



2 Reasons Canada's Banks Are Riskier Than Ever

Description

Canada's banks face a precarious future. As the economic crisis drags on, banks face higher losses at a time when credit quality has decreased. Nevertheless, some banks, like **TD Bank** ([TSX:TD](#))([NYSE:TD](#)) stock, could be safer than their rivals.

Here's a closer look at two reasons why banks are at heightened risk and why TD Bank stock deserves closer attention.

Provisions for losses

Every bank sets aside some money for loan losses. This capital acts as a buffer when consumers or businesses start defaulting on their debt. In other words, the provisions for loan losses protects the bank's investors.

Unfortunately, Canadian banks have some of the lowest loan loss provisions in the world. In fact, **Royal Bank of Canada** lowered its loan loss provisions to \$675 million, 76% lower than last year

The banks have set less money aside in the middle of a historic crisis. Corporations have been defaulting on their debt and going bankrupt at a record pace. On the horizon is another major risk: the housing market.

Housing market

Home loans or mortgages are, obviously, the core operations of Canadian banks. Canada's housing sector is the most critical part of the national economy. However, households have levered themselves to a historic maximum. As of August, 2020, Canada's household debt to gross domestic product ratio is 101%. The household debt to disposable income ratio is 172%.

In other words, the average Canadian family has \$1.72 in debt for every dollar of spending money, which makes the housing market risky. In fact, analysts at RBC Bank and the Canada Mortgage and Housing Corporation expect house prices to decline over the coming months.

Canadian banks have offered mortgage deferrals to millions of homeowners during this crisis. As these deferrals lapse, some households may be unable to pay and be forced to forfeit their houses. This collapse in the housing market will be reflected in the balance sheets of the nation's largest banks.

TD Bank stock

TD Bank reported its [third-quarter earnings](#) this morning. The bank declared \$1.21 in diluted earnings per share, compared with \$1.74 for the same quarter last year. In other words, profits have declined substantially.

A key reason for this reduction was the higher provisions for credit losses (PCL). According to the bank's management team, they've set aside an additional \$635 million for potential losses this year.

However, TD Bank stock is up 3% after the earnings report, as earnings were better than analysts expected. Higher provisions for loan losses also means the bank is better prepared for a spike in defaults. If the economic crisis drags on and consumers or businesses default on their debt, TD Bank could cushion the blow to its balance sheet.

The bank is also being conservative with its cash flow. The dividend payout ratio is just 52%, which means nearly half of annual earnings are saved for a rainy day. Despite the low payout ratio, TD Bank stock offers a sizable 4.6% dividend yield.

Bottom line

These factors make TD Bank stock one of the best passive income bets in the banking industry.

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