Question and Answer

Andrew Bowden
Head of Investor Relations

Thanks, Pete. All right. [indiscernible] you've got the first one to give to Craig. Thanks.

Craig Anthony Williams
Citigroup Inc, Research Division

It's Craig Williams from Citi here. A couple of questions, please. Firstly, around watchlist exposures being up 20% this period, 90-day past-due loans, up 19% I think. So why did collective provision fall in the period while GRCL and expected loss both moved higher? Is this simply a timing issue with collectives to move higher next year? And a second question around the Institutional Bank. Seems like it's working harder on capital efficiency, but balance sheet is contracting, revenue is falling. So is cost growth a suitable outcome? Or does -- is there a need for more focus on this -- on cost management as, surely, you can't expect write-backs to be a continual support for returns in that business?

Brian Charles Hartzer
MD, Group CEO & Director

Do you want to do the first one, and I'll take the second one?

Peter Francis King
Chief Financial Officer

Yes, okay. So Craig, on watchlist and substandard days, the 2 big drivers were the review of the New Zealand dairy portfolio, which did move quite a bit into that watchlist bucket, so still performing but watchlist; as well as mortgages. And just one thing on the -- on my chart on impairments, it doesn't pick up the interest-carrying adjustment which goes through revenue. When you take account of that, the collective provision's actually pretty flat, so it hasn't reduced in the half. So that's just one thing to bear in mind as you think about that. So overall, I think the -- it's those areas that we saw that are driving that less than we feel that the provisioning is pretty good for that level.

Brian Charles Hartzer
MD, Group CEO & Director

And, Craig, on the WIB side, we made a number of deliberate decisions to walk away from growth this year on some of the balance sheet side where we didn't think the returns made sense. And the team managed that really carefully through the year. We did take a significant step on costs. There's probably a bit more to do on costs there, but it's -- I think that we're being pretty sensible about making sure that we stay open for business over the next period. And there's also investments going on in technology and maintaining our position on the transactional side and the like. So we feel pretty good about how we're managing the balance setup.

Andrew Bowden
Head of Investor Relations

Jarrod?

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Credit Suisse. Brian, can we have a chat about the new ROE target? Look, everyone, I suppose, understands the previous aspirational target of 15%. What surprises me about the new range of 13% to 14% is that you're currently at 14%, so implicitly, you're saying that you can't make things any better, and this is about as good as it gets for Westpac in terms of returns. But that surprises me in terms of that's a new target out there. Could you make some comment on that?

Brian Charles Hartzer
MD, Group CEO & Director

Yes. Well, Jarrod, we're at the top end of that range this year. What we're trying to recognize is that the environment's gotten tougher, particularly on rates and the ongoing increase in regulatory costs and the like. We've still had some uncertainty about capital coming out of Basel. We still have uncertainty around what APRA is going to do around unquestionably strong. So we felt that over the medium term, it wasn't probably realistic to get back to a 15% level. That isn't to say that we aren't going to continue to manage capital very carefully and to continue to drive earnings growth. I mean, I think it's important to say, we're saying this is probably a realistic range given all the things we're dealing with for the medium term. But we're not saying that this is guidance about what we're going to come out with this next year.

Andrew Bowden
Head of Investor Relations

Jon?

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. You said at the start that you're focusing on mortgages, deposits and SME, which makes sense given they're the highest-returning products out there. But if you look around the market, you've got your 2 Melbourne peers coming back to Australia, and they're focusing on mortgages, deposits and SME. And your big Sydney peer down the road also focusing on mortgage, deposits and SME. Whenever you see 80% of the market focusing on in a few products which are the highest returning, doesn't this just mean that the margin and the ROE in these products are just going to keep going down and as we've been seeing for the last 5, 10 years, and that NIM pressure and ROE are just going to be ongoing as everyone squeezes into the most profitable products?

Brian Charles Hartzer
MD, Group CEO & Director

Well, Jon, I'd say, on the one hand, yes, it's certainly a competitive market, and we expect that to continue; on the other hand, it's not like the -- those other banks went away. Yes, they've been spending a lot of time on oversea -- dealing with overseas issues that they've had. But they've remained aggressive and fierce competitors in the domestic market over the last year, so I don't see anything fundamentally changing in that. And I guess, I would point back to the success that we've had in those businesses over the last year and advantage we have with the different brands, the progress that we're making on technology, particularly in the Business Bank, the way we've been able to grow the number of customers to grow share there. So we still feel, yes, it's competitive, but we're optimistic about our position in those markets.

Andrew Bowden
Head of Investor Relations

Victor?

Victor German
Macquarie Research

Victor German from Macquarie. Since Andrew didn't give us direction in terms of how many questions we can ask, I'll ask a couple.

Andrew Bowden
Head of Investor Relations

That'd be one.

Victor German
Macquarie Research

After this one. First, just if I could clarify Jarrod's earlier comment. So in terms of the guidance for ROE, would it be fair to assume that your guidance of 13% to 14% is predicated on additional capital rather than your views that earnings are likely to go backwards?

Peter Francis King
Chief Financial Officer

I might just deal with the technical question there. We're not providing guidance, just so we're really clear. We're seeking -- we've indicated [indiscernible].

Victor German
Macquarie Research

Well, you sort of have, at 13% to 14%?

Peter Francis King
Chief Financial Officer

In the medium term, but it's not guidance. Just...

Victor German
Macquarie Research

Okay. The second question I was hoping to ask was around costs. So cost growth this year was about 3%. You've delivered $263 million of cost benefits, which is around 3%, so underlying costs grew by about 6%. There was about $130 million or so of additional costs associated with investment, which is about 1.5%. So that takes us to about -- underlying cost growth to about 1 -- 4.5% for the year. Just interested in your observation that you've -- that's sort of reasonable cost growth you think is reasonable in this environment to go into FY '17, or have you largely addressed additional investment spend that you needed to address? And to what extent are you sort of committed to that 2% to 3% guidance on costs given that, in the past, we have seen sort of you started off with that guidance; but then over the year, things have changed? Are you sort of a bit more committed? Are you sort of more on top of the costs where we stand today?

Peter Francis King
Chief Financial Officer

I think what we've said is we'll aim to be at the bottom end of the range. And I think we'll set the business up to do that, but you can't predict the future perfectly. And I think you can see from the way we're managing the business in a disciplined way, we'll make the right choices. So 2% is what we're setting the company up for, and all the line execs are focused on that. In terms of the year-on-year movement, you're right, the investment coming down will be one of the reasons that cost growth does come down. But I think we're very clear that in an environment that's low growth, we want to be disciplined on costs, and that's how we've set the company up.

Victor German
Macquarie Research

But would you say an increase in investment is about the right level where we are now?

Peter Francis King
Chief Financial Officer

In terms of the cash spend, yes, it's about that level.

Victor German
Macquarie Research

Right. So you're not forecasting additional?

Peter Francis King
Chief Financial Officer

No.

Andrew Bowden
Head of Investor Relations

Brian?

Brian D. Johnson
CLSA Limited, Research Division

Brian Johnson, CLSA. 1 question, 3 subsets. First one, you've got a chart in there which shows TD rates have escalated quite sharply. When I look at the chart, the shape of it would indicate that they were increasing towards the end rather than over the period. Can we just confirm that, that means, right now, the NIM is probably run rate down on where it was over the period? The second one is, in the slides, you show basically that the access to the committed liquidity facility goes down by $10 billion between '17 and '16. But the actual LCR ratio you're running is about 135%. If you take that $10 billion out, it's back to about 125%. Is the target going forward 125% or 135%? And then the next one is on the ROE target or the ROE aspiration, whatever you want to call it. You haven't called out today the fact that capital requirements could go up under Basel IV. Based on the warm day that you enjoyed in Canberra, Brian, I'd just be interested, if we're to get a change in the capital, does this mean that ROE target could basically click down a little or a lot?

Brian Charles Hartzer
MD, Group CEO & Director

Do you want to have a go at the first?

Peter Francis King
Chief Financial Officer

So I think the first question was exit margin. And, Brian, you're right, the cost of funds did head up at the back end of the half; and therefore, the exit margin is slightly below our average for the half. On the CLF, it does go down $10 billion. Part of that will be absorbed by running a lower LCR ratio. So 135% has been built, expecting that runoff -- expecting that reduction in CLF. So we've done quite a bit of work this year. So we'd think 120%, around there, is probably a good target. And then on the -- on Basel, yes, I think my feeling at the moment is it feels like it's less of an issue than it was 6 months ago at Basel and probably more interested in APRA on unquestionably strong at this point. So I think we'll hear by the end of the year from APRA on unquestionably strong, and I still expect to see any rules next year with a transition period. So the key point there is there's time, there's time.

Andrew Bowden
Head of Investor Relations

Richard?

Richard E. Wiles
Morgan Stanley, Research Division

Richard Wiles, Morgan Stanley. If you've lowered the ROE target for the medium term, how come you haven't reviewed your target payout ratio? I would have thought the 2 go hand in hand?

Brian Charles Hartzer
MD, Group CEO & Director

Do you want to take that?

Peter Francis King
Chief Financial Officer

Yes. Well, I think when we thought about the dividend this period, we were -- we're staring into it with capital above the top end of the range, a pretty healthy franking surplus and don't know where we're going on capital. And when we looked at that, we thought, actually, we'll hold it flat. We used the DRPs we said we would to bring that effective payout ratio down into a range that's affordable, and that's how we've thought about the dividend decision this time. When we roll into next year, I think we'll have clarity on regulation. We'll also, I think, have another look at growth return, and we'll make another decision at that point on the dividend.

Andrew Bowden
Head of Investor Relations

Brett?

Brett Le Mesurier

Brett Le Mesurier from Velocity Trade. A question on your deposit funding. You commented that all your assets -- your loan assets were funded by deposits. But within the Consumer Bank, only half of the Consumer Bank loan growth was funded by growth in consumer deposits. The other half appears to have been being funded by growth in the institutional deposit base. Is it your expectation that that's the way you're going to be going forward, or are you hoping that your Consumer Bank deposit growth is going to equal your loan growth? And I also noticed the growth in your consumer deposits was all in TDs, and there wasn't any growth in transaction deposits. So are you also expecting that with the investment you're making in your Consumer Bank, that you'll be able to grow transaction deposits?

Brian Charles Hartzer
MD, Group CEO & Director

Your turn again.

Peter Francis King
Chief Financial Officer

So I think you're right in summarizing the balance sheet. The way we think about the balance sheet is we run a portfolio, so we get all the businesses together and think about the options or the opportunities in every market. And this time, the Institutional Bank did a great job with particularly some of the government clients, where we've got a pretty strong franchise there. So this period, it worked out that way. In future periods, we'll see. I think as Brian said, we think mortgage growth will probably come off a little bit. We want to be -- we're targeting system or above in deposits in the Consumer Bank. So we'll continue to manage that balance sheet in a dynamic way, depending on what we see in each of the segments. And just finally, you're right on; most of the growth was in TDs, I think because people took advantage of the fact that TDs are now paying more than online savings accounts.

Brian Charles Hartzer
MD, Group CEO & Director

But the general point is right as well, which is that deposit growth is going to be really important part of what we're doing. And certainly, the whole focus of the strategy around service has core transaction deposits as the fundamental basis of growing our business over time. And that's why we were quite happy with the growth in customer numbers that we had.

Andrew Bowden
Head of Investor Relations

Andrew?

Andrew Triggs
Deutsche Bank AG, Research Division

It's Andrew Triggs from Deutsche. Just a couple of questions, please. Firstly, on funding, quite a significant reshaping of the balance sheet during the period with the lower reduction on -- lower reliance on short-term wholesale, particularly offshore, but also as a whole. Do you think that the NSFR at 105%, that further work needs to be done? And also, on the long-term wholesale funding, whether the sort of mix of the tenor that you raised this period is similar to what you would expect in the future? And just a second question, just the size of the overall trade book at present and whether you think that needs to reduce further or if there are any other opportunities to reduce low-returning assets in the institutional franchise.

Peter Francis King
Chief Financial Officer

Yes, so on NSFR, just one thing to highlight is the denominator and the numerator in the NSFR are 5x the LCR, so you don't need to run as big a buffer in the NSFR. So 105% is a good position. It may need to be a little bit higher. We need to go through with APRA the final calibrations, so things like we're unclear yet how to treat some of the superannuation funds that come into the bank, and that's one of the bits of feedback we gave APRA, that these deposits have real value for the economy, so they should be recognized in the NSFR. So there's a few things to settle down, but I feel really good where we've ended the year. We do a lot on capital. We do a lot on funding. We've got an NSFR in good shape. We're well prepared for the CLF drop. So it was a big year. The trade -- I mean, just more generally on how we're managing assets rather than focusing on portfolios, we're really looking trade -- as each facility comes up, we're looking return, we're building in the new capital requirements, we're building in liquidity requirements, we're thinking about what might come out of Basel in setting up pricing, so it's a real -- it's not portfolios. It's customer-by-customer work that each of the business units are going through, both in WIB, in the Business Bank and in New Zealand.

Andrew Bowden
Head of Investor Relations

I'd like to take a call on the phones from Andrew Hill, please.

Andrew Hill
BofA Merrill Lynch, Research Division

I just had a follow-up question on the TD cost chart you have in there on Slide 18. I appreciate the exit margin was quite a lot higher through September. But in October, it looks like you cut your 3- and 6-months TD rates by 20 to 25 basis points. I'm just sort of -- I'm just wondering what sort of impact that has on the exit margin overall.

Peter Francis King
Chief Financial Officer

Well, Andrew, I think, yes, we're dynamic in pricing all our deposit products. And you're right, we did reduce some of the term deposit rates. That's not factored into that chart, but it certainly see the cost not rising as fast.

Andrew Hill
BofA Merrill Lynch, Research Division

But still rising?

Peter Francis King
Chief Financial Officer

Yes. We haven't got it down to that low point.

David Walker

David Walker from Clime Asset Management. Earlier, you mentioned political risk. Could we ask you to comment in more detail about what you see those are and has your view on what those are changed since your parliamentary testimony recently?

Brian Charles Hartzer
MD, Group CEO & Director

Well, I think there've been a lot of areas that have been looked at in -- across banking as a result of some consumer issues that have come up and some of the ongoing questions about the housing market and the like. We're seeing that come through in the form of lots more inquiries that we have to prepare for, lots more regulatory interventions that, as Peter was talking about, lead to us having to do a lot of research into the past. All those things add to cost and put pressure on regulators about various changes they might make. So we're not calling out anything particular there, just the fact that when you look in aggregate at the amount of money that we're spending responding to these things, it's quite significant.

Andrew Bowden
Head of Investor Relations

I'll take a question from the phone from Azib, please.

Azib Khan
Morgans Financial Limited, Research Division

Brian, so you mentioned earlier that you've won a potential number of transactional customers in WIB this year. Your loan growth has contracted in that business. So are you deliberately staying away from any term loan piece that would be involved with these new relationships? And is your focus just on the transactional business and maybe even markets going forward? And also, what has enabled you to win such a substantial number of transactional customers?

Brian Charles Hartzer
MD, Group CEO & Director

Well, we've had a lead position in transaction banking in WIB for over a decade, and that's the foundation of good long-term relationships, being able to manage people's payments and their transactional flows. And we have some fabulous technology capabilities and some great people in that part of the business, and that's helped us continue to grow. We certainly are not stepping away from term lending to our core relationship clients. We continue to look to support customers across the board. The growth there is -- what it's really saying is we're having to make choices about where you have a large institutional lend that doesn't have a lot of deeper relationship associated with it, where there's not a big opportunity for providing transactional banking or the other sorts of markets products that we can provide into there, then we're stepping back. If it's just a matter of renting our balance sheet, that's not what we're interested in. But for our good long-term relationship clients, we're absolutely there to support them on the debt side as well.

Andrew Bowden
Head of Investor Relations

I'll take a question from Andrew Lyons, please, on the phone.

Andrew Lyons
Goldman Sachs Group Inc., Research Division

Just Slide 23 had some interesting disclosures around your resi development portfolio and the LVR of 54%, which I think should keep going down just given the pipeline. Just 2 questions. Can you perhaps just talk about how that's trended over a longer period of time? And secondly, where is the -- I guess, the additional equity coming from that's seeing that -- seeing your LVR, I guess, come down?

Peter Francis King
Chief Financial Officer

Yes. Andrew, I haven't got the longer-term chart, but I think the anchor point would be maximum LVR of 65% is -- in that portfolio is where we've been thinking. So we've brought it down quite a bit as we look forward on the developments. And on the -- on mezz debt and what not, I think it's just come out of different parts of the economy, so I wouldn't pick any particular part to call out today.

Andrew Bowden
Head of Investor Relations

I'll take a call from Scott Manning as well, please.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Just some comments, please, on the margin management in the Consumer Bank, the margin for the period, down 3 basis points. Do you think you could have done a better job at managing that in the face of the pricing that was being put in the market? Do you think you followed price a bit too much? And then comments on how you're managing that book going forward given the pass-through of the August rate cut and also the recent withdrawal, some discounts on the front book?

Brian Charles Hartzer
MD, Group CEO & Director

I'll make an overall comment in...

Peter Francis King
Chief Financial Officer

[indiscernible] I'd say you can't talk about forward margins, yes.

Brian Charles Hartzer
MD, Group CEO & Director

Well, I think, Scott, what I would say is we have had a track record now, I think, over quite a number of years of managing our margins effectively and managing the trade-offs between margin and growth. This is a very dynamic market. There are a lot of moving parts. And I think the team has managed that very, very well. There are leads and lags from time to time. We saw a bit of that in the second half with the increase in deposit, term deposit rates, the mortgage repricing. We had some changes through the early part of the year with the application of different APRA rules at different times in different banks. That led to some funny things in terms of how different banks were pricing. But on balance, I think we've managed it pretty well, and we'll continue to manage it very closely going forward.

Andrew Bowden
Head of Investor Relations
And with that, I'm going to call to a close. So thank you very much for coming, and look forward to talking to you over the next few days. Thanks.