Question and Answer

Operator

[Operator Instructions] Your first question today comes from Craig Williams from Citi.

Craig Anthony Williams
Citigroup Inc, Research Division

A couple of questions if I could, please. Your expense statements are now made on a cash basis. Year-to-date, expenses, I think, are down 0.5%, but you had restructuring charges in last year's cash expenses. So were they in the fourth quarter in 2012, and should the expense profile year-on-year look better than the 0.5%, sort of, improvement you've reported thus far? And secondly, I note your commentary around your risk profile today. Your credit quality continues to improve, and it's represented accordingly in your impairment expense trend, some of this is the cycle and can be seen in peer results, too. But wondering if you had any views about the profile of analysts' forecast for impairment expenses for ANZ and those of your peers and whether the relativities adequately reflect the improvement in book quality that you've engineered over the past 4 to 5 years, or whether you think the market has sort of adopted a view, which reflects more the legacy credit profile of ANZ relative to peers and if that's sort of influencing some of your statements today?

Shayne Cary Elliott
CEO & Executive Director

So I will answer you in reverse order, actually. So yes, I think that's right about our provisions. Obviously, the market is looking for us to perform consistently on that, and we need to build credibility. We believe we're doing the right thing in terms of de-risking our book. I think some in the market are still pessimistic on that and perhaps need to bring down their estimates on R&D provisioning costs for the group. In terms of your comment around expenses, if we were to go back to that old kind of underlying [ph] , so removing one-offs and restructuring charges and things that were not on our underlying cost base, our cost will be essentially flat year-on-year.

Craig Anthony Williams
Citigroup Inc, Research Division

Yes, but Shayne, we're moving on from underlying.

Shayne Cary Elliott
CEO & Executive Director

Right. But I'm just using -- you're right. I'm just using it to explain because it removes the noise, which is the essence of your question, Craig.

Craig Anthony Williams
Citigroup Inc, Research Division

So on a cash basis, were your restructuring charges -- I think it was New Zealand from memory -- booked in the fourth quarter and therefore, in the essence, there's similar restructuring charges being taken through cash basis expenses this year? Would the gap get bigger on a cash basis year-on-year because at the essence, your restructuring charge is being repeated?

Shayne Cary Elliott
CEO & Executive Director

No.

Unknown Executive

Restructuring charges were broadly flat.

Shayne Cary Elliott
CEO & Executive Director

Yes, the restructuring charges were broadly flat across the period. I don't think there was any major quarterly noise on that.

Craig Anthony Williams
Citigroup Inc, Research Division

[indiscernible]

Shayne Cary Elliott
CEO & Executive Director

Yes.

Craig Anthony Williams
Citigroup Inc, Research Division

[indiscernible]

Shayne Cary Elliott
CEO & Executive Director

Yes, it was a write-down on software that was in the fourth quarter. That's correct. Craig, the story is a good one on expenses. We continue to be really focused on productivity and again, there is -- obviously, there's always a little bit of noise in things. What we're talking about here is we are continuing to bank productivity gain, getting that through most of our core businesses and divisions. We've made the decision that we want to reinvest some of that into a really important program, Banking on Australia program, which is our -- to really support the next phase of growth in our highest return business. But even with that, we'll be able to absorb that investment and still produce kind of core expense growth that's flat. And net result of all of that is very strongly positive jaws on a cash basis and if you want it -- and clearly also on an underlying basis.

Operator

Your next question comes from Mike Wiblin from Macquarie.

Michael Wiblin
Macquarie Research

My question is just around the margins. So it's a triple barrel, excuse me for that. Just some sense, Shayne, as to when you think the decline will stop, whether there's anything you can do to reduce the margin volatility, sort of these replicating portfolios that are out there. Is there any reason you don't need something like that? And then just in terms of calculation, so 20 basis points on IIB, stick that through the model, that looks like a 12 [ph] basis points on the group half-on-half and then a couple of basis points next period. Is the math right on that?

Shayne Cary Elliott
CEO & Executive Director

So to answer your questions, look, the issue around trying to forecast when a decline will stop is that much of the drivers of this are literally out of our control. It's to do with the level of, as I said -- half of the decline is actually driven by the level of average [ph] interest rates in the economy. And clearly, so when interest rates stop falling, our margins will stop falling. So it's hard to predict that one. In terms of reducing the volatility, as I mentioned in the comment, today, it's actually relatively diluted already in the sense that institutional -- and as you quite rightly point out, 20.4, we're forecasting it will only be actually 1.5. Your math is roughly right. That's not bad. They represent about 1/4 of our net lending assets. Before the fund rolls down, it would translate about 1/4 through to the group. Our focus is really on the managing and risk-adjusted NIM, if you will, making sure that we get paid for the risk that we're taking. And it's part of our strategy to reposition our book to lower-risk lending. We could say that that's actually an appropriate position given our strategy. Our strategy is to intermediate trade and capital flows in the region. That tends to be shorter term. It tends to be less kind of -- it's balance sheet driven as a strategy because we're focusing on debt capital markets, foreign exchange and other things. And so that will ultimately dilute the impact of NIM as a driver, not only of institutional earnings, but actually of group and that's entirely appropriate.

Michael Wiblin
Macquarie Research

So in that sense, we're in a bit of a transition phase. Is that what you're saying? That's what Ian says, rough, I guess.

Shayne Cary Elliott
CEO & Executive Director

Yes, and I think the comment, again, I made in the unit [ph] kind of goes back to something that Craig mentioned as well, there is obviously, over time, is a trade-off between margins and the risk profile you have in your book and ultimately, the provisioning that you end up taking through cycles. And our position is we prefer to have a lower-risk profile that comes with lower NIM, but it also ultimately will come with lower volatility and surprises on our provisioning line, and I think it's absolutely right. So we are in a transition phase that's been going on for some years at ANZ and will continue.

Michael Roger Pearson Smith
Former Non-Executive Advisor

If I could add to that, Mike, I mean, I think it's an important point that the volatility of NIM is actually reducing and the quality of credit is increasing. And I think perhaps the market hasn't really appreciated the juxtaposition between those.

Operator

Your next question comes from James Freeman from Deutsche Bank.

James Freeman
Deutsche Bank AG, Research Division

Just a couple of questions. Firstly, just on the Institutional margin. When does the de-risking component finish, from your perspective, in a drag on the margin that's having? And just also your view on sort of competition and what that is doing to the margin? And then just on your last point around the provisioning, I'm just interested to hear what you see as now a normal level for provisioning for ANZ, now that we're de-risking. The bank used 25 basis points as a normal through-the-cycle number. I mean, if you've done any work around that, where should we be thinking about as a new normal for ANZ in terms of the provisioning?

Shayne Cary Elliott
CEO & Executive Director

Okay. In terms of the de-risking of the book, I think -- I would say the bulk of that de-risking, if we could think about that in a static environment, which is not easy, but if we could think about it in a static environment, I think more of that is behind us than ahead of us. The issue is, James, that the nature of our strategy, if we're successful in executing it, obviously, which we intend to be, it will inherently grow things like trade finance faster than term bilateral kind of core lending in the term sense. So that de-risking over time actually won't stop, and I would say in the next 2, 3, 5, 7 years, that will continue to be the case. That's actually, and if you will, that is the embodiment of the strategy in terms of the focus on trade and capital intermediation. In terms of competition comments, the competition is intense. When there's a low growth environment, which we particularly see more recently here in Australia, people compete harder for the limited amount of opportunity that's in the marketplace, and we see that. That's not the core of our strategy. As we talked about before, ANZ has more opportunities available to us and we can deploy our balance sheet and our risk focus in different areas. So we can choose to, and we do, obviously support customers with competitive pricing when we need to. But if we think that the risk reward for that is not appropriate we can walk away from it. Competition remains intense. In terms of the marginal pricing that we see today, it's lower than it has been in the similar [ph] year ago. It does not appear to be, as of the minute, continuing the decline at the same rate, if that made sense, that's low. The impact that we're seeing in our book is that the new pricing levels slowly comes into our book as books refinance and reprice. And so we're getting the kind of averaging effect coming through into the Institutional book and that what I was referring to before. I don't know if you want to comment on provisioning or...

Michael Roger Pearson Smith
Former Non-Executive Advisor

Yes, yes. I'll talk about the competition because I think it is a tale of 2 party because we -- the environment in Australia has been particularly competitive and -- across the Institutional space, but also across Commercial and indeed Retail, particularly in the deposit side. So that level of competition has eased a little bit in terms of the volatility. And I think we're getting better pricing than we were. But Asia was quite tough, and that certainly has settled down. And we're seeing -- as I mentioned earlier, and that we're actually seeing that pricing in the trade book, for example, whilst it's below average in terms of the cycle, it's stabilized and volumes -- and the demand out there is still growing so that's the positive side of that. In terms of the provisioning cycle, what you should tell us about when it's sort of the bottom [ph] or not, I suppose, with all your models. But I look at the provisioning levels, they do go in cycles. We've come through 2 to 3 years of very large provisioning levels. We're now going into a period where the basis point charge is going to be less. You could pick here -- you could pick your number as to where that average should be. Is it 37 basis points? Is it 35? Is it 28? It depends very much on the nature of the book. But I think we are in a phase where that charge is likely to reduce a little bit or continue to reduce. We're not probably yet at the bottom of that cycle.

James Freeman
Deutsche Bank AG, Research Division

Maybe a different way of tackling that then is, could you give us an indication as to what the different provisioning rates will be for trade versus the rest of the book, just so we can put that into those models that we have?

Michael Roger Pearson Smith
Former Non-Executive Advisor

Well, trade is virtually 0.

James Freeman
Deutsche Bank AG, Research Division

[indiscernible]

Michael Roger Pearson Smith
Former Non-Executive Advisor

Yes, maybe -- and then 9 basis points collective provision probably, something like that.

James Freeman
Deutsche Bank AG, Research Division

[indiscernible] 9, I guess.

Michael Roger Pearson Smith
Former Non-Executive Advisor

I'll ask my CRO. I better be right on that.

Nigel Henry Murray Williams
Former Chief Risk Officer

In terms of provisions, one of your big drivers is also what happens in the small business market and the -- on the retail side as well. So we've lost some of the volatility that we saw on the large exposures you saw on the lately '80s -- sorry, late 2000s, 2008. But if we see an uptick in unemployment in Australia, then you're going to see that flow through the small business market and through unsecured lending.
In the trade, one of the things on loss rate is that it's actually very short term. It's 90 days and it's self-liquidating. So the losses there tend to be quite small.

Operator

Your next question comes from Rich Wiles from Morgan Stanley.

Richard E. Wiles
Morgan Stanley, Research Division

Shayne, I've got a question or a couple of questions on the margins. In the first half, the IIB margins were down 14 basis points. And at the time of the result, which was just 3 months ago, you said that you thought that margin pressure had eased and stabilized. And yet today, you're saying that the margins will be down 20 basis points for the half. So the half-on-half margin pressure has actually accelerated, and that's very different to what you expected 3 months ago. I assume that 3 months ago, you knew that rates were going to stay relatively low. So I'd like to know what's really changed in the past 3 months to deliver this worse outcome on margins than you expected at the time of the result.

Shayne Cary Elliott
CEO & Executive Director

Yes, so the comments we made about easing was actually around competition in terms of the pricing impact, going back through the transcript of what we said. But you're right to an extent in terms of the impact has been a little bit more than we had expected in the second half. I think that's fair. It is actually to do with the lower interest rate. I think at the time, our expectation about the level of interest rates was not to be -- not as low as they have ended up being. And that is the shift, if you will, between what we thought and what we see today. And there is a little bit of the foreign exchange impact on there as well. That's not huge, but it's a point or so. That has an impact, and that's to do with as the FX rate moves, the relative weighting of our onshore and offshore businesses run through into -- and obviously, that sits in Insto and the IIB businesses, where that kind of rubber hits the road on that. And so they're relative weight. Offshore businesses tend to be lower margin as they increase the weight because of the currency moves that come through. Obviously, that wasn't something that we had forecast either.

Jill Craig
Former Group General Manager, Investor Relations

Richard, one of the things that changed for us at the half year was that we saw the dominant impacting the second half will be the full year slow towards the lower interest rate environment, and that's certainly proven to be the case and that's consistent with what we're seeing today.

Richard E. Wiles
Morgan Stanley, Research Division

Okay. And can I ask just a question in relation to your comments on the Australian margin. I think you said for the Australian division, the margins were steady. Does that relate -- is that steady for the year-to-date? Is it steady in the last quarter? Because the margins were up a few basis points in the first half. They're up quite a few basis points -- about 6 basis points relative to last year. So is your commentary -- does your commentary mean they're steady versus the first half level, or they're likely to be steady year-on-year? In other words, there is some margin contraction coming through in this quarter?

Philip Wayne Chronican
Former Chief Executive Officer of Australia

It's Phil. So...

Michael Roger Pearson Smith

Former Non-Executive Advisor

Yes, of course [ph] , give it a try [ph] to answer.

Philip Wayne Chronican
Former Chief Executive Officer of Australia

And I think it's safe to say that the third quarter margin is broadly consistent with the first half as a whole. There might be some issues, but we'll take a point to offset in the fourth quarter. But certainly, they haven't emerged in the third quarter.

Richard E. Wiles
Morgan Stanley, Research Division

Right. So Phil, you're growing above system in housing?

Philip Wayne Chronican
Former Chief Executive Officer of Australia

Yes.

Richard E. Wiles
Morgan Stanley, Research Division

14 consecutive quarters?

Philip Wayne Chronican
Former Chief Executive Officer of Australia

Yes.

Richard E. Wiles
Morgan Stanley, Research Division

You're growing above -- I think you're probably growing above system in...

Philip Wayne Chronican
Former Chief Executive Officer of Australia

Commercial.

Richard E. Wiles
Morgan Stanley, Research Division

I think within the Australian division.

Philip Wayne Chronican
Former Chief Executive Officer of Australia

Correct.

Richard E. Wiles
Morgan Stanley, Research Division

That is, revenue progression is pretty reasonable.

Philip Wayne Chronican
Former Chief Executive Officer of Australia

The revenues are in good shape and as I said, the third quarter margins is consistent with the level of the first half.

Operator

Your next question comes from Jon Mott from UBS.

Jonathan Mott
UBS Investment Bank, Research Division

Just 2 very quick questions if I could. The first one is just clarification about the de-risking of the book, because one area that we look at a lot is the expected loss that you still provide in the result. And if you look at that for the last couple of halves, it's only come down a fraction, 1 basis point or 2, both as a percentage of EAD [ph] and in terms of GLA. So why isn't the big reduction in risk in the book being reflected in your expected loss? That's the first question. And the second question, ANZ announced that Alex Thursby was going to retire or resign on the 3rd of April. So it's 4.5 months ago. Can you give us an update on the potential replacement to that role given the size and importance for the group?

Shayne Cary Elliott
CEO & Executive Director

Nigel, do you want...

Michael Roger Pearson Smith
Former Non-Executive Advisor

Nigel will take the first part, and I'll take the second.

Nigel Henry Murray Williams
Former Chief Risk Officer

On the expected loss in the trade portfolios, the average life of the trade portfolio is just well under 6 months. So it's batting at [ph] just slightly over 90 days. Yet, the regulatory models use an expected life for the trade portfolios of 1 year, and it uses a Basel II calculation rather than a Basel III. So our view of the risk will be different from what the regulators would be in including the term [ph] .

Jonathan Mott
UBS Investment Bank, Research Division

Does that mean that the expected loss that you include in the cycle, this is meant to reflect is actually substantially lower than the numbers that you put out here?

Nigel Henry Murray Williams
Former Chief Risk Officer

On the trade portfolios, yes.

Jonathan Mott
UBS Investment Bank, Research Division

How is that reflected at the group level?

Shayne Cary Elliott
CEO & Executive Director

I mean, you can see that in the numbers yourself in terms of the trade assets. I think we disclosed that in...

Nigel Henry Murray Williams
Former Chief Risk Officer

We disclosed that at the half year.

Jonathan Mott
UBS Investment Bank, Research Division

It's not going to materially move the group though?

Shayne Cary Elliott
CEO & Executive Director

No.

Jonathan Mott
UBS Investment Bank, Research Division

But at the group level, you expect the loss [indiscernible] .

Nigel Henry Murray Williams
Former Chief Risk Officer

And your expected loss would lag that portfolio as it comes through as well.

Shayne Cary Elliott
CEO & Executive Director

Yes.

Michael Roger Pearson Smith
Former Non-Executive Advisor

In terms of your second point, Jon, IIB is being run at the moment by Gilles Planté and Steve Bellotti. They've been doing a great job of driving that business forward, as we make a decision on Alex's replacement, and we'll let you know when that one's ready to announce, but it should be soon.

Operator

Your next question comes from Jarrod Martin from Crédit Suisse.

Jarrod Martin
Crédit Suisse AG, Research Division

Mike, you opened up the call by talking about your performance remains in line with expectations that you had at the end of 2012 and with expectations that the analyst community have. But if we look at the components of that, you've outperformed from a credit quality and a bad debt charge perspective, which implies that your revenue targets are less than what you were expecting at the beginning of the year. I'm just wondering whether that's a concern going forward. And considering the number of questions on margin that you've had today, how much visibility does ANZ has on its margin outcome and confidence in that revenue picture?

Michael Roger Pearson Smith
Former Non-Executive Advisor

Well, I think the point you make is fair, but we have to understand that we are in a lower interest rate environment than we were previously. Obviously, that is an issue. I think that the increase in risk-weighted asset during the quarter was -- sorry, well, for the period year-to-date is still going well. Revenue growth is still exceeding that of cost curve, so we have good, positive jaws. And looking ahead, I'm very comfortable that we will continue to meet our numbers. I mean, how we get there, and I think we probably -- as income was slightly lower than we thought, kind of we adjust the cost, and we will continue to do that. So -- and in terms of getting the right number, obviously, we have to wait for the environment to improve a little bit, and I think that, that will happen.

Jarrod Martin
Crédit Suisse AG, Research Division

Let me put it another way, is your pre-provision profit on your expectations of where you thought it would be at the end of last year?

Shayne Cary Elliott
CEO & Executive Director

I think -- this is Shayne speaking. So first of all, you're right around the provisions, that the provisioning, we clearly stated in our comments that we expect it to be lower than what we had thought earlier in the year. And we're now saying we expect it to be slightly lower than the full charge for last year. So that is true. The second point is in terms of the PDP, why we spent a reasonable amount of time today talking about the impact of foreign exchange is that I'm not sure that the market fully understands or fully appreciated how the drop in the currency does impact our numbers. And therefore, I think when you look at that, that has also an impact on the components, if you will, of the results. So we are on track to meet market expectations, but the components and how we'll get there will change. A lot of that has to do with the currency impact that it has on warrants [ph] , whether its revenue expense or -- and even provisions actually turning in [ph] . So we are -- to the other question, revenue is as expected, thereabouts expenses are being well managed.

Operator

Your next question comes from Victor German from Nomura.

Victor German
Nomura Securities Co. Ltd., Research Division

My -- I've got 2 questions if I could. First, just to follow up on what, Shayne, you were just talking about now around currency impact. Are you able to de-risk an idea of the profile of hedges that are going to be rolling off next year and the impact that will have on your profitability next year? And also, just -- I guess there are a lot of questions on institutional margin, and your explanation in some of those questions is that there is some volume versus margin trade-off, which makes perfect sense. Perhaps, you can also give us an idea of what the revenue in the Institutional business have done over the quarter, so [ph] just to sort of separate their margin volume trade-off?

Shayne Cary Elliott
CEO & Executive Director

Okay. So in terms of the foreign exchange hedges, I think through the comments I made, would indicate that as of the moment, we are roughly kind of 2/3 -- 60% to 2/3 hedged. As a rule of thumb, we hedge out anywhere between 12 to 18 months. Again, these are broad generalizations, but 12 to 18 months. We tend to hedge in terms of an amount with a target somewhere between that kind of 50% and 75% hedging. It's possible that we move beyond those levels and depending on where the currencies are, and we do that in order to hedge the impact of currency volatility for our investors. And therefore, given that that's something that we look at pretty much on an ongoing basis, it's not really possible for me to say what our hedging ratio is going to be for next year. But I think you can use those guidelines because they're reasonably good estimates for your own model. And in terms of Institutional margin, in terms of volume, the Institutional business on -- well, IIB, on a year-to-date basis, has had a small amount of revenue growth. So we're up in terms of revenue growth. A lot of that revenue growth, you would take from our comments, has come from very good results in markets, in particular, customer sales. We also had the benefit of some trading profits in there to do with the credit spread contraction that we had earlier in the year, although that leaves a bit of an impact in the third quarter. And the Institutional lending business has actually not, in terms of non-trade, is not growing. The absolute numbers here, the volume there is kind of flattish or broadly flat. That is, again, part of our strategy, if you will. It is not our strategy to aggressively grow corporate lending and -- or institutional lending. The composition of that book, right, where and who has changed a little, although that tends to take time to work through the books. So it tends to be, as we've talked about, better quality names, a lower risk, tending to be more of that growth is coming offshore than onshore. So there's a mix change in there, and that is what is having the impact on margins that we talked about. So the dependency of IIB on institutional lending as a source of revenue is diminishing, in a sense [ph] . Okay.

Victor German
Nomura Securities Co. Ltd., Research Division

Yes. And just to clarify, your comments with respect to exchange rates, they just were U.S. dollar-related exposures, or they're also including New Zealand as well?

Shayne Cary Elliott
CEO & Executive Director

They include New Zealand as well.

Victor German
Nomura Securities Co. Ltd., Research Division

Right. So the 1.5% in the quarter, that's included.

Shayne Cary Elliott
CEO & Executive Director

Yes.

Victor German
Nomura Securities Co. Ltd., Research Division

That's overall.

Shayne Cary Elliott
CEO & Executive Director

Yes, that's -- yes, that's overall.

Victor German
Nomura Securities Co. Ltd., Research Division

And your comment relating to IIB, the growth rate relative to the March half average?

Shayne Cary Elliott
CEO & Executive Director

I was talking about the year-to-date business to prior comparable period.

Operator

We have no further questions at this time.

Jill Craig
Former Group General Manager, Investor Relations

Thank you, Tess. Mike, do you have any closing remarks?

Michael Roger Pearson Smith
Former Non-Executive Advisor
Just to say that I think that with a good result, we're well positioned for the full year, and I believe that we've got good momentum going into 2014. So many thanks for joining us today.