



Canadian Banks' Earnings Suggest a Bright Recovery in 2021

Description

It came as a delight for investors when Canadian banks reported better-than-expected profit numbers this week. Despite the ongoing pandemic, Canadian banks' strong Q1 results underline that the economic recovery is well on track. That's a big thumbs-up for the equity markets, too, which could drive stocks higher. However, although banks have reported solid numbers, the road to normalcy will not be totally trouble-free.

Canadian banks and their strong Q1 numbers

Canada's biggest bank, **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)), reported its first-quarter earnings on Wednesday. It reported a net income of \$3.85 billion for the quarter ended on January 31, 2021. That represents a decent 10% growth year over year.

Most importantly, Royal Bank set aside \$110 million in provisions for loan losses during Q1 2021. This was substantially lower than last year's provisions of \$4.4 billion.

Banks generally set aside specific amounts for loans that may go bad in the future, which are called provisions. During the pandemic and closures, Canadian banks took a little extra-conservative approach and reserved billions in provisions.

Royal Bank's lower Q1 provisions indicate management's confidence in the repayments amid the ongoing economic recovery. If loans did not go bad, as per the bank's expectations, the reserves would be used for more productive uses like aggressive lending or acquisitions.

Importantly, there was all-around growth for Royal Bank during the quarter. Its personal and commercial banking segment saw fair growth. The bank's capital market segment has been performing well for the last few quarters. But it has been the trend across the board due to rallying markets.

Provisions trend lower in 2021

Interestingly, all the big banks in the country that have reported so far have shown similar strengths. **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) reported a net income of \$2.4 billion for the first quarter against a profit of \$2.3 billion in a year-ago period.

On the provisions front, Scotiabank set aside \$764 million during the quarter, which was notably lower than its last year's [provisions](#) of \$6 billion. Note that Scotiabank's provisions will likely remain higher against peers, given its large exposure to Latin American countries.

Bank of Montreal ([TSX:BMO](#))([NYSE:BMO](#)) saw an even bigger increase in Q1 profits. It reported a net income of \$2 billion for the quarter, representing a handsome 27% growth year over year. Its provisions for credit losses came in at \$156 million compared to 2020 provisions of \$2.76 billion.

Top TSX bank stocks

Investors cheered Canadian bank's quarterly results this week. The optimism sent their shares higher than their respective pre-pandemic levels in March 2020. From their respective lows in March, RY, BNS, and BMO stocks have gained 55%, 65%, and 92%, respectively.

The banking regulator put a stay on dividend increases last March to maintain their balance sheet strength. Considering the recovery and strong financial position, it might allow Canadian banks to [raise dividends](#) this year.

Challenges and opportunities

Although the recovery seems in sight now, challenges are still far from over. How loan repayment plays out once the government stops stimulus checks will be interesting to see. Another worry could be slower vaccinations. Mutating viruses and closures could weigh on recovering business activities if vaccination remains slower.

Ramping up on vaccinations could play a game changer. Stock markets will likely get a boost from the approaching economic recovery and an upbeat quarterly earnings season.

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