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From credit quality to low rates: What Bay Street is watching this bank earnings season

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Canadian bank stocks have recently come under pressure as interest rates are set to stay low for even longer than previously anticipated. Concerns about the sector's ability to grow its loan book will also be centre stage for investors amid tougher mortgage rules and high household debt.

Here's a look at what Bay Street analysts and portfolio managers are watching out for as bank earnings season kicks off Wednesday.

The Analysts

"We are expecting steady results from the Canadian banks, including average year-over-year loan growth of approximately 8 per cent. Our forecast is driven primarily by growth in business loans as we expect mortgage loan growth of less than 5 per cent year-over-year."

"Partially offsetting our loan growth forecast, we anticipate incremental net interest margin pressure driven by the challenging interest rate environment."

"In particular, underwriting and securities trading revenues could disappoint. Expense management has been a focus for bank management teams given the revenue growth challenges."

"Household credit metrics should be stable on a linked quarter basis. Business credit has been uneven in recent periods, driven by one-off credit issues, but we do not anticipate widespread deterioration."

"Capital levels are strong and we are expecting dividend increases from CIBC and Scotiabank and some modest buyback activity across the group."

- James P. Shanahan, senior equity research analyst of North American financials, Edward Jones

"With the U.S. Fed starting a path towards monetary easing, we believe credit quality and Canadian housing data points are much more constructive."

"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 (except for CIBC) in order to help achieve positive operating leverage."

"We believe BMO shares are set up well to relatively outperform for the following reasons: the largest stock underperformance since last reporting, looking for [fiscal third quarter] earnings beat, high single-digit EPS potential in [fiscal 2019] and strong credit quality could provide additional upside."

- *Scott Chan, analyst, Canaccord Genuity*

"Heading into the third quarter, we are tracking commercial impairments and loan losses for Royal Bank, as more than half of the bank's corporate exposure consists of non-investment grade credit. An acceleration of risk in RBC's commercial lending book could signal a deteriorating credit environment for Canadian businesses."

"We are also monitoring performing loan losses for Scotiabank given the bank's relatively optimistic macroeconomic assumptions under [new accounting standards]. We noted in the second quarter that Scotia incurred higher performing loan [provision for credit losses] partly due to a revision of its forward-looking indicators."

"Lastly, CIBC's consumer loan portfolio might serve as a litmus test for the health of the Canadian consumer. We note CIBC experiences higher past due but not impaired loans relative to peers across several retail loan categories including residential mortgages, personal loans and credit cards. We will be tracking CIBC's retail impairments, delinquencies and loan losses heading into the quarter."

"We expect BMO to beat expectations, TD and Scotia to report in-line, and see CIBC, National Bank and RBC most at risk of falling short of consensus."

- *Nigel D'Souza, financial services investment analyst, Veritas Investment Research*

The Money Managers

"With interest rates falling in the U.S. and central banks getting more dovish across the globe, margins and more importantly margin guidance will be a key focus this quarter."

"The market will also focus on loan loss provisions given the rising fears of recession. We do expect to see an increase in loan loss provisions this quarter but it will be driven mostly by changes in accounting and not a spike in actual impairments themselves."

"Given the softening revenue outlook (slowing consumer loan growth) the market will be focused on operating leverage and each bank's ability to manage expenses in a more challenging environment."

"With that growth backdrop, current valuations appear reasonable and should provide a measure of downside support in turbulent markets. However, it will likely be hard to find reasons to drive share prices higher."

- *Michele Robitaille, managing director, Guardian Capital*

"Across the Big Six banks we expect we'll see earnings grow from 0 to 8 per cent year over year, with the strongest growth expected at Royal and TD and the weakest growth expected at CIBC and National Bank."

"We expect to see mild credit deterioration, reflecting the now fairly entrenched increase in personal bankruptcy and consumer proposal filings across the country as Canadians struggle with heavy debt loads. Nevertheless, credit provisions should remain below long term averages."

"Loan growth is likely to remain tepid in the consumer segment, although may show a slight uptick from the three-decade lows in mortgage loan growth we've seen in recent quarters as the housing market shows renewed vigor in some parts of the country."

"The tailwind to net interest margins from rising interest rates is over, and so growth will need to stem more from fee-based businesses like wealth management, and to a lesser extent perhaps the capital markets groups."

"Banks with big U.S. footprints will fare better than those with a more Canadian focus."

- Brian Madden, senior vice president and portfolio manager, Goodreid Investment Counsel

"Loan growth. Is growth in commercial lending enough to offset slower consumer loan growth? Is international loan growth enough to offset slower Canadian loan growth?"

"Loan losses are expected to be slightly higher, but how much higher? So far unemployment is still low, so we expect a small uptick from low levels."

"How is the integration of acquisitions going? Scotia buying Jarislowsky and MD Financial, TD buying Greystone Capital Management."

- Laura Lau, senior VP and senior portfolio manager, Brompton Group