What Is the Biggest Threat to Canadian Banks? Technology or the Economy?

Description

There's no shortage of risks facing the Canadian banks these days. Two risks in particular stand out.

One is the Canadian economy, which is facing a number of problems. The other is new technology entrants, which include peer-to-peer lending networks, robo-advisors, and new payment solutions.

But which one should concern bank shareholders the most?

Why the economy matters

The Canadian economy is struggling right now, and it's already having a big impact on the banks. Most notably, the decline in oil prices is damaging the economy. The Bank of Canada has responded in kind, cutting its benchmark interest rate—another negative for the banks.

This has already impacted the banks' results. Loan growth at **Bank of Montreal** (TSX:BMO)(NYSE:BMO) totaled just 3% in the most recent quarter, and adjusted net income growth fell to 1%. Last year at this time those numbers were 9% and 14%, respectively.

The news could easily get worse. Canada's real estate market is due for a correction, and consumer debt remains at record levels. The OECD is predicting growth of only 1.5% for Canada this year, which could prompt another interest rate cut. Loan losses could also rise substantially.

Meanwhile, the new tech entrants are facing plenty of barriers. One is the concentration of Canada's banking sector, which allows them to negotiate with tech companies in unison. In fact, that's exactly what is happening with Apple Pay. Other barriers include trust and regulation.

In any case, the tech companies are only picking off low-margin customers, the kind that banks don't seem to care about. To illustrate, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) just spent more than US$5 billion to buy City National Corp, which caters only to wealthy clients. They're certainly not concerned with a robo-advisor picking off City's clients.

Why new technology entrants matter more

The Canadian economy certainly has its concerns, but these problems will pass. The technology companies will be a headache for decades.

There are a few reasons why tech companies will always have an advantage over the banks. One is their low cost structure—the banks have expensive branches to maintain, while the tech companies never will. Second, tech companies are more nimble than the banks, and I don't see this changing either.

Technology companies should be especially concerning for **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD). The bank has a big branch network in the United States, a country where tech companies are gaining a lot of traction.

The verdict

Here at The Motley Fool, we always encourage investors to look past short-term trends, and focus instead on long-term fundamentals.

This is no exception. The Canadian economy may be scary, but these things pass, and will be long forgotten in 10 years. But technology companies are a serious threat to the long-term competitiveness of the Canadian banks. Thus, this is without doubt the biggest threat these banks face.

CATEGORY

1. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:BMO (Bank of Montreal)
2. NYSE:RY (Royal Bank of Canada)
3. NYSE:TD (The Toronto-Dominion Bank)
4. TSX:BMO (Bank Of Montreal)
5. TSX:RY (Royal Bank of Canada)
6. TSX:TD (The Toronto-Dominion Bank)

Category

1. Investing

Tags

1. Editor's Choice

Date
2025/07/21

Date Created
2015/06/08
Author
bensinclair