Alert! This Could Be a Banking Game Changer in the Summer

Description

The investing world is anxiously awaiting the next United States Federal Reserve rate decision, which will be held on Thursday. Traders were confident in a cut in early June, but markets have stabilized. The Fed is now expected to stand pat at its upcoming meeting.

Central banks in the developed world may take cues from the U.S. Fed in the summer, which is why Canadian investors should be paying attention. **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) recently released analysis that suggested the BoC will "reluctantly" cut rates. However, it predicts that this will not come until the second quarter of 2020.

Earlier this month, I'd suggested that a softening rate environment would be a positive for a domestic housing market that is under tremendous pressure. CIBC stock has been hit hard because of the turbulence in the broader housing market. Shares have dropped 8.2% over a three-month span as of close on June 17. CIBC bet big on housing in Canada's major metropolitan areas, and a sharp decline in sales has taken its toll. The bank saw its portfolio shrink by 0.9% year over year in the second quarter.

CIBC and its peers have benefited from improved margins over the course of the BoC's rate-tightening path, but loan growth has slowed markedly. A rate cut is more likely to underpin the housing market than help it stage a rally, but this is still a positive for CIBC and other lenders that have struggled since the market suffered a sharp retreat in 2017.

Royal Bank (TSX:RY)(NYSE:RY) stock has been relatively static over the same three-month period. Interestingly, both banks were named specifically by famed short-seller Steve Eisman. He forecasts that many of Canada's top financial institutions are not prepared for "credit normalization," and that this will shred share prices.

Stock market turbulence in late 2018 encouraged a sharp policy reversal from central banks across the developed world. Solid global growth in 2017 had many central banks vowing to shrink their balance sheets and pursue rate increases, albeit gradually. This policy path has not been given much time to bear fruit, and a rate reversal leaves questions about how central banks will proceed into the next decade. Indeed, U.S. Fed chairman Jerome Powell indicated in June that the monetary easing over the past decade has evolved into “conventional” policy.

What does this all mean? The path to “credit normalization” in Canada and the rest of the developed world is murky. Policymakers have demonstrated that they are more than willing to be accommodating in recent years, and this bodes well for Canada’s top financial institutions. As it stands today, Royal Bank is still one of the pricier options among the top Canadian banks. It last had a forward P/E of 11.4 — a higher-than-average price point relative to its peers.

Big bank shareholders should be paying close attention to the Fed meeting this week. Its policy decision will likely influence the BoC and other central banks in the developed world this summer.

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