Question and Answer

Operator

[Operator Instructions] We will now have our first question from Jon Mott from UBS.

Jonathan Mott
UBS Investment Bank, Research Division

A question for Shayne, if I could, and it just relates to the Pillar 3 document. You talked about the increase in arrears just coming up, but just looking through the Pillar 3, it looks like the other Retail impaired categories moved up quite a lot. So if you just look at the last 3 quarters, it looks like it's gone from about $422 million to $494 million and now to close to $600 million, $597 million in arrears. Not huge numbers, but the trends really picking up quite quickly. Can you just comment on that? And whether this is more than just a seasonality, which it looks like, is this Western Australia and what are you looking at? What should we be looking at?

Michael Roger Pearson Smith
Former Non-Executive Advisor

Sure. Jonathan, actually there are -- I'll draw your attention to -- on Page 6, there's a note at the bottom there, Note 6, which talks about -- there was about $100 million of impaired loans and facilities that were reclassified, and they moved from advanced IIB corporate to advanced IIB other Retail, and that was just a revised segmentation. And so that explains over that period, I have to look, I'm not sure exactly when that happened, Nigel, but certainly, on it, that explains the vast bulk of the increase between March and June.

Jonathan Mott
UBS Investment Bank, Research Division

Okay. Otherwise, I think you commented such that the pickup in Western Australia previously. Can you just go into that, especially given the comments the other banks are seeing.

Shayne Cary Elliott
CEO & Executive Director

Sure. Sure. I mean, the comments around WA or -- and Queensland, to some extent, I guess, were really related to 2 areas. Firstly, in terms of the residential mortgages. So as I -- as a broad observation, the mining -- the impacts of the mining downturn have reflected a small increase in past-due mortgages in both states, but it is relatively small. So in basis points, that, that -- the WA and Queensland moves would explain a couple of basis point increase in the past due portfolio. So that's one impact. It hasn't impacted -- that hasn't really translated in any particular IP in terms of mortgages. Secondly, clearly there's an impact on some of the corporate sector and that's what -- related to the mining services and other sectors. In total, it's not hugely material but obviously, it's an area of stress that we continue to monitor.

Operator

We'll now have our next question from Victor German from CBA.

Victor German
Commonwealth Bank of Australia, Research Division

I was hoping to touch on a couple of things that's been highlighted in this release. When you talk about International and Institutional Banking, you talk about things like complex macro conditions and difficult operating conditions. And it sounds like from a sort of broader macro perspective, it's a tougher environment out there. Just hoping if you could sort of elaborate where you're seeing those pressures coming from, whether it's more in Australia or in Asia? And is it resulting in more difficult environment on a credit quality perspective or from a revenue perspective?

Michael Roger Pearson Smith
Former Non-Executive Advisor

That's -- it's primarily a revenue issue. What we have seen is some margin compression, and that was mostly focused on Australia. There was a degree of margin tightening in, for example, in the trade book. We've see that over the last couple of years. But actually, Asia's margin seems to have stabilized. And in fact, we're hopeful that, that will actually start to improve. In terms of Australia, it's a liquidity story. The top end of town haven't been borrowing as much as they have previously. And therefore, competition has been fierce, particularly from international banks, and that is really what has affected that. Having said that, the business that has really done well is the sales business off the back of Global Markets, which has increased significantly. And if you look at where that is in relation to the trading income, sales-driven income is now the majority of the P&L of markets.

Victor German
Commonwealth Bank of Australia, Research Division

Right. And also just maybe drawing also on that, I've noticed that in the quarter your credit risk-weighted assets actually fell. We know that mortgage growth is quite strong for ANZ. Do we read this as, given all this margin pressures in Australia, you've actually been walking away from some of this business that is not meeting your...

Shayne Cary Elliott
CEO & Executive Director

Actually, Shayne here, the vast -- the reason that the credit risk-weighted assets actually shrunk a little bit has mostly to do with foreign exchange translation. So that's about, call it, $6 billion to $7 billion of the explanation. So if you exclude FX, and most of that FX has actually to do with the New Zealand dollar. So if you take that out, it did grow very slightly. Although you'll notice in terms of the composition here, is that there is a shift and while I talked about kind of portfolio balancing, yes, there is some, in particular, for example, some trade pricing, which is just too skinny in terms of returns and so, yes, we rebalanced. We don't want to do value destroying business and we push our risk-weighted asset appetite towards businesses that offer better returns for the group.

Operator

We will now have our next question from Jarrod Martin from Crédit Suisse.

Jarrod Martin
Crédit Suisse AG, Research Division

Shayne, thank you for providing the information around the collected provision. Questions particularly around the risk profile migration. And I suppose we have become comfortable with how provisioning is done now versus dynamic provisioning, you have to wait until you see something before you can provision for it. So my question is, on the risk profile migration, the extent that you've seen downgrades, is that a lagged indicator of what we've seen in the last 12 to 18 months in terms of slowdown of the economy and therefore, as we move forward, if we see a further slowdown in the economies and in stress in different segments, that we're just going to see and we're just seeing the beginning of what is a long cycle of CP increases?

Shayne Cary Elliott
CEO & Executive Director

Yes. So Jarrod, you're right that there's a mechanistic approach to that CP in terms of risk migration. Obviously, we don't calculate the risk profile of our customers in real time and so there's inevitably a lag to that. But that's really the purpose of some of the overlays that we put in place. So if we do identify stress, whether it's in the mining sector or due to general economic conditions, it is within our prerogative to put a management overlay to kind of forecast that. And then as those risk migrations start to come through, in the normal course of business, we would therefore start to release those overlays. And that's what essentially happened in this period of 9 months, you start to see very small, by the way, that very small reduction of some of those overlays because those risk migrations are coming through.

Michael Roger Pearson Smith
Former Non-Executive Advisor

I think it's important to understand that the book is actually in very good shape. And in fact, if you think about in terms of basis points of impairment, I mean, we're probably in a better position than we've been for years. And -- I mean, the question to ask is are we at the bottom of the cycle? And I guess, the answer to that is yes. Is it going to get significantly worse? I don't think so. But it's not going to get better.

Jarrod Martin
Crédit Suisse AG, Research Division

So then I suppose the follow-on question then from a shareholder return perspective is you've got 3% more shares on issue, you've got just a small headwind of increasing bad debts going forward, your 65% to 70% payout ratio top end of the range, does that come into question?

Shayne Cary Elliott
CEO & Executive Director

No. I mean, our policy -- our dividend range is 65% to 70%, we think that's sustainable for the kind of medium term, as we see it. I mean, clearly, you're right, there are pressures around provisions and there will be pressures around capital levels and therefore, the onus is on us to improve our capital efficiency. You're starting to see some of that coming through you and I talked about that in terms of portfolio rebalancing and also productivity.

Operator

We'll now have our next question from Andrew Triggs from Deutsche Bank.

Andrew Triggs
Deutsche Bank AG, Research Division

Just a couple of questions. Firstly, any observations on the margin trend in the Australian Retail book on the Corporate and Commercial in the quarter? And secondly, you mentioned the potential for an RWA efficiency program. What does it involve? And does it include the Asian corporate standardized book?

Michael Roger Pearson Smith
Former Non-Executive Advisor

Yes. Look, I think Commercial is basically pretty stable. I mean, we have -- you've seen a little bit of pressure on the asset side of the book. But that has been made up for the slightly improved margin on deposit. So I'm not too concerned there. I mean, it's a competitive market but continues to be a good market for us. And that business is going well. Sorry, the second part of your question?

Shayne Cary Elliott
CEO & Executive Director

Yes. So Andrew, the RWA efficiency is really just about us and ongoing improvements in our data quality, et cetera, to make sure that we get the risk weightings right and correct and kind of optimized. The -- what you're talking about there in terms of moving from standardized to advanced, obviously, that would be of benefit, but that really -- that depends on us having a sufficient time series of a certain volume of data. So that's not counted in at the moment in terms of our plans but obviously, that would be a benefit if and when that came through. And that would be dependent on, obviously, regulatory approval at that time.

Andrew Triggs
Deutsche Bank AG, Research Division

And Shayne, the portfolio data review that was mentioned that was highlighted on Page 2 of the slide deck, although that seemed to be at odds [ph] with an RWA efficiency program sort of driving benefits, what drove that data review?

Shayne Cary Elliott
CEO & Executive Director

The data -- which slide pack are you talking from?

Andrew Triggs
Deutsche Bank AG, Research Division

From the RWA asset movement for 3Q, is that the $1.6 billion impact?

Shayne Cary Elliott
CEO & Executive Director

Oh, right. Yes, so the point here -- it's a good point. So the data review obviously goes both ways. I mean, the right thing to do here is get the data correct to make sure that, that is right. That doesn't mean that it's always going to result in reductions. Over time, I think it's important to say, that if we were to do a time share in those, net -- on a net basis, this has provided more benefit than not. But the reality is there will be periods of time, and this is one, where that goes and it actually results in an increase. Now, on one hand you might class [indiscernible] so well that's more RWA class half full says -- actually, it's better to be right because, one -- and when we have the risk weightings correct, we are able to price risk appropriately and understand what we're pricing.

Operator

We'll now have our next question from Brian Johnson from CLSA.

Brian D. Johnson
CLSA Limited, Research Division

I had 2 questions, if I may. The first one is the capital impasse for the interest rate risk in the banking book has gone down a little over the period with text talks about how you've had some portfolio release. But I believe there's been some methodology change. When we have a look at the movement in 3- and 5-year bonds, you'd think the embedded value, the embedded gain would have basically declined. My first question is could we get a feeling on the breakup of how much the embedded value declined over the quarter and how much capital was released by this change in the methodology on the interest rate risk in the banking book? And the second one, just mathematically, Shayne, you've got $383.958 billion in risk assets. You add $3 billion of capital in, that's 78 basis points, which kind of implies your core equity Tier 1 to be closer to 9.4. But today, you're saying 9.3. I'd just be interested if we could get some explanation of that 10 bps of capital, where it's gone?

Shayne Cary Elliott
CEO & Executive Director

I think Rick will confirm that the 10 points relates to the Wealth debt unwind. The first tranche of that debt matured, Brian. But it's still on one more tranche of debt to go, but that's almost exactly 10 basis points.

Brian D. Johnson
CLSA Limited, Research Division

So that -- the 9.3 is actually excluding the residual 10 bps of Wealth?

Shayne Cary Elliott
CEO & Executive Director

The 9.3 includes the first maturity of the Wealth, not the second.

Brian D. Johnson
CLSA Limited, Research Division

Okay. Perhaps I might speak to Rick about it later on because the numbers just don't seem to work. But anyway...

Shayne Cary Elliott
CEO & Executive Director

I think it's a rounding issue there, but we'll talk to you there.

Brian D. Johnson
CLSA Limited, Research Division

It's a chunky one?

Shayne Cary Elliott
CEO & Executive Director

No, no, it's not a chunky one. I think, because we're talking -- you're talking one -- this -- anyway, we'll take it offline.

Richard Marc Moscati
Former Group Treasurer

That 10 basis is unwind in the quarter. One $5 million of Wealth that had been repaid. And we have one more tranche coming up, which is of equal size, also 10 basis points, which I think it is [indiscernible].

Shayne Cary Elliott
CEO & Executive Director

And that's the difference between the 9.4 and the 9.3, yes. In terms of the embedded market value, there is -- in terms of IO, there's very little change over the quarter.

Brian D. Johnson
CLSA Limited, Research Division

So that's despite the fact that we know the 3-year bond rate went up and every other bank's reported a negative delta on the embedded gain?

Richard Marc Moscati
Former Group Treasurer

I think we've had like $300 million of risk-weighted asset change on the quarter. Our numbers have been relatively stable. We've had no change in methodology. Look, that will run off over time. There's no doubt that the embedded value will run off over time over the next 2 to 3 years, so that will take away some of that shelter. At the same time, if and when rates start rising and the yield on the portfolio actually also rises, and so you get a pickup in terms of interest income.

Shayne Cary Elliott
CEO & Executive Director

I mean, I think the point to your question, Brian, is there's no overriding methodology change that's kind of polluting these numbers in any way.

Operator

We'll now have our next question from Thomas Monaco from Nighthawk Capital.

Thomas J. Monaco
Nighthawk Capital Ltd

Can you talk a little bit about the international business, more specifically New Zealand and I guess, your dairy exposure? And how much is this as a percentage of the New Zealand business and the overall?

Michael Roger Pearson Smith

Former Non-Executive Advisor

Do you want Nigel to...

Shayne Cary Elliott
CEO & Executive Director

Do you want to talk about that, Nigel? I mean...

Nigel Henry Murray Williams
Former Chief Risk Officer

Yes. So I think the dairy exposure is in the half your packs, so you'll get a little bit more information on that. And you'll see that several years ago, we changed our criteria for credit on the dairy portfolio. That resulted in a reduction in that portfolio. The main changes there were around interest rates and serviceability in a lower payout. So given those changes we made 2 years ago, currently very comfortable with where the portfolio sits.

Thomas J. Monaco
Nighthawk Capital Ltd

Okay. But I mean things have deteriorated quite rapidly since that period of time. I was just wondering how much of your capital --

Shayne Cary Elliott
CEO & Executive Director

So I think -- no, no, it's a good question. I think the point is that we acted really early on the dairy portfolio so we've significantly reduced our exposure there, particularly around high-risk sector of dairy which was the farmers who essentially were struggling to cover interest payments. And what's happened in New Zealand, yes, while dairy prices are lower, [indiscernible] and is a broad statement. Farms have improved their debt levels quite considerably and are much better positioned to withstand that. Having said that, clearly, if it is a protracted downturn and prices stay low, there will be stress in that sector. But we feel well provided for, we've got a good portfolio. And it's clearly something that we monitor incredibly closely. As a general rule, dairy makes up about 1/3 to 40% of our overall agricultural exposure, which in itself is not -- it's not big in the scheme of our total balance sheet. But yes, it's a high area of focus for us and will continue to be.

Thomas J. Monaco
Nighthawk Capital Ltd

I think it's pretty significant as a percentage of the New Zealand business. And I was wondering how much of your capital that you recently raised is going to be utilized for the New Zealand business, if at all?

Shayne Cary Elliott
CEO & Executive Director

None of it. 0.

Thomas J. Monaco
Nighthawk Capital Ltd

None.

Shayne Cary Elliott
CEO & Executive Director

The capital raise has got nothing to do with New Zealand, it's got nothing to do with that. The New Zealand business actually, as of -- at just -- our Chief Risk Officer may talk on the board, we sit there, it is well capitalized, it is well provided for in terms of dairy, it remains an area of focus. Yes, of course, it's under stress and yes, of course, management is very focused on it, but we have much less exposure today than we've had in the past.

Michael Roger Pearson Smith
Former Non-Executive Advisor

I think it's also important to remember that the last time the dairy industry was stressed, which was 2009, 2010, interest rates were significantly higher. And the lower interest rates will also help the business. But as Nigel said, we fundamentally changed the portfolio and we have exited a number of the higher-risk farmers. So we're very comfortable with where we sit at the moment. But we are continuing to watch it.

Thomas J. Monaco
Nighthawk Capital Ltd

Okay. I mean, is there something that you can give us more clarity on how you reduce the risk in the portfolio?

Shayne Cary Elliott
CEO & Executive Director

Well, we...

Michael Roger Pearson Smith
Former Non-Executive Advisor

So if you go back to previous analyst calls, our previous halfs would detail what we did some 2 years ago and over that period. And we looked to the interest cover ratio, the expected payout through the cycle, and those farmers that didn't meet a certain criteria, we asked them to refinance. If you didn't look -- go and look at the relative market share, you can actually see there change in our portfolio and the change in the other bank portfolios.

Jill Craig
Former Group General Manager, Investor Relations

Thomas, I will contact you off-line to go through it in a little bit more detail. But suffice it to say, we also did a New Zealand Investor Day on the 4th of June this year and talked to that issue extensively there and so I'll be able to direct you to some publicly available material on that. So perhaps I'd give you a call after this call.

Thomas J. Monaco
Nighthawk Capital Ltd

Oh, that would be great. Thank you. Could we -- could you also go through a little bit the Asia portfolio since that's a high degree of concern for a lot of folks?

Shayne Cary Elliott
CEO & Executive Director

I mean it's a pretty big -- it's a broad area. So...

Michael Roger Pearson Smith
Former Non-Executive Advisor

Yes. I mean, basically, the Asian portfolio is performing very well. And in fact, it's probably higher quality than the Australian portfolio. There is a little bit of problem in the Indonesian book. But again, it's very, very small and it's certainly contained. But the rest of the book is actually performing extremely well.

Shayne Cary Elliott
CEO & Executive Director

Just to circle back, so it's in the high 70% of the book in Asia is investment grade. So it's very high quality. And the business portfolio there, if we look at our business exposure, it's not heavily weighted towards corporate lending. So it has a much higher weighting towards Global Markets and trade and other business lines, which are shorter-term and generally high -- lower risk.

Operator

[Operator Instructions] We will now have our next question from Matthew Wilson from JCP.

Matthew Wilson
JCP Investment Partners Limited

Just a question on the Asian partnerships. They were a very important and strong contributor to earnings in the first half. Things seem to have changed, could we get some comment specifically on AMMB with the issues confronting that bank: You've lost your CEO; oil prices are down in an oil price economy; you've got a higher GST there; Najib Razak has obviously being involved in a corruption scandal, which involves your bank and your directors; and the stock's down 25% in the last 3 months or so.

Shayne Cary Elliott
CEO & Executive Director

Okay. Well, in the interest of full disclosure, I am a director of AmBank. So, yes, you're right that the Malaysian economy is going through some difficulty at the moment and that is being caused by 2 areas. One is about lower commodity prices, in particular oil, which has a significant impact on the economy; and two, there are political issues in Malaysia, as you well know, in terms of some of the allegations being made against the Prime Minister at this point. AmBank continues to trade well relative to the macro opportunities there, but there's no doubt that these both issues have an impact on revenue and profitability. Just to make something very clear, AmBank did not lose its CEO. Its CEO finished his contract and has moved on, and that's just part of a normal transition. And we will be announcing a new CEO shortly. So I think AmBank is a relatively small contributor to ANZ. The profitability of the partnerships has not significantly changed in the quarter or in the last month. So it continues to be -- they continue to perform as expected with a little bit of weakness, as you quite rightly point out, particularly in Malaysia at this point.

Matthew Wilson
JCP Investment Partners Limited

And are there any potential governance issues given sort of AML requirements of taking money from a government official?

Shayne Cary Elliott
CEO & Executive Director

I don't think it's appropriate to talk about that. We're not having a call for AmBank. We're a shareholder of AmBank, not -- we don't run the business there.

Matthew Wilson
JCP Investment Partners Limited

But you're a director.

Shayne Cary Elliott
CEO & Executive Director

Yes, but this is not an AmBank call. Perhaps we should -- we can have that conversation off-line.

Operator

There seems to be no further questions at this time.

Jill Craig
Former Group General Manager, Investor Relations

Thanks, everybody. It goes without saying that if you would like to follow up on any issues during the day, if you contact the Investor Relations team. And as mentioned earlier in the call, with any media listening in, if you can contact Stephen Ries and the media team. Thank you to everyone for participating and we'll end the call there. Thanks.

Michael Roger Pearson Smith
Former Non-Executive Advisor

Many thanks.

Shayne Cary Elliott
CEO & Executive Director

Thanks.

Operator
Thank you. That does conclude your conference for today. Thank you for participating. You may now all disconnect.