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Stephen Higgins: Good afternoon, and welcome to the conference called this afternoon to discuss ANZ six-monthly trading update. My name is Stephen Higgins, and with me on the call we have our CEO, John McFarlane, and chief financial officer, Peter Marriott. As per usual the format of this will be John and Peter providing some brief comments on the trading update and then we'll open it up to questions and answers.

Now, for the final time, John?

John McFarlane: Thank you, Stephen, and thank you all for joining us today. Today's particularly important to me for two reasons. One of course is the result itself. We've got another year where we've got strong revenue growth, which is our number one priority. And secondly, after 10 years at ANZ, this is my final formal communication with you as shareholders. But you can rest assured that my focus will remain pretty solid right through to the 30th of September when I depart.

I'm very pleased to report that ANZ is continuing to travel well. The Personal business, New Zealand and Asia are all continuing to produce strong results. However, as you know, Institutional is having a soft year, and so we've faced up to that. We've acted decisively to put new management in place. We're taking the actions necessary to manage the business more tightly, and you'll see that the results of this action will come through in the next 12 months.

Over the last 10 years, and even during the early turnaround years, we've always looked to the future, toward the medium-term rather than any individual half-of-year. These results, and the results you've seen of the past, really reflect that. Also, I made it very clear at the

beginning of the year, while the market tends to focus on the very short term, while we've respected that, we've nevertheless stayed with a higher expense, and Asia build-up, rather than trying to maximise this, my final year's outcome, principally so we could underpin future years and provide a solid platform for my successor, Mike Smith, to build on.

Now, those of you who have been on the journey with me over the last 10 years will know that I'm pretty cautious about looking forward. As it turns out, the year to date has gone well, and to plan. However, it's become prudent over the last month to reflect the uncertainty in global markets which could impact the future, including the last two months of this year. Accordingly, I've consciously tempered this update with an element of caution, not for the year so far, but for the next two months which are quite uncertain.

If you would like an example of that, if you look at the one-month bill rate, which is really the rate against which funding normally takes place, that's sitting at this point at 6.85, that's 35 basis points over cash. The average premium over cash, over the last four years, has been 12 basis points, which is why we put in the update that if this were to continue mortgage margins are being pressurised by almost 25 basis points, and were that to be sustained, would lead to a rise in mortgage rates, all other things being equal.

Now, having said all of this, we do expect this uncertainty to reverse sometime in 2008, which will place ANZ in a very strong position. From a personal standpoint, I'm very convinced that wealth management has seen its best, and will be less exciting going forwards for the industry. I'm also very convinced that Asia will be much more strategic and also much more exciting, which all augers well for ANZ and for my successor.

So let me conclude before my final remarks at the end of questioning, by thanking all of our investors for your support over the past 10 years. And in turn, we've provided the highest levels of honesty, openness and transparency in our briefings, and I hope you'll give my successor the same support. So I'll thank you and I would now pass you over to Peter who'll give you some more detail on the update.

Peter Marriott: Good, thanks, John. You'll notice that this update focuses particularly on the results up till the end of July. In a moment I'll give you a little bit of insight as to how August has gone, and then talk about some of the variables for September. But I think one of the first things to focus on is that this will be a year which will have record income growth for ANZ. Last year we had 8.4 per cent income growth; this year we're talking about income growth which is high in our target range. That of course also includes absorbing the effects of the exchange rate, which have gone against us this year, both in terms of the New Zealand dollar and also in terms of the US dollar.

So it has been very strong income growth, particularly out of our Personal, our New Zealand businesses, and of course within the partnerships, including businesses like INGA. We'll talk about that and some of the drivers behind that in a moment. Let's just momentarily reflect on August and September.

In terms of the month of August, the only real highlight has been the effects of the funding squeeze, the increase in the cost of funding that John was referring to before, which has put pressure on mortgage margins. It's important to understand that, as a crude rule of thumb, it's around \$700,000 a basis point, is the cost per month to mortgages of the higher level of the bill rate, and that's probably only offset by about a quarter by the effect that there is on deposit margins, recognising that a large part of our deposits are effectively priced as BBSW cash management accounts, term deposits and so forth, and

also recognising the proportion of the book now, which is wholesale funded. So very sensitive to that rate outcome.

In terms of Markets, trading results for August were essentially in line with plan, but there was an expectation of stronger results, I think, out of that Markets business when we last spoke to you. For September itself, normally September is our strongest month of the year, particularly with a lot of deal closures coming out of the Institutional business. To give you an example of that, in 2006 the income was up by \$40 to \$50 million in the month of September in Institutional alone, as a result of deal closure. And in the current environment, whilst there's still a very, very strong pipeline out there, our expectations for the level of deals actually closing in the month of September is much lower than what it was in 2006. And that means that we don't quite have that same kick-up that we would traditionally have as we approach the year end.

Looking more generally at some of the drivers around the business, our volumes have been growing well. In terms of our interest earning assets, year to date we're up 10.8 per cent, and so far for the half we're running at about 5.6 per cent, so there's good volume growth continuing to come through. And with the Personal business and New Zealand being the strongest, we've got growth in the Personal business so far this half for four months of 4.7 per cent. In the New Zealand businesses, 5.4%, so good volumes there. And Institutional up about 3½%.

Most pleasingly there within Institutional, I think you'll agree given the comments we made at the first half, is that the Business Banking business is up 7.3% in volume, so far these four months. So it's pleasing to see a bit more momentum emerging in that business, which was clearly one that was soft in the first half.

From the deposits point of view, across the 10 months, Personal deposits are up by 10 per cent, and margins have been maintained. Within the Institutional business, deposits are up by 17 per cent in the Trade and Transactions area which handles all the large-end deposits and Corporate deposits, and within Business Bank by 8 per cent.

So now, on margins, I guess the key focus is what's happened in the second half, and what we see is happening at the moment. We see that the margin for the second half is likely to go down by a little bit less than the normal level. That's in terms of the underlying margin. As you know, we often have noise from half to half, caused by how much appears in trading securities income and how much appears in Net Interest Income. But backing out that effect and looking at what's happening to the businesses, the margin depression in the second half is a little bit less than the normal level.

In particular, that's probably around the competition, where competition is still quite strict in the mortgages businesses here within Australia, where we'd have probably about one basis point contraction across the whole group caused by that. Not quite as much in New Zealand, and in fact pleasingly in New Zealand at the moment, new business is being written at a higher margin than maturing business. So that bodes well for future performance there.

On deposits, again across the half, our deposit margin's been keeping pretty stable from a competitive point of view. So the margin outlook is reasonable.

You remember in the first half that we had relatively low levels of cost growth, and in the second half, the costs will be higher. And this reflects particularly the Personal business, which, if you might recall, actually had its costs going down in the first half. A lot of timing issues there around the spending on marketing, the new branches

coming on-line, new FTE being brought in as part of the revenue growth initiatives that Brian had; and also the increase of costs within Institutional and some effects of exchange rates and so forth. And this is one of the key things why we've said our cost will be near the top of the range.

I need to also, just on a purely accounting matter, need to note that of course the second half will include the consolidation of E*Trade, which adds to income and cost growth, and also includes the consolidation that some of you may not have appreciated, of Stadium Australia. By virtue of the restructure of facilities with Stadium Australia, we're the owner of that business and have to consolidate it, so that brings on about \$20 million of income and \$20 million of costs, which also will be one of the reasons why cost growth appears higher.

In terms of provisioning, I think it's fair to say that there's been no surprises on the provisioning front. Our consumer losses are tracking very much in line with plan, as we had in the first half, and the same in the second half. And there's certainly been no surprise on the corporate side of lending either. We said and stressed at the beginning of the year that we expected our provisions to be significantly up this year, and I think market expectations reflect that. And that recognises that last year we had an unusually low level of provisions.

And I remind you that last year our 13.2 per cent earnings per share growth was boosted by as much as 4.8 per cent, by the low level of provisions. So correspondingly this year there is a drag of a couple of per cent because of the growth in the level of provisions. But there's no surprises within that.

Obviously, though, that's just an update as of the end of August. There's always what may emerge in the month of September, but at this point we don't see any reasons for concern there.

On the arrears in general across the consumer portfolios, arrears have been keeping quite stable. A slight increase in retail mortgage arrears but reduction in wholesale arrears, and overall 90 day arrears have been quite stable.

A slight increase in non-accruals in the Institutional business. There's a couple of medium-size names, one in the mining industry and one in transportation, which have occurred during the half which just mean non-accruals increase slightly. But there's certainly no evidence of any overall portfolio quality change across that portfolio.

And the other thing, I think, which has been a feature of our results over the last three halves at least, has been a higher level of recoveries. We said we didn't expect a higher level of recoveries in the second half, and that certainly continues to be our expectation.

From a foreign exchange point of view, and I think at the beginning of the year we said that the FX rates would affect our earnings per share growth by round about 0.8%, 0.9% from the New Zealand dollar, and that continues to be the case. But for most of the year, the Aussie has been very strong against the US dollar, and whilst these numbers will probably come up a little bit, given the weakness of the Aussie in the last two months, certainly for the year to date, there was a drag from the strength of the US dollar by about 0.6% as well, recognising the proportion of our earnings that come out of US dollars.

You will have noticed in there, I've made a comment about significant items, just to round off the Group P&L before we start talking about the divisions, and the first one there is an adjustment to the profit that

we recognised in the first half on Fleet Partners. That arises following a favourable tax ruling that the restructure of our TrUEPrS hybrid instrument a few years ago resulted in a capital loss for tax purposes. And those capital losses then allow us to shelter the tax that would otherwise have been payable on Fleet Partners, resulting in a \$54 million gain.

But whilst on the subject of tax, of course, you all know that the tax rate in New Zealand is to be reduced, and that has the effect, though, of requiring a restatement of our tax timing differences in New Zealand. And particularly because of the collective provision, our tax timing difference is a net asset, and so the reduction in the tax rate results in a restatement of that net timing difference on the balance sheet to a cost to the P&L of around the NZD\$27 million mark.

Now, that number will depend obviously of the timing differences that exist as of 30 September, but on current timing differences, it's that order of magnitude. So net, the significant items will go up for the half.

Looking at the divisions, as John said, Personal continues to be the star, with virtually all of the sub business units on track for double digit PBP growth, and the only exception to that being Mortgages and that's a basis risk story, with basis risk being up four basis points even before the recent margin tightening. So it meant their income growth is a little softer. The underlying business is performing extremely well.

Also, as I alluded to before, in the second half, the income growth is much stronger. I think some people looked at the first half income growth in Personal and thought it was slowing. But the second half income growth is much stronger, and as has been the pattern now, the cost growth is also higher as well, reflecting marketing and timing of other costs that we mentioned earlier on in the summary.

So, it'll be another good result for Personal and certainly in profit before provisions terms, almost as strong as last year. So hopefully it continues to be a sector-leading result.

As John mentioned before, the soft results for the half so far have been out of Institutional, where we were earlier expecting a stronger second half, putting some additional momentum. But at the moment, the expectations are more of a flat result in profit before provisions terms for Institutional.

There's been a number of factors that have come into play there. The Markets business is looking to have a very strong result for the year, but the second half is not as strong as what the first half was, and was not as strong as what we expected, when we last spoke to you. So there's been some softening off in that space, but still that will be a very good result for the full year.

On the Corporate Finance side of the business, there's been some tax law changes in New Zealand, which have meant that part of the business there will likely need to be reassessed and there are some accounting write-offs that arise also probably as a consequence of that, reducing their earnings outlook.

And then within the Working Capital business, still looking to get some more volume growth coming out of that business, and not quite as much as we'd earlier hoped. There's been some small losses on some credit default swaps which were in place for hedging purposes, which are mark to market.

The good news of course within Institutional business is very much the same story as we've said at the half year, which is that business is performing very well in Asia, very well within Australia, but the weak

area has been within New Zealand. Indeed of the performance of the Institutional business compared to plan this year, 70 per cent of that weakness is coming from New Zealand, reflecting in part very good Markets results in 2006, relatively more subdued Markets results in 2007, and lower earnings coming out of the Corporate Finance business, for some of the reasons I mentioned before.

As I said in the update, the New Zealand business is looking like it's going to have a very good year, with all of the major businesses there having double digit fair profit before provisions growth, or very close to double digit. So New Zealand will be a strong performer. Qualifier to that of course is that last year New Zealand had extremely low provisions, and in fact last year their level of credit provisions was less than one basis point, and for the New Zealand business, the ELP is around 17 basis points. So you can see it was extremely low levels. This year we expect the provisions not to be supported by the level of write-backs that led to one basis point. And that will mean that the net profit growth in New Zealand is not as strong, but the profit before provisions growth is looking very good.

In terms of our partnerships, the last of the divisions, it's very pleasing to see strong performances coming out of INGA. Year to date their profit is up 27 per cent. That's a contribution in our books, so it's been a very pleasing result. And also our Asian investments are doing well. The headline earnings for Asia will of course be boosted further by the new investments, but those new investments, certainly in their first year, don't add a lot to P&L, because the earnings yield is fairly close to the funding cost, so for the group's overall P&L, it's not a major contribution, but we obviously look to the future years and the growth that will come from that portfolio.

Clearly a summary by me wouldn't be complete without making some comment about the recent market turmoil, and I think it's fair to say,

as we mentioned in the media release, that there has been a negligible impact on us. I think we've been very pleased to see that our low risk approach to trading and a very conservative approach to structural funding, and a lot of the planning scenario work we did, has put us in good stead to handle the turmoil that has occurred within the marketplace. We have been, nonetheless, taking opportunities wherever we can to strengthen liquidity even more, to provide more contingency, and we're very comfortable with our level of liquidity.

And I remind you that one of the things that we've been doing from a structural funding point of view over the last few years has been increasing our proportion of term wholesale funding. The result of that has been that we have the lowest level of short term wholesale funding as a proportion of assets amongst our peers. In a current market where there's been a movement very much to short term funding and relative tightness in longer term funding, that has served us very well, and has left us in a strong position.

From a Markets trading point of view, we've had relatively modest impact. And I say that in the sense that if you look over the last two months there have only been three days on which we actually lost money in the trading portfolio. And the largest loss was \$5 million on one day, so you can get a sense that we've been able to absorb the market turmoil with very little impact from a volatility of those earnings point of view. And the pure trading side of the business is softer but the sales side is doing reasonably well. But nonetheless, recognising that the market conditions, we're running all the more conservative positions at the moment. And that inevitably will mean lower trading earnings, because we're not taking our positions in the current uncertainty, and hence an expectation of softer result for the next couple of months.

In terms of exposures to the markets that have been most in focus of investors and the broader financial markets of late, I think there's been various comments around us that reconfirm that we have no direct exposures to the subprime CDO market. I think of late there's been a lot of focus on conduit vehicles, and we have around \$5.5 billion in limits for ANZ-sponsored conduit vehicles, which are currently drawn to about \$4.6 billion, \$2.5 billion of that is now on balance sheet, for the reasons which I'm sure is very well familiar to you, that we provide liquidity lines to those vehicles and the market for such commercial paper that funds those vehicles has dried up, and so therefore we've needed to honour our obligations under liquidity facilities.

We would think that over the next six weeks that the majority of the remaining \$2.1 billion of CP will probably end up coming on balance sheet, and certainly that's what our liquidity planning assumes. So we'll end up with around \$4.6 billion, probably around balance date to put such liquidity lines on balance sheet.

Now, I stress though, that the underlying assets of those conduits are of high quality. They consist principally of residential mortgages and they are all prime borrowers. We have the benefit as well of 100 per cent lenders mortgage insurance. The underwriting criteria do not allow for subprime. We also have rural loans which are structured in such a way with other parties having the first loss, so that the overall structure has a AA- rating. Auto loans which are also AA- level, trade receivables which similarly are structured with other people taking the first loss facilities at a AA- level. Finally there's insurance and corporate and commercial assets within there. So all the assets are of high quality.

One component within that, and it's probably worth mentioning, though, there is a US \$25 million exposure to a AAA rated CDO, which

matures in December 07, but there is no subprime. As I said, it is a CDO, but only US \$25 million, and it's AAA rated, as I said, maturing in December. So we don't have any current concern around that.

Indirect exposures are of course in the current environment harder to get your mind around. But currently we have no concerns and we're very closely monitoring all our various counter-parties for any second wave impacts arising from the current market turmoils, and as I said, we don't have any specific reasons for concern, but it's something which continues to be closely monitored.

Now, one of the side impacts obviously, and I think a few of you have focused on this issue, I've noticed, in some of the analysts' reports, obviously bringing close on \$5 billion onto the balance sheet that wouldn't have otherwise been there, will have a slight impact on our capital ratios, but it is very modest. From an ACE point of view it's only about 10 basis points, and from a total capital ratio, around 20 basis points. So it certainly can be comfortably handled within our current levels.

So, in summary, before I open it up for questions, I think the key point is the one that John made at the outset of his comment, that this will be a very strong income year for ANZ, and certainly it sets a new benchmark for us. We continue to invest in developing the franchise, and have been very pleased at the results coming out of the Personal, New Zealand and out of the partnerships. The Institutional business has been a little softer, which has the effect of, obviously, diluting the overall outcome, but we look to better results on that business in the years ahead.

So at that point, Stephen, I'll hand back to you.

Stephen Higgins: Thank you, Peter. On that note, we will open it up for questions.

Question: (Jeff Emanuel, UBS) Got a question on your mortgage commentary. You commented that if this basis risk continued to hurt, at around the 25 bp mark, you could potentially look to increase the prices. So I'm just keen to look at a couple of aspects of that. Firstly, don't you see this more of an opportunity to gain share against the non-banks? And in that context, wouldn't a price increase hurt that outcome, particularly because not all big banks may follow? And secondly, would you really look at a back book repricing of everyone on the variable book, or would it be more a reduction of discounts on the front book?

John McFarlane: I think it's impossible for me to say what we might do here. But I'd make a number of more general points. The first point I'd make is I have a sneaking suspicion that the whole consequence of this turmoil will be positive rather than negative, simply because we've been experiencing right across our books on the assets side very, very tight margins on the wholesale side, and on the retail side. Also, there hasn't been a flight to quality, in terms of investors. What they've gone to is to treasuries, and they've shied away from all corporate type paper.

What that has done has therefore potentially restricted the funding available at reasonable prices to the banking industry. So those who are desperate, which we are miles from because we've got a very large percentage of medium term debt in our balance sheet, so we can fund business as usual here at ANZ, really without much difficulty.

But this tightness of funding is meaning that for those people wishing to me more aggressive on the assets side, the funding is simply not available. If it is available, it comes at a very high cost as I said, if the one month rate is at 25 basis points premium over normal funding levels. And therefore, this is not a time to take share at low prices.

This is, in fact, a time to make sure that the scarce funding that is available in the market to the banks, and it's not easily added to at this point in time, either, but that scarce funding is added to the best assets that we can find—those with the highest return on risk—and therefore we are shying away a little bit, from low yielding assets simply because it's very difficult to find borrowers who are willing to pay the market rates for those, at this point in time.

So my sense is much more that we will start to see benefits in our spreads going forward, once borrowers return to the market place. What will happen on the mortgage side is banks, I doubt, can sit and swallow a 25 basis points increase cost of funds, particularly in the broker markets. So in that case, it really depends how long this is sustained. If it actually moves away quickly, which I doubt, then things will probably return to normal. But if it doesn't, then there certainly is going to be serious consideration towards what mortgage rates generally should be, across the book.

Having said that, we have no immediate plans to change rates, but as you can possibly imagine, we don't like being squeezed like this, and we're keeping it under active review.

Question: John, if you go back to 1997, when the Treasurer really first had a go at the banks, you know, moving rate differently from the cash rate, there really hasn't been any major bank move its variable pricing on mortgages. So this would be, you know, a significant change in approach by the big banks, if that happened.

John McFarlane: Because we're not a market leader, we've never been a first mover in these circumstances. But that said, these circumstances at the moment are quite unusual. They are not normal. And remember, mortgages are essentially funded over market rates, not over a central bank rate. And in that respect, at some point, mortgage margins will

need to return to normal, and therefore this pressure as it continues will lead to upward pressure on rates. There is no question about that. And I don't think we're the only financial institution who's said that.

Stephen Higgins: Thank you, Jeff. Next question?

Question: (Andrew Hill, Deutsch Bank) Just in respect of passing off on some of the pain from the higher funding costs, I'm just interested in what your views would be about whether any of this will be passed through into the mortgage broker channel?

John McFarlane: It's the same answer I just gave. Obviously the thing we're looking at most closely at this point in time is low profitability asset generation. We're also, of course, looking towards any form of high quality liability generation as well, at reasonable prices. You can therefore safely assume that we will not be particularly aggressive in any form of low margin of discounted product, and in fact, we have actively reduced any form of discounting in assets up to this point, trying to normalise and perhaps gain a premium at some point. But I won't say specifically what we're going to do.

Question: (Craig Williams, Citigroup) If I could just ask a question with respect to the basis cost pain which you're indicating you're currently experiencing. You compared that versus a four year average. I'm just wondering how that compared with second half 06 in terms of the basis cost on mortgages?

Peter Marriott: I think the key thing there is that from last year, from all of 2006 through to 2007, the basis cost prior to this recent compression was about four basis points extra. Now, what the effect will be for the month of September will then have to be factored into that to work out how much it's going to add. But we're at least worse off by four basis

points, and it could be five or six basis points, depending on what finally pans out.

We certainly would hope that we don't maintain this level of differential, 25 basis points, because that would clearly be very expensive for the whole industry if it was retained at these levels.

John McFarlane: Were we to have had this briefing a few days ago, we would've been talking about 15 basis points. In other words, the rate has been volatile, essentially been as high from memory as at 45 basis – I think it was 6.95 immediately after the – 6.90 or something immediately after the 25 basis point cash rate. So it's actually been bouncing around, and is partly a function of the market, but it's partly a function of the degree of liquidity supported by the Central Bank.

Question: (Matt Davidson, Merrill Lynch) My question was on the Institutional division again. I guess over the past year the commentary has moved from avoiding low margin business to facing up to some issues. I'm just wondering if you could give us a bit more colour on what the issues were, and whether any costs had been taken up front this period around that? And I guess, strategically, when you look out next year, what will drive the material improvement in an Institutional that you're flagging for that division.

John McFarlane: Maybe Peter and I might share that. First thing, there's nothing unusual about any provisioning we're taking with respect to Institutional, so there's no upfront fix that we're applying that needs a provision. That's not the issue here. For a period of, I suppose, about three years, we've been running a relatively high rate of expense growth in order to achieve higher revenue growth across our Institutional division. In fact, we did achieve that pretty much in Australia and in Asia.

But what has happened in Institutional is the revenues associated with that have always been prospective, and in fact in the third year of investment, we expected them to come through really strongly. And as it turned out, they didn't come through. And so in a sense, what we had was a mismatch between the level of investment that was there and the level of the outcome. In fact, it's interesting that it's come from overseas rather than Asia and Australia.

Now, in that environment, we've therefore become uncomfortable about such high expense growth in Institutional, and of course we will start to pull it back to the extent sensible to going forward. I recognised this issue pretty early on this year, and we started to take action, which in my sense was not enough tight management over the growth and timing of head count, and the growth and timing of expense, relative to revenue production. It's been fundamentally the problem.

Of course, the other problem in Institutional has been the fact that there's been in the previous year we have substantive recoveries; we have substantive recoveries in the first half, but we can't prospectively expect those either in this half or the next half. And so we knew that was going to be ahead in the Institutional line. Now, I recognised that we needed to tighten up. In fact, I pretty much was actively engaged in the individual businesses towards the end of the first half. But it became pretty self-evident that unless the management tightened up and changed their style of management in the business, we weren't really going to succeed.

So I approached the board to alert them to our prospective change in management, and of course one of the problems with governance things today, is it takes a while for that to work through the system. Which of course then came hard on the back of my succession, and we didn't really want to complicate succession with this.

I think, put simply, that we do believe that the margins will improve in this business, simply because there is no capacity to take on low margin activity sensibly at these funding rates. So that's positive. And secondly the business is under much, much tighter management control and has been since Peter Hudson's appointment. I'm actually quite secure in the knowledge that that tightness will start to flow through into better outcomes.

And a whole list of other actions being taken in the business, one of which is getting asset growth at higher margins, of course. Because one of the problems in the first half was very weak asset growth in that division. Which actually was not a group requirement. In fact, if anything, we would have preferred something like 10 or 12 per cent asset growth in that business. But the asset growth was a fraction of that.

Peter Marriott: And John's making a key point there. Whenever you look at the results for this division, you can't help but notice that the largest individual profit contributor is the one that is not performing well. That's the Debt Product Group, which means just how much are we writing in terms of lending, and what's happening with margins? So our Debt Product Group is one-third of the earnings. It'll have a negative profit before provisions growth this year, and that obviously drags down the average for the whole division. Next year the expectation is for much higher volume growth and that is what Peter Hodgkin is focusing on, or one of the many things he's focusing on, and also, hopefully some improvement in the margin outlook, which would help it.

Ideally, we'd like to get the Institutional business back up into double digit territory obviously, from a profit before provisions point of view,

and you can't really do that without getting a better result out of their product group.

Question: (Jeff Emanuel, UBS) John, I was going to ask you about, obviously the blow-out in credit spreads having an impact on corporate confidence taking on new lending, but also the bank's willingness to lend, and I know you mentioned that it's good for margin, but obviously there's a volume effect, so what are you seeing in terms of the month of August? Are you seeing a real slowdown in corporate willingness to take on debt and your inclination to take on that debt as well?

Peter Marriott: I think what is clearly happening out there in terms of volume growth is that as the capital markets dry up, there is an actual tendency for business to come back to their relationship bankers. So there is the potential for more volume to come through. There hasn't been a big impact of that on the balance sheet so far, but I think that as you look over the months ahead there is likely to be some stronger balance sheet growth coming through in that business. Both from that effect and also the effect of some of these deals that I mentioned before that are in the pipeline.

Too early to call an absolute trend though Jeff, this is still me predicting rather than actually being able to point to hard numbers just yet.

John McFarlane: Let's make sure you understand. Because of a strong funding position, because the banks as a whole worldwide are facing a squeeze, we're actually business as usual in assets. The only assets that we are constrained in are very large and/or very low yielding, or non core business. We're funding core business fully and aggressively – but of course, the price has gone up and that might persuade some borrowers to perhaps wait and to see if circumstances alleviate. But

given that this is probably slightly structural for a period, I don't think that people will wait all that long.

Certainly we've encouraged our core clients, if you are a bit short of funding, now is not the time to be in that position.

Question: You're only seeing this as a temporary displacement, not as a sign of things to come.

John McFarlane: No, we're seeing it as a temporary displacement but barring further information. I think, we're largely unaffected by the direct effect of the sub prime. We're actually minimally affected by the collateral aspects of the sub prime also. But that is not true of the banking system worldwide. I think the problem is nobody knows who is affected, and that's what's causing this issue really around the world.

It's not an Australian effect that is at the heart of this issue here, it's actually a global affect that's having a cascading effect on funding of Australian banks. Remember, we're doubly solid, and even doubly solid banks have restrictions on the amount of money they can raise, particularly overseas at the present, and that's all banks worldwide. And one would have assumed that given that the Australian banks are largely unaffected through the direct measures here, that at some point in time there would be a flight to quality. But we've not even seen that flight to quality at this point and people have come right out of the market.

I wouldn't overstate the effect, but on the other hand, you know, worldwide, but perhaps it's having a more aggressive effect in Australia than perhaps it needed to.

Peter Marriott: Yes, certainly Jeff, what we're seeing in the markets is that anything that's not vanilla, there's a preference for short term, clean, and also

in terms of within our own group, the preference from borrowing from the parent rather than borrowing from subsidiaries for example, you have to pay a higher price to borrow from a subsidiary. So it has to be clean now.

But if these current conditions were to remain, because we've been still raising term funding, we raised as much term funding over the last month as what we would normally on the average for each month if you look at the annual program, we're still able to get term funding. But it costs more, and likewise, even short term money is costing more.

But to put that into context, if the current wider spreads were to be sustained from a wholesale funding point of view, that would add about \$30 million to our funding costs. It's not large. The mortgage basis risk issue is certainly a much larger one. I would certainly think that \$30 million of additional funding costs should be more than offset by a widening, a natural widening, in corporate spreads, because it's both the same markets.

John McFarlane: In fact, in some ways we have an advantage, not a disadvantage, at this point in time. And the reason I say that is that we have the strongest liquidity of the banks. And this is not a time to have low medium term debt, and to have low liquidity. This is not a time for that. And the effect of it is on your ability to actually grow assets. And that's why we're actually in quite a good position, given the strength. So in other words, it's cost us over the past two or three years by having higher ratios, but these are the times when it starts to pay off.

Question: (Brian Johnson, JP Morgan) John, I'd like to congratulate you on a pretty amazing ten years, first off. Just a general comment, I reckon it's fantastic how you can communicate to all the banks that they

should all jack up their housing rate without that being some kind of legal problem.

John McFarlane: That's not quite what I – I was answering the question.

Question: But you know, it's interesting. I'm sure every other bank out there, everyone will be listening in and you've just told them all what everyone should do. But anyway, that not being the point John, the question that I had was about Origin. If you have a look at Origin, from memory, when you guys announced you were selling it it was doing an ROI of about 15 basis points. We know it's entirely wholesale funded. Is it drawing too long a bow to suspect that it's actually now in the current environment not making any money at all? And if that is the case, could you give us a prospect for actually selling it or winding it down, or getting rid of it? Whatever. Because it would look to me as though it's actually chewing up a lot of capital that could be deployed elsewhere.

John McFarlane: You're right that in this environment it is a more difficult prospect, the sale of a business. But on the other hand, it's also non core for us. Look, at the end of the day were we to keep it then that is perfectly manageable. That's not a structural issue for us. I just believe that we shouldn't hold onto businesses. Peter is busily looking through the pack to see if he can be more specific on what's happening to Origin margins.

To your first point, I was not trying to signal as to what we or the banks should do. I was simply trying to be honest in the answer of the question. The one thing about us is that we actually try and answer the questions fully and frankly, and I did not give any indication as to whether we would or would not raise rates.

- Peter Marriott: I've only got for the month of July, they were still making money. Unfortunately I haven't got it quickly at my fingertips what the margin they were making was. I think there would still be a positive margin. Because remember with Origin there's no costs, or very, very little costs, so they have much lower margin, but their overall ROA actually wasn't too much worse. But my gut feeling, but I have to confirm it, we'll obviously give you this detail as part of the full year, was that even at the current cost they'd still be making a profit, but it's probably pretty well zero.
- Question: John, just if I may, because I'm going to push him with a second one if I may. Just when you're talking about this being a short term thing, the fact is that every day when we come into work there's some other disaster that besets us. What makes you so confident that the trough isn't a long way off? I mean, to give you a small example, these SIVs around the world, there's a trillion dollars of asset backed securities, whatever you want to call them, that effectively there's no bank capital held on that are going to end up on bank balance sheets. So I'm just wondering what makes you so confident that we actually know all the crap out there and that in fact this is as bad as it gets, as opposed to what seems to be a situation that every two days seems to be getting much worse?
- John McFarlane: I think you'll probably find that there are some financial institutions around the world that are actually consumed in meetings trying to work their way through this circumstance. You can safely assume that we actually don't need those meetings here at this point in time. Because I think our direct exposure is reasonably well known and accurate, and we are not concerned about that.
- Question: But John, all Australians...

John McFarlane: What we're concerned about is a prolonged funding crunch, and our assumption is that in that, investors will, in order to perform, will need to put their money somewhere at some point soon, and therefore, assuming that they can find islands of quality around the world, then there will be flight to quality and therefore, for those organisations that are unaffected and are business as usual, then, should all other things being equal, this is the first sort of crunch I've seen for an awful long time where there hasn't been a flight to quality.

Question: But John, you yourself are saying that you're swimming in liquidity at the moment yourselves. You guys are cashed up, you guys aren't leading the charge and basically out there investing in CDOs and ABS of everyone else. I mean, that's the problem, is that everyone is waiting for someone else to do it. It's come back to what I was saying before. The problem that I would have thought is that if you have a look at all the Australian banks, we're net borrowers from overseas.

I suppose what I'm interested in is what if things get worse. Because every day I come in and there is some new disaster. And they're not mild problems, these are massive problems that we seem to be becoming aware of. I draw your attention to the recent announcement from DBS, the one from Bank of China that suddenly found some sub prime exposure that they hadn't realised. I mean, things seem to be getting worse rather than better.

John McFarlane: Yes, but I'm not saying that the general situation might not be sustained, but what usually happens is that those organisations that are felt to be safe, and clarified that they're safe, what then tends to happen is that people start to differentiate where they put their money, and the general situation is not necessarily the specific situation, particularly for the Australian banks.

I am making an assumption, you are correct, because I don't know the answer to this. But I've been around an awful long time and I've seen an awful lot of stuff, and I am making an assumption based on the amount of time I've been around, and it's that the general situation will become specific at some point, and that there will be a flight to quality in that timeframe, and that will alleviate the situation as far as ANZ is concerned.

Question: It's been a pleasure hassling you from this end of the phone.

Peter Marriott: Brian, just going back to your earlier question, I've dug out some figures on Origin. Origin has got around about a 55 basis point interest margin and the ROA for this half (before the recent turmoil) is looking around the 20 basis points level. So what I said before seems like about right. You take up 25 basis points, take off tax, you're basically down to pretty well break even. If 25 basis points was to be sustained.

Question: (Brett Lemesurier, Wilson HTM) Six months ago, or at the end of the first half result, you said that you were focusing on increasing RORWA and Institutional. Growth was an issue. It sounds to me like it's too hard to increase RORWA now and that you need to go after growth. Is that the right interpretation of what I'm hearing?

John McFarlane: No. In a sense we're indifferent as to how that is delivered, but you can safely assume, if you are to articulate a number one priority it would have been earnings growth, not RORWA.

Peter Marriott: Yes, and you don't want earnings growth at the time shrinking your RORWA, because then that won't become viable from a capital point of view. So unfortunately, it's an "and", yes, you don't want to shrink yourself to glory at a higher and higher ROA but no growth, but then at the same time you don't want to create a large business with high

profit that isn't actually adding a shareholder value by having ROA falling through the floor. So we're looking at trying to get both, solid growth but maintaining the RORWA, or at least not destroying it.

Question: From what you've said, don't we have declining RORWA this half and no earnings growth? For second half relative to first half?

Peter Marriott: Yes, RORWA is down in the second half, but it's driven by higher provisions in the second half, because of the – remember we had that one off recovery in the first half.

Question: Yes, that's right, that's the reason it went up in the first half.

Peter Marriott: The normalising for that, if you look at the EVA for example, the EVA which will then normalise the credit cost is looking like it's going to be flat half on half.

Question: Right, but we've got no earnings growth from the first half to the second half, right?

Peter Marriott: Yes, that's at a profit before provisions level, that's correct.

Question: Therefore, the RORWA, on a normalised basis, is declining?

Peter Marriott: Save for what happens with these conduits which won't be necessarily in the average for very long, because they're coming on at the end of the period, there's not a lot of RORWA growth either.

Question: And given that expenses won't be able to grow very much because income isn't growing very much, what's the solution again?

John McFarlane: We're expecting income to grow. And in fact, you know, because we'll get asset growth. We do have a good pipeline of transactions. Our

issue is whether they close in September or close next year. And we are expecting – we're actually placing much more emphasis on reasonable margin asset growth than perhaps was done under the previous leadership.

Question: (Craig Williams, CitiGroup) Do you view the current squeeze in liquidity and movement in asset prices as perhaps providing potential for M&A or other investment opportunities for the group, given its strong liquidity and capital position in the short term?

John McFarlane: I doubt it in the short term, because the reality is that any acquisition that we want to make ideally should be accretive or only temporarily marginally diluted. And when you look at the things that we might acquire, they tend to be at a higher PE than we're getting at this point in time. But I do think what will happen is that marginal players, particularly those who are needing funding, will get shaken out of the market were this to continue. And therefore, if sustained the opportunity set can change. So I think this needs to work through the system for people to work out what's what. And then to see, once that works through, what opportunities are there. But I doubt that there are any substantive opportunities in the very short run with the relative PE issues.

I hope this has been an informative briefing. Less so from the standpoint of updating you on where we are with respect to this year, but perhaps a little bit more colour on what is happening on the global scene, and it's implications for Australia, which actually in some senses may be a little overdone.

What is certainly happening is that asset margins are on their way up, simply because we have scarcity of funding across the industry, and therefore there are positives and negatives associated with this. I'm very pleased that we took action over the past few years to run solid

capital levels, solid term debt levels and solid liquidity levels, because it's in preparation for times like this that you do that, and it's only rarely that they come along. So that puts us in a pretty good position.

Looking further back, I do hope that we've justified your support and I would thank you for your support to me over all these years. And I hope we've repaid that by transforming ANZ over that period, but also delivering a consistently good performance.

But we've also created a much more transparent organisation for shareholders and I think most people would agree that our disclosure is market leading and we try and help the industry with what's happening in the industry, not just with what's happening ANZ.

So in summary, although I've still got another month full time to go, and I'll still be running hard over that period, it has been a great ride. I have loved every minute of it, and it is my last formal communication with you, so I would take this opportunity to thank you and to wish ANZ every success going forward. And in fact, I genuinely believe that for ANZ the best is actually yet to come, rather than anything else.

So on that note let me say goodbye and thank you.

End of Transcript