Are Royal Bank (TSX:RY) and Other Bank Stocks at Risk?

Description

We're starting to see some warning signs that the economy might be starting to slow down.

Despite a favourable jobs report recently, rising interest rates and gas prices have been stretching consumers to their limits. The Bank of Canada has also put its foot off the pedal, at least for now, when it comes to more interest rate hikes. And while that might be good news for consumers with a lot of debt, it suggests that things might not be going as well as the government was expecting.

This could put lenders and big banks like **Royal Bank of Canada** (TSX:RY)(NYSE:RY) at risk. Not only does it mean that there is more risk for default, but it could also result in fewer new mortgages and less growth for RBC and other banks. Low interest rates have helped new home buyers get mortgages and under more challenging economic conditions, but won't be the case anymore.

For investors, increased credit losses combined with softer sales growth could make bank stocks unattractive buys. RBC saw revenues increase by 5.5% during its latest fiscal year, a solid rate of increase. Without strong mortgage growth, however, it could be a lot smaller going forward.

The fear is noticeable as in the past year, RBC's stock has risen just 4.5% and although it's up to start the year, it has underperformed relative to the **TSX** as a whole.

We'll get more insight into just how strong economic conditions are when RBC and the other Big Banks report their earnings this week.

One lender, **Home Capital Group Inc** (TSX:HCG), has already reported on its earnings and didn't see a big decline in mortgages. Surprisingly, the company actually saw mortgage originations increase by 4.9%. While that was definitely a positive result, it still didn't result in a better performance overall, as earnings were down around 20% year over year.

The company didn't see enough growth in other areas while expenses crept up and eroded away what otherwise was looking to be an improved quarter. Increases in compensation and interest expense were a couple of key areas where costs had risen noticeably from the prior year.

Nonetheless, for Home Capital, it was another good quarter to show that the lending company has come a long way since its well-publicized liquidity issues. It has outperformed both RBC and the TSX over the past year, rising by more than 31%. Home Capital is still hoping to see more of the same, and despite the challenges in some big markets, the company is still optimistic about the future.

In its press release, Home Capital stated that “The Company believes that current market conditions suggest a balanced and sustainable real estate market going forward, supported by healthy and rational levels of competition.” While tighter mortgage rules will certainly help to balance out hot real estate markets, we could see a lot more fallout as a result of the increased interest rates in the months to come.

For now, investors might want to take a wait-and-see approach before deciding to buy either of these stocks today.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:RY (Royal Bank of Canada)
2. TSX:HCG (Home Capital Group)
3. TSX:RY (Royal Bank of Canada)

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