Is Now a Good Time to Be Making an Investment in Canada's Banks?

Description

Last week, Canada's central bank, the Bank of Canada (BoC), concluded the fifth of its eight regularly scheduled meetings. And when it did, it announced that it would be raising its policy rate once again — the fourth time it has done so over the past 12 months.

That should come as welcome news for Canadian lenders like **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), **Royal Bank of Canada** (TSX:RY)(NYSE:RY), **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), and **Bank of Montreal** (TSX:BMO)(NYSE:BMO).

That's because just as the news broke that the BoC would be raising its benchmark rate, all of the banks promptly came out in lockstep and announced they would be raising their own benchmark rates as well.

Higher interest rates on things like mortgages and lines of credit mean higher revenues, margins and profits for the banks — all good things.

So, that's the good news, but is there a catch?

There is — and the catch, if you will, is that higher interest rates will make it more expensive for firms and individuals to borrow in the credit markets.

Because the cost of borrowing money increases when rates go up, those borrowers, generally speaking, can't afford to borrow quite as much.

And while that's one thing, it also means that more of their incomes — or, in the case of a firm or corporation, revenues — are directed towards interest expenses, which, in essence, just go back to the bank and are therefore re-directed away from other value-added projects and investments.

So, less money goes into the system, and that ends up impacting firms, which end up having a harder time selling their goods and raising prices, and that can impact the strength of the country's labour markets.

Basically, the recent actions taken by Canada's central bank could help to boost the banks' profits in the short run thanks to higher rates on variable-rate loans, but if it turns out that those same higher rates end up dampening consumer spending or firm's willingness to invest in capital projects, it could have detrimental effects down the road.

All this goes without discussing the implications of the latest policy announcement on Canada's housing market, which has been the focus of so much attention in recent years.

Bottom line

Among the banks, dividend and income-focused investors will likely be most drawn to CIBC for the attractiveness of its dividend.

Bank of Nova Scotia, meanwhile, may offer the best opportunity on a relative basis, as its shares have, for the most part, lagged its peers so far this year.

Investors who already hold positions in the banks may want to continue adding to their stakes — particularly if they are following some type of dollar-cost averaging strategy.

Meanwhile, Fools that are looking for something with a bit of an added kick may be better off looking elsewhere for an even better opportunity.

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jphillips