What Do The Bank of Montreal's Disappointing Numbers Mean for Other Banks?

Description

Going into the first earnings season of 2015, there was plenty of pessimism to go around among the Canadian banks. And now, at least so far, it seems that pessimism is warranted.

The Bank of Montreal (TSX:BMO)(NYSE:BMO) kicked proceedings off on Tuesday, reporting a net income of $1.0 billion for the first quarter of 2015. This was down 6% year-over-year, or 8% on a per-share basis. The results also missed analyst estimates by $0.12, or $0.10 on an adjusted basis.

As expected, BMO shares have fallen in response, down about 1.3%, as of this writing. Investors are also worried about the other banks, and have sent their stocks down as well.

So, what exactly contributed to BMO's poor results? And is this a warning signal for the rest of the banks? We take a look below.

Tight margins

For years, banks in both Canada and the United States have been waiting for interest rates to rise. This would allow the companies to charge higher rates on loans. And since deposit rates are practically stuck at zero anyways, this scenario would certainly lead to higher margins.

Unfortunately for the banks, that has not played out. In the U.S., the Federal Reserve is reluctant to raise rates as long as inflation is so low. North of the border, Bank of Canada Governor Stephen Poloz cut the benchmark interest rate from 1.0% to 0.75% in January. In response, the Canadian banks all cut their prime rate from 3% to 2.85%.

This showed through in BMO's margins. In Canada, the bank's net interest margin decreased by three basis points quarter-over-quarter. In the U.S., where competitive pressures have been increasing, BMO's net interest margin decreased by nine basis points. These may not sound like big numbers, but they make a big impact on the bottom line. And the other banks will be facing this problem too.

Slumping capital markets earnings

The news wasn't any better from the Capital Markets division, where net income declined by 20% year-over-year. The oil slump is probably responsible for much of this. Because energy firms are doing so poorly, BMO Capital Markets has seen its corporate and investment banking revenue decline. There have also been "credit and funding valuation adjustments"—in other words, some of BMO's debtors may not be able to pay the bank back.

Just like the tightening margins, this is something all the banks have to deal with.

A decreasing appetite for loans

This has been a worry for years. As the narrative goes, Canadians are heavily indebted, and any dent in the economy and/or real estate market would decrease our appetite for loans. And this would be bad for the banks' loan growth numbers. Once again, this showed through in BMO's first-quarter numbers, where Canadian Banking loans grew by only 3% year-over-year. A year ago, this number was 10%.

So Canadian bank investors, be warned. The future isn't always like the past, no matter how much we want it to be.

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