Bank of Canada Stands Pat on Interest Rates: Will Bank Stocks Continue to Soar?

Description

The Bank of Canada elected to stand pat on interest rates when it concluded its meeting on October 25, maintaining the base rate of 1%. The bank cited record high household debt, the threat of a deeper correction in housing prices, and the precarious state of NAFTA negotiations as reasons to exercise caution.

The bank said that the threat of NAFTA cancellation had the potential to dramatically damage business investment in Canada. Following these comments, odds makers and analysts have promptly adjusted further rate hike projections. Some estimate that March 2018 is now the earliest the bank will seek to hike rates once again. Unsurprisingly, this is also the extended deadline settled on for NAFTA negotiations between the three North American powers.

The S&P/TSX Index dropped 50 points on the same day as the market digested the news. With major concerns over investment and Canadian debt, will Canadian banks continue the incredible run that began in late August?

Shares of **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) were up 0.33% when trading closed on the same day. The stock has climbed 11% over a three-month period and 8.9% in 2017. TD Bank remains robust due to its U.S. exposure, the greatest proportion of any other Canadian bank. The Bank of Canada warned that burgeoning U.S. GDP growth could put downward pressure on business investment in Canada, even disregarding a scuttling of NAFTA.

Of particular interest is U.S. tax reform, which could be passed by the end of the year. The proposed plan will lower the U.S. corporate tax rate to 20% from the current 35%, and the top personal tax rate from 39.6% to 35%. It will also abolish the estate tax. The potential windfall from the reform has Wall Street excited about the prospects for growth, and with TD Bank making major inroads in its U.S. operations, it could see a major boon if the plan comes to pass.

Bank of Montreal (TSX:BMO)(NYSE:BMO) stock was up 0.21% on the same day as it marches toward triple digits. The stock has increased 3% in 2017 but was slow to pick up after third-quarter results in which it failed to hike its dividend. Regardless, Bank of Montreal also has sizable U.S. exposure, which could mitigate imbalance in some of the worst-case scenarios the Bank of Canada came up with.

Analysts have forecasted the potential for slower growth in credit segments following tightening and new regulations being introduced to cool Canadian housing. Recent mortgage regulations introduced by the OFSI will force uninsured home buyers to undergo a stress test beginning in January 2018. These factors, combined with debt-to-income ratios that are already sky-high, could result in a more dramatic correction across the country.

Statistics Canada released reports in October indicating that a broader slowdown in the Canadian economy could emerge in the last months of 2017. GDP was flat in July after eight consecutive months of growth, and overall retail sales were down in August.

Investor sentiment could drag down Canadian banks after a huge uptick in September and October, but I still like the aforementioned picks for the U.S. exposure.

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