Will Canadian Banks' Higher Earnings This Week Boost the TSX Index?

Description

After setting aside record amount on potential credit losses last quarter, Canadian banks are expected to be better off in the third quarter. Their provisions for credit losses will be lower than the second quarter of 2020, which will likely boost their bottom lines.

Expect higher earnings on a sequential basis

Some of the Big Six bank stocks have seen some upward momentum recently ahead of their third-quarter earnings last week. Notably, higher than expected earnings could continue to push **TSX** bank stocks further higher.

Though Canadian banks' earnings are expected to increase in the third quarter compared to Q2 2020, they will likely still be lower compared to Q3 2019. Importantly, the whole situation for Canadian banks looks grim compared to last year, as several negative factors have stemmed at the same time.

Record low-interest rates will hamper net interest margins, while provisions will directly dent their net incomes.

Canadian bank stocks have underperformed broader markets by a wide margin in an epic COVID-19 relief rally. While the **TSX Index** soared more than 45% in the last five months, Big Six bank stocks have managed to increase only 25% on average.

Royal Bank of Canada (TSX:RY)(NYSE:RY), the country's biggest bank by market cap, will report its third-quarter earnings on August 26. In the earlier quarter, its earnings halved as credit loss provisions surged to record highs amid the pandemic. Banks generally set aside specific amounts for loans that may go bad in the future, which is called as a provision.

RY stock has recovered 36% since its record lows in March, standing tall against peer Canadian bank stocks.

What’s next for Canadian banks?

The second-biggest bank **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) will report on August 27. Its net income halved in the earlier quarter but is expected to play out relatively better in Q3 2020. TD Bank stock is up approximately 24% since the pandemic crash.

Government stimulus and higher profits from the financial market trading divisions will also help boost the bank’s bottom lines in the third quarter.

Bank of Nova Scotia (TSX:BNS)(NYSE:BNS) could be the most vulnerable among peers mainly because of its huge exposure to Latin America—among the worst-hit by the pandemic. Its earnings fell 40% in the second quarter, relatively better compared to peers. Scotiabank will report its earnings on August 25.

The stock saw little recovery after the pandemic crash. Whether the third-quarter earnings fuel its stock in the short term will be interesting to see.

Bottom line

Investors should note that top Canadian banks are well placed to tackle the crisis and will likely emerge stronger. They are well-capitalized and are fairly above regulatory requirements. Though they are reporting sizeable profit declines, dividend cuts are unlikely.

However, how asset quality alters after government stimulus and moratorium period are over remains to be seen.

Notably, Canadian bank stocks look attractively valued due to their subdued movement in the last few months. Their dependable dividends will be particularly comforting for investors in these uncertain times.

Importantly, a faster than expected economic recovery should significantly boost TSX bank stocks in the medium to long term.

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