



Will Rising Geopolitical Risk in Latin America Impact Bank of Nova Scotia (TSX:BNS)?

Description

Canada's third largest lender, **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) over the last decade has invested considerable capital to expand its business into Latin America.

Bank of Nova Scotia, or Scotiabank, is a top 10 ranked institution in some of the region's largest economies including Mexico, Chile, Colombia and Peru. That has seen its [international division](#) by the third quarter 2019 become responsible for generating almost half of the bank's net income.

While that was extremely beneficial for Scotiabank when Canada's economy softened and the housing market slowed, it is now proving to be a significant risk that could have a material impact on the bank's performance.

Latin America, a region long recognized for its political and economic instability, once again finds itself convulsed by civil unrest.

Rising geopolitical risk

Chile, long touted as the region's most developed economy where Scotiabank operates the third largest privately-owned bank, has been wracked by protests since the government moved to lift public transport fares.

The initial protests morphed into general unrest focused on extreme inequality and lack of opportunity for many Chileans. The scale of the dissent saw the government respond in a heavy-handed manner that has caused it to escalate and spread.

There are fears that this will have a sharp impact on an economy, which is heavily dependent on copper mining and exports to drive growth.

Weaker manufacturing activity among many major industrialized economies coupled with the fear surrounding the trade war between the U.S. and China is weighing on copper, which has lost 2% since

the start of 2019.

Any decline in gross domestic product (GDP) growth will cause demand for credit to decline and impaired loans to rise, thereby impacting Scotiabank's performance in Chile.

Similar unrest broke out in Colombia last week, where Scotiabank is the fifth-largest bank by assets. The Andean nation's economy was significantly weakened by the prolonged slump in crude and the government of President Ivàn Duque has been facing a fiscal crisis, sparking further unrest over inequality, low wages and a lack of opportunity.

The failure of Duque to implement the historic 2016 peace accord with the largest insurgent group the FARC, ongoing conflict between various other illegal armed groups and a resurgence in narco-trafficking have led to increased crime and insecurity.

While Colombia's third-quarter GDP growth has firmed to 3.3%, well above the multi-year low of 1.5% for the same period in 2017, the [economic outlook](#) is not as positive as some analysts believe.

Low household incomes, stagnant wage growth and growing indebtedness are weighing on consumption, while business confidence remains weak because of growing unrest and insecurity.

This has seen a decline in foreign investment since the oil boom peaked in 2013 along with a notable decline in credit and loan quality, which will impact Scotiabank's earnings in Colombia.

The International Monetary Fund (IMF) has also downgraded its outlook for Peru, anticipating year-over-year GDP growth of 2.6% compared to well over 3% at the end of 2018.

Scotiabank is the third largest financial institution in Peru and slower growth will have a negative effect on earnings growth.

The bank's international division has long been touted as an important growth engine because of Latin America's modernizing and rapidly growing economies, which would offset a softer Canadian economy and housing market.

The recent civil unrest in Chile and Colombia along with a weaker economy in Peru has the potential to derail the bank's expected earnings growth.

Foolish takeaway

The economic impact of those events will be magnified by softer commodities prices caused by declining global manufacturing activity and the trade war between the world's two largest economies, the U.S. and China.

For these reasons, Scotiabank's performance over the last quarter of 2019 and into 2020 may not be as strong as anticipated.

Nonetheless, investors shouldn't panic, however, as geopolitical risk in Latin America typically ebbs and flows, while commodity prices are cyclical by nature, meaning that a recovery could occur at any time.

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