Question and Answer

Andrew Bowden
Head of Investor Relations

Thanks, Phil. Gail, can you come back up again? Thank you, all. [Operator Instructions]

James Freeman
Deutsche Bank AG, Research Division

It's James Freeman from Deutsche Bank. Gail, I was just interested in your cost to income chart that you put up. Basically, that's showing that you've been around the 40% to 41% now for around, looks like 3 or 4 years. You seem to be unable to crack below 40%. If I listen to what you're saying today, it's more investment spend to be coming. Can I just get an idea as to when you expect to be able to actually improve that cost to income ratio? It's been relatively steady now for a fair few years.

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

Yes, we came down a bit this year, James, as you would have seen, but we haven't got a particular target on that. The target is to remain best-placed amongst all of our peers with a decent margin. So that's the target, because ultimately, what we've been looking to do is manage the core earnings, and it has been a slower revenue growth environment. So manage the core earnings and make sure that we remain best-placed relative to our peers. So I would expect that we're going to continue to find very significant cost efficiency benefits because we've got significant momentum in our cost agenda, in our productivity agenda. And I spoke briefly to the work that Brian Hartzer and John Arthur have got under way. So we will continue to drive the efficiencies, but we're going to want to continue to invest that because we want to build growth agenda for the long run. So we're very concerned about top line growth, very pleased this year with a 6% top line growth. We want to make sure that we can continue to grow top line growth, so it's not just all about cost.

Andrew Bowden
Head of Investor Relations

Jon.

Jonathan Mott
UBS Investment Bank, Research Division

Got a question. Jon Mott from UBS. Just got a question, and so you talked about it quite a lot was capital. And you talked about wanting to be at the top end of the range at the end of each half year. And also you talked a lot about franking and also the need to stop the deleveraging, which is impacting the return on equity. So if I read between the lines, it looks like you're trying to flag that you're generating a lot of capital. Sooner or later, you've got to start doing something about that more actively. So should we start to be thinking that from next year on, DRP probably starts to look to buyback and offset the dilution from the DRP, then going forward from that, you have to get a bit more active with your capital management if we remain in a profitable environment with limited credit [indiscernible]?

Phillip Matthew Coffey
Former Chief Financial Officer

Gee, I hope all that plays out. But the logic of your argument is right, Jon. I mean, we would like to -- first of all, we wanted to say, "Well, what kind of capital level do we need to have and to achieve the priority 1 that Gail called out: being strong?" And so we stress test that, and we said, "Well, we need to have a buffer that means that our common equity Tier 1 ratio is over 8%." Then the second thing was, well, there's variability in it, so we need to make sure that we call out what kind of range you should expect. Once we consistently operate where our ratio is pointing higher than that range, then we've got options to look at. And we're not a believer that you just keep building capital forever because of the deleveraging impact that you mentioned. There's a number of different options that we can consider. I'm sure the directors will give thought to all of that when we're in a position to manage our capital, but it will be something that we would like to think we are looking at as we get through 2013.

Andrew Bowden
Head of Investor Relations

Victor?

Victor German
Nomura Securities Co. Ltd., Research Division

Victor German from Nomura. Very strong performance on deposits in the half, and I think AFS has grown by about $14 billion, institutional growing by $12 billion. Are you able to just talk perhaps a little bit about where you and how you were able to derive that growth? And also give us an idea whether any part of that growth has been driven by sort of larger-end financial institution deposits, say, over $10 million, which are not necessarily going to be as attractive as we move into Basel III environment.

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

Well, as I mentioned, Victor, we've definitely put a big focus on the quality of the deposit raising that we do, obviously bearing in mind we're moving to a new liquidity regime of liquidity coverage ratios and so on. So the quality element really matters, that's been part of the culture of raising deposits and making sure that we first and foremost win our own customer transaction and savings accounts. So I think there's about 11.5% increase in transaction account balances, and that's pretty pleasing. Obviously, RAMS is a new launch for us, so that's another vehicle for deposit raising. And we've raised over $1 billion in the 6 months or so that RAMS has been up and running. In Institutional Bank, Rob, you may want to comment on the progress that you've made in Institutional Bank and the specific question that Victor asked on the percentage of financial institution deposits.

Robert Whitfield
Former Chief Executive of Westpac Institutional Bank

Look, I mean, it's true to say, we've really been able to leverage off the deep relationships we've got and the leadership position in the transactional banking. And so we have competed very aggressively for balances right across the board from the working capital balances but certainly all the way through to term deposits as well, and that has seen really solid growth this year. In terms of deposits over $10 million across, lots of them are over $10 million, but we are very alert to all the Basel III requirements. And so we're really focused on raising our deposits in a way that's going to be sustainable under the new rules and regulations.

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

Deposits and wealth, Victor, would be the only other element I'd add to that, so quite a focus on the self-managed super funds element and the deposits in our platform. So that will be an increasing area of focus for us.

Andrew Bowden
Head of Investor Relations

Craig.

Craig Anthony Williams
Citigroup Inc, Research Division

Craig Williams from Citi. Acknowledging Jon's earlier question and your response, Phil. Once the payout ratio is high and credit costs are low, you might not want to build in a more permanent sort of dividend uplift or trajectory or permanent payout uplift. With a $1 billion of franking credit surplus, is perhaps a one-off special dividend consideration in the mix?

Phillip Matthew Coffey
Former Chief Financial Officer

It's great the way you guys are spending all my capital before we've got it, but, yes, that's possible, Craig. But we have to get to a point where our capital is consistently above that range before we would consider any of those things.

Andrew Bowden
Head of Investor Relations

Richard.

Richard E. Wiles
Morgan Stanley, Research Division

It's Richard Wiles from Morgan Stanley. Gail, you mentioned that there's good momentum across all the businesses, that's clear in your retail and business banking franchises. I'm not sure it's that clear in institutional. There's a good markets income performance, and while we don't want to criticize you for that, it may not be sustainable going forward. And in the second half, the institutional margin fell 20 basis points. I wonder if you could outline the reasons for that and also comment on what you expect to happen in 2013, particularly in relation to our lending competition.

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

Okay. Well, let me kick off, and, again, I think Rob may want to provide a little bit more specific insight and detail on the margin piece. I am really pleased with how our institutional business has performed over the whole year. Yes, you're right, the stronger performance was in the first half, but year-on-year, you look at all of Rob's businesses, be it debt market -- debt capital markets or foreign exchange or global transactional banking, Hastings, all of them have actually -- or Asia -- had very good pickup in revenue. It's almost double-digit revenue, I think, for across the board. So -- and that's largely on the back of excellent customer relationships. So that's the key for Rob and his businesses, driving that deep customer relationship with institutional customers. I mean, clearly, on the margin side, I think we're consistent with peers that there clearly has been a squeeze on margin, and it's mostly on the financing side. And going forward, I'd be interested to hear what Rob says, but certainly, it seems to me the financing margin pressure is likely to continue somewhat due to the intensity of competition but perhaps ease a little on the liability side.

Robert Whitfield
Former Chief Executive of Westpac Institutional Bank

Absolutely. If I just build on that a little, Richard, just to give you some insight into the half-on-half margin story that you picked up on. It's true to say that our second half margin did decline by 20 basis points, but we've called out in the IDP pack that, that was largely due to one-offs. And if you remember, that was really the bringing forward of the establishment fees that we've called out in the second half of '11 and the first half of '12. And so when you strip that out, I would actually refer you to the underlying annualized declining margin, which is 11 basis points. And so if you wanted to think through how that's going to translate for 2013, that's probably as good a crystal ball as any. We've heard our competitors talk about the slow growth environment. There really is competitive intensity on the asset side of the balance sheet. And if the slow growth environment continues, as we expect it will, then the margin pressure -- competitive pressure will continue on the asset side. Perhaps the opportunity for us is on the liability side, and that may be if the reserve bank continues to reduce the absolute interest rate in Australia, that might ease a little the competitive pressure on the liability side. So you'll see active margin management from us. We do expect a decline, and I would focus on that annualized number as a best guess indicator.

Andrew Bowden
Head of Investor Relations

Jarrod.

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Crédit Suisse. Just in reference to the table on Slide 11, in particular, the second half over first half metrics. I know you talk about the good momentum in the business with cash earnings growth, revenue growth, et cetera, but the one aspect where it's actually missing is the dividend growth of only 2%. So while I suppose you're talking a story of good momentum, proof in the pudding is that it's not there in terms of what you see in terms of dividend. I'm wondering whether there is a bit of hesitation, bit of conservatism or whether the payout ratio previously was unsustainable.

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

No. Look, I'm surprised that, that's an area of concern. I mean, with $0.02 dividend increase is, we thought, imminently appropriate based on where we are, but there's no concern that underpins that. It's been pretty much our pattern of increasing dividends. And so another $0.02 is continuation of that pattern of increasing dividends. I think as Phil has said, we've still got a way to go -- a little bit of a way to go to be entirely where we want to be relative to that preferred range of 8% to 8.5%. At this time, at end of September, you'd want to be at the top of that range, and so we're not there yet. So we'd just better factor here, but this was actually an easy dividend decision to make, relatively speaking, I have to say. There wasn't a whole lot of discussion about this one. It seemed like a fairly straightforward one based on the strong performance, 6% over the year, $0.02 -- 2% and $0.02 for this half. It wasn't a lot of discussion point.

Jarrod Martin
Crédit Suisse AG, Research Division

If I look, the cash earnings were substantially above consensus, yet the dividend was only up $0.02. You said it's an easy choice, it's actually got $0.02 here. Overall earnings were well ahead of the market.

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

We didn't feel we needed to do more than $0.02. It's consistent with our pattern. We're still in a process here of building our capital to get to the level that we want it at, in that range of 8% to 8.5%. We feel very well-placed and that we've done the heavy lifting. We want to be in a good spot next year. So all of those were the factors that made it an easy decision.

Andrew Bowden
Head of Investor Relations

Brian.

Brian D. Johnson
CLSA Limited, Research Division

Brian Johnson, CLSA. I know everyone here is encouraging you to ramp up the payout ratio. What I'd be interested -- Phil, in the text, you say financial conglomerates, you're not quite sure, but you don't think it'll be significant. But the domestic CP rule hasn't yet come out. Would that 8.5% target potentially move? Or should we be thinking that perhaps there's a few unknown pieces there that you could actually see that number adjusted up? Second one is that when you actually have a look at this result, it's quite significant that the previous difference between the economic capital and the regulatory capital has now been allocated out to the operating units, which I would applaud. But the 2 questions on that is because you don't have to put regulatory capital away for deposits, is it sending a bit of a false signal to Mr. Hartzer's business? And the second one is, does this mean that your fundamental pricing of mortgages or pretty well most of your products goes up as of tomorrow because clearly, you're getting a lower return on equity in the operating unit? So DCP's product to pricing.

Phillip Matthew Coffey
Former Chief Financial Officer

Okay. So the logic we would use is that if the domestic CP implementation led to a higher regulatory threshold, then we would have to think about that because we're looking to maintain a buffer over that threshold. We don't know where the domestic CP regime is going to land in Australia, and to the best of our understanding, APRA's been pretty happy with the level of capital that Australian banks have got and hasn't been looking to push that higher. So I guess the question will be, as they look into domestic CP, knowing that it's potentially 2016-type implementation, what are they actually doing? And does it actually lead to a higher regulatory threshold? That's the most I can say at the moment. We feel confident enough with where we stand today, with what we understand today to establish that operating range. In terms of the economic capital allocation, I don't think Mr. Hartzer believes that he's got a free kick here, and we clearly look to allocate capital, not just on the credit risk-weighted assets but the operational risk in the company. And deposits end up wearing a fair bit of that because of the amount of the company that's attributed to raising deposits across the company. Our pricing is clearly a function of not only the ROE that we generate but the alternatives that we have, the growth opportunities we have, the competitive environment that we're in, the ability to cross-sell out of 1 product into another. So there are a lot of things that go into our overall pricing strategy, and so you shouldn't expect any dramatic changes tomorrow. In fact, we've been operating with these changed transfer pricing arrangements for a while now. So what you see is what you get.

Andrew Bowden
Head of Investor Relations

Brett.

Brett Le Mesurier
Asia Pacific Prudential Securities Pty Ltd., Research Division

Brett Le Mesurier from BBY. Gail, in your outlook statement, you commented on a number of the financial characteristics of the business, but you stopped short on giving a direction as to whether you thought the EPS would be higher or lower from '12 to '13. Can you comment on the concerns that you have that led to you stopping short of making comment on EPS?

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

Look, I think I was pretty specific on a range of things. So I'm really pleased to have put a flow under the ROE, I'm really pleased to talk about increasing our dividend, I'm really pleased to be specific about where we stand with regard to our expense to income and expect to remain low. So I'm not going to put a marker out on every single metric. But clearly, if we get -- if we deliver on the strategy, as we have been this year, you're going to see an improved ROE and you're going to see an improved EPS. I mean, that's clearly very much a key driver for us of our performance. So it's one we measure, it's one we track, it's one very high on our radar screen.

Phillip Matthew Coffey
Former Chief Financial Officer

But we will endeavor mightily to not give earnings guidance, Brett.

Brett Le Mesurier
Asia Pacific Prudential Securities Pty Ltd., Research Division

I wasn't seeking earnings guidance. I was just curious as to what was [indiscernible]. I thought I might have shaken something out.

Andrew Bowden
Head of Investor Relations

Mike.

Michael Wiblin
Macquarie Research

Mike Wiblin from Macquarie. Look, just a question on mortgage repricing. Given out of cycle mortgage repricing recently, it would seem to indicate that there's been a bit of pressure on funding costs right across the sector, with Westpac as well. If I look at this result and I look at half-on-half margin improvement for RBB and St.George, I couldn't really have told that, obviously, you've got a pretty big increase in margins. Could we get some color as to what's going on there, what's driving the margin improvement, I suppose whether more repricing is needed and where the spot margin is sitting today?

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

Well, let me kick off on that. I mean, obviously, look at the margin overall, and the margin overall has come down with regard to the customer-related margin. So Phil's chart, which separates out Treasury and Markets, you can see the margins come down, in fact, in both halves. But I think we're being quite disciplined in offsetting the additional cost of raising retail deposits because that's where the biggest factor of competitive intensity has been, has been raising retail deposits. So we've been able to offset that quite effectively in the repricing that we've done on the lending side. In the latter part of this year, we've also done more in the way of term funding. So we didn't do much in the early part of the year, as you know, but in the latter part of the year, we've done more there. And we've also in the latter part of the year repaid some of the short-term debt, which, as we discussed earlier, is the most cheapest form of funding that we have. So that will give us some margin headwind into this coming year. And from an exit margin point of view, if you look at end of September, it's clearly lower than the printed margin here for the second half on our customer-related margin, but we've immunized that to some extent, already, of course, with the October repricing on mortgages that's already done. So I think it's leads and lags, it's understanding these different factors and making sure that we're disciplined and that we are consistent. And I think you can see we've got that pattern so far.

Andrew Bowden
Head of Investor Relations

Scott.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Scott Manning from JPMorgan. We actually did a report a little while ago that suggested your ROE line in the sand is 15%. I had a whole bunch of questions lined up on that, so thanks for clarifying that in your slide pack today. As a consequence of that, one of the things we've noticed is quite substantial out-of-cycle rate rises in the mortgage book, 10 basis points above peers there. How are you thinking about the profitability versus growth argument? And if your allocating capital and your transfer pricing mechanism of funding is on one level, but your peers' is on another level, it might lead to different outcomes. How comfortable are you that you've got it right? And how flexible are you to adjust to the peers' reactions to your pricing?

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

Well, again, let me kick off, Phil, and you or Brian may want to add something to this. But very much in the mortgage space and the low credit growth environment that we've been having over this past year, we've been happy to make sure that margin is the priority because we've actually grown our mortgages at around 0.7%, 0.8% of system. We said we'd grow a little under system, at or around or a little under system. But system is really low. So system has been 4.7%, we've grown at 4%. We're really happy with that, especially if you take the 4-year view where we've grown mortgage market share 2 percentage points. So 4-year view, grown 2 percentage points. This year, low credit growth environment, really have work to do on the retail deposit side, wanted to make that a priority in our organization, I'm happy to grow somewhat under. On the pricing differential, I mean, it's been pretty much of that order for a long period of time, this isn't something new. And our retention of our customers remains outstanding. So you can have look at the Westpac RBB in particular, have a look at the detail information in the IDP, and you'll see the retention of customers remains outstanding. Phil, do you want to add to that?

Phillip Matthew Coffey
Former Chief Financial Officer

Look, I think volume margin trade-off is something that's really important and we look at the whole time, and Gail has sort of indicated to you where we thought the greatest returns were going to come from. Your question, Scott, around if the industry goes in different path from where we're at, then we would obviously have to look hard and say, "Are we all right? Or is the market right?" Right now, I think we feel that the metrics that we're putting out really supports the strategy and helps to embed the strategy through the company. And so we will be looking to pursue that path in a pretty disciplined way for quite some time.

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

And just one more thing I could add to that, actually, Scott, is we've got the benefit of having several brands, and that does allow us to price differently and manage it as a portfolio. So our Bank of Melbourne brand, for example, is at exactly the same rate as NAB and CBA. So we've got that benefit. RAMS is below that. So for those customers that are looking for the cheapest of all the mortgages, RAMS sits below Bank of Melbourne, and then we've got St.George sitting in between, Westpac and Bank of Melbourne and BankSA sitting also in between. So we've got the benefit of a range of brands that allow us to run it as a portfolio.

Andrew Bowden
Head of Investor Relations

We've got 1 last question, I think, there from Victor again.

Victor German
Nomura Securities Co. Ltd., Research Division

It's Victor German again. I just wanted to also ask a question about your liquidity. We've seen one of your competitors increase -- well, it appears as though they increased their liquidity quite substantially in the last half. Are you able to talk about how you see your position relative to your peer group? And do you think there is some catching up to do on that front?

Phillip Matthew Coffey
Former Chief Financial Officer

Look, no. I think we're looking to make sure that everybody is reporting liquidity in the same way. I guess, from our perspective, you can think of liquidity in 2 ways. You can think of it as what's available on any particular day to meet outflows or you can think about it as what's the regulatory liquid assets that I have to meet my LCR ratio requirements. Our focus when we report liquid assets is the latter, so we don't take into consideration assets that might be held by Rob Whitfield's trading team that are repo eligible. You could say that they are eligible liquid assets, but if they're held in a trading book, then you can't rely upon them to be there when you would need them for an outflow. And certainly, the regulator won't include them in your LCR calculation. So you can see them in our results, but you won't see us add them into our liquid asset calculation. When talking to the regulator about LCR, and we've all recently put in the first round of sort of 3-year funding plans and how that plays through to the LCR, I think what we're seeing quite rightly is that there's just as much focus around how will you manage the outflow side of the equation as the liquid asset side of that equation, and we're definitely focused on both those elements. But just to simplify the answer with regard to your liquid asset question, we don't feel that we've got a shortfall in liquid assets and we're only looking at those that comply with the LCR requirement.

Andrew Bowden
Head of Investor Relations
Okay. Well, thank you very much, everyone. Thanks for coming, and good afternoon.