Did the Bank of Nova Scotia (TSX:BNS) Warn Us About a Recession?

Description

Bank earnings season is always one of the most anticipated times of the year. The **S&P/TSX Composite Index** has enjoyed a solid year, up 18.72% thus far. The rebound from last year's double-digit drop is particularly impressive given the uncertainty of the economic backdrop.

The quarterly results of Canada's big banks are heavily scrutinized, as they offer a unique perspective on the Canadian economic picture. As primary money lenders, they can provide insight into consumer and business borrowing activity.

When demand for borrowing softens, it is usually a sign that the markets are fearful of a potential recession. Likewise, as Canada's debt burden continues to hover around record highs, a higher than expected provision for credit losses can be a sign that consumers have reached peak borrowing.

On Tuesday, the Bank of Nova Scotia was the first of the Big Five to report earnings. All four of its Big Five peers don't report until the first week of December. Can the Bank of Nova Scotia's fourth-quarter results provide insight as to what to expect next week? Let's take a look.

Decent, yet nothing to get excited about

The Bank of Nova Scotia posted mixed fourth quarter results. Earnings of $1.82 per share met expectations while revenue of $7.97 billion missed estimates by $10 million. It wasn't a big miss, and revenue still increased by 7% over the fourth quarter of 2018.

Earnings per share crept up by a mere 1.15% and the company's return on equity (ROE) fell by 50 basis points to 13.3%. For the year, adjusted earnings grew by 0.4% and ROE dropped by 100 basis points. It appeared to be a disappointing year for the company.

The company missed on three of its four mid-term objectives – earnings growth of 7%, ROE of +14% and positive operating leverage. As we've seen, earnings and ROE missed by a large margin, while its adjusted operating leverage came in at negative 2.1%. The only objective it met was to maintain a strong CET ratio (11.1%).

It wasn't all bad, however. The company has been in transition as it attempts to exit some ill-fated acquisitions. It is focused on streamlined international operations and in 2019, it bought back 15 million shares for cancellation.

Of particular importance is the performance of its Canadian retail banking segment. On the positive side, total revenue jumped by 3.5% over the fourth quarter of 2018.

On the negative, PCL continued its upward trend. Year over year, it jumped by 24% and for the full year, PCL increased by 22.8% to $972 million, up from $794 million in 2018.

Although it remains an ongoing concern, it is important to note that PCL accounts for a very small percentage of outstanding loans. Despite an increase of three basis points, year-end PCL accounted for only 0.51% of total loans, which is well within an acceptable range.

Foolish takeaway

The Bank of Nova Scotia's transition to a more focused bank is a positive. Unfortunately, it is having a short-term impact on results as its global banking segment continues to be a drag on results.

On the bright side, Canadian and business consumer loan growth was strong, pointing to continued confidence in the economy. Although a rise in PCL is worth monitoring, it's not yet pointing to significant troubles ahead.

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