



Part 2: The Impact of Lower Rates and a Potential Recession on Canada's Banking Sector

Description

In part one of this two-part post, we talked about the confluence of factors that have helped (and I use that term loosely) contribute to historically cheap interest rates both in Canada and across most of the world's leading developed nations.

Now, some readers may not appreciate this point fully, but the fact remains that banks have been (rightly so) anticipating and [planning for](#) the scenario of a secularly lower interest rate environment for quite some time now, as is evidenced by the shift to more fee-based revenues in recent years and away from relying so heavily on interest sourced revenue streams.

That factor should help banks with stronger service-oriented business units weather the storm of lower interest rates, at least on a relative basis going forward.

In particular, **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)), **Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)) and **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) immediately come to mind, thanks to some fairly significant investments in their respective wealth management and advisory divisions over the course of the past decade.

However, the constant demands placed on banks to grow their revenues and earnings at all costs could also have some detrimental consequences.

For example, the need to continually raise fees on traditional run-of-the-mill banking products – things like every day checking and savings accounts – runs the risk that one day (if not already) the average Canadian is no longer getting a fair bang for their buck out of their every day banking institution.

It's not at all unreasonable to suggest that this is a trend that could continue to pressure some Canadians – and probably younger ones in particular – to seek out newer, more disruptive banking models that have come to the fore in recent years thanks to advances in technology, fintech and robo-advisory services.

That potential development coupled with the fact that home-ownership – and by direct proxy – the

mortgage lending business is increasingly becoming a rich person's game, and, by the same token, out of reach for many middle-class Canadian households suggests that the long-term future of Canada's banking system may not resemble today's picture.

The one thing we do know, however, is that banks are increasingly lending out larger sums of money to clients than ever before, and at cheaper borrowing rates than they ever have before in their entire and longstanding existence.

Now I'm not typically a cynic nor am I much of a naysayer – far from it, in fact!

But at some point, there's an underlying reality of economics at play that we're dealing with here, and one would think that eventually at some point, something will have to give.

No reason to panic

However, it's critically important to point out that banks not just in Canada, but around the world have come under immense scrutiny in recent years in the wake of last decade's financial crisis.

That's in addition to the fact that Canada's financial regulations even prior to 2008-09 were already among some of the most restrictive in the world.

All of which gives me good reason to believe that an outcome like we saw in the U.S. a little more than a decade ago isn't all that likely to happen a second time here in Canada.

Lower growth for longer?

But between a rock and very, very hard place – is Canada's banking sector running out of room to move?

Perhaps.

I continue to like the Canadian banks for their [reliable dividend payouts](#), which still have plenty of room to grow sustainably thanks to their conservative payout versus earnings ratios.

But if you're intent with an investment is to look ahead to the future, there are many other industries out there that continue to welcome, indeed even embrace, technological change, disruption, innovation and growth and all at a much more rapid pace than what the banks have been able to offer Canadians – both as their customers, and investors, thus far.

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