These 3 Stats Show That Canadian Banking May Have More Pain Ahead

Description

By now, most Canadian investors are aware that banking is in a tough spot. Between slowing mortgage growth, rising household debt and a sluggish economy, many of the Big Six have been feeling the heat from the broader economy. Although the effects of economic woes have not been spread evenly between Canada's biggest banks, few have come out totally unscathed. As proof, one need only point to the fact that all of them have been increasing provisions for credit losses (PCLs), which indicates that they believe credit risks are rising.

All of the above explains why U.S. hedge funds started taking short positions against Canadian banks. Their thesis was based mainly on declining credit quality, which is why they targeted domestic-oriented banks like **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM). Now, however, we've got even more alarming economic news — and this time even the more internationally oriented banks aren't safe.

We can start with one statistic that is bad news for not only banks but Canadian business in general.

The economy grew at just 0.4% last quarter

In Q1, the Canadian economy grew at just 0.4% year over year, despite an insanely weak dollar that should be spurring export growth.

This is very bad news for a bank like CIBC. Although it does have some U.S. operations, they're tiny as a percentage of total revenue. What this means is that if the domestic economy is sluggish, CIBC suffers. And sluggish it is: 0.4% GDP growth is a tiny fraction of the U.S. growth rate and puts us dangerously close to a recession.

Inflation is running at 2.4%

Recently, higher food prices have been driving inflation up. In May, core inflation reached 2.4%, which is near the upper limit of the Bank of Canada's target range. Inflation can hurt banks' real earnings, because banks deal in debt instruments that are paid off in nominal terms. For example, when a customer takes out a fixed-rate mortgage, they commit to pay off a certain amount plus a fixed interest rate — the bank isn't at liberty to raise interest rates to compensate for inflation. This creates a potential problem for a bank like CIBC, which depends heavily on domestic mortgages to earn revenue.

New housing starts dropped by 13.3% in May

Last but not least, we have the fact that new housing starts fell by 13.3% in May. Housing starts are an important leading indicator, which means they show whether the economy will grow or contract in the future. A reduction in housing starts indicates the latter, and 13.3% is an absolutely colossal decline.

Banks in particular tend to rise or fall with the broader economy, as their business is closely tied to economic fundamentals. Unfortunately, both Q1 GDP growth and housing starts are pointing toward a recession, which is not good news for domestic-focused banks like CIBC. On the plus side, you could always buy a more U.S.-oriented bank like **TD Bank** and benefit from the comparatively frothy growth south of the border.

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andrewbutton