Start of Transcript

Introduction

Melanie Kirk: Hello, and welcome to the Commonwealth Bank of Australia's Results Briefing for the year ended 30 June 2023. I am Melanie Kirk and I am Head of Investor Relations.

Thank you for joining us. For this briefing we will have presentations from our CEO, Matt Comyn, with a business update and an overview of the results. Our CFO, Alan Docherty, will provide the details of the results, and Matt will provide an outlook and summary. The presentations will be followed by the opportunity for some questions. I will now hand over to Matt. Thank you, Matt.

Matt Comyn – Business Update and Overview

Matt Comyn: Thank you, Mel, and good morning, everyone. It is good to be with you today. Throughout the year, we have been very focused on supporting our customers, investing in our communities, and providing strength and stability for the broader economy. We are very conscious that many Australians are feeling under pressure in the current environment. The rising cost of living is impacting all of our customers. While most of our customers remain well positioned, we are seeing more people access their savings buffers.

We also recognise that some customers are finding the current environment very tough. We are proactively supporting customers in need. This includes contacting every customer coming off a fixed rate mortgage to discuss options, as well as providing flexibility and financial assistance for those who need it.

To help save on everyday expenses, navigate the changing economic environment and plan for the future, three million of our customers have engaged with our money management tools. This year, we have helped more than 150,000 Australians buy a new home, and have lent $35 billion to help small businesses create jobs and grow.

Safety and security remains a priority across the community. This year, we have prevented and recovered more than $200 million in potential scams. We have invested $750 million to protect our customers and the community from the threat of financial crime, cyber attacks, scams and fraud.

Strong and stable banks benefit all Australians. This year, we have further strengthened our balance sheet to ensure we remain well positioned to support our customers, and the broader economy. We have also made a commitment to maintain our regional branch footprint for the next three years, to support local communities and businesses. We continue to have the largest ATM and branch network in the country, and our call centres are based in Australia.

We also recognise that many Australians rely on dividends to support their income. This year we have returned $10 billion through dividends and buybacks, benefiting over 12 million Australians.

Before I get into the detail of the result, I wanted to spend a few moments on the impact of higher rates. To combat inflation, central banks around the world have raised interest rates in order to lower the demand for credit, and lower aggregate demand. As a result of higher rates, banks receive more interest from borrowers, but pay more interest income to depositors.

By way of example, our depositors received an additional $10.7 billion in interest payments last year, five times more than the prior financial year. The average interest rate earned by depositors has increased by more than the average rate paid by home loan customers, mainly due to the impact of fixed rate loans and greater home loan discounting across the market. Payments to suppliers and employees increased 5% to $11.6 billion during the period. Our shareholder profit increased by $600 million, or 6% in the year.

We often receive questions on the Bank's profitability. We thought it might be helpful to look at our profit in the context of the past decade. The Commonwealth Bank has grown significantly larger during that time, with customer deposits increasing by $380 billion. We are also significantly stronger, holding nearly twice as much Tier 1 capital, and substantially more liquid assets, than we did a decade ago. This helps to protect the economy withstand unexpected shocks, like we have seen recently in international markets.

But this additional strength also comes at a cost, which we estimate to be between $7 to $11 billion per annum across the Australian banking industry. That cost has not simply been passed on to customers. Our profitability has fallen substantially in the last decade, and is currently lower than a number of international markets. Our strength allows us to invest, to continue to improve the experience we provide to customers, and to remain prepared to support our customers and the broader economy through challenging times.

Turning now to our performance. We have finished the year with peer leading Net Promoter Scores across all key customer segments. This customer focus, coupled with consistent, disciplined execution, has delivered volume growth in all core lines of business. As a result, our statutory net profit after tax increased 5%, and our cash net profit after tax increased 6%. We have maintained strong liquidity funding and capital positions throughout the financial year. And we have continued to manage our share count through buybacks, which has helped earnings per share increase by $0.45.

Our operating performance and capital position has allowed the Board to declare a full year dividend of $4.50, an increase of $0.65 on the prior year. Operating income for the year was up 13%, driven by volume growth and higher net interest margins. Operating expenses were up 5%, driven by inflation and increased technology spend, to support the delivery of our strategic priorities.

Pre-provision profit was up 19%, reflecting our strong operational performance. Despite loan impairment expense increasing by $1.5 billion, cash net profit was up 6% on the prior year to $10.2 billion.

We have continued to strengthen our balance sheet, and we remain well placed heading into a lower growth environment. Our balance sheet is 75% deposit funded. Weighted average maturity of our long-term funding is five and a half years, and liquid assets are $189 billion. We have implemented APRA's changes to the Prudential Capital framework, which were effective from 1 January 2023, and have a Common Equity Tier 1 capital ratio of 12.2%, well in excess of regulatory minimums.

Our portfolio has remained sound, with arrears and impairments below long-term averages, supported by a strong labour market and savings buffers. Troublesome and impaired assets increased to $7.1 billion, or 51 basis points, which remains well below historic averages. Home loan arrears remain near record lows at 47 basis points. Given the uncertain outlook, we remain well provisioned and capitalised for a range of economic scenarios. We hold total provisions of $6 billion, which is $2.2 billion above our central economic scenario.

The impacts of the current environment are being felt unevenly across our customers and the economy. In aggregate, we are seeing prices rise at about 6% across the economy, and yet household spending on a per capita basis is increasing, at around 3%. This reflects a pullback in the volume of goods and services consumed by households. The increase in mortgage repayments is predominantly impacting households aged 25 to 55. Younger Australians also tend to have lower incomes, and the smallest savings buffers. They are most sensitive to changes in the cost of living. We see customers in the 25 to 34 year old age group pulling back on spend most acutely, and reducing their savings given the impact of higher mortgage and rental payments.

After years of very low interest rates on their savings, millions of Australians are now also benefiting from higher rates on their savings accounts. By way of example, our customers over the age of 65 received approximately $2 billion in additional interest income last financial year.

Our home loan portfolio remains resilient, but we continue to watch it closely. Over the past four years, redraw and offset balances have grown substantially faster than home loan volumes. This trend has continued in the past 12 months, where many of our customers have paid down or offset their loan balances where they can.

One trend we are observing is customers bringing savings balances back to the Commonwealth Bank from other institutions as their fixed rate mortgages mature, in order to offset their loan balance. While we know that there are some customers that are finding the current environment very challenging, we are still seeing only a small number of customers currently falling behind on their repayments. Both our 30 and 90 day arrears remain near historic lows because customers are taking practical steps to adapt to the higher rate environment.

We have seen some uptick in 30 day arrears in the past 12 months, and expect that 30 day and 90 day arrears will trend higher over the course of the financial year. Requests for hardship are still down about 27% versus pre-COVID levels, but these figures will rise.

Across the economy, borrowers have only felt about two-thirds of the current cash rate increases, and this is because repayments do not increase immediately, and also due to the expiry of fixed rate loans. We continue our disciplined execution of our strategy. Our core business continues to perform well through our customer focus and operational execution. The strength of our franchise continues to be underpinned by deep, trusted customer relationships.

We are very fortunate to serve approximately 11 million retail and over one million business customers. Our leading proprietary, physical and digital distribution channels enable us to deliver a superior customer experience and better understand and serve our customers' needs.

We will continue to deliver highly differentiated customer propositions so that customers have very personalised and relevant experiences, driving loyalty and advocacy. We have also been very focused on making disciplined volume margin trade-offs, and are regularly reviewing how we compete given the atypical market conditions.

In our core Retail business, there continues to be intense competition and a challenging margin outlook. The operational performance of our Home Buying business remains very good, and we have taken a number of steps to ensure our lending posture delivers sustainable financial returns. This has had an impact on our volume performance, particularly in the last quarter.

The mortgage market in New Zealand is even more challenged, where pricing conduct is difficult to reconcile. We have pulled back on volume growth in New Zealand, given the unsustainable returns with growth in the second half well below system. Our Institutional Bank has contributed to our result in a variety of ways. We have seen approximately $40 billion in credit risk weighted assets over the past six years, and a net funding of $73 billion over the past five years, including $11 billion in the past year. This has further supported our balance sheet and capital allocation to enable us to grow our Business Banking franchise and to continue to invest in our overall customer proposition.

As you know, we made a strategic choice a number of years ago to increase our investment in Business Banking. More than 25% of businesses now consider the Commonwealth Bank their main financial institution. We hold $68 billion more in Business Banking deposit balances than we did in June 2020, a 43% increase. This growth in primary customer relationships has meant transaction banking now contributes 48% of the Business Bank's revenue, up from 34% in financial year 2020.

We have continued to grow volumes above system in the past 12 months, with lending balances growing $14.5 billion, or 1.4 times system. This deepening of primary customer relationships and prudent lending growth has resulted in strong earnings performance from our Business Bank. The cash net profit after tax has grown over 30% year-on-year, and the Business Bank now contributes approximately 40% of Group profit after tax.

This year we launched CommBank App version 5.0, with a simplified and enriched customer experience for our customers. We have made it easier for customers to manage their personal and business accounts, find and access money management tools, and discover different features and money saving offers exclusively available to CommBank customers. We have also now integrated CommSec investing into the CommBank app, giving customers the ability to view their holdings and trade Australian shares and ETFs. Early results from the launch of the new app are promising. We have seen more customers using the app, and more engagement in the app. Our daily logins increased by 11% in the month of July, and we have seen a 40% increase in feature and product discovery.

App 5.0 builds on a strong multi-year history of leadership in digital banking. Every year we have more digitally active customers who log in more frequently each month, and who are more engaged when they are logged in. Our app is used by more customers than any other financial services app in Australia, with 7.8 million active users, and with a peer leading Net Promoter Score of 26.2. On average, our customers are now logging in 39 times per month. The volume and value of payments also continues to grow, and we are seeing nearly $80 billion of transactions processed each month through our app.

In the current environment, a key focus is providing customers with timely and useful information to help them manage their budgets. We are proactively contacting every customer coming off a fixed rate mortgage to discuss options and provide practical support, and are extending support to our business customers.

In addition, our digital capabilities play a critical role in giving customers greater visibility and insight into their finances, and providing support through our money management tools. More than 3.2 million customers have engaged with our digital tools like Bill Sense, Money Plan and Spend Tracker. Through our Benefits Finder feature, customers have now received over $1 billion in discounts, entitlements and benefits.

Digital and technology are also critical to keeping our customers safe. We have launched a range of new digital protection features this year, and have been able to prevent or recover over $200 million from scams targeted at our customers. One of these is Caller Check, which we use about 50,000 times per month. When we call our customers, we now send an alert into their CommBank app so that our customers have confidence that the person they are talking to is really from the Commonwealth Bank. Name Check identifies if a customer is trying to send money to a place where the account number and name do not match. And this feature has helped one of our customers avoid a $1.2 million mistake in payment, and on 16 million occasions has provided customers with the reassurance that their money is going to the right place.

And our newest feature, Customer Check, uses the CommBank app to further verify a customer's identity and branch. Maybe let me just bring that to life with one of my favourite examples from the last week. We had a customer who was interstate. We had someone who had come into the branch misrepresenting themselves to be the customer, trying to withdraw about $8,000.00 to supposedly purchase a car. Our branch teller suspected something might not be quite right. They pressed the real time customer check in CommSee, which is the system that we use to serve all of our customers. It popped an alert in our CommBank app to the real customer saying, "Are you currently with a CommBank specialist? It could be in branch or it could be in your home". They immediately came back and said, "No". Popped that message to our team. Of course when our member of staff went back of house to check and talk to the Fraud Management and Scam Team, the customer, or the purported customer, ran out of the branch.

To me, it is just a great example of the technology that we can bring to bear to give our customers that real time confidence and reassurance. And so protecting customers from cyber security threats, financial crime, scams and fraud is a huge priority for us. And we have invested $750 million this year to keep our customers safe. Using these digital tools and alerts, we provide customers with confidence to more safely navigate the ever changing threat landscape, and also provide a gentle reminder to stay vigilant. We are here to help and encourage anyone who has any questions or concerns about their financial situation to get in touch. And with that, I will hand over to Alan, who will talk through the result in more detail.

Alan Docherty – Results in Detail

Alan Docherty: Thank you, Matt, and good morning to everyone who has dialled in. I will cover the financial results for the year in a little more detail, and also provide some more colour around how we have further strengthened key settings, in order to both support our customers, and also deliver sustainable returns to shareholders.

As always, these results were driven by a combination of macroeconomic factors, management actions, and franchise strengths. Looking firstly at the macro context. Interest rates are now at highly restrictive levels, and due to intense price competition for home loans, margins peaked across the banking sector in late 2022. As competition for deposits increased, we have then seen continued margin pressure over the most recent six month period.

Our economic fundamentals remain strong, with full employment, healthy aggregate savings buffers, and rapid population growth. This shows up in our results in the form of continued low arrears rates, further growth in offset account balances, and record levels of new transaction account openings.

That said, the rate rises are having their intended dampening effect on real household disposable incomes, and we have begun to see a moderation in per capita discretionary spending. We expect this to continue as the full extent of tightening is felt. And we again topped up our loan loss provisions as we take a forward looking view of the economic slowdown.

Turning secondly to the results of management actions. A continued focus on our customers is showing up in our leading customer advocacy scores. A focus on consistent, high quality operational execution has driven significant growth in pre-provision profits. And we are responding to tighter financial conditions by further strengthening our key balance sheet settings, which enables us to both support our customers, and deliver strong and sustainable shareholder returns.

Thirdly, our franchise continues to evolve. Both Retail and Business main financial institution share remains strong and a return on equity remains sector leading. These factors have driven continued growth in customer deposit balances, and a very strong level of organic capital generation. We have deployed a small portion of our significant capital surplus to further reduce our share count, and this has helped drive another increase in the dividends paid to our shareholders.

Now on to the detail. Statutory profits from continuing operations were $10.2 billion. Non-cash items this year were relatively small, with continuing cash profits also rounding to $10.2 billion. Cash profit is 6% higher than last year, with strong growth in pre-provision profits partly offset by higher loan losses. There were a couple of one-off items that have previously been disclosed, that reduced the headline growth rates in both income and expenses this year. And so I will focus on the underlying performance in this presentation, which was full year operating income growth of 12.7%, and expense growth of 5.5%.

You can see here the difference between the full year and sequential half growth rates. In the second half, income growth was 0.4%, with lower net interest income due to falling net interest margins, offset by higher global markets income, and higher equity accounted profits from our associate investments. That fed into slightly weaker operating performance for the sequential half, and cash profits were down 2.8% as we increased provisions for loan losses.

Looking firstly at the growth in underlying operating income over the year, net interest income increased significantly from strong volume growth of between 5% and 10% across each of our main lending and deposit products, as well as a recovery in margins from the lows observed in the prior financial year. Other operating income was lower over the year, largely a function of divested earnings and lower earnings from associates.

In the second half, income growth slowed to 0.4%, as net interest margins began to compress. And this slide decomposes that five basis point reduction in margin over the most recent six month period. Continued competitive pressure on domestic home lending drove six points of that seven basis point contraction in lending margins.

The competitive situation in New Zealand was even more intense, where the margin on new home loans is currently less than half of the level we see in Australia, and significantly below the cost of capital. As a result, we have chosen to grow well below system in New Zealand, and have limited the impact to one basis point of Group margin decline over the most recent six month period.

As flagged at our February results update, we have seen increased deposit and wholesale funding costs, which reduced margin by four basis points. And also the benefit of higher rates on our replicated products and equity hedges, which increased margin by six basis points.

As we look ahead to the next financial year, the same factors that we have previously called out will continue to be important considerations. Headwinds include the competitive pricing dynamics in home lending and deposits, the rate of customer deposit switching, and increasing wholesale funding costs. The trajectory of short and long-term interest rates will also be important for both deposit portfolio margins, as well as the reinvestment rates applied to our replicating portfolio and equity hedges.

Turning now to operating expenses, they increased by 5.5% over the year. This was largely a result of inflationary increases in wages and supplier input costs, and higher volume costs. Our ongoing business simplification initiatives delivered incremental cost savings of a little above $200 million this year, and our cost to income ratio improved by around three percentage points to 42.8%.

Turning to our balance sheet settings, and looking firstly at credit risk, loan impairment expenses were $1.1 billion, as loan loss rates normalised closer to long run averages. Leading indicators of credit risk have started to increase from a low base, with 90 day arrears increasing over the most recent six month period. Further increases in arrears are expected as pressure continues to build on household disposable incomes.

Corporate troublesome and impaired exposures increased, primarily driven to downgrades to a small number of exposures in the property and construction sectors. As you can see in the call out box on the far right, TIAs do, however, remain well below long run averages.

As rates continued to rise over recent months, we decided to further top up both consumer and corporate credit provisions. Toll provisions increased to $6 billion. This represents a buffer of more than $2 billion to our central scenario of a relatively soft landing for the Australian economy, and gives us approximately 75% coverage of our stagflationary downside scenario.

I thought it helpful to provide some insight around how the components of our loan loss provisioning behave under the Accounting Standards, as we work our way through the course of an economic cycle.

Under AASB 9, we must at all times take a forward looking view of the expected credit losses on our existing loan portfolio. These rules were deliberately framed to allow banks to increase provisions ahead of an economic downturn, and therefore strengthen financial system stability. The different components of provisions are set out in the table on the right hand side of this slide. Our base collective provisioning models look at current indicators, like consumer arrears rates and troublesome exposures.

We then add two forward looking components; FLAs, or forward looking adjustments, and the MES, or multiple economic scenarios. FLAs are judgemental overlays applied to very specific cohorts of Retail customers and Business segments. For example, right now we have specific consumer FLAs for home loans originated at the bottom of the rate cycle. And specific corporate FLAs for sectors of concern such as the construction sector and B grade office properties.

The MES operates at a more macro level. When we forecast an economic slowdown, we model the expected credit loss of different scenarios, and MES overlays tend to increase provisions. As you enter the bottom of the economic cycle, consumer arrears and troublesome exposures increase. This leads to an increase in base and individual provisions. At that point, the FLAs applied to those same customer segments are de-recognised. There is therefore a degree of natural offset between these components as we move through an economic cycle.

The MES overlay also generally reduces after you pass the bottom of the cycle as forecast economic variables start to improve. Standing back from all of it, you will likely see higher provisions late in the economic cycle, and lower provisions following the bottom of the cycle. Whether loan impairment expenses are higher or lower during that period of contraction will be a function of the actual losses incurred, compared with the predicted losses inherent in the MES and FLAs overlays.

For many years, we have sought to hold industry leading provision and coverage levels through the cycle that eats into our capital surpluses in the short-term. However, it also means that when a credit deterioration eventuates, we incur relatively lower annual loan losses, and can deliver more stable earnings and dividends over the long-term.

The rest of our balance sheet settings also remain industry leading, with our deposit funding ratio increasing to 75%, and long-term funding settings remaining conservative. Short-term wholesale funding remains at a historical low proportion of total funding of 7%. I expect this metric to increase over the year ahead as we use some of this spare capacity to fund maturities in the RBA term funding facility.

On capital, we have delivered a Common Equity Tier 1 ratio at 30 June of 12.2%. This is 10 basis points higher over the half, as another period of strong organic generation was partly offset by the completion of a previously announced on-market share buyback. Today we also announced a new $1 billion buyback, which would take our CET1 to 12% on a proforma basis, and $8 billion surplus to the APRA Prudential minimum of 10.25%, and nearly $5 billion above the Board target of 11%.

The final dividend of $2.40 represents a 14% increase on the prior year, and takes our full year payout ratio to 74% close to the middle of our policy range. Given a very strong capital position, the Board has decided to again neutralise the DRP in respect of the final dividend.

In closing, I wanted to share how we have positioned our key financial settings for the coming economic slowdown and how this helps support our customers, the economy and our shareholders through uncertain times. As you can see on the left hand side of this chart, we have strengthened provisioning, created spare funding capacity, and retained significant surplus capital as the economy begins to slow. We have also positioned our structural hedges of interest rate risk to provide significant support to net interest earnings over future years.

Our return on equity has increased this year to 14%, supported by earnings growth and buybacks. That has allowed us to generate strong levels of organic capital, which funds the extension of credit to our Retail and Business customers. For our shareholders, we seek to provide healthy and sustainable dividends, and efficiently return surplus franking credits. This provides them with the incentive to continue to invest their capital into the Commonwealth Bank, and support our customers and the economy over the long-term.

I will now hand back to Matt, who will take you through the economic outlook and a closing summary. Thank you.

Matt Comyn – Closing Summary

Matt Comyn: Thanks very much, Alan. The fundamentals of the Australian economy remain strong. The jobs market remains tight, with unemployment still near historic lows, high business investment and strong terms of trade. We recognise, though, that all households are feeling the impact of higher inflation and higher rates. We can see households taking practical steps to adjust to this new environment. Consumer demand has slowed on a per capita basis, but immigration is providing a structural tailwind for the economy.

Even though wages are rising, the combination of higher inflation and higher interest repayments has meant that real household disposable incomes have fallen around 5% year-on-year. Higher rates are having the intended effect of slowing growth and lowering inflation. Inflation appears to have peaked, and we expect economic growth to fall below 1.5% this year. Borrowers have only felt about two-thirds of the current cash rate increases, given that repayments do not increase immediately, and due to fixed rate loans, many of which expire in the next six months.

Given this, we believe we are near the end of the rate hike cycle, but that rates may stay high for some months to come. We are also mindful of the potential for entrenched services inflation, which is possible if productivity does not improve alongside wages growth. Our base case remains a soft landing, and we are expecting these pressures to ease as inflation and interest rates start coming down next year. The economy remains fundamentally sound, and stronger than many international markets, and we remain optimistic about the outlook.

So in summary, the Commonwealth Bank remains strong and stable. This allows us to support our customers today to invest for the future, and to support Australia through the economic cycle. We have a distinct proposition and more customers are choosing to bank with us. This has allowed us to deliver strong operational performance, and return over $10 billion to shareholders through buybacks and dividends.

This has been underpinned by consistent, disciplined, operational and strategic execution. Our strengthened and conservative balance sheet is a highlight of our result, and provides flexibility to navigate uncertainty and support our customers and the broader Australian economy, while delivering sustainable returns to our shareholders.

I will now hand over to Mel, and look forward to your questions.

Q&A

Melanie Kirk: Thank you, Matt. For this briefing, we will be taking some questions from analysts. When your phone line opens, please state your name and the organisation that you represent, and to allow as many as possible to ask questions, please limit your questions to no more than two questions. The first question comes from John Storey.

John Storey: Hey, Matt and Alan, thanks so much. It's John Storey from UBS. Alan, thanks for the detail just around the provisioning. I mean, the market obviously remains reasonably cautious just on the normalised credit experience for CBA. I mean, I think the timing has certainly been pushed out over the last few reporting periods, and I also appreciate you've got a $2.2 billion additional overlay over your central scenario. But just looking at some of your probability weightings around your scenarios, I do note that those have changed, particularly over the last six months. Is this an indication, so first question here, is this an indication that CBA's views around a softer landing relative to what you previously had, you've got more confidence in that now? That's just the first question.

Alan Docherty: Thanks, John. And that is the case. I mean, six months ago, there was a greater degree of uncertainty around in particular, the terminal cash rate in Australia, both in Australia and many other jurisdictions around the world. There have been increasing terminal cash rate expectations through that period. We feel, as Matt mentioned in his economic outlook, that we are closer to the end of the rate cycle at this point.

And so I think we have got more confidence around that terminal cash rate. We increased that in both the central scenario and also the downside scenario. That led to increased level of expected credit losses on both of those scenarios. And then we increased the probability weighting towards that central scenario. So central and upsides now, 57.5% probability, which is a higher probability than we had previously. So yes, it is really a reflection of more certainty around where some of those key economic fundamentals are headed, John.

John Storey: Got you, got you. Matt, maybe just a second one. It's just really around your views on competition in the market, both on the asset and liability side of the balance sheet. There does feel to us that there is some rationalisation that is come back into the market.

Also, we would just be interested to get a view on some of the margin drivers, particularly in the fourth quarter. We have calculated roughly about a three basis point decline in NIM in Q4. Maybe you could just answer the question around competition, and then just around that, your fixed rates, you have got a big fixed rate roll off heading into December 2023 related to that margin question. What are you having to invest in price now, to retain customers relative to what you're having to invest three or six months ago? Thanks.

Matt Comyn: Yes, sure. Thanks, John. Look, maybe I will make some comments. I suspect we might return to this via some other questions. Look, I think clearly the last 12 months has been, I think, pretty atypical in terms of a very rapid change, particularly in the basis of competition. If I just deal particularly with home lending. I think over a period of time, certainly throughout COVID, from our perspective, there was a good basis of competition around particularly operational processes, differentiated execution. As we got into the first half, very, very aggressive price-based incentives to levels that, I mean, have been colourfully described by many over the last six months, so I won't add to that, but certainly we would consider not to be sustainable.

As you know, we led the removal of cashbacks, I think clearly they, and we talked about that at the half, they are causing a headwind to margins. We had, I would say, the least to benefit, clearly, by removing those cashbacks. I think also importantly, it would seem that some of the evidence would support that distorts customer behaviour. So, I mean we led that change, that has been adopted by most players, but all of them have lagged our implementation. So hence we had a softer month in June. July will be a softer month on volumes there.

So, as we look out today in terms of current pricing, still extremely competitive and aggressive. I would say it has modestly changed. I think our overall sense is it has probably exaggerated the level of change that is seen by market observers. It is going to be a key indicator, obviously, in terms of NIM into financial year 2024. Alan and I both touched on New Zealand, I am happy to come back to that.

Then I think on the rest of the asset side, I mean, all aspects of the business are continuing to be competitive, and we see that going forward. Obviously home lending was the most concentrated. Liabilities, I think one of the things that is on our mind going into FY24 is clearly, and Alan will no doubt expand on it later, just the funding issuance. We have got all the term funding facilities maturing. Our balance sheet is in an extremely strong position. But clearly a number of our competitors, we feel, are going to have to compete pretty aggressively for deposits to offset some of the wholesale funding issuance they will need to do, and probably less room on the short-term wholesale funding.

So I think that is definitely one to watch. Maybe it normalises across both assets and liabilities. And so that is one of the areas that we are meeting on extremely regularly as a management team to look at all of the settings that we have got in market. How do we compete most effectively? Obviously, we are going to continue to compete in those markets. We are not prepared just to cede share for the sake of it. But we are very focused on sustainability over the medium term too.

John Storey: Thanks very much, Matt.

Melanie Kirk: Great. Thank you. The next question comes from Jonathan Mott.

Jonathan Mott: Thanks, Matt. Can I just follow up on John’s question then? With the margin that you’re seeing, if you look from the third to the fourth quarter, two to three basis points, ongoing pressure through that period, and I know it moves around month to month. Is that the trend that you would expect over the next 12 months? So obviously moderating from the very aggressive compression that you saw in the March quarter from December, when the NIM peaked back in October, that has given these headwinds around two to three basis points per quarter, looks like the correct trend.

And then I just wanted to follow on with a question on slide 15. You call out that home loan market share grew at about one times system through the year. But above that, you say that excluding Unloan and Bankwest, it was 0.8. I wanted to get a feeling, did that change when you put through the repricing around that March, April period? Did you see a change in the split between the CommBank brand versus Bankwest and Unloan?

Matt Comyn: Yes, sure. Why don't I start, and Alan, you can add to it, as obviously there is a bit in that, Jon. Look, I think we recognise that this is going to be a topic of a lot of enquiry. I mean, you will be able to reasonably accurately calculate the exit margin. We are not going to give it precisely. There is also the problem with the exit margin or even monthly margins, there is a bit of noise in there. So it is a bit of liquids benefit, for example, in the June month.

I mean, as we look forward into the year ahead, there is obviously a number of factors that the big contributors, maybe I will just deal very quickly on the positive side, we are going to get higher benefits from replicating portfolio hedges and the duration of equity.

And then just on the pure competition side, we have touched on deposits. We certainly have a view on what is the proportion of price-based discounting that is going to weigh on margins that is going to come from home loans. They are probably the main factors.

So I guess, Jon, one of the things that we are trying to grapple with is, I mean, even within our own forecasts, how to best help the market determine what that should be. I do think there are a couple of items in there that are pretty lumpy. Clearly, the home loan competition really stepped up, as we called out in Q2 of our financial year. And that has really weighed on margins across the whole market.

I mean, in particular, in terms of your second question on volume; yes, I mean, as we have talked about before, we have been prepared to – we are trying to grow the category of digital direct via Unloan. I think particularly, what has weighed on our market share performance, certainly our volume, will be the removal of cashbacks. Leading that out, leading that out first, and everyone else delaying after that, that was the biggest driver of it. A soft June, July be will be softer, from what we can see.

And as you would appreciate, we want to make sure that we are competitive. We are certainly not going to reward competitors who are just trying to shift share. But ultimately, we are comfortable losing some share of low return, which it would be in that month.

And so I think we have got to get that balance right. We will look at those price settings across all of those, make sure we are competitive for our customers. But clearly we want to make sure that there is a sustainable margin profile to be able to support customers going into the future.

Alan Docherty: Yes, the only piece I would add, Jon, is that, I mean, of the forward looking considerations, the one that did not really impact as much in the last couple of quarters as we might have expected six to 12 months ago, was wholesale funding, and including the basis risk premium. Basis risk premiums remained very low over the most recent couple of quarters. We would expect based on the implied futures on BRP, that that will start to increase from here.

We are also likely to see a lot of term issuance, not just from domestic banks, from banks all around the world, as they deal into their version of the RBA term funding facility. So I think there is going to be more that is going to feed in, and more competitive pressure on deposits in each of the domestic deposit markets. And so yes, the trajectory for both the quarter and the half was down. As you can see in the numbers we published today. And then the forward looking considerations, I think the ones to watch are going to be intensification of deposit competition, and higher wholesale funding costs.

Jonathan Mott: Thank you.

Melanie Kirk: Great. Thank you. The next question comes from Richard.

Richard Wiles: Good morning. Richard Wiles here from Morgan Stanley. Matt, I've got a couple of questions on costs. There has been some talk in the industry and some recent media reports about a major cost reduction exercise at CommBank. Can you comment on whether that is the case, and whether you're aiming for a significant step up in your annual cost saving targets?

And separately, do NAB and ANZ's recent decisions to award some of their staff pay rises of 17.5 and 16.5% respectively over four years, have any implications for CommBank? And can you comment on the potential implications of multi-employer bargaining for the same job, same pay laws that the Government has proposed?

Matt Comyn: Yeah, sure, Richard. Why don't I start with the second question first, and then I will come back to outlook. Look, we currently have an offer that is tabled with the Financial Services Union. We have communicated to our team. We hope that it will be supported, and it is 12.75% over three years. But I mean basically the four year number from the peers, they are adding back what they paid last year. So if you add it back, it is comparable. I think it is actually 17%, so it is a very small difference between, I would say, what we can see across the three peers. I think it is a reasonable position.

Now clearly we have been comfortable to put that offer forward. Obviously we think it is compelling. We hope it will be supported, but that remains to be seen. I guess the second part of that, naturally, that is putting, and when we talk about even our FY23 expense performance, the higher wage growth clearly puts pressure on our cost line. We can then therefore see what that expenditure increase will look like over the next few years.

To answer your first question, I would not characterise it in that way at any time. I mean, as we have talked about publicly many times, and we do not, as you know, give forward cost guidance. But what we do want to do is make sure that we are both prepared to invest in our business for the near and medium term. And for us, we have been prepared to take on additional resources to support higher volumes. Certainly we have had a very large investment envelope over the last few years, from a regulatory and risk perspective. We have clearly made a lot of progress there. We are keeping our investment spend high, but we are also very cognisant, clearly, of the environment that we operate in, the outlook for revenue, and clearly the outlook for expenses.

And so, I mean, it is just a function of who we are. If we make changes to the way we work or to our operating model, and every change in FTE or reduction in FTE is difficult. But if there is a small change, given our overall size of our business, that tends to be picked up in the media. So we will be balancing that very closely. We have done a lot of work as a management team preparing for that. We think that is the most responsible approach to both deliver and support our customers, but also support our owners over the near and long-term.

Richard Wiles: Alan mentioned $200 million of cost savings in the FY23 year. You don’t have ambitions or targets to ramp that up significantly in 2024 and 2025?

Matt Comyn: Well, I think consistent with what we have said previously, we tend to talk about our – we have an ambition and we have plans that we work through from a management perspective. We do not necessarily communicate those in advance. We more talk to, as you know, about what we have done in the period, and some of the headwinds that we have had from an expense perspective are because we have been prepared to, as an example, expand the investment envelope.

We have brought more technology in-house. We have obviously added resources. But as we look forward, certainly where we have been able to finish some major regulatory and risk investments, we think there will be some opportunities to reduce our costs in that area. As we brought more tech in-house, we have reduced our costs to ASPs or external technology companies. And as you will see, there is a breakdown of the investment mix. As we are putting more into areas like productivity and growth, we want to improve the processes to deliver a better outcome for our customers, but that also improves the automation.

I think the other thing that Alan had called out is we have increased investment in particular in cyber and scams alongside financial crime, and that is unlikely to reduce in the coming periods.

Richard Wiles: Thanks, Matt.

Melanie Kirk: Great, thank you. The next question comes from Andrew Triggs.

Andrew Triggs: Thank you, Mel. Hi, Matt and Alan. Slide 64 shows the rate of switching into higher rate deposits reduced in the fourth quarter across both the domestic Retail and domestic Business deposit bases. I'm interested to know whether we can read too much into this, given I presume there are some seasonality impacts, especially in the Business space where the month of June is always a strong month for loan growth, and new lending often drives the creation of new deposits. So any comments you could provide on that, Alan, in terms of whether we can read much into that fourth quarter move?

Matt Comyn: Yes, I mean, look, and I will let Alan explain, I think there are a couple of things worth highlighting. I mean, one of the ways I think we look at it is a little bit, what is the compositional mix on deposits pre-COVID, and comparing that to where we are, and then what are we actually observing?

And then, I think we called it out, one of the things that we could see showing up, let's say in household deposits, has been some of the fixed rate maturities actually bringing deposits back into CBA. That is probably giving us a tailwind we did not necessarily fully anticipate. But we do expect to see some switching, the exact rate of that switching across, into both savings and into TDs, remains to be seen. I think your point about it stabilising is important.

I think from a business, just observe perspective. You are seeing more businesses consuming some of those cash balances as well. I think one other factor that we have seen is the Government and the ATO have had very accommodating settings in terms of ATO debt. That is a reasonable proportion of outstanding balances. I expect that that will tighten over the next year or two. I think that is reasonable. So you add all of those aspects up, there are a couple of things we are watching very closely from a funding and balance sheet perspective.

Alan Docherty: Yes, and Andrew, I think your observation is correct. The seasonality around deposit switching between different types of accounts as you get into financial year end, and so what we were careful to point out was that there was a reduction in the rate of switching. I do not think switching is a phenomenon as an end either in the Retail deposit base or the Business deposit base. I think in particular, we added some historical context around the composition of our Retail and Business deposit base over the last number of years.

And you can see on the following slide on 65, there used to be a much larger proportion, for example, of term deposits within the Retail customer base. And so as we continue to see very attractive term deposit offers in the market and intensified deposit competition, I think it is likely we see further increases in switching towards term deposits as well as at call savings accounts.

So yes, the rate of switching certainly reduced noticeably in the quarter, but there will continue to be switching in the next financial year. We will continue to be transparent with the market on the levels that we see across both portfolios.

Andrew Triggs: Thanks, Alan. Actually, just to follow on with that slide 65, it expresses it well, on the Retail deposit side, that's the area where it looks like still well below pre-COVID levels. Whereas on the Business side, term deposits are back at the same ratio of total deposits that they were pre-COVID. Does that explain, I guess in the sense that there's more inertia in Retail Banking? It could be a bit more lagged effect rather than Business, which has been quite upfront?

Alan Docherty: There are also aspects of franchise growth in Business Banking over the last few years. We have added a lot of MFI share, we have added a lot of new transaction accounts in the period between 2023 and 19 December. So the franchise shapes a little different. And so I think that is part of the reason why the term deposit mix is a little lower at June 2023. But yes, I think that suggests that there is certainly further changes on deposit competition ahead, particularly in the Retail space.

Matt Comyn: The only other thing I would add that we have observed, and obviously this only applies to those with a, let's say, home loan or outstanding debt, is that we are seeing more of that show up in offsets. And that makes sense; as the rate environment has risen, the interest component on people's P&I, particularly for owner occupier, they should be paying down non-deductible debt. So you are seeing maybe more of the deposit balances consolidate to reduce the interest bearing balances.

Now, I accept that more of the proportion of customers that are in TDs tend to be at a later stage in life and not necessarily, certainly not all holding housing debt. But yes, I mean, we look and have various assumptions about how we think that will move over the course of the year. And I think as Alan said, there will be some behavioural elements as well as price pressure, depending on funding profiles across the rest of the market.

Andrew Triggs: Thank you.

Melanie Kirk: Thank you. The next question comes from Andrew Lyons.

Andrew Lyons: Thanks. It's Andrew Lyons from Goldmans. Just two questions, if I may. Just firstly, Alan, you've provided some additional disclosure just around your high sustainable returns, which includes disclosure on the franking neutral payout ratio being 80%. Now just given you also note that dividends are now the only way to return surplus franking credits back to shareholders, is it likely that you may over time push your payout ratio towards the top end of your 70% to 80% payout ratio target range, having historically favoured the middle of the range?

Alan Docherty: I mean, there is a number of factors that go into the Board's consideration of a dividend at each reporting period, Andrew. I think it is important, franking surplus balances and how they are trending is one aspect of the considerations. There are many others, but it is an important aspect, and one of the things we wanted to call out on that slide. Across a range of balance sheet items, there are a number of structural hedges, buffers that we have built into provisioning, buffers on capital. And obviously the franking balance we look at very closely, to make sure that we retain a healthy surplus there.

We are very pleased with where the franking balance sits. That franking neutral payout ratio of 80%, that has not moved around very much in recent years. Although it is another consideration obviously when we come round to recommending the Board approving any sort of capital or dividend distribution. And yes, the statement around the dividend being the only mechanism to distribute, that is just a reminder to the market following the last Federal Budget where dividends are the only way we can distribute that surplus franking credit.

Andrew Lyons: That is helpful. Thanks. Thanks, Alan. Matt, just a second question, maybe for you. Slide 7 is really interesting, particularly the chart that shows how Australian banks collectively have gone from among the most profitable developed market banks, to being now among the least profitable. Despite this, there still appears a perception that the Australian banks over-earn to the detriment of their customers. That's certainly what my conversation suggests.

And so in light of this, to what extent do you see not just the reality as problematic, i.e. does falling Australian bank profitability potentially put at risk where global capital gets allocated, but also the perception of Australian banks as over-earning as problematic, which might see further regulatory pressure placed on that profitability?

Matt Comyn: Yes, no, Andrew, thanks very much for the question. It is obviously a very important topic. I guess my first point, clearly it is not an Australia-only issue, given recent events, let's say in Italy. I mean, as you know, we have received a lot of questions about this, in terms of profitability, and also how banks contribute more broadly. And so we tried to set out some of the best set of facts to illustrate how that has changed over time.

I mean, within your question is one of, I think, the key points. It is not a choice between profitability or doing a good job for customers. You can do both. I think every business certainly over the medium or long-term has to do both. If you are not doing a good job by your customers, you are not winning new customers, you are not able to grow. You cannot possibly generate sustainable returns. And so that is part of it.

And I mean, you are quite right, the second leg of that is also how important it is for banks to be profitable, particularly at this point in the cycle, because it is a competitive context for capital. And if a financial institution or banking system of a particular country is below cost of capital, well, why would shareholders then invest money into that? And that, of course, leads to very bad lending outcomes, the inability to be able to support the broader economy. We have seen that, and there are many case studies of that, particularly in Europe.

And so we do think it is an important topic and debate. We always feel comfortable explaining our decisions. We think, as such a large company in the context of Australia, we should be subject to a lot of scrutiny, and we try to prepare at least some facts to be able to support that discussion.

Andrew Lyons: Thank you. Appreciate it.

Melanie Kirk: Thank you. The next question comes from Victor.

Victor German: Thank you, Mel. Victor, from Macquarie. I also wanted to ask a question on the slide 64, and the deposit mix chart. And the question I have is, if I look at your non-interest bearing deposits, obviously, and I think, Matt, you alluded to it as well, massive increase relative to pre-COVID levels. Are there any structural things that we should think about to justify that increase in the context of a higher rate environment? Obviously, customers presumably will try to gravitate towards better rate deposits. Is there anything that potentially should stop it going back to where it was in 2019?

Matt Comyn: I mean, look, I will unpack, and Alan, you add. In terms of, I mean we got a very significant growth rate during COVID. And I think there are a few factors contributing to that. One, clearly, and we have seen this in the past, where the signs of stress and volatility were a big net deposit beneficiary. We feel like we have got a very good deposit gathering franchise on both the Retail and Business. That helps a lot, because we have got the main Bank relationship. In a business context, obviously, that is where a lot of the day-to-day working capital transactional flows, it obviously helps us with the lending and risk identification.

Then of course during COVID particularly when there was a lot of fiscal stimulus, because of the breadth of our customer base, we benefited from that. We see a little bit of a natural unwind as the cycle turned. That was some part of the headwind in terms of volume performance in household deposits.

And then I think it is probably a factor of, as I said earlier, we would see directionally switching back into similar areas. But it depends a little bit on individual circumstances. Like I said, whether there is the presence of a loan or not. And then I think in Business, it is probably similar factors that we have talked about; a function of operating performance of businesses, funding of working capital, but business lending still remains strong. So we see that expansion of the money supply showing up in other parts of the household sector. So I think directionally it will move. It is a question about what is the rate of change. And as Alan said, at least that relative rate has stabilised.

Alan Docherty: I mean, the other franchise aspect, because there is obviously going to be cyclical aspects related to the level of rates, and the level of deposit competition in the market, but also from a franchise perspective, we have invested a lot in our everyday banking experience, both in the Retail Bank and the Business Bank. There are a lot of features attached to our everyday transaction accounts, which customers are really benefiting from. We covered some of them today, in terms of supporting customers through cost of living pressures.

And the other aspect that has changed in the last couple of years is obviously with the borders reopening. A very big increase in the level of net migration into Australia. We are achieving record levels of new transaction account openings, driven by both non-migrants, but also the return of migrants and that strong level of net population growth in Australia, which is going to that weighting towards non-interest bearing deposit accounts.

So there are both cyclical factors, there is also franchise factors. So yes, I think both of those we will need to bear in mind as we look at how that proportion of deposit composition moves over the next year or two.

Victor German: Thank you. That makes a lot of sense. And second question for me on New Zealand. I think, Matt, you volunteered to potentially provide a bit more colour on that. If we look at your Group margins, say relative to 2020, they're pretty much back to the same level. Whereas New Zealand even after decline in this half, they're still materially up. Is that just a factor of liquids having an impact, or is there a factor that New Zealand margins, obviously a slightly different market, and some of those normalisation in margins potentially take a bit longer? Would just be interested in your thoughts on how that market is likely to evolve, and whether it is likely to lag performance in Australia or not.

Matt Comyn: Yes, I mean maybe if Alan wants to talk more broadly on some of the margin swings. I think one of the things that we notice very sharply, we certainly did in the first half, and unlike the second half in Australia, there has not been any improvement, or said another way, that level of competitive intensity. And I think lack of sustainability on some of the lending margins, particularly in home lending I do think are difficult to reconcile. I am trying to think, without telling you exactly what the margin is, maybe I will give you a few of the composition parts which will help you calculate it, I think, pretty accurately.

At least the last time I looked, I think a two year fixed, and I think maybe the average term in New Zealand is probably 18 months. But let's say the two year fix looks at about 6.79 customer rate. I think two year swaps is about 5.5. The extra part you need is you need to calculate what the weighted market curve would be for five years, which might be hard for you to calculate. But if you guess that was a bit more than 100 basis points, you are pretty close. You can do the maths when you unpack that on what that margin might be, and that does not seem sustainable.

Alan Docherty: And on our New Zealand margin trajectory, I mean, we took very deliberate targeted action around volume rate trade-offs in that market. That has helped slow the level of margin contraction that you would otherwise have seen if we were continuing to grow at or above system on housing in New Zealand. And so that has been the main factor around how we are managing volume and rate within that context of a very intense level of competition for home lending.

Matt Comyn: Yes, and I think the ASB team, I mean, they have sunk well below system and they are maintaining discipline. So there is also a point where you need to defend. Now it is a low growth environment, but look, I think that has clearly been an area of focus for the team. And we are seeing similar trends with a further deterioration in New Zealand. So it will be interesting to see how that will change in FY24.

Victor German: And on the deposit side?

Matt Comyn: Certainly not to that level. I mean, it is competitive, and for all the same reasons that we have talked about in the Australian context. It feels like on the lending side, both in Australia, but continuing at a greater rate in New Zealand, there is more of a disconnect in terms of lending margins because they are a much higher fixed rate market. Those margins seem to be well below what we would have otherwise seen or expected.

Victor German: Thank you.

Melanie Kirk: Thank you. The next question comes from Brendan.

Brendan Sproules: Hi, good morning. Brendan Sproules from Citi. I have just got a question on your funding mix on slide 32. This year you've kept those percentages very stable in line with your loan growth. But just looking at some of the system aggregates, it does appear as though in Australia, as it has in other developed nations, broad money may have contracted in June. Household deposit growth has kind of collapsed as well. What's the outlook for that mix in terms of funding lending growth in FY24? And if deposit growth is very weak, as it appears to have become, do we expect that we'll see sharp rises in long-term funding and short-term funding to fund that growth? And then I have a second question.

Alan Docherty: I think we will see increases in short and long-term wholesale funding in the next financial year. But on that June change in household deposit, and the broad money aggregates, we have seen a lot of that come back in July. So a lot of that, Brendan, was actually some switching we think from personal accounts into business accounts for particularly small business owners through that June fiscal year end. We have seen seasonality of that type in past periods and we have seen, it was, I think, more pronounced in June than we had seen for a number of years, but we have seen a lot of that come back. Certainly a share of that came back into our deposit accounts, retail deposit accounts during the first three or four weeks of July. I think we have seen about 80% of that June decline come back in that period.

So I would not read too much into the June trends on household broad money. I think more broadly money supply, certainly lower growth than maybe we have seen over the past two or three years, which has been a very unusual period of expansion in money supply, still moderate, but positive growth in broad money supply more broadly. And then the dynamics between households and business will be a function of how businesses are performing, where wages end up and the sort of spend and propensity of the consumer. But I would not read too much into the June month on household deposits.

Brendan Sproules: Sure. Thank you. And my second question just relates to the short-term, long-term funding mix. I mean, you've obviously made the point at this result, and I think you made it in February, Alan, that the short-term funding is below average, and you feel that you have capacity there. I did note that your long-term funding task has ticked up a little bit in the half. I think it's $68 billion now for the full year 24. To what extent is that at its maximum capacity, or do you have an ability to grow that further, if we do see broad money continue to slow faster than loan growth?

Alan Docherty: Yes, certainly when we come up with our funding plans, we make sure we have got plenty of capacity across term issuance. And we have also, as we have mentioned in the last number of results, when we drew down on the term funding facility, we repaid a large proportion of short-term as well as long-term wholesale funding, because we knew that when we came to this financial year 2024, when you see the spike of maturities on the TFF, we wanted to keep spare capacity in the short-term stack to allow us to help partially meet the maturities on the term funding facility. So, we have kept that capacity there and will deploy some of that capacity as we roll through the maturities this period.

One of the other things we did, obviously when we – we have known for a long time the maturity date of the TFF. We avoided issuing other forms of term debt into those same maturity windows. So again, that gives us further flexibility. But yes, we are feeling comfortable about the term funding issuance we have got planned. There is further capacity there. For example, if lending grows above our expectations or we decide to step away from some aspects of deposit gathering, if the pricing does not meet our volume rate trade-offs. But yes, we are feeling comfortable about the funding task in the year ahead as we do with the TFF maturities.

Brendan Sproules: Thank you.

Melanie Kirk: Thank you. The next question comes from Carlos.

Carlos Cacho: Carlos Cacho, Jarden. Thanks for the chance to ask a question. I was just wondering if you could give us any more detail on the six basis points on home loan margin compression you call out on the NIM slide, in terms of a the split of that between back book and front book pricing.

Matt Comyn: Sorry, let me just double check, Carlos, there was a little bit of background noise; additional colour on how much of the…

Carlos Cacho: So yes, there's the six basis points of home loan lending compression that you called out. Just how much of that is back book versus front book pricing?

Alan Docherty: I mean, there was obviously those both elements in there. We have seen, I think over the past 12 months, we have seen more than three quarters of our standard variable rate portfolio either be refinanced, or a new origination over that period. So there is a component of both. We have not disclosed the exact split within the six basis points, Carlos, but yes, there are elements of both in the six basis points.

Matt Comyn: I mean, in some ways Carlos, it is hard to be really precise insofar as 45% of the volumes are refinanced. Obviously we are focusing on retention and a lot of the fixed rate maturities, obviously, of our customer base. We are proactively contacting some parts of our customer base, given the pricing differential. I mean, at the half, there was a lot of interest in the front book, back book expansion and that has contracted quite substantially over that six month period, which is the natural consequence of that activity.

Then obviously, as we play forward, depending on what is happening with pricing, we would expect that to continue to converge. And from our perspective, there are some segments of the market we are not competing as aggressively for and there are others where we are. And as I said, there is a lot of that focus on the retention of our existing customer base and supporting them well.

Carlos Cacho: Thanks. Maybe following up on that, on the retention question, you called out a 90% retention rate for fixed rate customers rolling off, which is modestly lower than I think what you called out last half. Or maybe that was, I'm not sure if it was on the call or in other conversations, but is that a rate that you're quite happy with? Would you like it to be a little bit lower? It is a decent bit above peers. And what are you doing to impact that retention rate?

Matt Comyn: Yes, we are pretty comfortable with where it is overall. Obviously, it is one of the metrics that we are watching, and of course we are looking at both the volume margin and risk characteristics of both new and existing. And we feel like it has been within that just by like a couple of percent, we feel like that balance is right. Look, we have got a lot of capabilities in terms of engagement with customers, both in terms of preparation for fixed rate maturity events. So they are really well prepared, but also to make sure that we are putting through targeted and personalised offers to customers.

So we have got both the capability from a pricing perspective as well as some of the tech that we have built within the app to make very personalised offers. And we are not tending to participate to the same extent in just the straight out refinance across the market, which is still extremely aggressively priced. And the majority of that would be going to the very small number of banks that still have a cash back offer, which I think would make it pretty unprofitable business over that period of time.

Carlos Cacho: Great, thank you very much.

Melanie Kirk: Thank you. The next question comes from Ed.

Ed Henning: Hi, it's Ed Henning from CLSA. Thanks for taking my questions. Just following on the question on mortgages, can you just touch on, with all the fixed rates rolling off now and you talked about book margins getting a little bit better, are they now accretive to margin as those fixed rates roll off?

Alan Docherty: The switching, we have not called out switching in the half because it had no net impact on the net interest margin in this period. We have modelled out how the switching is going to look over the next year or two. And again, it is going to be, the new business margins have variably improved a little, but I would say broadly neutral. I mean, to the extent that there is maybe a point or two where we will call out in future periods if we see anything, but it is going to be broadly neutral.

So when we have seen the negative switching, when the move to fix eventuated in the last two or three years, we called out accumulative impact of that, that negative impact of switching. We are not going to see a commensurate positive impact of the switching back, currently broadly neutral. Maybe there is a point or two of margin over the next couple of years, but that remains to be seen. It is just going to depend on where standard variable rate new business margins land up in the years ahead.

Ed Henning: Okay. Thanks. And then just secondly, on impairments, just if they head up as the economy heads down, can you just talk about the pro-cyclicality impact on capital and your ability to continue buybacks in a period despite elevated provisions?

Alan Docherty: The pro-cyclicality, we have already seen that to a large extent because of that forward looking approach, and that is why we have built the level of provisioning relative to the central scenario that you see, you have seen it over the last number of halves and you will see another increase in the provisioning today. While we are not seeing much in terms of increased arrears rates or troublesome exposures, we are able to apply some of those conservative forward looking adjustments. And we have obviously increased the impact of the MES overlays over the past six months.

So the point of the construct of the standard, and why I wanted to spend a little bit, I think starting the conversation on it today, I think it is a longer conversation that we will see play out over the next few halves. But we are able to bring forward some of those aspects into this result, in order that it is not a pro-cyclical impact on provisioning and on capital, when you are the depths of an economic downturn. We are looking ahead. We have taken a view on what that might look like. We have got a considerable buffer on our base case of our central scenario. And so I think that, as I said, it eats into capital surpluses now, because we are holding that $2.2 billion extra provisioning over and above the central scenario.

So that should limit the extent of any sort of pro-cyclicality or further capital imposition as we head into the contraction. But it all depends, as I mentioned, on what the actual level of losses are. If we are overpredicting the losses, as was the case during COVID, then you would see a release of provisions. If we are under predicting losses, then you would see further increases in provisions. So we will need to see how the actual economy pans out relative to the predictions that we have made within FLAs and MES.

Ed Henning: Okay, That’s great. Thank you.

Melanie Kirk: Thank you. And our next question, and it will have to be our last, is from Matt Dunger.

Matt Dunger: Yes. Thank you very much, Mel. Matt Dunger from Bank of America. If I could ask on slide 27, the funding costs, you’ve called out four basis points impact. Are you able to unpack the deposit switching versus price competition and funding costs impact for us?

Alan Docherty: So the switching is three basis points of that four basis point impact. And then we have seen further deposit pricing in term deposits. That is offset by the benefit of higher rates on some of the non-replicated savings deposit balances. So that is a net wash. And then we have seen one basis point of higher wholesale funding. So switching is three of the four points, Matt.

Matt Dunger: Thank you, Alan. And if I could just ask a final one on the FTE increasing 2% in the half. Talking about the shift to in-house technology earlier, how far through this are you, and is this delivering a lower cost outcome over time?

Alan Docherty: Yes, I mean, we are going to continue with the insourcing work that we are doing. We have seen commensurate reduction in the external providers that the technology team used historically, commensurate with the increase in technology FTE that we have brought in-house. There is further work to do there. So I think that will continue, and really that is playing out within our cost base with, you have seen it turn up as higher staff costs with a commensurate reduction in the cost of the external service providers which used to turn up in the technology cost line within the OpEx disclosures. But yes, that is going to be a continuing feature, at least for the next year or two.

Matt Dunger: Thank you very much.

Melanie Kirk: Great. Thank you very much. That brings us to the end of time. So thank you very much for joining us. And we look forward to engaging with you over the course of the next week. Thank you.

End of Transcript