2020 Could Be the Year That Debt Catches Up to the Big 5 Banks

Description

The New Year is a critical period for Canada's Big Banks. While the Bank of Canada held interest rates steady in 2019, the growing debt is posing a threat to the country's banking system. With consumer debt rising to excessive levels, will it catch up with the industry dominated by the banking giants?

As early as March 2018, Moody's Investors Service issued a warning that the Canadian economy is most at risk of a banking crisis. Banks such as **Toronto-Dominion** (TSX:TD)(NYSE:TD) and **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) are facing a year of uncertainty.

Resilient Bank

The fiscal Q4 2019 earnings of Toront0-Dominion declined by 4% to $2.85 billion versus the same period in 2018. On a full-year basis, however, the most popular Canadian bank posted an $11.7 billion profit, which is a 3.61% improvement compared with the previous year.

According to the TD Bank Group's President and CEO Bharat Masrani, 2019 was another demonstration of the bank's strength and resiliency. He cited the modest earnings growth amidst a challenging macroeconomic environment. Similarly, Masrani highlights the strategic investments to strengthen the business.

The investments by TD's Canadian Retail were in core infrastructure and new digital capabilities. Its U.S. Retail Bank saw higher loan and deposit volumes although lower margins offset them.

In spite of the apprehension by analysts, TD expects to overcome the challenges in 2020. Management is relying on its proven business model, purpose-driven brand, and forward-focused approach.

During the 2008 financial crisis, among all banks or companies, only TD reported both revenue and income growth.

Simplified footprint

Scotiabank acknowledges the bumpy road, although it holds a positive earnings outlook in 2020. Management expects to deliver organic growth in the single digits — a projection within the forecast range for the entire banking industry in Canada.

This $89 billion bank is confident of improving earnings quality because its repositioning efforts in the last four years are nearly complete. With a simplified footprint, it opens a path to higher capital ratios. Also, the steps should meaningfully reduce its risk profile.

To assuage the fears, Scotiabank wants investors to know that the key credit metrics are stable, including credit quality, net write-offs, gross loan impairments, and delinquency rate. This year, the bank is focusing on managing expense growth in line with revenue growth. Investments in technology will also continue.

Scotiabank is reminding investors of its strong record of consistent dividend increases over its corporate existence — a reflection of both strong profitability and prudent capital deployment.

Starting in fiscal 2020, Scotiabank will make yearly dividend policy decisions.

No alarm bells

Toronto-Dominion and Scotiabank appear to be in a position to manage the harsh operating environment this year, including rising consumer debt. Should the banks produce weaker financial performance, they will not stray from the industry's historical averages.

Both banks survived the recent financial crisis with flying colours. While profit margins will be under pressure in 2020, it won't trigger alarm bells. If you're worried about the stocks' dividends, they're safe and sustainable.

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