
The key drivers of NAB's cost of funds

February 2012

Contents

1. Key Themes
2. Customer Deposits
3. Term Wholesale Funding
4. Short-term Wholesale Funding
5. Overall funding cost picture

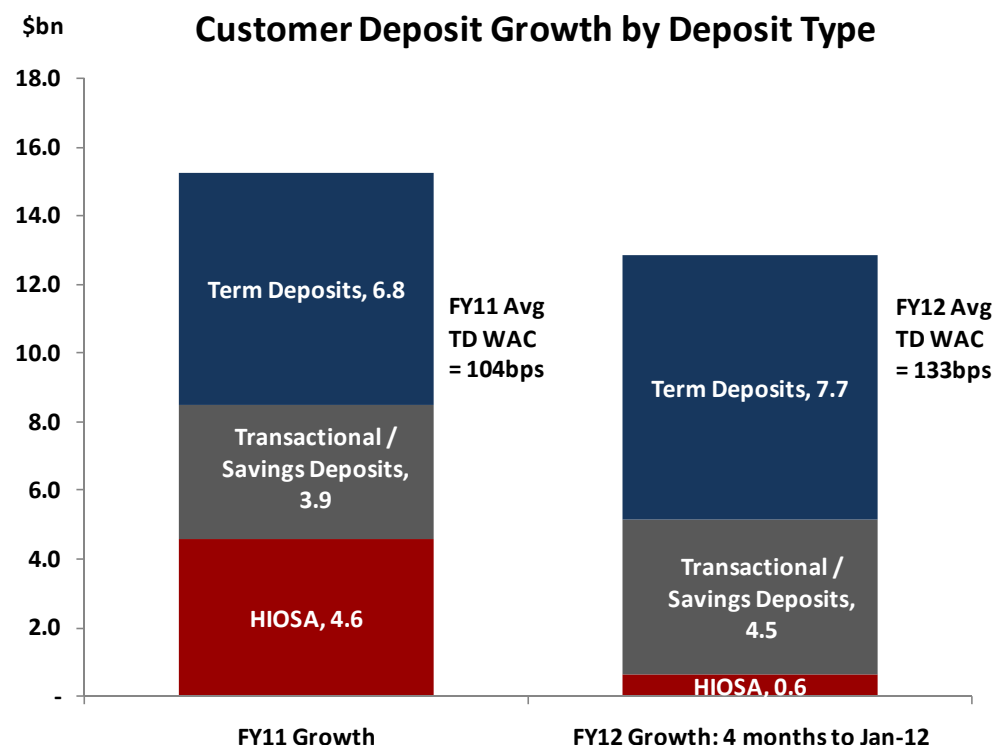
Key Themes: Funding and Liquidity Costs

- Recent instability in Europe and the subsequent closure of term wholesale funding markets has placed further pressure on bank funding costs since the start of FY12, after a period of relative stability;
- Term deposit costs have risen substantially in recent months as, while BBSW has fallen significantly, the interest rate paid to customers on term deposits has been relatively stable;
- Term funding new issuance costs have also risen significantly, since the re-opening of term markets in December, although this is yet to have a material impact on the portfolio cost, which has been rising steadily since 2007;
- The Bills-OIS spread has increased significantly since mid 2011, causing a substantial increase in overall funding costs;

Customer deposits: Composition

- NAB's housing loan growth strategy has necessitated strong growth in stable funding sources (see Chart 2);
- This has driven a more expensive product mix, with growth largely funded through relatively expensive Term Deposits – See Chart 1);
- This trend has been exacerbated by the closure of term markets, with planned growth in term funding replaced by domestic term deposit growth in FY12;

Chart 1:



Source: NAB internal data (average core deposit transfer pricing volumes);
WAC = Weighted Average Cost
HIOSA = High Interest Online Savings Account

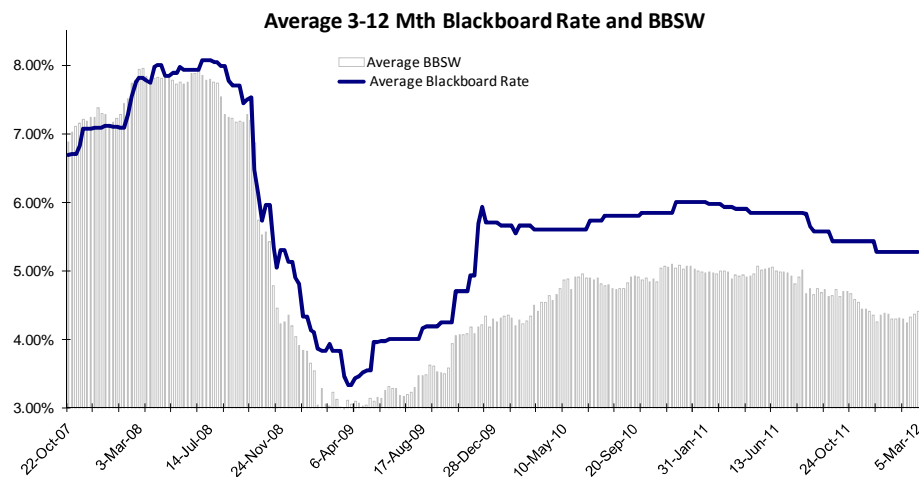
Chart 2:

APRA Australian System growth		
NAB GLAs	12 months to Sep-11	3 months to Dec-11
Growth	12.5%	3.1%
Growth relative to APRA System	1.8x	1.5x
NAB Deposits (excl. CDs & FIs)	12 months to Sep-11	3 months to Dec-11
Growth	14.8%	2.2%
Growth relative to APRA System	1.5x	1x

Customer deposits: Term Deposits

- The cost of new term deposits has risen substantially in recent months as, while BBSW has fallen significantly, the interest rate paid to customers on term deposits has been relatively stable (See Chart 3);
- Declines in BBSW have also driven changes in behaviour, with customers electing to invest for shorter terms given the inverted swap curve;
- This has had the impact of repricing the term deposit book more rapidly (as shown in Chart 4);

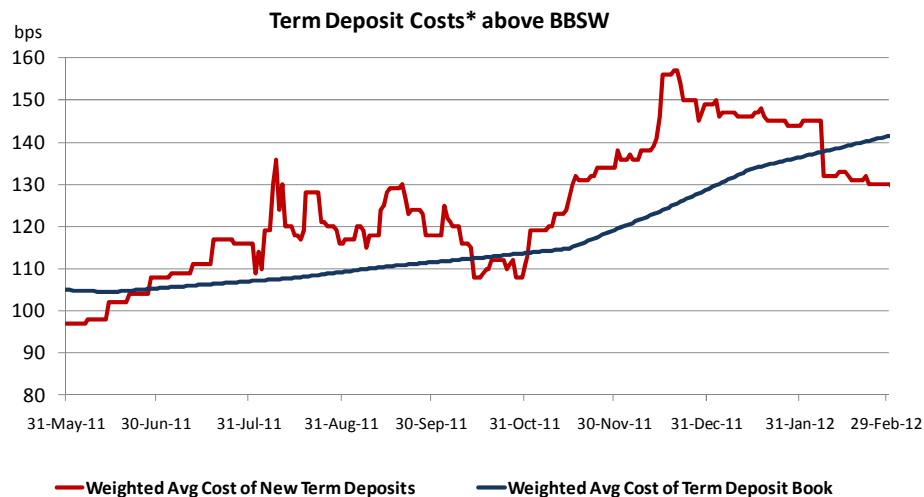
Chart 3:



Source: NAB Weekly Advertised Term Deposit Rates since 2007

^ Represents advertised term deposit rates, used here as a peer comparison. These make up less than 15% of total term deposit costs.

Chart 4:

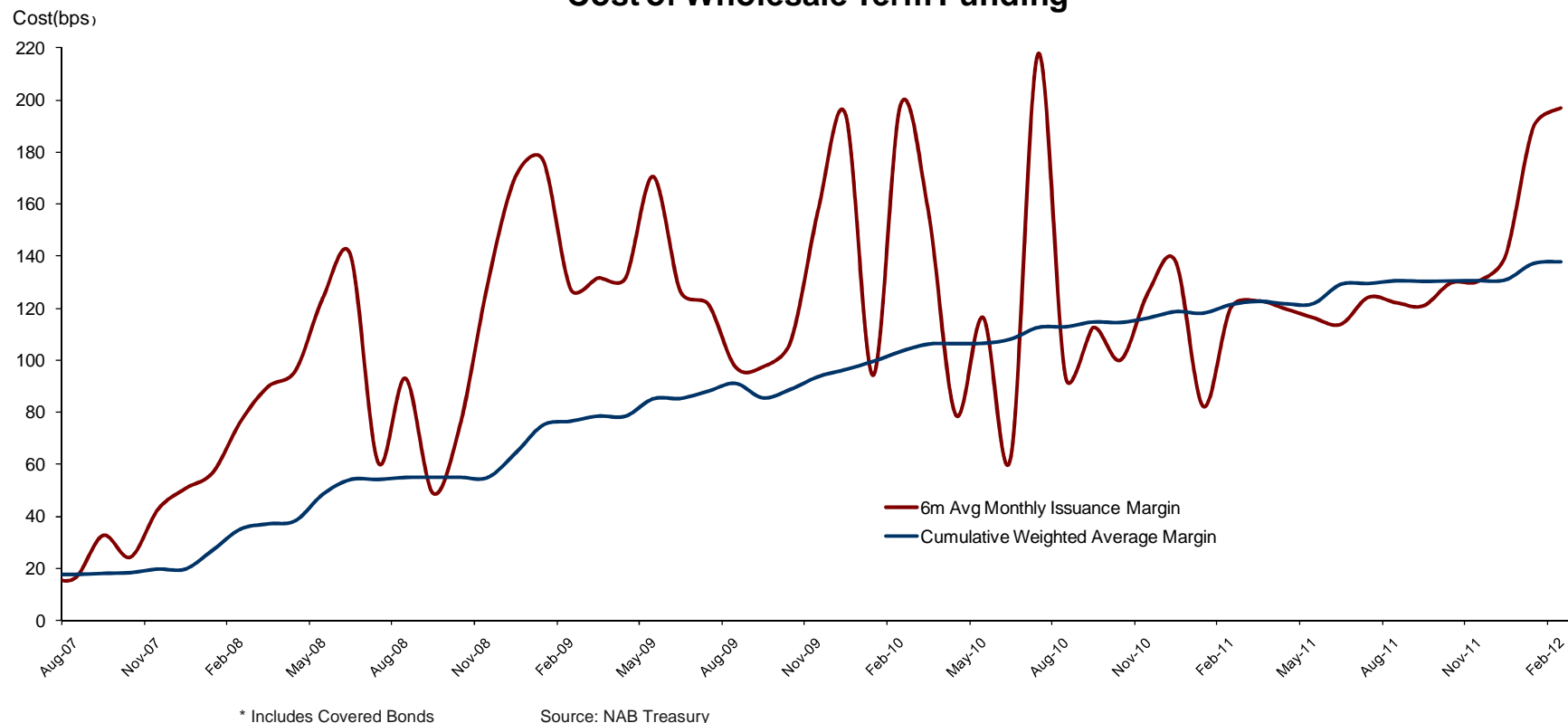


Source: NAB Internal data

*Total term deposit costs including negotiated rates, and excluding FI deposits

Term Wholesale Funding

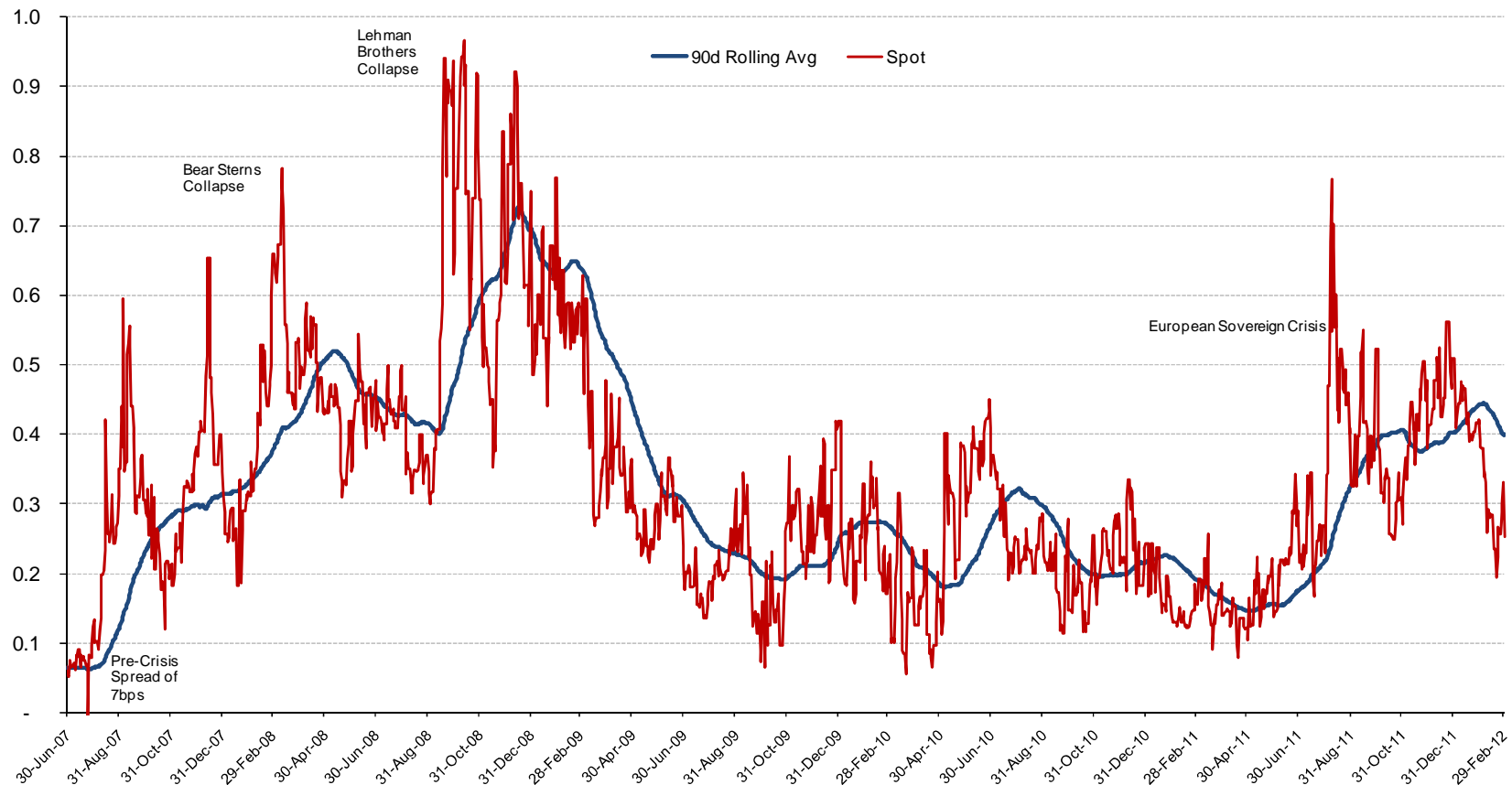
Cost of Wholesale Term Funding*



- Narrow issuance windows and market instability had been a feature of term funding markets over the past 18 months;
- NAB did not complete any significant senior unsecured issues between Aug-11 and Dec-11, with funding targets now revised to reflect market conditions;
- The reopening of term markets in December, has allowed NAB Ltd to issue \$6bn in secured and unsecured funding YTD, at an average cost of 199bps above 3m BBSW;
- This is yet to have a material impact on the portfolio cost (which has been rising steadily since 2007), but provides a significant headwind to funding costs if spreads remain elevated;

Short-term Wholesale Funding

Chart 6: %



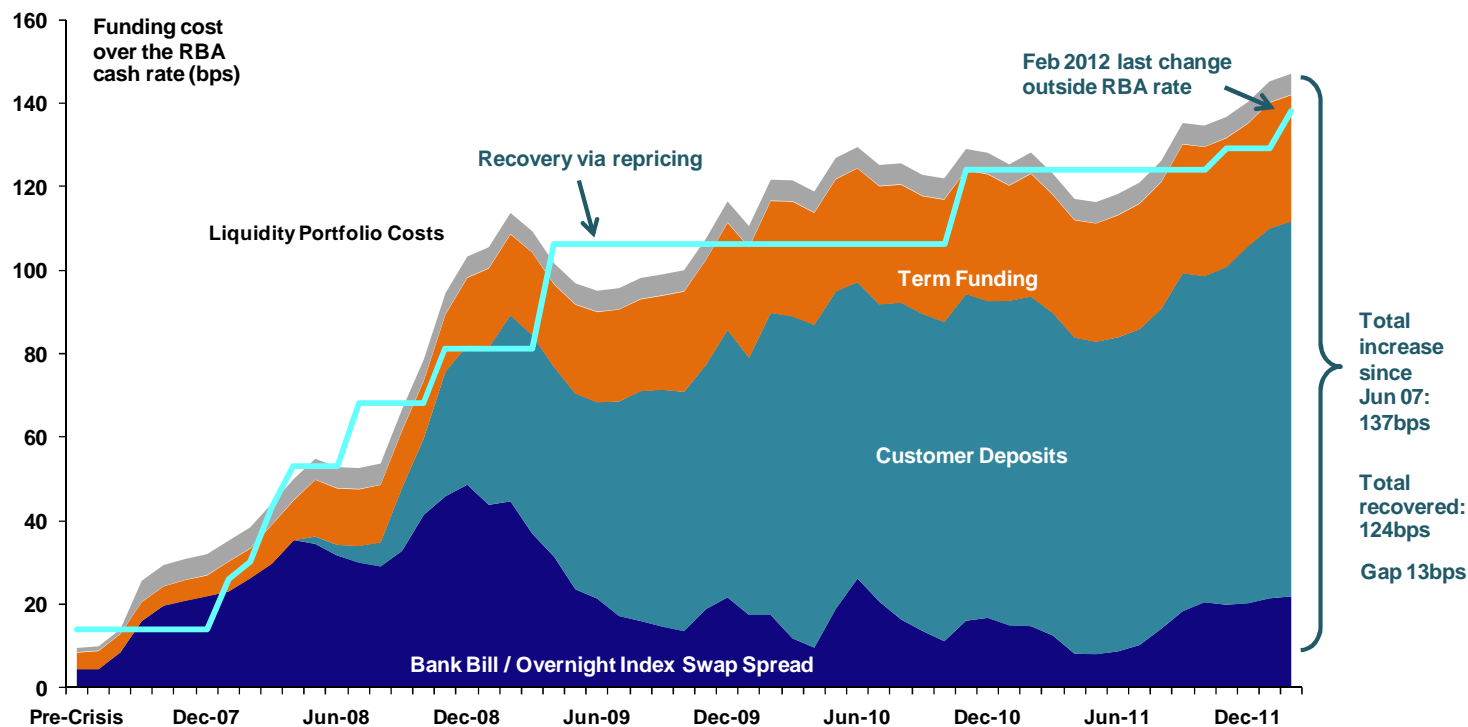
Source: Bloomberg

- European sovereign concerns and the increased appetite for short term funding by the major banks (given the closure of offshore term markets) increased the Bills-OIS spread significantly in August. It has since remained at elevated levels, although it has started to moderate in recent weeks as offshore term markets have reopened.
- The size of the exposure (approx. \$100bn), as well as the short term repricing profile of the risk, make any volatility in this spread a significant contributor to overall funding costs.

Overall funding cost picture

- Funding costs have increased 137bps since Jun-07 vs. 124bps of mortgage repricing outside RBA rate changes;
- In the 5 months to Feb-12, overall funding costs have increased 13bps, primarily due to changes in term deposits costs and the Bills-OIS spread;
- The outlook is negative for the next quarter given increased term issuance and that 30-40% of the term deposit book has yet to reprice at elevated spreads;
- Given the current cost of these funding sources vs. returns on new lending, risk-adjusted incremental returns are marginal.

Chart 7:



Source: NAB Treasury & Bloomberg

Important Information

National Australia Bank Limited (ABN 12 004 044 937, AFSL 230686) its related bodies and any other officer, employee, agent, adviser or contractor thereof ("NAB") does not warrant or represent that the information, recommendations, opinions or conclusions contained in this document ("Information") is accurate, reliable, complete or current. The Information has been prepared for information purposes only. Any statements as to past performance do not represent future performance. The Information does not purport to contain all matters, relevant to any particular investment or financial instrument and all statements as to future matters are not guaranteed to be accurate.

In all cases, anyone proposing to rely on or use the Information should independently verify and check the accuracy, completeness, reliability and suitability of the Information and should obtain independent and specific advice from appropriate professionals or experts. The Information is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs.

To the extent permissible by law, NAB shall not be liable for any errors, omissions, defects or misrepresentations in the Information or for any loss or damage suffered by persons who use or rely on such information (including by reason of negligence, negligent misstatement or otherwise). If any law prohibits the exclusion of such liability, NAB limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable. NAB, its affiliates and employees may hold a position or act as a price maker in the financial instruments of any issuer discussed within this document or act as an underwriter, placement agent, adviser or lender to such issuer.

This information is governed by, and is to be construed in accordance with, the laws in force in the state of Victoria, Australia and any dispute or claim arising from, or in connection with, the Information is subject to the non-exclusive jurisdiction of the courts of that State.

Please be aware that any telephone calls to NAB may be recorded. If you would like more details regarding the privacy of your information at NAB, please visit the NAB website.