



## Bank of Canada Rate Cut Could Pressure Canadian Banks

### Description

The Bank of Canada surprised some economists this week by cutting its key lending rate by 25 basis points to 0.5%, its second reduction so far this year. The central bank also slashed its outlook for the economy and predicted a contraction in the second quarter, but stopped short of calling it a recession. The central bank blamed the impact of low oil prices and weaker-than-expected exports for the contraction.

The rate cut could have implications across many market sectors, particularly banking, noted Barclays analyst John Aiken. "The immediate impact of the 25 bps rate cut by the Bank of Canada on the banks' valuations is expected to be negative," said Aiken in a report. "Further, we anticipate that the market's outlook for growth will moderate further in 2016, encapsulating an even greater slowdown in loan growth and incremental margin pressures."

Aiken says Barclays does not anticipate any incremental stimulus from increased consumer borrowing from the rate reduction. "Further, we anticipate ongoing margin compression as a result through 2016, despite the apparent move by the banks to attempt to maintain some of their margins by reducing prime by only 10 basis points."

**Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)) was first out of the gate with a 10 basis-point reduction in its prime rate; **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)), **Canadian Imperial Bank of Commerce** ([TSX:CM](#))([NYSE:CM](#)), **Bank of Montreal** ([TSX:BMO](#))([NYSE:BMO](#)) and **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) followed with a 15 basis-point cut.

Aiken adds the anticipated weakness in the Canadian dollar stemming from the rate cut could provide some immediate relief for banks that have earnings outside of Canada, as the translation boost will provide a tailwind to earnings. "On the flipside, however, net balance sheet exposures outside of Canada will result in some pressure on regulatory capital, although we do not believe that it will be sufficient to place any serious pressure on the banks."

Admittedly, this rate cut is nowhere near the surprise that took place in January, Aiken noted. "However, we anticipate that the valuation impact (relative to the TSX) is likely to parallel that

experience.” Barclays’s analysis suggests that Wednesday’s rate cut will likely result in short-term valuation weakness for the Canadian banks.

After the Bank of Canada’s surprise rate cut in January, the initial impact on share price valuations was somewhat subdued, Aiken pointed out. But following the bank’s decision not to cut their prime rates in lock step with the central bank, and instead opt for a 15 basis-point reduction, share price valuations declined by an average 7% cumulatively for the group, underperforming the broader S&P/TSX by roughly 300 bps.

History appears to be repeating itself, with all of the big banks closing modestly higher on Wednesday after the rate reduction. Keep in mind that’s just what happened after the January rate reduction, followed by a short-term decrease in the big banks’ stock prices. Long-term investors need not worry, but expect to see some volatility in the short term as the banks come to terms with the new, lower lending-rate reality.

## **CATEGORY**

1. Bank Stocks
2. Investing

## **TICKERS GLOBAL**

1. NYSE:BMO (Bank of Montreal)
2. NYSE:BNS (The Bank of Nova Scotia)
3. NYSE:CM (Canadian Imperial Bank of Commerce)
4. NYSE:RY (Royal Bank of Canada)
5. NYSE:TD (The Toronto-Dominion Bank)
6. TSX:BMO (Bank Of Montreal)
7. TSX:BNS (Bank Of Nova Scotia)
8. TSX:CM (Canadian Imperial Bank of Commerce)
9. TSX:RY (Royal Bank of Canada)
10. TSX:TD (The Toronto-Dominion Bank)

## **Category**

1. Bank Stocks
2. Investing

## **Date**

2025/09/30

## **Date Created**

2015/07/16

## **Author**

dwatt

default watermark