



How Healthy Are Canada's Banks Compared to Their Global Peers?

Description

Not a week goes where I don't see another article discussing the parlous state of Canada's banks, particularly their high exposure to an overheated housing market and poor growth prospects.

But I disagree with the majority of these articles. Despite the risks faced by Canada's banks, I believe they are among some of the highest quality banks globally. They came through the global financial crisis — the most significant global financial calamity since the Great Depression — in relatively good health. I believe they stand out as being among the most productive, efficient, and least risky banks globally, and I think they are solid long-term investments for every portfolio.

Let me explain why.

1. They are generating some of the best returns globally

If we take a closer look at the return-on-equity or ROE of Canada's banks we can see they are outperforming both their U.S. and Australian peers. A report from global consultancy PricewaterhouseCoopers showed that Canadian banks had an industry-wide average ROE of 17%, which is far higher than the 12% for U.S. banks and the 16% for Australia's banks.

For the third quarter of 2014, all of Canada's big six reported impressive ROEs. The standout performer was **Canadian Imperial Bank of Commerce** with an ROE of 21%, closely followed by the **Bank of Nova Scotia** ([TSX: BNS](#))([NYSE: BNS](#)) with an ROE of 20.6%.

2. They continue to operate efficiently

Canada's big six operate more efficiently than their U.S. peers with an average efficiency ratio of 57% compared to 67% and more importantly, they generate more income per employee than their U.S. counterparts.

For the third quarter, the most efficient of the big six was the Bank of Nova Scotia with an impressive efficiency ratio of 48%, well below the laggard among the big six, which was the **Bank of Montreal**, with a ratio of 65%.

This means the Bank of Nova Scotia is operating extremely efficiently giving it the ability to generate solid returns for investors, which is reflected in its high ROE. I expect this to continue with [the bank set to take](#) \$451 million in pre-tax charges for its fourth-quarter 2014 as it restructures its Canadian and International businesses to drive further efficiencies.

3. Canada's banks are well capitalized

Canada's big six have an average tier 1 capital ratio of 11.4%, well above the minimum regulatory requirement of 8.5%. This is also above the average tier 1 capital ratio of 10% for Australia's big four banks, but lower than the 13% for U.S. banks.

The best capitalized of the big six at the end of the third quarter was Bank of Nova Scotia with a tier 1 capital ratio of 12.3%, giving it a solid buffer well above the regulatory minimum. This highlights the disciplined approach taken towards capital management in the bank.

4. Credit losses among the big six continues to remain low

Currently the big six have an average gross-impaired-loans ratio or GIL of 0.7%, which is half of the 1.4% for U.S. banks and lower than the 0.9% among Australia's top four banks. This is quite surprising given the indebtedness of Canadian households, with household debt now at 163% of net income which is significantly higher than the 111% for the U.S. but lower than Australia's 180%.

At the end of third quarter **National Bank of Canada** ([TSX: NA](#)) had the highest quality credit portfolio with a GIL of a mere 0.4%. Bank of Nova Scotia had the highest-risk credit portfolio with a GIL of 0.9%, but even this is well below the ratios typically seen even with the major U.S. banks.

This highlights the balance sheet strength of Canada's banks as well as the conservative and prudent approach taken to managing risk, particularly credit risk.

If I were to select one big six bank as my preferred investment it would be Bank of Nova Scotia. This is because it has the most efficient operations, which sees it generating a solid ROE, while having some of the [best growth prospects](#) due to its exposure to fast growing economies of Chile, Colombia, Mexico, and Peru.

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1. NYSE:BNS (The Bank of Nova Scotia)
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