



Bank of Nova Scotia (TSX:BNS) Is Under Pressure After a Lacklustre 2019

Description

Canada's third largest lender **Bank of Nova Scotia** ([TSX:BNS](#)) ([NYSE:BNS](#)) was the second worst performing of the Big Six banks during 2019. It returned, before dividends, a paltry 7% during the year compared to the **S&P/TSX Composite Index** gaining a notable 19%. There are emerging issues that could weigh on what is known as Canada's most international bank during 2020.

Significant short interest

Similar to many of Canada's major banks, Scotiabank is attracting considerable interest from [short sellers](#) seeing it ranked as the fifth most shorted stock on the **TSX**. It's mainly U.S. hedge funds and traders that are responsible for this negative attention.

Their thesis is quite simple; they're expecting a decline in credit quality which, when coupled with a cooler housing market will have sharp impact on earnings growth and balance sheet quality, leading to a decline in market value.

There are certainly headwinds facing the banks and particularly Scotiabank, but it won't be Canada's housing market that will weigh on their performance. The growing consensus among analysts is that Canada's housing market will strengthen over the course of 2020.

Sales activity is expected to keep rising and the national average house price during 2019 had grown by 9% compared to a year earlier, boding well for the performance of the more domestically focused banks.

It is for this reason that short interest in **Canadian Imperial Bank of Commerce** has declined substantially since the start of 2020.

Softer global outlook

Weaker global growth will impact Canada's banks but will have the sharpest negative effect on

Scotiabank, the most international of the Big Six, having established significant business in Latin America, notably the Pacific Alliance nations of Mexico, Chile, Colombia and Peru.

The IMF recently downgraded its forecasts for 2020, reducing anticipated global GDP growth from 3.4% to 3.3% because of lower than expected economic activity in emerging economies.

Latin America was one region that attracted significant downward revisions from the IMF in its latest World Economic Outlook. It has sharply marked down the growth prospects for Mexico and notably Chile because of [civil unrest](#).

There are also signs that Colombia's economy could also falter, with the Andean nation being rocked by protests since November 2019.

It appears that dissent against the administration of President Duque will continue, with the government unwilling to meet the demands tabled by a myriad of interest groups. If protests intensify, it could have a marked impact on Colombia's economy and reduce 2020 GDP growth from the IMF's forecast 3.6% to as low as 2.9%.

This will negatively impact Scotiabank's 2020 earnings because the Pacific Alliance countries have become a key growth driver for the bank. For the fourth quarter 2019, loans in those nations grew by 10% year over year, boosting the loan portfolio for Scotiabank's international dividend by 8%.

The strong growth experienced by Scotiabank's operations outside Canada was responsible for its international business generating 37% of its adjusted fourth quarter net income compared to 32% two years earlier.

Another threat to Scotiabank's earnings in Latin America is that many nations are dependent upon the extraction and export of commodities to drive growth.

Reduced economic activity in the major emerging economies of India and China, which the IMF has predicted for 2020, will lead weaker commodity prices, notably for base metals, oil and coal.

That will further impact Colombia, where crude is responsible for generating around a third of export earnings as well as Peru and Chile, with both nations heavily dependent on the mining of base metals including copper to generate growth.

A general economic slowdown in those countries coupled with narrow margins because of lower interest rates will harm the profitability of Scotiabank's international operations, thereby weighing on its overall performance.

Foolish takeaway

Despite an improving housing market and firmer economic growth in Canada, the worsening outlook for Latin America could have a marked impact on Scotiabank's 2020 performance.

While the bank is certainly an appealing long-term play, it increasingly appears that it will struggle to deliver significant value in 2020.

CATEGORY

1. Bank Stocks
2. Investing

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1. NYSE:BNS (The Bank of Nova Scotia)
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