



The 2020 Outlook for Canada's Big Five Banks Appears Bleak

Description

Most Canadian banks experienced a lacklustre 2019, with the Big Five failing to outperform the broader market. The worst-performing of the big five was **Canadian Imperial Bank of Commerce**, which gained a mere 6%, while **Toronto-Dominion Bank** and **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) both gained 7%.

The best performer was **Bank of Montreal**, which rose by almost 13% and was closely followed by **Royal Bank of Canada** gaining 10%.

In all cases, this is significantly less than the 19% return of the **S&P/TSX Composite Index**. While there is speculation that the Big Five are attractively valued and will deliver value during 2020, the outlook is not as positive as some pundits believe.

Worsening outlook

Weaker economic growth — which sees the IMF predicting that Canada's GDP will expand by a modest 1.8% during 2020 — doesn't bode well for the banks. This because there is a correlation between GDP growth and consumption of credit, a key earnings driver for banks, meaning that if economic activity softens, then the demand for credit diminishes.

A softer housing market is applying pressure because despite predictions that sales will increase during 2020, activity will still be significantly weaker than in 2017, when the Big Banks reported solid results.

The lack of economic growth coupled with the extreme indebtedness of Canadian households and stagnant wages will trigger a downturn in credit quality causing non-performing loans and credit losses to rise placing further pressure on earnings.

For these reasons, analysts are predicting that 2020 earnings for the Big Five will grow by a modest 3% on average.

CIBC is one of the most vulnerable because of its considerable dependence on the Canadian market. By the end of 2019, 84% of the bank's loan originated in Canada and domestic residential mortgages accounted for 51% of all loans outstanding.

Scotiabank will also suffer during 2020, not only because of the poor outlook in Canada but also because of its considerable international exposure.

The bank has built an impressive business in Latin America focused on the Pacific Alliance trade bloc composed of Mexico, Colombia, Peru and Chile where it's ranked as a top-6 financial institution.

Those nations are an important growth driver for Scotiabank – and are responsible for significantly boosting 2019 earnings for its international division to see it responsible for 39% of Scotiabank's annual net income compared to 32% two years earlier.

Despite the considerable promise shown by its international operations, Scotiabank has hit a snag in [Latin America](#). Many economies in the region are under considerable pressure, and 2020 GDP growth may not be as strong as originally anticipated because of significant political and economic risks.

Mexico's central bank recently revised its 2020 GDP growth forecast downward by 0.7% compared to earlier predictions to be somewhere between 0.8% and 1.8%.

The outlook for Latin America's second-largest economy remains poor because of weaker oil and a sharp increase in violence because of the drugs war. Colombia and Chile have been rocked by anti-government protests, which are weighing on the economy.

Then there is the threat posed to commodity prices by a weaker Chinese economy because of the coronavirus outbreak. China is the world's largest consumer of commodities, and any weakness in its manufacturing or construction sectors would cause prices to tumble, particularly for oil and base metals.

It is speculated that the pandemic could shave up to 2% off China's 2020 GDP growth, which could cause commodity prices to plummet.

Commodity exports, notably oil in Colombia and Mexico as well as base metals for Peru and Chile, are an important driver of economic growth for those nations.

Weaker prices caused by a sharp decline in economic activity in China will weigh on those economies leading to substantially lower growth, in turn causing demand for credit and hence Scotiabank's earnings to fall.

Looking ahead

There is considerable uncertainty surrounding the global economy that's weighing on Canada's economy and commodity prices, boding poorly for the Big Five banks.

Scotiabank is among the [most vulnerable](#) because of its considerable exposure to Latin America, where heightened geopolitical and economic risks are weighing on the region's outlook. For those reasons, Scotiabank will struggle to deliver value during 2020.

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