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Introduction

Melanie Kirk: Hello and welcome to the Commonwealth Bank of Australia's Results Presentation for the half year ended 31 December 2022. I am Melanie Kirk and I am Head of Investor Relations. Thank you for joining us for this virtual results briefing. For this briefing, we will have a presentation from our CEO, Matt Comyn, with an overview of the business and an update of the results. Our CFO, Alan Docherty, will provide details of the financial results and then Matt will provide an outlook and summary. The presentations will be followed by the opportunity for analysts and investors to ask questions. I will now handover to Matt. Thank you, Matt.

CEO Presentation

Matt Comyn: Thanks Mel and good morning everyone. It is great to be with you today to present the Bank's Half Year Results. Before I get into the detail of the result, I want to spend a few moments on the disconnect that we have observed in the past six months between our headline measures today and some of the underlying conditions. The cost of living pain for many customers is very real, and yet the impact is not yet evident in our first half financial performance. We are very conscious that many of our customers are feeling significant strain from rising interest rates alongside the rising costs of electricity, groceries and other household items. This is becoming increasingly challenging for many households and an increasing source of worry, given that the cash rate is likely to rise further in the coming months.

If we assume that there are two further cash rate increases, Australian homeowners have had to date only experienced about half of the likely impact on monthly cash flows. We are proactively contacting every customer who is coming off a fixed rate mortgage this year, so we can discuss what kind of support and options we can offer them.

We can see some customers drawing down on savings and reducing spending to compensate, and yet we have not seen this translate into customers falling behind on repayments. While this has resulted in higher earnings in the period, it is driven by timing rather than the economic reality of higher rates. While there has been an improvement in margins as the cash rate increased from emergency levels, margins have not returned to pre-COVID levels. We saw margins peak in October on a month-on-month spot basis.

Funding costs have increased significantly, which has also coincided with escalating price-based offers across the home loan market in Australia and New Zealand. We believe home loan pricing across the industry is below the cost of capital. On the other hand, this has served to dampen the impact of rising rates on home loan customers.

Against this backdrop, we have been focused on serving our customers well and disciplined execution in this highly competitive environment. This half, we finished the period with peer leading net promoter scores and have delivered a strong financial result. Our continued balance sheet strength and capital position means we are well placed to support our customers and the broader Australian economy.

We are announcing today a dividend of $2.10, fully franked, and neutralised dividend reinvestment plan and an expansion of our on market share buy-back program by up to $1 billion.

Turning to our results, our statutory net profit was $5.2 billion. Cash net profit was also $5.2 billion, up 9% driven by strong net interest income, partly offset by higher operating costs and increased loan impairment expense. Our operating performance was $7.8 billion, up 18%. Our operating performance and strong capital position has allowed the Board to declare a first half dividend of $2.10, an increase of 35 cents on the prior corresponding period. Our operating income was up 12% for the half, driven by volume growth and a recovery in margins. Operating expenses are up 5% driven by wage and supplier inflation, and higher IT costs. Pre-provision profit was up 18%, reflecting the strong underlying performance. Loan impairment expenses normalising post large write-backs in the last financial year, while credit quality remains sound. The combination of 18% growth and operating performance and higher loan impairment expenses resulted in cash profit up 9% on the same period last year.

Our balance sheet remains strong heading into a lower growth environment, and we hold substantially higher capital levels. The balance sheet is 75% deposit funded. Weighted average maturity of our long-term funding is 5.8 years and liquid assets are at $193 billion. Our common equity tier one capital ratio is 11.4. We have implemented APRA's changes to the Prudential Capital Framework, which were effective from the 1 January 2023 and have a pro-forma capital ratio of 12.1%.

The overall credit environment remained very benign in the period. However, we are watching closely for early signs of stress, particularly among higher risk cohorts.

Troublesome and impaired assets decreased modestly to $6.3 billion from $6.4 billion in the half. Home loan arrears are at near record lows at 43 basis points, although leading indicators suggest that arrears will start to trend upwards from here. Given the uncertain outlook, we remain well provisioned and capitalised for a range of economic scenarios. We hold total provisions of $5.5 billion, which is approximately $2 billion above our central economic scenario.

Our core business continues to perform well through disciplined execution. The strength of the franchise starts with our strong customer relationships. We are fortunate to serve nine million customers and over one million businesses, and to have the leading proprietary physical and digital distribution channels. Through our CommBank app we have nearly nine million touchpoints with customers each day, and by delivering a superior customer experience through our digital channels, we are able to develop deeper relationships to better understand and serve our customers' needs. We continue to invest in our Customer Engagement Engine, which is now making 53 million decisions in real time each day to deliver superior customer experiences.

We have also built a number of proprietary assets over time to better manage and assess risk using transactional data representing approximately 40% of payment flows in Australia. These assets allow us to deliver superior customer experiences at scale, driving customer advocacy and NPS, which are increasingly important in a digital era.

We finished the half with peer leading net promoter scores in all of our key segments; consumer, business banking and institutional. We led the market on net promoter scores for 11 of the last 12 months in our business bank. But despite being number one, we still have a lot of work to do to improve our absolute scores, and this will continue to be a significant focus for us in the years ahead.

Our NPS is critical to building customer relationships. 35% of Australians consider the Commonwealth Bank to be their main financial institution, which is more than double our nearest peer. In business, one in four businesses consider the Commonwealth Bank their main financial institution, an increase of one and a half percentage points in the last 12 months and 21% more than our nearest peer.

Transaction account relationships have again grown strongly in this period. We opened 716,000 new retail transaction accounts in the half, an increase of 50% and now have nearly 1.1 million business transaction accounts, which is up 9% year on year. Having a

transaction banking relationship allows us to better understand customer needs and risk, and underpins continued growth in both home and business lending. More than 95% of our home loan customers and approximately 90% of business lending customers hold a transaction account with us.

As you know, we made a strategic choice to increase our investment in business banking. Cumulatively, over the past three years, we have directed an incremental $600 million of investment into our Business Bank, resulting in strong customer and earnings growth. Since December 2018, we have delivered market-leading MFI share growth of 170 basis points. And over that same period, deposit market share has grown 270 basis points to 22.4%. We hold $68 billion more business banking deposit balances than we did in June 2020, which is a 43% increase. This growth in primary customer relationships has meant transaction banking now contributes 47% of the Business Bank's revenue, up from 34% two years ago.

And the Business Bank has moved from a net asset position of $38 billion in June 2019 to being fully deposit funded today. We have continued to grow volumes above system in the past 12 months, with deposit balances growing $8 billion at one and a half times system and lending balances growing $16 billion at one point three times system.

This deepening of primary customer relationships and prudent lending has resulted in strong earnings performance. Return on target equity has increased by a third over the past three years, and the Business Bank now contributes 38% of Group profit, after tax.

Our Business Bank now leads the market on NPS, MFI share and MFI growth, deposit share and deposits growth and merchants market share. Despite higher growth, we remain second in market on business lending. We have remained cautious given the economic uncertainty and continue to focus on opportunities to further grow our business by leveraging our transaction banking advantage.

A big focus for our investment in Business Banking has been payments and merchant acquiring, which underpin the relationship we have with our business customers. We have launched a range of new smart terminals and have more than 50,000 devices now in market, 30% of those to new merchant customers. These new devices allow us to build differentiated propositions by industry verticals, and we have been particularly focused on health care and hospitality.

In health care, we enable digital claiming of rebates via full integrations into Medicare, the NDIS and various health insurers and access to digital receipts. This has helped us to win new health care clients, including the NDIS, and it has supported strong lending growth of 21% in the health care sector.

For businesses accepting online payments, late last year we launched a new e-commerce proposition called Powerboard, which helps businesses get online and with a few clicks, offers a broad range of payment services to their customers without the need for costly technical integrations.

The home lending market is undergoing a period of extreme change and intense competition. There are a number of contributing factors, including aggressive volume growth, the cyclical slowing in new lending growth, the pending surge in fixed rate maturities and high levels of refinancing. This has occurred at a time where wholesale funding costs have increased substantially. Cashbacks are growing in size and prevalence, and we estimate that banks have deferred costs relating to cashbacks of over $1 billion. This figure has increased almost 50% in the past two years, and combined with a substantial increase in commissions over the same period, creates a margin headwind that will flow unevenly across the market.
The operational performance of our Home Buying Business remains strong, and we are regularly reviewing how we compete, given the atypical market conditions. We have a number of unique assets, including the largest home lending frontline team, a direct-to-consumer digital proposition, Unloan, and a distinct proposition through Bankwest. We also now account for approximately 37% of all proprietary originated loans in Australia. We decision more than four in five home loan applications within a day and 64% of proprietary applications are auto-decisioned in less than 10 minutes.

We are very focused on proactively engaging with our customers as the surge of fixed rate rollovers occurs across the industry over the coming 12 months. Unloan, the digital direct home loan we launched mid-last year, is becoming an increasingly important channel and is already funded over $1.5 billion of loans.

We are able to pass on the lowest servicing and distribution costs from a direct-to-consumer model, through a competitive rate that rewards customer loyalty and does not rely on cashbacks, honeymoon rates or fees, and through Home-In, our digital e-

conveyancing service, we have now settled over $3 billion in home loans, with 98% of these customers taking up a CBA home loan.

To navigate the current economic and competitive environment, we will continue our focus on strong, disciplined operational execution across all channels- proprietary, digital and broker.

Digital remains central to our strategy. We continue to grow digital engagement and now have over 8.3 million digitally active customers, nearly a million more than two years ago. The Net Promoter Score for our mobile banking app sits at a peer-leading 28.5, and the digital Net Promoter Score in our business segment also sits at a peer-leading 11.4. Through digital, we see increasing returns to scale in terms of building deeper, more trusted customer relationships, better understanding customer needs and risks, and delivering a superior customer experience.

Strong digital assets and engagement allow us to help customers in a range of ways. One area we have been extremely focused on is fraud and scams, given the growing prevalence in the market. Customer losses to scams were estimated by the ACCC at over $2 billion in 2021, and our data suggests they have been more than doubling each year since. We have a range of services and security features in place to help protect our customers. We have been investing in technology to keep our customers safe, including real-time monitoring, fraud prevention technology and secure banking.

We are also doing all we can to raise awareness and educate customers about the actions they can take to stay safe online. We have contacted more than 9 million customers about uplifting their banking security. The security check up in the CommBank app also walks customers through key steps to keep accounts and cards secure, from activating location-based security and setting up alerts. And we also recently introduced two unique features, CallerCheck and NameCheck.

CallerCheck is a new app feature that allows customers to verify whether a caller claiming to be from the Commonwealth Bank is actually legitimate. NameCheck helps customers ensure that the account they are paying to belongs to the person they are trying to pay. We have dedicated teams working around the clock to look out for unusual activity across our customers' accounts, and we are reaching out promptly if we detect anything suspicious.

We also know that many of our customers are concerned about the cost of living pressures and rising interest rates. We have increased deposit rates nine times in the past nine months, and are helping customers better manage their finances through budgeting and spending tools in our CommBank app. Customers have now accessed more than $1 billion in benefits and entitlements through our Benefits finder feature, which will help with the rising costs of living.

We are here to help our customers and encourage anyone who has questions or concerns about their financial situation to get in touch with us. And with that, I will hand over to Alan to talk to the result in more detail.

CFO Presentation

Alan Docherty: Thank you Matt, and good morning to everyone who has dialled in. I will unpack the financial results to 31 December in a little more detail, and I will also cover the changes to our regulatory capital which arose from our prudential framework provisions, which became effective on the 1st of January this year.

In summary, these financial results were driven by a combination of macroeconomic variables, management actions and franchise strengths, and we are well positioned to support our customers and the broader economy as financial conditions continue to tighten during the 2023 calendar year.

Looking firstly at the macro context; interest rates have increased very quickly to their highest level in more than a decade, while unemployment is at a 50-year low. The full effects of the rapid tightening of interest rates are still to emerge, but we fully expect to see a moderation in discretionary consumer spending in the months ahead. Those macro factors have manifested in a rapid recovery in our net interest margins, continued historical lows and arrears rates due to full employment, but also increased loan loss provisioning as we take a forward looking view of that coming slowdown in consumer spending.

Turning now to the results of management actions; our continued focus on customer outcomes is manifesting in our leading customer advocacy scores. Our focus on consistent, high quality operational execution has contributed to the significant growth and pre-provision profits. And as a management team, we are responding to the tighter financial

conditions with a deliberate conservatism and our funding risk settings together with careful calibration of credit risk settings.

Finally, looking at how the structure of a franchise is evolving, we have seen another period of improvement in both Retail and Business main financial institution share, as well as continued growth and customer deposit balances. This has driven strong organic capital generation in the period, which enables us to continue to support our customers' lending needs, as well as continue to reduce our share count and sustainably increase the dividends paid to our shareholders.

Now onto the detail. Statutory profits from continuing operations were $5.2 billion. Non-cash items within continuing operations were relatively small, with continuing cash profits also rounding to $5.2 billion. That cash profit represents 8.6% growth on the same period last year. That was the result of operating income growth of 12%, operating expense growth of 5%, pre-provision profits increasing 18%, and loan impairment expense returning somewhat closer to long run averages during the half.

Looking firstly at operating income. Net interest income increased by $1.9 billion on the prior comparative half. A combination of strong volume growth in all businesses, and on both sides of the balance sheet, and also the recovery in net interest margins.

Other operating income decreased by $400 million over the same period. This was largely due to the revenue foregone from divested businesses, and low associate earnings. Excluding those items, we continue to see strong underlying volume driven growth in deposit foreign exchange and business lending fee revenues.

Turning now to net interest margins. Over the most recent six month period, margins increased by 23 basis points, with the benefit of rising rates on deposits, the replicating portfolio, and the equity hedges partly offset by lower lending margins.

Taking a slightly longer view of margins in the box at the bottom right, margins have recovered back to around the same level we had seen in 2020, before the full impact was felt of the historical lows in interest rates during the COVID response. Margins do, however, remain lower than they were four or five years ago, despite the overnight cash rate sitting at a decade high. And you can see the monthly spot margins peaked around October, before stabilising in the December quarter. This was due to the increased intensity of home loan and deposit price competition offsetting the benefit of rising rates.

As we look ahead to the second half, the same factors that I have called out previously 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. Against that, the trajectory of domestic interest rates will determine the strength of the remaining margin tailwind from deposits, the replicating portfolio and our equity hedge.

Turning now to operating expenses. They increased by 5.2% on the prior comparative period. Excluding the slight increase in remediation costs, underlying costs were up 4.4%, due to inflationary increases in wages and supplier input costs. Growth and other costs were offset by our ongoing business simplification initiatives. And our cost to income ratio improved by three percentage points to 42.5%.

Turning to our balance sheet settings, and looking firstly at credit risk. Loan impairment expenses were $511 million in the half, as we see loss rates begin to increase off an extremely low base. Leading indicators of credit risk remained benign, with the 90-day arrears rates within our consumer portfolios below where they were a year ago, and corporate troublesome balances remaining at historic lows.

As you would appreciate, we are looking closely at very early stage arrears of even one day or more, across both our consumer and corporate portfolios. These have increased in the last few months, though off a very low base, and they remain well below long run averages. We are watching those measures closely, and do expect arrears to increase in the coming months.

Given the expected tightening of conditions in the year ahead, we have decided to top up both our consumer and corporate credit provisions. Total provisions were increased by $200 million to $5.5 billion. This provides us with a $2 billion buffer to our central scenario of a relatively soft landing for the Australian economy, and gives us approximately 80% coverage of the potential $6.9 billion loss modelled under a stagflation rate downside scenario.

Our balance sheet settings remain peer leading, with our deposit funding ratio increasing again, now at 75%. Long-term funding settings also remain conservative. Given we are forecasting much tighter financial conditions over the next couple of years, we have again reduced short term wholesale funding to a historical low proportion of total funding of 7%. This form of funding used to represent 26% of our liability stack.

This conservatism costs money. We could increase our net interest margins by shortening our funding mix closer to industry peers, but we feel keeping extra capacity in this part of the funding stack remains the prudent course, given the current macro environment.

On capital, we have delivered a Common Equity Tier 1 Ratio at 31 December of 11.4%. This is 10 basis points lower over the half, largely due to the progress we made on the on-market share buy-back in the last six months. Our pro forma CET1 capital from 1 January 2023 under the new APRA capital framework, was 12.1%, an increase of 70 basis points, and well above the new prudential minimum of 10.25%.

Today, we also announced a $1 billion upsize to our on-market share buy-back, and the completion of that buy-back in the period to 30 June would see an expected change in capital of 25 basis points.

I thought it would be helpful to provide some more detail on how the new prudential requirements manifested in our new capital ratio of 12.1%. As we had previously indicated, the aggregate effect of the prudential changes are to increase the reported capital ratio as a result of a lowering of risk weighted assets. As you can see on the bottom right of this chart, when you take into account our higher capital target of 11%, the overall capital requirement remains broadly the same. Asset classes that have seen a reduction in their risk weighting included owner-occupied home loans, and commercial property exposures.

Importantly, we can now take account of greater risk discrimination in these portfolios, and more fully recognise the benefit of high quality collateral held against these exposures. On the other hand, risk weightings increased for investor home loans, as these exposures are generally more highly geared.

New Zealand risk weightings increased, in alignment with the new RBNZ requirements, and operational risk capital increased under a simplified and standardised calculation, which is now proportional to the level of banking income. All other risk weighted assets remained largely unchanged.

The first half dividend of $2.10 represents a 20% increase on the prior comparative dividend, and a normalised interim dividend payout ratio of around 70%, in line with our longstanding dividend policy. Given our very strong capital position, the Board have also decided to again neutralise the DRP in respect of the interim dividend.

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

CEO Outlook and closing summary

Matt Comyn: Thanks, Alan. The Australian economy continues to respond to the higher cash rate, which has increased 325 basis points over the past nine months, to levels we have not seen since late 2012. The starting point for the Australian economy is strong, as the impact of these changes continue to flow through. Unemployment remains near 50-year lows. Underemployment is low, and the participation rate is near record highs. Energy and commodity prices have supported strong export volumes in terms of trade, non-mining investment remains strong, and migration has recovered.

However, there is a disconnect between headline measures and the challenging conditions for many households and businesses. In the past year, gas prices are up 17%, fuel prices are up 13%, and grocery prices are up 11%. And these impacts are even more acutely felt by mortgage holders, given increases in the cash rate.

We have seen the household savings ratio fall to 7% from a COVID peak of over 23%, and house prices have fallen 9% from their peak in April last year. We can see savings buffers being drawn down, particularly for customers at higher risk from rising cash rates. And there is more impact to come, given the changes in the cash rate take time to work through the economy, and the market expects at least two further rate rises.

A customer with a $500,000.00 loan for 30 years on a variable rate has already seen repayments increase by $700.00, with another $400.00 likely to come in the next six months. Given this and the fact that 40% of home loan customers were on fixed rates, roughly half of the total expected impact has been felt by homeowners so far, rising to 75% by July.

In 2023, we expect GDP growth to slow, driven by a pullback in consumer spending. A significant slowdown is expected in many key global economies this year, and the outlook appears particularly challenging in the UK and European Union.

Australia is well positioned, but the effects of a slower growth environment will be unevenly felt. However we will be ready to support our customers feeling the strain. It is a challenging situation for policy makers and many of our customers, but we remain

optimistic that a soft landing for the Australian economy can be achieved, and we remain of the firm view that the medium-term outlook remains positive.

In summary, we have delivered a strong result with customer relationships and engagement translating through to volume growth. This has been underpinned by consistent, multi-year, disciplined execution. Our balance sheet and capital position remain strong. And looking ahead, we will continue to invest in the Bank's core retail business and institutional banking franchises to further differentiate our proposition and extend our digital leadership.
While we are facing a period of economic uncertainty, we are optimistic about the medium-to-long-term opportunities for Australia. The strength of our balance sheet means we remain well positioned to continue supporting our customers and the broader Australian economy while delivering consistent and sustainable returns to our shareholders. I will now hand back to Mel to go through the questions.

Q&A

Melanie Kirk: Thank you, Matt, for this briefing, we will be having questions from analysts and investors. I will say your name, but please state your organisation that you represent. Please also limit your questions to no more than two questions to allow others the opportunity to ask questions. We will now start with the first question from Andrew Lyons.

Andrew Lyons: (Analyst, Goldman Sachs) Thanks, Mel. Good morning, Andrew Lyons from Goldman Sachs. Matt, just a question: you noted your view that industry wide mortgages are being written well below cost of capital, and yet despite this, I note that you still grew mortgages in Australia about in line with system over the half. So just in light of this, could you just provide some more detail as to the extent to which your strength in proprietary lending improves the relative return metrics and how your mortgage strategy might evolve if current pricing does remain. I've then got a second question.

Matt Comyn: Yes, sure, and good morning Andrew. Look, I think you are right. We are slightly above system in the six months, but down over a 12-month basis. I guess, as I set out in the comments, we are finding it certainly an atypical environment and one that we are managing very closely. I think in particular, as we have seen rising funding costs and clearly there is a range of factors contributing to this, we have been surprised that we

have not seen some changes in terms of the pricing and offers that are available in market. I think there is probably some downside risk to margins there as well. We have typically seen a higher level of basis risk or bills overnight cash spread. And so I think it is for us a period where we will be, continuing to manage all of our settings very closely on both sides of the balance sheet. And I think that is incredibly important and necessary. Of course, we are going to continue to try and play to our strengths, we certainly feel like we have, relative advantages, not just in our customer franchise, but of course in our technology and the relationship that we have with customers.

The broker channel is, of course, a very important channel, but we have the strongest proprietary channel and mix. We have seen that grow from probably a third of proprietary mortgage originations a couple of years ago to now be 37%. We have seen strong growth in Unloan, but look, we are participating in that market and clearly, you know, we are also seeing the impacts of that flow through. And, no doubt you and others will have some questions around margins and where they stabilised in October and the outlook. And of course, there is uncertainty around that, but something that we are very focused on.

Andrew Lyons: (Analyst, Goldman Sachs) Thanks, appreciate it, and then just a second question, you did note that the first half 23 reported results, you did not particularly reflect the environment we are in and there was some timing there. That said, 42.5% cost to income ratio is the lowest you have delivered in a number of halves I just guess given the various moving parts around inflation and expenses and rates and margins, I'd be just keen to get your views or your comments on the extent to which you think CBA can sustainably deliver a low to mid 40s cost to income ratio.

Matt Comyn: Yeah, no thanks Andrew and of course, to try to indicate that I mean, net interest margins, as you know very well across the industry, have been under real pressure for many years and particularly during the sort of emergency cash rate settings, you see a recovery in those margins, you know, particularly in that six-month period. There are, as we have just discussed, a range of different factors. Of course, that is the predominance of what is driving the relative change in the cost-to-income ratio, which is a metric that we look at, but certainly not the only metric.

I think as we have said in the past, we will continue to look very closely clearly at any operating and investments that we are making. As you would have seen, we have been prepared to increase our investment both in areas like business banking and technology

more broadly. Of course, we want to be and need to be satisfied that we are earning an appropriate return on those investments. Certainly, in the context, as we talked about earlier in business banking, that has been a very beneficial strategic investment. But we are going to continue to sort of manage that, our cost base very carefully and something, of course, as we look forward into multi-years of what we think the income environment of where will be and potentially, some of the structural changes in the competitive landscape. We also want to make sure that we have got the right flexibility in our cost base and we are making investments to make some structural reductions to that cost base, predominantly through improving processes.

Andrew Lyons: (Analyst, Goldman Sachs) Thanks so much.

Melanie Kirk: Thank you, Andrew. The next question comes from John Storey.

John Storey: (Analyst, UBS) Thanks very much. It is John Storey from UBS. Matt, I just wanted to ask you about net interest margins. I think slide 23 that you put up was pretty interesting. It looks like margins have peaked, as you mentioned in October. One of the things that certainly surprised me is the rate at which your funding costs have increased and it doesn't bode that well, I guess, for other banks that are more wholesale funded in the market. You've had a 100 basis point increase in your cost of interest bearing deposits in the six month period. So just wanted to get a sense around the delta and whether or not you actually see a slowdown, you mentioned some timing differences. I think you've got an interesting slide just showing what's happened with term deposit funding mixes. So the question is, do you see a slowdown in the rate of increase in terms of funding costs? That's my first question.

Matt Comyn: Yeah, no problem, John. Look let me start and I will throw to Alan who no doubt can add some more specifics. I mean, yeah, we have touched on and clearly an increase in wholesale funding costs on a relative basis, as you indicated. We have got more capacity and resilience, which is really important from our perspective, not just from capital provisioning, but also in our funding stack. And so we feel that we are better able to absorb those the relative changes, certainly versus peers. And, you know, Alan and I are very focused on managing for sort of flexibility and resilience, which enables us to probably time the market in some cases. We certainly had a strong last six months of issuance. We have had a strong start to the year in issuance, including the largest ever

domestic bond issuance, and in terms of our weighted average cost, I think it looks very favourable versus peers.

Alan Docherty: On wholesale funding, as you know, John, I mean, banks, not just domestically, but all around the world and are increasingly tap in wholesale funding markets. And you have seen a big rebound in wholesale funding costs, and that is likely to be sustained. Basis risk has not normalised back to levels that we have seen over the long term. You have got to expect that that is a matter of time before you see a normalisation and basis risk, so you are not seeing that feeding through yet.

And on the deposit part of the liability stat, you will see an increased deposit competition. And you know, we have engaged very markedly in that regard. You have seen a very attractive deposit, term deposit and savings rate offers made, particularly in that back quarter and that manifested through in terms of that net interest margin on a spot basis in the back calendar quarter of December. And again, switching and deposit competition is going to be an ongoing feature in calendar 2023.

John Storey: (Analyst, UBS) That's great, and then just a second question is around the Business Bank. I mean, obviously a phenomenal result that was delivered there, as you mentioned, 40% of group earnings now coming from the business banking division. Just to the question on this is more around asset quality. I mean, you are seeing early signs of stress in the book around unsecured and retail, but then you also saw a significant increase in the charge in business banking. So I just wanted to get a sense the 23 basis points in business banking, what is happening with business banking clients? Do you see, you know, further stresses emerging here. The charge looks like it's a lot higher than a through the cycle level already and is this where you expect higher impairment charges to manifest themselves?

Matt Comyn: Yes, I mean, look, firstly, the credit environment remains very benign across sort of Retail and Businesses and both in terms of what we can see directly in the book and also anecdotally talking with customers across a range of different industries, very strong trading conditions in the six months to December. Of course, there will always be some smaller individual names within those subsectors, and we are thinking much more about the future period. We have been very focused on making sure that we are, from a credit origination perspective, pricing our forward curves, adding more contingency in around sort of our costs in areas like commercial property, making sure we are thinking

through sort of contingency and delays which have come in. At this point we are not per se concerned around the credit quality of the broader outlook.

We probably, on the balance of our total provisions, would think there would be more stress in the non-retail. I think just the impact on household consumption over the course of the year will inevitably flow through into the non-retail book, particularly in some of those discretionary retail sectors. But if you look at origination, both from a probability default, also just security positions where LVRs have been for some time, I think we feel very comfortable in terms of total provisioning.

Alan Docherty: Yes, I mean, what you are seeing in terms of the loan loss rate with corporate starting basis points overall for the half. But the loan loss expense in the half, very much, has taken a forward looking view and bringing those factors back in through some of the downside scenarios that we can model out, we have seen very little in terms of the flow, in the Business Bank, in terms of the clients and bad debts. We keep a very close eye on very early stage arrears. There was a little increase in corporate early stage arrears, but they have all cured since the end of the year. So we are not seeing that flow through yet, but we do expect things to tighten and those arrears rates to increase both in consumer and corporate in the year ahead. But the abundance of caution on the top up to the provisioning on the Business Bank in this period.

John Storey: (Analyst, UBS) Thanks, very much Matt. Thanks Alan.

Melanie Kirk: Thank you John. Our next question comes from Jonathan Mott.

Jon Mott: (Analyst, Barrenjoey) Hi, Jon Mott here from Barrenjoey. I’ve got a question that kind of follows on from Andrew Lyon’s earlier question, where you have seen in that slide 23, the competition is very intense and it drove the fall in the NIM in the last couple of months in the year. And you have also said Matt, and you have reiterated the statement, that mortgages are being written below the cost capital.

If we take a step back and we also look at the APRA stats, what it shows is that you’ve re-engaged in the housing market over the last couple of months. In the last couple of months they have actually been winning shares, growing above system in November-December period, which would suggest that you're the one that's driving a lot of this competition. Is that a fair assessment? And why don't you just step back out of the market at this stage and only focus on high quality customers where you already have a relationship with?

Matt Comyn: Yes, I mean, Jon, I'd say, not a fair assessment. But a couple of factors that are certainly worth sort of picking up on. As you have seen in the past and as you know, we have certainly been prepared to step in and out of the market. We probably, if you go back to sort of mid-year, we looked at some of the share loss that we had there. We were trying to stabilise and also we want to engage closely with our customers. It is predominantly around retention, but there are also, of course, high levels of refinancing activity. We are very confident we are not driving. In fact, we feel we are substantially in some areas, lagging others, particularly in areas like cash back. It is a market that is hard to get the precision around the settings about exactly where we like. I mean, when we are above system, we are talking sort of a couple of basis points.

And then I think on both sides of the balance sheet as we have looked at both, what has happened in liabilities, how that market is evolving, some of the benefits that we had through the COVID period, we are just trying to get those overall settings right. I mean, obviously, I have to be very conscious about not turning my mind to future actions that we might be taking, but it is fair to say that we are watching the dynamics very carefully and certainly prepared to make the necessary adjustments. But confident that we are not driving the pricing at all, but we are participating in a market which is atypical to the one that we have seen over just about every period I can think of in the last 20 years.

Jon Mott: (Analyst, Barrenjoey) Okay, and just following, a follow-on question, sorry, Alan? Sorry, I thought I heard something. Another question, if you put on slide 63, which just shows a change in the mix of deposits that we've seen coming through, and it shows quite over a period of time from basically pre-pandemic to today, material change in the deposit mix, and it looks like a worm's turned, if you want to call it that, especially in Retail and to some extent the Business Banking as well, do you expect that to normalise all the way back to where it was back in December 2019? How much of a headwind is this mix of deposits likely to be on your margin and your funding costs over the next two or three years?

Matt Comyn: I mean, look hard to say exactly how much. It is certainly something that Alan would be happy to talk to. We have watched that very closely and are still very confident about the earlier guidance that we have given about rate increases. I would say it has been relatively modest, the compositional shift in Retail, as you said, there has been a big growth in transaction balances. That also makes sense, we would put it down to, we probably gained about 80 points of share during the two years of COVID, just given the

customer base and the government payments that went through. Some of that starts to unwind, we get into a high spend environment. We have got a high proportion of spend across debit and credit, so there are some smaller factors that play through. But I mean, you are quite right, we are looking at sort of the liability stack across the different products and thinking through different scenarios, both in Retail and in Business.

And I mean, broadly, we would certainly expect – you will see that composition shift most into TDs but it has not been too significant, or certainly not beyond our expectations in Retail and Business is a little lumpy. We saw a bit more in Q1, which we think is mostly seasonal, about almost 70% of the shift in Q1 versus the second quarter. So, I mean, it is certainly something that we are watching closely.

Alan Docherty: Yes, I mean, I do not think there was anything unexpected about those trends given the macro backdrop and the very attractive yields on offer. I would say, going back to Dec 2019, I think there would be a couple of things you would have to adjust relative to that time period. One is just the broad increases, and broad money supply over that period. And so in an absolute sense, there is obviously more dollars and money supply in the system and money supply, unlike in other parts of the world, is continuing to grow in Australia, and so that will provide some support around all of the deposit categories.

And also, we have had a big change in terms of the franchise build in both the Retail and Business Bank over that time period. We have been growing MFI share in both Retail and Business Bank. And so again, I think that provides support to some of those transaction deposit categories in particular. So, it has not been unexpected what we have seen to date, but obviously we will keep a close eye on it and we have called it out as one of the considerations around the second half margin.

Melanie Kirk: Thank you, Jon. The next question comes from Richard Wiles.

Richard Wiles: (Analyst, Morgan Stanley) Good morning, everyone. Alan, I've got a couple of questions for you. The first one relates to deposits and also to slide 63. It shows you've got $250 billion of at call interest bearing deposits. Given the focus from the Treasurer on deposit rates at the moment, I thought it was interesting to ask about the difference between Goal Saver and Netbank Saver. Goal Saver, you’re now offering 4%, Netbank Saver, it’s more like 1.6%, the standard rate.

So what proportion of those $250 billion of at call deposits are in each of those two products? How much are in Netbank and how much are in Goal Saver?

Alan Docherty: Well we have not provided that level of granularity in the disclosures, Richard, so we have got significant balances in both those products, and we have got very strong rate also available on Netbank Saver at the moment. We do not, as you know, provide product by product level balance statistics across either side of the balance sheet.

Matt Comyn: Yes, I guess what I would add, Richard, is across a range of different products, I mean, Netbank Saver, yes, there is an introductory rate of 4%, Goal Saver, which is a very popular product, without wanting to split out what the balance composition, that is running at, for Award Saver is, been running a 12 month TD. So there is some very competitive rates in market, as you would expect.

I think the other thing on that category of questioning, often we get asked about the relative speed we are putting up rates and products. I mean, we have been very careful to make sure that we are broadly within the 10 and 15 day range. We are putting out both, our rates on both sides of the balance sheet, and that is broadly in line with what we were doing as rates were coming down.

Richard Wiles: (Analyst, Morgan Stanley) Okay, and if I could ask a second question. A year ago, Alan, you included a slide that said a 25 basis point rate hike would boost margins by around four basis points over time. Given that rates have moved a lot higher, I imagine that sensitivity has changed, so could you provide us an update on your sensitivity to higher rates, and can you also talk about how you expect the replicating portfolio to support margins in the period ahead?

Alan Docherty: Yes. Thanks, Richard. So yes, the sensitivity that was particular to low rate deposits net of replicating portfolio was an over time sensitivity. So we need to, the replicating, the yield on the replicating will change tractor over that five year period. So we have not changed that sensitivity or provided any updated guidance on that, so that sensitivity still holds over the longer term. We will see in the fullness of time, whether it is borne out.

You would expect obviously the rate of switching to change over that period. And so you are going to see a different sensitivity early in the rate cycle, versus the middle and the end of the rate cycle, and over the next couple of years. So we keep an eye on that. We

have not updated that outlook. I think that the sensitivity I would say still holds over the longer term.

On the replicating portfolio and on the duration of equity, we have provided our usual disclosures and updated them around the average tractor rates there. And so obviously you are seeing that in the margins in the first half, and you continue to see that come through in the second half margin considerations, that we are putting on new replicating tractors at the five year marginal swap rate, the new equity tractors at the marginal three year swap rate, and they are higher than the average tractor rate that you have seen. So you will see continued support for margins through the operation of those hedge balances. So I think you will see that, that will be a continuing theme for the year ahead.

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

Brian Johnson: (Analyst, Jefferies) Good morning, everyone, and it is nice to hear a bank talk about balance sheet strength. That said, if we have a look at page 87 of the profit release, and I was calling this out, I think, at the last result as well, is when you have a look at your central scenario, we have got the cash rate finishing the year at 3.6%, house prices falling a further 10. Given that we started this cycle with the cash rate at 75, it is already 335, that terminal rate looks very low relative to what the market is saying, and the house price decline. Can we just get a feeling on the veracity of that central case provisioning? So it's page 87 of the result.

Alan Docherty: Yes, thanks. Thanks, Brian. That terminal rate was effectively the consensus rate when we struck the result during the early days in January. So that was obviously the consensus terminal rates moved significantly since then, given the hawkish comments coming out of the RBA's recent meeting. And so that terminal rate has moved a little higher.

In terms of the overall impact, though, on the central ECL, as you know, the central ECL, we have got relatively moderate weighting on that central ECL. We have got very high weighting on the downside scenario, which is a much higher terminal rate than current expectations. We have moved some other assumptions around on that central ECL, including further house price reductions relative to the reductions that we have already seen at the December spot, and the unemployment rate has also changed since the previous central ECL. So there are a few moving parts in there.

Changing that terminal rate to current consensus terminal rate would not have a material impact on the 3.5 billion ECL that we calculate, particularly as we have got such strong collateral coverage on many parts of the portfolio, both consumer and corporate. But yes, that terminal rate assumption is a little dated, given the events of the last couple of weeks.

Brian Johnson: (Analyst, Jefferies) Okay. Just a second one, if I may, for Matt. Matt, you have been asked a lot about housing. I would make the observation that given ANZ have disclosed they have got $1.3 billion of capitalised upfront commissions. Perhaps those numbers, the billion dollars perhaps looks a little bit light. But that said, when we have a look at CommBank's household deposit market share, and I just want to read through sequential months. So I mean, August 2022 it declined 12; the next month it declined nine; the next month it declined nine; the next month it declined nine; and in December it declined another 11.

When we have a look at the market at the moment, you can see that CommBank used to have outsized profitability on housing lending. Clearly, the incremental loans at the moment are being written, you are saying, below the cost of capital, which is really a function of the fact that you are stepping back into the market, I'd sense. But if we have a look at this household deposit market share that you have lost, when do you have to come in and really step into the market to basically defend the franchise in the household deposit share?

Matt Comyn: Yes, no, thanks BJ. I think the 1.3 that you are referring to in ANZ, I have not looked at the number myself, but I would guess that probably includes both capitalised broker commissions as well as capitalised expenditure around cashbacks. We have certainly tried to total the cashbacks across the industry and looked at the NIM headwind for us, and also for peers.

Then on household deposits, yes, you are right. I would say if we looked at that period, we have been very focused on then trying to stabilise share in the last couple of months. As we have looked at some of the underlying reasons, and I touched on it earlier in terms of we got some of the benefits in COVID in terms of Government expenditure in the way that was unevenly felt across our customer base and the scale. There are a few of those elements that are unwinding, which are providing a headwind.

We have certainly, for a variety of reasons, including wanting to make sure that we are supporting our customers, we have stepped more into some of the sharper deposit pricing

across a range of products more recently. And so again, as I touched on earlier, it is very much for us about both sides of the balance sheet. We feel that we have got fairly unique competitive strengths on the deposit gathering side, and a combination of technology and digital offering. But as you know well, there are some very competitive offerings in market. And so perhaps the competitive intensity changes to that side of the balance sheet.

It has been, obviously a number of things have changed in the last six months, and it is not uncommon across many industries for it perhaps to be different lags and changes in terms of relative competitive intensity in different parts of the market. And so it remains to be seen. But I mean, your broader assumption is quite right in terms of the way we are looking at it, and the relative importance for us.

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

Brendan Sproules: (Analyst, Citi) Hi, it's Brendan Sproules from Citi. I've just got a couple of questions on particularly your NIM slide around the lending margins, but outside housing. So my first question is on the institutional and banking institutional division, where you had the falling assets and quite sharp falling NIMs. I was wondering if you make some comments as to some of the business drivers there?

And then my second question is in the retail division, where you saw your consumer finance NII fall something like 15% on flat balances, and maybe you could describe some of the NIM pressures that you are seeing there.

Alan Docherty: Yes. So yes, in the Institutional Bank we have seen a decline in margins through the sequential period. Some of that relates to classification differences between the interest income and other banking income, so you will see a little bit of a pick-up in other banking income driven by the operation of a fixed income and commodities portfolio. So it was a tougher period for them in net interest income, but they picked up a little more in other banking income. And it is really just the higher funding costs manifesting through that commodities portfolio that is the real driver of the IB&M and the interest margin headwind in this period.

On the Retail portfolio, on consumer finance in particular, credit card rates do not change through the cash rate cycle as much as many other products. And so you are seeing the effect of effectively stable yields on credit cards and personal lending products, in a period

where the cash rate is increasing, and obviously the funding costs are increasing. So there is a little bit of that pressure manifesting through that asset pricing part of the waterfall on consumer finance.
Revolve rates also reduced again in the period, so there is a contributing effect from lower revolve rates in the consumer finance portfolio in that six month period as well, Brendan.

Matt Comyn: Yes, and revolve is just an example, that would be down, Brendan, 20 percentage points over the last several years, which is, of course, a bit of a function of the broader economic backdrop. So that is the percentage of people with interest bearing balances, but it is the contribution of both that and predominantly, they are not a pass through from the changes in the cash rate.

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

Andrew Triggs: (Analyst, J.P Morgan) Thanks Mel, morning Matt and Alan. First question please, just around the deposit book, obviously re prices, reasonably slowly in term deposits in terms of the averaging onto the net interest margin but quickly in savings deposits, and that does make it somewhat difficult to model. How long do you think it will take this increased deposit beta that we are seeing generally to play through the margin? Is it a few quarters that it takes to largely wash its way through? Or is it more protracted than that, do you think?

Alan Docherty: I mean, we have already seen a lot of change in pricing, particularly, accelerated, I think, increasingly over the last six month period ending the December quarter and you are continuing to see, I think, strong competition for both transaction at call savings and term deposit pricing.

So, you started to see that feed through, that will continue for the next few quarters. I mean, we obviously provide disclosures at that level and the average balance sheet as well. So you can start to see how those yield moves are feeding through. We have tried to give you a view of deposits, domestic, retail and business deposits on slide 63 that has been referenced earlier. So, that will continue to flow through, I think, over the next few quarters in particular. You have seen a lot of it in the margins in the half to date.

Andrew Triggs: (Analyst, J.P Morgan) Thanks, Alan. Second question, sorry to harp on about your mortgage growth, but one change that CBA has made recently is improved

price transparency in your mortgage offerings, and it does show that CBA pricing for low risk home loans is only single digit basis points above the likes of the Macquarie best offer in the market. I'm just sort of interested in, (a) why the move to the better price transparency? And (b) what does that say about the, I guess, commodity-like nature of the product, considering the strength of CBA's brand name, technology, distribution network, et cetera?

Matt Comyn: Both important points, I mean, I guess strategically, of course, it still remains. We are very focused on a primary relationship with customers, that obviously helps on the – I mean, I think it is probably protracted on the liability side, but ultimately, hugely focused on having that main bank relationship in both Retail and Business, which has helped us in liabilities. We think it gives us an advantage trying to secure the strongest share of proprietary and direct relationships.

I think the more recent change, it is really a function of, I think, particularly as we have seen a more elevated level of discounting across the market and then some of the pricing constructs, which there is a smaller proportion but still a reasonable portion of loans priced off the SVR. We are just getting feedback from customers, it is a little harder to tell exactly what sort of end price we were going to get. And so that is predominantly some of that change.

And then look our pricing across tiers really differs and depending on the customer base and of course, there are both, existing relationships, which is our core focus, a broader view on customer lifetime value. Alan touched on some of the considerations from a capital on Basel III. We will price more sharply, but certainly not leading and always lagging, and the competitor that you touched on is a very significant originator of mortgages in the market at the moment.

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

Victor German: (Analyst, Macquarie) Thank you, Victor German from Macquarie. I was hoping to actually follow up on this mortgage discussion as well. Obviously, a lot of questions on that already, but if we look at the number that you disclosed with respect to margin compression, the past five basis points, relating to competition, and a little bit elevated relative to history, but it is not a particularly large number, particularly in the context of the front of back book spread that we are seeing and a lot of customers moving

from fixed into variable. I'm interested in your thoughts as to where that goes from here, whether you think that number gets bigger as more customers are getting better rates? And can you give us maybe a sense of what proportion of customers in the half have already been repriced to newer rates? That would be helpful as well. And then I have a follow up question on expenses as well. Thank you.

Alan Docherty: I mean, one of obviously the key dynamics, as we look over the next six to 12 months, Victor, as you know, is the amount of refinancing that is going to come through on our fixed rate mortgage customers. We have got disclosures of around, I think we have got around $96 billion of fixed rate customers that will be rolling over the course of the next 12 months. You have seen obviously a large number across the industry, and so that level of discounting that you have seen in the six-month period, we are likely to see an increased run rate on that from the natural charm of that portfolio. And it is obviously very price sensitive, as you can understand, the price sensitive borrower at the moment, given the large increase in rates. So that is the key, I think, dynamic as we look six to 12 months out in terms of the level of discounting that we have seen in the six months and then how you project that forward over the course of the next 12 months.

So that is obviously going to be a factor in second half margin.

Matt Comyn: Yes, Victor, we would say that we think that gap is going to narrow. May be another way to think about this, in terms of another external source, I cannot remember the page number, but in the statement of monetary policy the RBA put out last Friday, there is a comment in there about the weighted average standard variable across the market. I think they put it at 35 basis points less than the cash rate increases. That gives you a sense of sort of what the portfolio level is. We think it might be higher than that depending on peers across the market, but that sort of gives you a sense that this is going to normalise the front book, back book, obviously, depending on how the dynamic plays out in the market more broadly.

Victor German: (Analyst, Macquarie) But in terms of sort of churn, do think that that's already kind of happening or is that more of a second half or half 2024 story?

Alan Docherty: I mean, certainly, and that has been a constant theme, I think of the mortgage market, for the last few years where there has been, I think, a lot of proactivity in terms of more competitive pricing within the back book given a lot of focus around market share across the industry. So that has been an ongoing thematic. There was

certainly additional churn in the back book through that six-month period. And I think, given the refi market and the higher level of absolute rates and the economy, it will continue to be a feature in the period ahead.

Matt Comyn: I think clearly, there is a lot of interest in that area. Maybe just a very quick comment in terms of backdrop and context. We have all seen very substantial share shift over the last few years. And clearly there is a reaction and response to that. We have got a falling level of system of volume growth that is available in market against that backdrop. Net interest margins have been expanding at an industry level. And then, in other periods where we have seen pretty rapid changes in funding costs, it depends a little bit on transfer pricing mechanisms and how that has been transmitted through.

So we think there are explanations for what has potentially been occurring in the last six months, and then of course, we need to make the right decisions every day in terms of how do we best support customers and also choose to compete.

Victor German: (Analyst, Macquarie) Thank you. On expenses, I think, in the past, you often chose to invest into franchise when revenue conditions were supportive. If we're looking at a more tougher outlook for margins from here and what volumes are slowing as well, how were you thinking about managing expenses in this environment? Is that a time when you want to increase your productivity initiatives? Or do you feel like there's still a lot of investment that you want to make to continue your leadership position that you talked about throughout the result?

Alan Docherty: I mean, we have had a very consistent approach, I think, around business simplification, productivity initiatives. We will continue that, regardless of the macro backdrop. We obviously need to be very conscious around what is the pre-provision profit outlook, given tighter financial conditions and a slowing top line, which is likely given the conditions that we are looking at and the period ahead. So I am not sure it is a very different approach to the one we have had in past periods. You have seen in past periods, as managed, our cost base relative to the level of revenue performance ongoing approach to delivering productivity improvements.

And one of the things that is changed in the last couple of years is we are able to allocate more of our investment allocation towards productivity and growth initiatives. That has been a gradual change in the share of that envelope, which is gradual and appropriate.

And so we will continue to invest, I think, in both strategic growth and productivity initiatives for the foreseeable future.

So not a very different approach on costs to the one that we have talked about through the historic lows and rates, and a pretty anaemic topline environment over much of the past four or five years.

Melanie Kirk: Great, thank you, Victor. The next question comes from Ed Henning.

Ed Henning: (Analyst, CLSA) Hi, it's Ed Henning from CLSA. Thank you for taking my questions. Can you just touch on the three basis points of higher liquids costs in the margin? Was that from increasing the term or carrying excess liquids? And do you anticipate the liquids creating a further headwind, or will this unwind, and if so, when, as the first question?

Alan Docherty: Yes. So most of the three basis points was actually an increase in some repo balances that we hold in the Institutional Banking and Markets Division. So there was about one basis point of the three related to liquids that we hold at the HQLA, that is the numerator for the liquidity coverage ratio. So are both in the category of non-lending interest earning assets. They both an increased over that period. As I look ahead, I mean, the repo balances will move around, depending on the spreads available in that market, so that can change over time.

In terms of the broad trajectory on liquidity, that is really going to be a function of money supply growth, and then our share of deposit growth. I think across all of our franchises, we have been doing a good job over many years. We have continued to grow MFI share, continuing to grow transaction accounts. You have seen that through the overall growth in customer deposit balances, and those deposit balances will attract and need to hold more liquid assets. So in an environment where if you assume the money supply is going to continue to grow, albeit at a slower rate in Australia, which would be our forecast, then you should assume that deposits will grow commensurately, and liquidity will grow commensurately, and that will be a headwind, if you like, in terms of the nominal net interest margin, albeit as you know, it does not have much of an earnings impact in the interest income.

Ed Henning: (Analyst, CLSA) No, that is great, thanks. And historically, you've called out about a 12 basis point headwind when the shift from variable to fixed rate loans. Now the front book's lower than the back book, and there's lots of competition there. Is still a

tailwind when loans are starting to shift back to variable, or not nearly as much as the 12 basis points?

Alan Docherty: Yes, it is not going to be nearly as much as the 12 basis points. There was a one basis point benefit in the half from the switching from fixed to variable. But yes, as we have talked about, given the level of front book margins on the floating rate product, it is going to be less of a tailwind as we look ahead, as things stand.

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

Matt Dunger: (Analyst, Bank of America Merrill Lynch) Yes, thank you, gentlemen. If I could ask on the average funding size of new mortgages up strongly about 7.5% half on half, are you able to comment where this is coming from, and what impact LVR limit you have called out on page 82 might have, and to what extent that this is feeding home loan offsets as well?

Alan Docherty: Sorry?

Matt Comyn: What specifically on 82?

Matt Dunger: (Analyst, Bank of America Merrill Lynch) Slide 82, I was just referencing the LVR limit, what impact they would have on the strong growth that you have seen in new mortgage funding.

Alan Docherty: This is the tightening of LVR limits for high value properties. I mean, really, we would see that, as I mentioned in the presentation, that given the tighter conditions as we look ahead, we are continually recalibrating all of our balance sheet settings. One of the things we are doing on credit risk settings in both the consumer portfolio, home lending, also in our business credit settings, looking at areas where we think there would be increased risk, increased credit risk. And so we adopted some tightening around LVR on very high value properties, given their exposure obviously relatively to falling house prices, and falling collateral values against high value lending.

So that is not a material part of the flow, however, in volume terms, so that I would not expect that to be showing up in terms of overall volume performance, given the majority of the book is not in those very high value properties.

Matt Comyn: Yes, I think that is exactly right. It would have a very minimal impact. I mean, LVR lending, or higher LVR lending has come down. I have seen prior cycles at the

very large loans that can be some lumpy losses, and hence why we have tightened there. We are trying to obviously be very thoughtful about where we are competing.

I think the other probably big change is higher DTI lending has come down very substantially, which is both from a setting perspective, but also it is a function of as the buffers are being applied to a much higher cash rate environment, we have set that out on one of the slides, as a commensurate reduction in borrowing capacities as well. But all things being equal, that is not a bad thing either.

Matt Dunger: (Analyst, Bank of America Merrill Lynch) Thank you. And if I could just follow up on capital allocation; how are you thinking about that, given your comments around mortgage returns, around APRA's changes to lowering commercial property risk weightings? How are you thinking about deploying capital versus maximising the dividend payout ratio?

Alan Docherty: Yes, I mean, so we obviously look at risk adjusted returns across all of our product types. The capital was obviously a big impact on that. On particular changes around risk weighting, I mean, in some ways, the way to think about the capital changes are more, I think, the changes play to our franchise strengths, in the sense that we have got, we have had a very well collateralised commercial property portfolio. Under the old rules, it adopted a supervisory slotting approach, where you had to take a very punitive risk weighting on those exposures. We can now bring the full collateral to bear in assessing the capital that we hold against those exposures.

We were always happy with a risk appetite and settings in that sector. I am not sure that – I mean, the change in the prudential capital requirements does not change our overall view of risk appetite and where we are willing to grow. So that individually would not change our view on that sector and our appetite for growth in that sector. I think what you are really seeing is the true economic risks related to that portfolio now are more, there is more discrimination and more granularity in that assessment as we work out the capital ratio. So that does not necessarily change our view on that sector.

On home loans, we have always had a very strong focus on proprietary business. Our owner-occupied home loan mix is very high. Again, the greater risk discrimination and the prudential requirements, I think, reflect the economic benefit that was already there in terms of lower losses on that portfolio, relative to other forms of home lending. So again,

the greater risk discrimination I think just gives us a better reflection of the underlying economic risks that we have been writing.

Matt Comyn: Yes, I mean, granularity really helps with sharper capital allocation. As we have touched on today, we want to manage for the long term. We are very focused on resilience overall, investing in our franchise, in our strengths. Obviously, we are fortunate, we have got a business mix that is able to generate organic capital, and no change to things like our capital allocation into our dividend payout ratios, et cetera.

Melanie Kirk: Great, thank you, Matt. We will have to take our final question from Carlos.

Carlos Cacho: (Analyst, Jarden) Thanks Mel. Carlos Cacho from Jarden. First up, a question on borrowing capacity, still on that slide 80. Your chart on the top left shows what looks to be maybe a 30% fall in capacity. Given you previously disclosed those charts showing that eight to 10% of borrowers borrow the maximum, presumably a lot of those borrowers are not going to be able to refinance or qualify for their current loan. But is there any indication of what share of recent borrowers are going to struggle to refinance, leave to a competitor, or even extend their loan term with you, based on those falls in capacity?

Matt Comyn: Yes. So maybe firstly there, the borrowing capacity, I think, it is not quite 30. Maybe it is like 27, 26 or 27%. And obviously there are some differences in terms of scenarios. I mean, we have, as you would expect as those buffers are applied, it is a tighter serviceability test. I would say it is a very small impact to date.

I think the other part, as we have looked forward as well, we have tried to estimate what proportion of customers against a much higher rate environment. And of course, then – which we think is a very small number, you are relying on a number of different assumptions there as well, in terms of obviously the year of origination matters, both in the context of how their income may or may not have changed. But if you assume it is basically inflated over that period by CPI, sometimes borrowers only provide enough income to actually meet serviceability. I think many borrowers do that. Then you have got to look at expenditure, and then what might a reasonable level of expense reduction be? And of course, that depends on your starting position.

So you start basically, and it is probably not a particularly helpful answer, but you start in lower single digits, and get much lower, depending on what sort of assumptions that you push out. And of course, it is again circular with where does the terminal cash rate end up?

Carlos Cacho: (Analyst, Jarden) So that would imply there would be less than that 10% who borrowed close to the maximum?

Matt Comyn: Yes, our estimate would be lower than that. Yes.

Carlos Cacho: (Analyst, Jarden) And then just a second question around the quality of the mortgage book; you showed on slide 78, a modest rise of 30 day arrears, and how you are seeing a bit of an increase in one day arrears, albeit of a low level? Are you seeing any common trends across those customers that are falling behind repayments in terms of, you know, geography, you know, reasons for job loss or, you know, purchasing at a certain time? Is there any customer characteristics that you're particularly watching as a warning sign now?

Alan Docherty: Yeah, I mean, we are watching across a number of characteristics. I would say, though, that the increase in the very early stage arrears that we have seen was more a function. The thematic across most of that was actually operational changes in terms of making sure that you have got enough money in your account as your scheduled repayments increasing. And because we have gone through this very unusual period where there has been, well there has had to be lots of changes to scheduled repayments, you find there is a minority of customers who just need to get the right money in the right account so that they make the right payment. It turns up in something called partial arrears, which means they pay. They might pay the old minimum and they have not yet paid the new minimum.

And so that is the vast majority of the early stage arrears and you see a very high cure rate. So those arrears do not turn up in the 30 day plus because, you know, the customer makes the full repayment, after it goes one day in arrears, and so they get back to performing very quickly. So it has more been an operational change for people to get used to higher scheduled minimum. That is the driver of what we have seen in very early stage arrears. And obviously, we are keeping a close eye on that because we do expect a cohort of customers in some of the cohorts you mentioned to come under more stress as we go onto calendar 2023. So we are keeping a very close eye on it. We have not yet seen that manifest in the early stage arrears as yet.

Melanie Kirk: Great. Thank you, Carlos. That brings us to time. Thank you very much for joining us for the briefing, and please let us know if you have any follow up questions and we will come back to you. Thank you for joining us.

End of Transcript