2 Banks That Might Forecast Tough Economic Times

Description

For years, doomsayers have been predicting, at the very least, a downturn in the Canadian economy. Much of the negativity has been tied to overleveraged Canadian consumers with their fancy cars and giant houses. The threat of a gloomy economic future is not without merit, seeing as Canadians are carrying a staggering amount of debt. With each Canadian *on average* owing around $1.78 of debt for every $1 of disposable income, the potential economic impact becomes ever clearer.

The problem for the negative case for the economy, though, is the fact that after years of negativity, central bank warnings, and international studies, nothing has ever materialized. But an investor's job is to look at what might be coming, so digging into the quarterly results of smaller, Canada-focused banks might be a good way to see what may be coming for the Canadian economy.

Earnings

Bank quarterly reports, especially those that are mostly focused on the Canadian economy, may give insights into any signs of economic weakness. And for the first time in a long time, bank earnings have not been as stellar as they once were. **National Bank** (TSX:NA) just reported earnings that came in below analyst estimates. The bank attributed much of the impact, however, to recent stock volatility and its financial markets division, which saw earnings drop 17% over the previous year.

Laurentian Bank (TSX:LB) also had a quarter that was not particularly great. It was so disappointing, in fact, that the bank decided to lay off 10% of its entire workforce. The bank had a 33% decrease in net income over the previous year, which is even more alarming than the results reported from National Bank. Again, the bank quoted poor performance from capital markets as its primary driver for its decrease in profit.

Loans

In order to see if there is increasing economic weakness, investors should be checking into the strength of the banks' loan books and their provisions for loan losses. National Bank's provisions increased slightly but were essentially flat for the year. Its residential loans were up 5% over the first quarter of 2018. Personal loans were down 1%, basically flat, and business and government loans were up a healthy 14%. Judging from its loan book, the economy is still borrowing, so there could be further for this economy to run.

Laurentian Bank, though, had a much more difficult quarter. Its loans did not fare so well as National Bank's when compared to the same quarter of 2018. Business loans were essentially flat, but residential loans were down 11%. Personal loans also decreased, which the bank explained was due to recent consumer behaviour of reducing household leverage, which could impact the economy if spending decreases further.

Do earning forecast an economic slowdown?

The drops in profit for both banks were reported as primarily being impacted by the banks' financial markets business. If it is merely trading activity that is costing the banks, there might be nothing to worry about.

But a deeper look into the banks' loan books, especially in the case of Laurentian Bank, shows that there seems to be a change in consumer behaviour as borrowing slows, impacting consumer spending. That reduction might eventually impact the debt-driven Canadian economy.

Unfortunately, the banks, no matter how well run they are, are dependent on the consumer being willing to take on more debt. Investors would be better off investing in the larger, more diversified, Canadian banks that are not as dependent on the Canadian economy as opposed to smaller ones. There is a very good chance that this is not the last of the poor results coming from these smaller companies for the foreseeable future, so investors need to prepare themselves accordingly.

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