. So I think it's hard to imagine that that will really abate anytime soon.

Alan Docherty
Chief Financial Officer

Yes. And on the deposit side, yes, we've seen obviously the sort of the lower rate environment feed through into those deposit margins. We've done some repricing in the period although swap rates have been falling as well. So net-net, term deposits have still been a little bit of a drag of 1 basis point, as you can see on that slide.

And then looking ahead, there's potentially some offset to the headwind that we can see through broader liability repricing, albeit within that guidance that we provide around the 7 basis point headwind year-on-year. You've obviously got the forward effect in each subsequent period of that continued runoff of the reduced tractor rate on the replicating portfolio on the non-rate-sensitive deposits and also the continued roll-off of the equity hedge. And so those headwinds remain. And to your point, I mean, we'll look at other actions we can do to try and offset some of that headwind, although those headwinds are structural.

Melanie Kirk
Head of Investor Relations
Thank you, Brendan. That brings our briefing to a conclusion. If you have any follow-up, please come back to CBA Investor Relations, and thank you for joining us for the briefing.