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Big Six banks brace for 'challenging' outlook on prospects of lower interest rates, roiled capital markets

Weaker economies have also forced the banks to set aside more money for possible loan losses

Royal Bank of Canada will be the first of the Big Six to report third-quarter earnings on Wednesday, followed by Canadian Imperial Bank of Commerce on Thursday and the other four banks next week.

Peter J. Thompson/National Post

Volatile capital markets and skittish central bankers have helped put the expenses of Canada’s biggest banks in the spotlight this earnings season, with analysts and investors set to scrutinize spending when the Big Six lenders start to report a fresh batch of financial results later this week.

Lenders have had to cope with challenging conditions for growing their revenue this year, such as trade-related uncertainty that has roiled capital markets, and central banks that have paused or begun undoing interest-rate hikes, which will affect the banks’ retail margins.

Share prices of the big banks have lagged that of the broader Canadian market this year as well. As of Monday’s close, the S&P/TSX Index had gained about 13.8 per cent since the end of 2018, while the TSX financials group was up 9.4 per cent.

National Bank Financial analyst Gabriel Dechaine noted recently that the Big Six banks have had average earnings-per-share growth of “only” three per cent during the first half of their fiscal year, which ended April 30.

Lenders have also fallen short of analysts’ quarterly consensus forecasts eight out of 12 times, he said, partly because of credit conditions, but also because of an uptick in spending. Executives, however, have suggested they can throttle back spending growth.

“While several factors have played a role … expense growth has been an important headwind, with the average Big-6 bank delivering 6 per cent expense growth (against 5 per cent top-line expansion),” Dechaine wrote. “Unsurprisingly, four of the banks have guided to lower second half expense growth as a primary means to improve bottom line performance (and to achieve positive operating leverage).”

Weaker economies have also forced the big banks to set aside more money for possible loan losses. In a recent report, ratings agency DBRS Ltd. said the big banks’ credit losses were still at “historically low levels,” but that they could rise with an even-gloomier economic outlook.

Still, while it has been relatively rough for the earnings of Canada’s big banks, they continue to crank out billions in profit.

Overall, the Big Six banks are expected to see average earnings-per-share growth of around six per cent for their quarter ended July 31, "the best of a lacklustre year so far," wrote CIBC World Markets analyst Robert Sedran in an August 12 note. Expense growth could factor into future earnings growth, though.

Expense growth has been an important headwind

National Bank Financial analyst Gabriel Dechaine

"We will be watching for differences in expense control that were flagged on last quarter's conference calls, see muted market revenues (consistent with the U.S. banks) and expect the interest rate environment to matter more to the outlook than it does to the (third-quarter) results," Sedran added in his third-quarter preview.

Since the second quarter, Canaccord Genuity is "shifting our focus on items relating to bank stocks," analyst Scott Chan recently wrote.

"With the U.S. Fed starting a path towards monetary easing, we believe credit quality and Canadian housing data points are much more constructive," Chan said in an Aug. 15 report. "On the other end, our focuses in the (second half) of this (fiscal year) revolve around decelerating revenue growth (e.g. slower loan growth, margin pressure, market sensitive businesses) to be managed closely with expense reduction … in order to help achieve positive operating leverage. We admit this will be challenging for most banks this year."

Cost containment is important for the banks, as they have become more conscious recently of their spending, according to ***Nigel D'Souza***, an analyst at ***Veritas Investment Research***.

"But that is ultimately a function of growth being more constrained," he said.

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BMO Capital Markets analyst Sohrab Movahedi predicted in an Aug. 14 note that Canadian banks will get more of a lift from their international retail operations and wealth-management operations for the quarter, "which should more than offset flat Capital Markets earnings and low-single-digit growth in Canadian retail banking."