RBC (TSX:RY) Could Be Doomed If the Housing Market Crashes

Description

Next to a recession, investors in Canada fear a housing market crash. Many see the housing market bubble as more critical than a stock market bubble. Usually, a housing bubble follows a rapid increase in housing prices until the levels are no longer sustainable. A decline will then ensue and the effects could last longer.

For the period between 2013 and 2019, there is a significant rise in the prices of real estate. The home owning costs in 2018 were already above the 1990 or the year Canada saw its last housing market crash. In April of 2019, the Bank of Canada admitted that the housing market was in uncharted territory.

Against this backdrop, let's focus on the largest bank in Canada and the biggest company on the **TSX** in terms of market capitalization. Is **Royal Bank of Canada** (TSX:RY)(NYSE:RY) doomed if the housing market crashes?

Higher loan loss provision

The real estate industry in Canada accounts for 12% of the country's GDP. If the housing market turns for the worse, mass selling of properties could occur. The sharp decline in prices could then snowball and create a larger problem.

RBC is bound to take a hit because of its large exposure to the slowing housing market. If mortgage originations were to lessen or stop, real estate-related income would drop. Similarly, the risk of default could rise as the drop in prices could result to negative equity.

Homeowners would owe more on mortgages than the current value of their properties. The level of comfort is that two-thirds of mortgages are covered by insurance. Investors find it worrisome to see RBC increase its total provisions for credit losses during the third quarter by 23% to $425 million.

RBC seems unperturbed by the prospects of a housing crash. With net income during the third-quarter rising by 5% to $3.3 billion, the banking giant was able to increase its dividend. The quarterly earnings seem to indicate that the mortgage books of RBC is rock solid.

RBC Chief Executive Office Dave McKay was confident in saying, “Our focused strategy and diversified business mix continue to deliver strong returns for our shareholders as we leverage our scale and investments in technology to create new value streams for our clients.”

The strong showing of the personal and commercial banking, wealth management and insurance divisions were the reasons for the strong quarterly earnings. But the performances of the capital markets, investor and treasury services divisions were below par due to the challenging market conditions.

Wide MOAT

RBC is the largest publicly-listed company on the **TSX Index** with a market cap of $153.45 billion as of this writing. Since its founding in 1882, the bank experienced decades of rapid asset growth. Today, this top Canadian bank is one of the world’s most systemically important banks.

Despite the headwinds of a slowing economic growth and low-interest rate environment, RBC has done an admirable job during the third-quarter. Its operating performance was decent with an ROE of 16.7%.

My take is that the bank deserves a wide moat rating. RBC will continue to deliver the best returns for shareholders notwithstanding a housing market crash.

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