National Australia Bank

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ASX Announcement

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National Australia Bank December Quarter Trading Update – Solid Performance in a Challenging Environment

Key points

- The Group's first quarter unaudited[1] cash earnings result was approximately $1.1 billion – a solid result in light of the challenging market environment. This result is consistent with that of the previous corresponding period.
- Group revenue growth remains strong despite rapidly emerging weakness across the relevant economies. Australia Banking and nabCapital Markets Division were particular areas of strength. Australia Banking achieved robust business lending growth and effective margin management. nabCapital Markets Division benefited from volatility which drove high levels of risk management trading for business customers.
- Areas of softness in revenue were primarily the United Kingdom, where significantly higher funding costs could not be adequately recovered, and in MLC due to the impact of declining investment markets on Wealth Management FUM.
- Group estimates continue to put cost growth at around inflation for the full year.
- Deterioration in economic conditions has led to a decline in asset quality across all businesses:
  - Group 90+ days past due and gross impaired assets to Gross Loans and Acceptances (GLA) has weakened from 83bps at 30 September 2008 to 108bps at 31 December 2008.
  - The Group charge for bad and doubtful debts (B&DD) in the December quarter was $824 million. The specific provision charge was $521 million, approximately half of which related to three individual name exposures. The collective provision charge was $303 million, mainly reflecting a decline in customer credit ratings across all businesses.
- The Group funding task is well advanced. Year-to-date, over 60% ($12.3 billion) of FY09 term funding requirement of $19 billion has been raised. Customer deposit flows continue to be very strong.
- The Group continues to maintain a conservative liquidity position.
- The Group capital position is also strong, with the Tier 1 ratio remaining comfortably above 8%.
- Given the uncertain economic environment, the Group is cautious on outlook and continues to emphasise conservative settings and balance sheet strength.

[1] The first quarter result is based on management financial information and has not been subjected to external auditor review.

Business Commentary

Australia Banking

Economic conditions deteriorated during the December quarter, resulting in a slowdown in system credit growth with further weakness expected over the remainder of FY09.

For NAB, above system volume growth in business lending has driven market share improvement. Growth in mortgage volumes has been below system, mainly due to a continued emphasis on more profitable proprietary channels. Lending margins have benefited from close management, including appropriate pricing for risk across the portfolio.

Deposit volumes have shown solid growth, but margins have been eroded by heightened competition and changes in product mix.

The ratio of 90+ days past due and gross impaired assets to GLAs increased to 93bps at 31 December 2008 (up from 79bps at 30 September 2008).

Wealth Management

Consistent with industry experience, MLC's funds under management declined during the quarter reflecting negative net flows and widespread market declines. Given lower volumes, management has accelerated cost reduction initiatives to help offset pressure on income.

Insurance sales have been strong and in-force premiums are above the previous corresponding period. The quarter saw an increased claims experience.

Income on retained earnings was negative reflecting the performance of investment markets.

United Kingdom

The United Kingdom economy is experiencing a severe recession affecting all local banks to a material extent. Despite these conditions, NAB's UK banking franchises continue to be profitable.

The Region has been significantly adversely affected by unrecoverable funding costs. This worsened during the quarter, with further expansion of the spread between the official base rate and 3 month LIBOR – up from an average of 77bps in FY08 to an average of 227bps in the December quarter. The business is also absorbing the cost of participating in the UK Financial Services Compensation Scheme.

In addition, but of lesser materiality, B&DD charges rose and asset quality measures deteriorated, largely as a result of the slowing UK economy. The ratio of 90+ days past due and gross impaired assets to GLAs increased to 164bps at 31 December 2008 (up from 99bps at 30 September 2008). The worsening environment is expected to lead to further asset quality declines over the course of the year.

Retail deposits grew strongly, rising 5% during the first quarter. Business lending volume growth slowed, reflecting reduced demand.

Although the current environment is difficult, NAB's UK banking franchises continue to perform better than local peers on most dimensions.

New Zealand

The New Zealand economy remains in recession, with the slowdown being experienced accelerating during the December quarter. Business and consumer confidence levels are at historic lows. The NZ banking market remains highly competitive and is increasingly so with respect to deposits.

Given the poor market environment, BNZ has maintained its prudent capital and liquidity positions. Margin pressure from higher funding and liquidity costs has continued and this has been compounded by additional costs under the Government’s Retail Deposit Guarantee Scheme.

Growth in lending volumes has continued to slow although ongoing repricing initiatives are assisting asset margins.

The slowing economy combined with rising unemployment and falling investment is creating increased pressure on asset quality. The ratio of 90+ days past due and gross impaired assets to GLAs increased to 87bps at 31 December 2008 (up from 54bps at 30 September 2008).

There is a continued focus on cost efficiency through process improvement.

nabCapital

The strong underlying performance of last year has continued through the first quarter. This has been substantially offset by higher B&DD charges, predominantly relating to large high profile exposures. The ratio of gross impaired assets to GLAs increased to 124bps at 31 December 2008 (up from 104bps at 30 September 2008).

Global Markets has benefited from increased cross-sell, improved margins and strong trading performance. Corporate lending margins remain an area of focus with continued progress on repricing. However, a substantial proportion of loans has yet to reprice.

Balance Sheet Commentary

Capital

At 31 December 2008 the Group’s Tier 1 capital ratio remained comfortably above 8%. This is consistent with the Group's desire to maintain a strong Tier 1 ratio during the current market dislocation.

The movement in the Tier 1 ratio since the 30 September 2008 level of 7.35% is primarily attributable to the equity placement in November 2008, together with an increase in RWAs reflecting:

- Continued asset growth; and

- A modest impact from Basel II pro-cyclicality.

The Group will continue to explore opportunities to further strengthen the capital position by utilising existing Tier 1 hybrid capacity, where market conditions permit.

Bad and Doubtful Debts Provisions

Collective Provision balances have increased by $256 million since 30 September 2008. Specific Provision balances have increased by $249 million since 30 September 2008, with the majority of these concentrated within the finance, property and retail sectors.

Total provision balances (including the credit risk adjustment on assets at fair value) as at 31 December 2008 stand at $3,929 million ($3,294 million as at 30 September 2008).

Funding and liquidity

Year-to-date, the Group has raised $12.3 billion in term wholesale funding, representing more than 60% of its 2009 full-year requirement of $19 billion. The majority of this has been raised utilising the Australian Government Guarantee. The weighted average term to maturity of the funds raised is 3.65 years.

The Group continues to maintain a conservative liquidity position. Benefiting from strong deposit performance, the Group’s Stable Funding Index was 76% at 31 December 2008 (72% at 30 September 2008).

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