Latest Rate Hike Boosts the Attractiveness of Bank of Nova Scotia

Description

Bank of Canada's decision to hike interest rates, with the headline rate increasing to 0.75% last month, has been a boon for Canada's banks. Higher rates will boost revenue and expand margins, making the banks more profitable. The move to boost interest rates is an important outcome for Canada's banks. This is because the saturated nature of Canada's financial services market, near-record levels of household debt, and tighter prudential standards have all conflated to reduce opportunities for growth.

While the Bank of Canada's recent decision will benefit each of the Big Six, it is **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) that stands out as the best long-term investment.

Now what?

What can be characterized as Canada's most international bank has established a solid operational footprint outside Canada in some of the fastest-growing and most developed economies in Latin America. That means its fortunes are not solely tied to the domestic mortgage market like the more Canada-centric banks, such as **National Bank of Canada** and **Canadian Imperial Bank of Commerce**.

Bank of Nova Scotia has been able to enjoy the higher margins that are available in Latin America because of higher official interest rates in the region.

Currently, the headline rate in Colombia, where Bank of Nova Scotia is ranked as the fifth-largest bank, is 5.5%, or more than seven times Canada's official interest rate of 0.75%. The same can be seen in Peru, Mexico, and Chile, where the majority of Bank of Nova Scotia's operations are located, which have official rates of 7%, 3.75%, and 2.5%, respectively.

As a result, the reported second-quarter 2017 net interest margin — a key measure of a bank's profitability — for Bank of Nova Scotia's international business was 5%, or more than double the 2.38% reported for its Canadian operations.

Along with a rapidly expanding lending portfolio in Latin America combined with improving creditquality, these factors have all been drivers of the bank’s growing profitability in the region.

Second-quarter net income for international banking rose by 3% quarter over quarter and an impressive 17% year over year. This growth will continue as the economic recovery across the Latin American region gains momentum because of higher commodity prices. As economic growth picks up in those nations, their central banks will look to hike interest rates, further boosting the profitability of Bank of Nova Scotia’s operations. Stronger economies and higher rates also mean that the currencies of those countries will appreciate, giving Bank of Nova Scotia’s international earnings an additional lift.

So what?

The correlation between higher interest rates and greater profitability for banks is quite clear. That means the recent rate increase will give Bank of Nova Scotia’s earnings a healthy boost, which, along with the growing profitability of its international business, should translate into a fatter bottom line.

Any significant growth in earnings will increase the likelihood of the bank rewarding investors with yet another dividend hike. Bank of Nova Scotia has already boosted its dividend for the last six years straight, giving it a tasty 3.9% yield and making it an appealing dividend-growth stock.

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