Question and Answer

Cameron Anthony Clyne
Former Executive Director

[Operator Instructions] So I'll start with John Mark.

Analyst

John Mark [ph] from UBS. Just a question on costs and the jaws comment right at the end. And just wanted one on -- and it caught my attention, if you flip to Page 37 of the actual result, not the presentation, but the results, you've got a table there of full-time employees. And you can see employees really jumped up in the half by 6%, and every division saw quite a big increase in hiring, which looks like you're embedding, higher costs are going to kick down for a while. At the same time, you don't have the benefit of the below-the-line restructuring costs that you've been taking, which were quite substantial during the year. Are you comfortable with this big increase in costs that you've effectively locked in for the next year, especially given the revenue outlook for the banking industry, it still does look patchy for at least the next 12 months, and with regulatory risk coming through as well, it couldn't be any longer than that?

Cameron Anthony Clyne
Former Executive Director

We feel comfortable with our half cost position. We've taken some targeted opportunities to hire or call out the business bankers that we've hired this year. We've also made additions in personal bank. We're taking on advisers. We are now moving to an environment we're going to manage the jaws, and we can't predict the revenue side necessarily, but we're comfortable with our cost position. Even though we're moving off the guidance, what we have established is a clear view within the organization that we have reasonable track record of managing efficiency. The other thing is in some of those costs, there's obviously a significant uptick in people on the next-generation program. Now that will run off over time. It's a very substantial investment as well. That's not been baked into our long-term cost but will provide long-term benefit.

James Freeman
Deutsche Bank AG, Research Division

James Freeman from Deutsche Bank. I just wanted to ask on the margin if I could, just where the spot margin sits at the moment? I think, Mark, you mentioned that the margin was down in the fourth quarter, and just sort of getting a bit of an indication as to where that sits now. Has the trend continued on the way down? And just if you could also comment on the UK margin? That fell quite substantially in the second half. Just sort of where that's sort of sitting at the moment, as well?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes. The fourth quarter margin, there is some volatility in this, so you can't necessarily just draw a line through it. But the fourth quarter margin, I think, was 2.21%. So I think three basis points weaker than the second half. And the UK margin is primarily a function of the lower capital benefit. As I said, it was GBP 32 million capital benefit lower in the year, of which GBP 23 million was in the second half. So obviously, that flows straight to margin. But if we compare the margins we get on the products on average to front book margins, they're all still higher. There was $4 billion of new lending in the year replacing runoffs, so we slowly bringing that into the equation, but it doesn't come in that quickly of course.

James Freeman
Deutsche Bank AG, Research Division

Has the trajectory into the first quarter continued in terms of that decline of three basis points? Would it continue to go down with the group?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

I haven't spent much time looking at the October result.

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Crédit Suisse. Just a question on capital in reference to Slide 105. I know you're saying that under Basel III, you've got 6.65% core Tier 1, ignoring any upside where local regulation is a bit more punitive. Can I just get you to comment on that in reference to -- also, John Laker's comments a week ago in a speech where he made the comment that there are a number of areas where Australia is more punitive on the capital side of things, and it would take a lot for APRA to actually reverse those at one point. And then the second thing he followed up, saying that a shoot of the lowest common denominator in terms of capital, i.e. the 7%, was not something that APRA was looking at. So is there a circumstance here where APRA looks at your core Tier 1 being at 6.65% then looks at a target ratio being north of potentially 8% when you sort of putting the systemically important side of things as well, and that the capital situation is not as comfortable as what I suppose was originally first thought for the Australian banks.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

I don't think -- APRA thought long and hard about why and where you should deduct things from capital. So I don't think that just because the Basel Committee comes out taking some of the pain, not all of the pain, I don't expect APRA to go back on decisions they've made. Certainly not. So I think if there's going to be an outcome, it's going to be more to the 6.65% than it is to the eight point whatever. It is important to understand the 8.19%, because we spent a lot of time in offshore markets, raising debt from investors who want to have an equivalent view across organizations. So that's an important thing to understand nonetheless. Quite exactly where effort's going to come out on these things, whether we are going to be seen as a systemically important institution, I don't know. That'd be nice. Actually, it might not be nice. So I just think there's a lot of moving pieces on this, and so it's hard to predict. Eric, is there anything you want to add? Eric's our Treasurer.

Eric Williamson

I think your answer was spot on. What we've tried to do in this slide was provide a bit of a range of outcomes. And as Mark said, the Basel III's harmonization position and APRA's approach to that is a bit unclear, but we've tried to quantify that, an 8.19% number. And then, APRA have been very clear, saying that where their standards currently exceed the Basel III minimum, they're not really mainly to retreat, and where they're below, their view will be to take the deductions. So that's why we've presented it in a way the 6.65% ignores any upside. I do think it's hard to be quite aggressive on deductions and also quite aggressive on where you want to set the minimum target. So, on the minimum, Basel target's been set at 7%, and I guess we're going to add buffer to that, but it's hard to play on deductions and on the minimum ratio as well.

Craig Anthony Williams
Citigroup Inc, Research Division

Craig Williams from Citi. Six months ago when we sat here, you talked about a business banking pipeline that was the strongest you'd seen in five years. Can you talk about the confidence you have on the -- your economist's forecast or not, turnaround in the relative growth rates and business lending expected in 2011 from minus 3.5% to positive 6.5%, given that estimates would seem to be under a bit of pressure from the ATO right now? You talked about some signs of life in the fourth quarter. Where are you seeing those coming from, and your expectations for NAB's growth versus system over the next 12 months?

Cameron Anthony Clyne
Former Executive Director

I'll get Joseph to comment with a bit more detail, but just to sort of give you a little bit of overview, we still do hold the business credit growth will rebound in 2011. There is a substantial pent-up demand out there that has to be fulfilled. The pipeline remains strong. In fact, if anything, it's a little stronger than we saw at the half year. And I don't know where the system's going to land, but we would have an expectation to grow above it, as we traditionally have. We've got the number one franchise. So, Joseph, you want to give more color to the pipeline?

Joseph C. Healy
Australia and New Zealand Banking Group Limited

Sure. Well, as Cameron mentioned, the pipeline remains strong. It's actually got stronger in the second half, mainly in the larger corporate sector, I call it top 500 companies. It is somewhat subdued in the SME sector, so we would expect to see system growth rebound closer to the end of the first quarter calendar FY 2011, and we anticipate that we're going to see mainly from the top end of town, which I'm calling the top 400 or 500 corporates. For balance sheets, they're in a very good position, well-placed to meet the investment decisions that businesses will need to make. So we do remain confident of seeing credit system growth return. As Cameron mentioned, 6.5% is our anticipated FY '11 increase, and we would expect to outperform the system given the momentum that's clearly evident in the Business Bank. It has been evident in the Business Bank for quite some time, as indicated by Mark.

Richard E. Wiles
Morgan Stanley, Research Division

It's Richard Wiles from Morgan Stanley. Cameron, the retail bank showed positive jaws in the second half, 5% revenue growth, 4% cost growth. Do you think that your jaws can improve in the retail bank going forward? And how reliant would that be on any repricing of homelands that you obviously haven't done since April '09, and therefore wasn't a feature of the second half result?

Cameron Anthony Clyne
Former Executive Director

I'm not going to sort of predict where the jaws might land, but I think what we feel comfortable about in the Personal Bank is it's on a much more sustainable footing now. So many of the levers are in our control, and many of the threats that might emerge in that space, be they competitive or inventory threats, aren't really going to concern us. So for example, a number of the things that have been announced in the government program with credit cards are the stuff we got rid of a year ago. So it doesn't stop our momentum in that sense. So we feel, from a Personal Bank point of view and probably in this half, it's starting to come through, is the business has got momentum and is on a very positive footing from a standability point of view. Now, the interest rates, it's very tough on where that might move, but we do feel a lot better about the Personal Bank than we, perhaps, did six, 12 months ago.

Operator

Matthew Davison from Merrill Lynch.

Matthew Davison
BofA Merrill Lynch, Research Division

My question was on the Personal Bank and in particular the margin trends. You've arrested the decay from minus 30 bps to minus 6 bps in the last period. The lending margin and the deposit margin were both pretty flat. I'm just interested, given the result there on the lending margin, whether you continue to be comfortable with the mortgage strategy that you're running, given you've been able to hold lending margins fairly stable? And also just some broader observations on what's happening on the deposit side, and whether you could see that being positive influence in the coming six months?

Cameron Anthony Clyne
Former Executive Director

I'm not going to get into interest rate forecast, but I think what we've demonstrated is a commitment to be competitive over the last probably 15, 18 months and, yes, we're seeing volumes come through that, and it's a bit hard to predict what might happen in the competitive environment. But we certainly see it's delivering volume for us, and it's allowing us to average up the quality as well. On the deposit front, Lynne, do you want to...

Lynne Margaret Peacock
Former Chief Executive Officer of United Kingdom

Certainly. One of the advantages we have, obviously, is we are able to run different brands. So we've been able to, certainly, through the full year, grow strongly around the UBank, and in the last six months, certainly through the NAB-branded deposits as well. So we're continuing to see solid competition moving between the online accounts and the turn deposits as well. But it's starting to moderate to some degree as well. But that will clearly be in an area of competition. But where we've seen the strong growth in transaction accounts, you'll start to see more sustained balance growth through there, which is much stickier business.

Operator

Your next question comes from Johan Vanderlugt from Daiwa Capital Markets.

Johan Vanderlugt
Daiwa Securities Co. Ltd., Research Division

My question is about the personal banking division as well, so another one for the alliance, I'm afraid. Page 94 in the slide show pack. If I look at a breakdown in terms of origination, I see a sort of big fall in terms of the proprietary channel, from 75% to 61%. Then if I look at the commentary on page 56, you're actually referring to increased capacity and improved efficiency, which was initially a focus on the broker business. My question is what can we expect in terms of initiatives to be focused on the proprietary channel? If I look at the number of retail outlets that went up by 25 for the half. So can we expect further deterioration of the share of the proprietary channel, or will it stabilize at around that 60% mark or probably go up? Because it has some implications for the net interest margin.

Lynne Margaret Peacock
Former Chief Executive Officer of United Kingdom

When you look at the split of flows, it's in fact not deterioration of the proprietary channel. It's actually strong growth of the broker channel. So, typically, in this country, by and large, one in two loans are typically taken out through a broker. If I look across the industry, on average, somewhere between 40% to 55% of flows typically come through brokers. And historically, we've been significantly underweight, and that's what you can see in that chart. So what you're seeing, actually, is strong growth in the broker business. The proprietary channel has continued to grow, if we look at the full year, at 1.2x system and over the last month or two and half well above that as well. So there is still very strong growth above system in the proprietary channel. We certainly though have been improving in investing in front-line people in very small business bankers, which we've been doing with the Business Bank, and ensuring we've got our service capacity there as well. So being in a position to be able to improve service as we grow and make sure that we can actually provide a deeper, more cross-sell opportunities into the future and a deeper service experience. So the initiatives are to enable to continue growth, but really where you're seeing the split is about the even stronger growth in the broker, but still above system in the proprietary channel.

Ben Koo
Goldman Sachs JBWere Pty Ltd, Research Division

Ben Koo from Goldman Sachs. Just a question on the business banking side. When we're looking at the margin trajectory half and half, it looks like it's now tapered off and leveled out. As we look forward, given the common stress of just about how the growth's in the top 500 I would have thought that's -- is that going to be a business, mix-wise? Can we negative the margin? And then if you could just talk about competitive forces in the markets right now, how you just see them playing out as well, if that's stabilized or if competition is stepping up?

Cameron Anthony Clyne
Former Executive Director

Sure. I think it's fair to say that we don't see any upside on margin. We think margin's pretty much peaked. I think when you look at the slide, they're at very healthy levels. We would anticipate -- there's two dynamics at play. One, we anticipate that margin on your business will be -- we would expect to be at lower margins, given competition. And given that the risk in the economy is less today than it was a year ago -- offset to some extent by the fact that we've got about 12% of our book still at pre-GFC pricing, and that will be getting repriced. And that'll be that last repricing wave across the portfolio. So we're really pricing that at the current market, which is obviously higher than the pre-GFC market. So those are the two market dynamics. The other factor that's quite important in understanding margin in our business is the strength of the relationship franchise. So we do not anticipate that we will be as exposed to margin erosion in terms of the way that we manage our customer and build our business, as might be the case for other players in the market. And we've shown that resilience, that the quality of the relationship commitment that we've had does have some economic value in terms of margin management, and we'd expect to see that, on a relative basis, to be evident going forward. Well, obviously, we anticipate that fee -- there's a strong line between new business activity in terms of lending and fee growth, but also the way that we're growing our transaction banking account. So we're seeing good progress in that, and I'd expect that we will continue to see good growth there. But a lot of it's going to be driven by system activity, and a lot of it's going to be determined also by our success in growing our transaction banking penetration, which had been showing good progress consistently over the last couple of years.

Analyst

Leif Garrett [ph] from Numerup [ph]. Just a question on underlying profit. If we back out SGA business unit, your underlying profit actually went backwards by about $100 million in the half. And in light with the earlier question from John, given that your cost growth is arguably accelerating in '11, do you think you'll be able to achieve positive growth in underlying terms in 2011, and where do you think that will come from?

Cameron Anthony Clyne
Former Executive Director

I haven't actually done that analysis, but obviously you've still got rebasing going on, particularly in the markets and, to a less extent, in the treasury area in those numbers, if you just take SG&A out. And I think an important thing for us to get decent underlying profit growth, having rebased in the next period, is going to be continued strength on the Personal Bank side but an upswing on the business side. If we do see a swing from negative 3.5% to plus 6.5% on the business side, that's going to give us ample opportunity to move the underlying.

Analyst

Mike McCrow [ph]. I just wanted to make a point that with both political parties criticizing banks for their competitive ways and -- particularly with regard to the mortgage, I would say that you guys have an incredibly competitive product out there in UBank, which anyone would have to say is probably at the bleeding edge rather than the leading edge in that area. And in all these accounts, I can't see any reference to any of the numbers around UBank in terms of the number of billions of dollars in UBank and what division it's reported under or what impact it's had on that margin change, the margin change you point out in terms of the lag with the Reserve Bank rate. Can you answer any of those thoughts or concerns?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes. I mean, in these results, it's reported as part of the Personal Bank. And it is a high-margin, low-cost offering. but it's in-line with marginal cost of funds in wholesale areas and term deposits and things like this. It's not extraordinarily expensive. And while it's making a contribution to our liquidity, at the same we're building a franchise. And as Cameron said, we're already planning to bring on UBank mortgages in the second half of the year, and then it's always a test bed for our next-generation capabilities, so we'll bring on payments capabilities in due course and so forth. I'm sure my kids will be happy if, in their lives, they never see inside a bank branch or meet a bank manager. And this is really a franchise that will appeal to the online next generation, and we need to value it for what it can contribute in the meantime, but recognize that we're on a long journey to build a franchise.

Analyst

How many billion of deposits is in it?

Cameron Anthony Clyne
Former Executive Director

I think it's at about $5 billion.

Brett Le Mesurier
Axiome Equities

Brett Le Mesurier from Axiome Equities. The regulatory expected loss increased by about 10% the last six months. Loans increased by only 3%. And the loan growth was in housing, so the increase in regulatory expected loss looks surprising in the context of those numbers. Can you explain why we have that high growth in regulatory expected loss?

Cameron Anthony Clyne
Former Executive Director

Yes. The regulator progressively works through different asset classes and makes sure they're happy with model overrides and classifications of different kinds [ph] of loans. And in this particular period, we had APRA make some adjustments to the way we treat certain commercial real estate exposures, and that gave rise to higher capital impost [ph]. I don't know, Bruce, if you want to add anything to that?

Company Speaker

That's it.

Analyst

It's TS [ph] from Southern Cross. I just can't find too much details on your agribusiness lending business. Can you -- because I believe it's your core competency. Can you just comment on this business? I mean the competition, the margin outlook, that sorts of things?

Cameron Anthony Clyne
Former Executive Director

I mean, we would like to think it's a core competence. We're the largest agricultural lender in Australia. We've very significant franchise in New Zealand, obviously significant capability emerging in the U.S. There are always going to be challenges in this sector, whether it be the current debate going on around the irrigation space. But then there's been drought and a whole range of other things. I think the thing we like about agriculture, I guess, as a sector to lend into, is that it actually is one of the most long-term stable growth businesses that exists. Now growth is not spectacular year-on-year, but it's very steady, and that remains steady whatever the factors happen to be, whether it's rising populations, changing diet and range of other things. So we think it's a very attractive sector to be in. The second thing about it is, it is probably one of the businesses that's at the heart of our relationship model. I mean, we've had a long track record of recruiting out of agricultural colleges, recruiting off the land. So we've got people that have a very fundamental understanding of what it means to run a commercial farming or agricultural enterprise. So, yes, it's probably, actually, one of our more stable businesses in terms of margin, outlook and growth. They'll never be spectacular and there'll always be environmental challenges thrown at it, but it's probably one of those businesses that we feel pretty confident about.

Richard E. Wiles
Morgan Stanley, Research Division

Richard Wiles from Morgan Stanley. Cameron, six months ago, you told us that you would only acquire in the UK if you could do a deal that was significantly EPS and ROA-accretive. You've subsequently pulled out of any participation in the sale of RBS assets in the U.K. And then earlier today, you've told us that your acquisition appetite is less. Could you just provide a little bit of clarity on your specific strategic intentions and acquisition ambitions in the UK?

Cameron Anthony Clyne
Former Executive Director

The criteria hasn't changed since the half. If we see opportunities there that will have a significant financial accretion at the group level, we'd obviously consider them. The reason I say -- by the same token, we also don't rule out divestments. So they know [indiscernible] our price, we've always been consistent with that. In the absence of either a very attractive acquisition or an attractive divestment, status quo remains the option. You improve the franchise going forward. The reason I say our acquisition appetite is low is we don't really see huge opportunities there. If they emerge, we'll consider them, but we're not seeing them there. The price is just the -- opens the gate. If you meet some price criteria, you've got to think about the regulatory implications, because we've got to deal with both the [indiscernible] and APRA, and they want to obviously increase the really intense [ph] domestic franchises, and we've got to deal with immigration risks. So price is just the first hurdle, and it doesn't mean if you get through that price, that you won't get through the subsequent two. So that's why we're just putting some criteria around that. But our financial criteria hasn't changed since the half.

Operator

Your next question comes from Stuart Allbritton [ph] from Baylor [ph].

Analyst

Just on the DRP discount. You had one, you got rid of it, and now it's back again. What's that say about your capital planning?

Cameron Anthony Clyne
Former Executive Director

We're just coming back to this core Tier 1 and wanting to take -- not every opportunity, but take an opportunity every time to reduce the potential headwind that we have on the capital side. So by putting a small discount and uncapping, we've probably moved from about high teens to about 35% drawback of the dividend, which just keeps the capital healthy and makes it more likely that we'll arrive in 2013 in good shape.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Scott Manning from JPMorgan. Not willing and wanting to set a precedent for relying on economists' forecast, but most are predicting rates to go up by 100 basis points over the next 12 months. So I just wanted to gauge your impressions of the vulnerability to your business credit growth, and mortgage credit growth rates in particular, to that higher interest rate environment.

Cameron Anthony Clyne
Former Executive Director

I think our current forecast is 100 basis points as well. So I think we're in that camp. Look, there'll be implications, obviously, about -- potentially on demand, but we'll still leave it at 100 basis points, settling below where we started from many respects, but particularly on the personal side. We do still see -- I mean, housing, we still think that levels of housing, business credit growth to be obvious [ph] start peaks, but they'll probably be the more sustainable one. And we still have some factors driving them. There is dwelling under subprime, there is predicted to be stable to falling unemployment, which would help. And on the business side, there is some very substantial pipeline, at a point that has to convert. The pent-up demand is there. So I think the interest rates, even with 100 basis points, with those other competing factors, should actually see the outlook being okay.

Operator
It looks like that's it for questions, sir. Thanks very much for showing up this morning.