One Big Reason to Avoid Bank of Nova Scotia (TSX:BNS)

Description

Canada's banking sector has often been praised for its stability and is generally the go-to investment for risk adverse investors. Lately however, Canadian banking stocks have been under pressure thanks to low interest rates and slowdowns in loan generation. Based on the latest loan data from the Office of the Superintendent of Bankruptcy, we can anticipate loan losses to climb in the coming quarters, adding further pressure on the banking sector.

Rising insolvencies point to grim outlook for the sector

As if the low interest rate environment wasn't already bad enough, the recently released report from the OSB painted a pretty grim picture for our banking sector. In May, consumer credit continued to deteriorate, as consumer insolvencies increased 9% year over year, with Ontario experiencing a particularly pronounced deterioration of 16% over the same period.

These loan losses are contrast to the general economy, which continue to see unemployment rates remain low at 5.5% for June. That said, the divergence in employment and insolvencies can most likely be explained by a catch-up effect from the Bank of Canada's previous rate hikes.

Further, an April poll conducted by insolvency firm MNP Ltd., found that 35% of Canadians believe a further interest rate hike would move them toward bankruptcy, while 54% of Canadians expressed concerns about their growing debts. Which Canadians are the most vulnerable to interest rate headwinds? According to the survey, Atlantic Canadians were the most at risk of insolvency, followed by Quebec and Ontario residents.

Which bank to avoid?

While the banking sector is lauded for its safety, especially when contrasted against their American counterparts, one bank I would avoid would be **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) owing to a sharp increase in its provisions for credit losses (basically an expense set aside for delinquent loans) in the Canadian banking segment, of 23% year over year to 252 basis points and +8% compared to the prior quarter.

More important, the Canadian retail banking segment revenues came in at 2% below the prior year's numbers, in contrast to its peers such as **CIBC** (TSX:CM)(NYSE:CM) which saw commercial banking revenues increase 1% over the same time frame. To make matters worse, in late June BNS announced that it would be divesting its previously touted Puerto Rico and U.S. Virgin Islands and booking an after-tax net loss in the range of $300 to $360 million.

The bottom line is that although Canadian banks are known for their stability, the macroeconomic outlook is not conducive to a bullish thesis. Canadian household credit remains at all-time highs, and we can anticipate further loan losses as the impact of 2018's rate hikes begin to flow through.

At the same time, interest margin issues will most likely continue into 2020, as rates will remain low throughout this period. However, I am not inclined to discount the sector entirely, but will certainly eschew BNS in favour of any one of its peers.

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Date
2025/08/16
Date Created
2019/07/13
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