



## Are Low Oil Prices Hurting Canadian Banks?

### Description

As oil prices fell, many analysts warned that Canadian banks could suffer. Over one-third of Canada's economy is related to the energy sector, so as the space weakened, many predicted that numerous companies wouldn't be able to pay back billions in bank debt. Consumers, especially oil and gas workers, were also expected to get hit.

Now that we are roughly two years into the downturn, are major financial institutions feeling the pain? The CEO of **Bank of Montreal** ([TSX:BMO](#))([NYSE:BMO](#)) recently commented on the situation.

### Nothing to report ... yet

"We're not seeing increases in delinquencies yet," Bill Downe, CEO of Bank of Montreal said at the company's annual meeting this month. He said the small impact that the bank has felt thus far was "as expected," with strength in other areas offsetting any oil-related weakness.

Even if oil prices remain depressed, he believes the majority of companies will combine operations rather than go under. "The story of the oil patch is much more a story of restructuring than it is one of failure and default," he said. "That means the strongest companies are going to buy weaker companies."

While these comments are reassuring for investors, they don't paint the entire picture. The oil and gas industry accounts for only 2% of Bank of Montreal's loan book. Albertan consumers, the hardest hit by the downturn, represent just 6% of total loans. The total impact of falling oil prices would be fairly limited if it were isolated to these loans only. Unfortunately, falling oil prices have the potential to hit areas that aren't directly tied to energy.

### Low oil impacts interest rates, consumer spending, and housing prices

"With more than three-quarters of big banks earnings still tied to domestic-based operations, beset by the deteriorating domestic economic outlook, the market appears to be taking an increasingly negative view on the Canadian banks."

That quote, by **Barclays PLC** analyst John Aiken, is more representative of the pervasive impact falling energy prices have. He believes that exposure to oil and gas assets posed the greatest danger for the banks and could reduce 2016 earnings by up to 4.3%.

The first impact is falling interest rates. Rising unemployment and falling wages stemming from oil and gas cutbacks have forced the government to reduce borrowing costs with the hope of spurring economic growth. As rates fall, banking profit margins get squeezed. So even if existing borrowers honour their debts, new loans will be less profitable.

Second, lower consumer spending and borrowing have brought years of consecutive economic growth to an end. Falling paycheques will eventually restrict housing demand, eliminating a major source of new wealth creation over the past decade.

Collapsing commodity prices will “ultimately shock Canadian household income and home prices,” National Bank Financial warned in a 56-page report published in February. The report argues Canadian banks have prospered in recent decades largely due to a financial regime centred on Canadian households taking on more and more residential mortgage debt, pushing home prices higher and overall household debt levels to record levels.

### Who's at risk?

The Big Six Canadian banks include Bank of Montreal, **National Bank of Canada** ([TSX:NA](#)), **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)), **Canadian Imperial Bank of Commerce** ([TSX:CM](#))([NYSE:CM](#)), **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) and **Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)).

Together, they carry over \$100 billion in credit exposure to the oil and gas sector. According to CIBC, some defaults may ensue as the energy sector reels from a prolonged decline in prices. So, pick your banking investments carefully.

### CATEGORY

1. Energy 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:NA (National Bank of Canada)
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