



Is RBC Stock a Buy in December 2022?

Description

Canadian bank stocks marched higher in October, but the rally soon waned. And that's expected, given the geopolitical instability and increasing recession fears. Canada's biggest bank, **Royal Bank** ([TSX:RY](#)), is trading 12% lower from its highs early this year. TSX bank stocks do indeed look appealing after their correction this year. However, banking investors are mulling whether to enter now or wait given the impending weakness amid further rate hikes.

TSX bank stocks and rate hikes in 2022

Bank of Canada again raised rates last week, taking them to 4.25%. The central bank has increased rates by 400 basis points in the last nine months, representing a very accelerated pace amid record-high inflation. Banks generally have higher net interest margins during rising rate periods. However, recession fears and higher provisions have weighed on their earnings this year. As a result, TSX bank stocks are trading 10%–15% lower than their highs in early 2022.

Royal Bank of Canada is the country's largest bank by customers and market cap. Its scale and earnings stability make it stand tall among its peers. For the fiscal year 2022, Royal Bank reported a net income of \$15.8 billion, a drop of 2% compared to 2021.

While the earnings drop may not bother investors much, the number of higher provisions could be worrisome. For the latest reported quarter, RY raised its provisions to \$381 million, a significant jump from earlier quarters.

Banks make provisions for loans that could go bad in the future. Almost all Canadian banks have notably increased provisions in the recent quarter, indicating a gloomy financial outlook for 2023.

What's next for Royal Bank in 2023?

In fiscal Q4 2022, Royal Bank reported average volume growth of 9% in both loans and deposits in its Personal and Commercial banking segments. In the same quarter, its common equity tier 1 (CET1)

ratio came in at 12.6%, higher than regulatory requirements but much lower than peers. The ratio indicates the bank's equity capital compared with risk-weighted assets and shows its ability to withstand shock.

In October 2022, Royal Bank agreed to buy HSBC Canada for a whopping \$13.5 billion. The acquisition — that too with a decent premium – indicates Royal Bank's focus on growth. While the deal is expected to increase RY's scale, it will likely bring down its CET1 ratio. Canada's biggest bank expects the deal to add \$1.4 billion in incremental profits from 2024.

Royal Bank looks strong fundamentally, and the recent weak market performance is largely due to macro challenges. In the last 10 years, the bank's net income has grown by 8%, compounded annually. Note that it has returned 12% compounded annually in the same period.

RY stock currently yields a decent 4%, in line with its peers. The bank aims to give away 40%–50% of its earnings as [dividends](#). Its long dividend payment history indicates reliability, which stands particularly strong in volatile markets.

Conclusion

Royal Bank of Canada does look appealing for the long term mainly because of its scale and stable earnings prospects. Its dividends and [valuation](#) fall in line with its sectoral peers. However, the stock might not witness a quick turnaround due to the economic uncertainties.

Higher inflation and rate hikes indeed pose a serious challenge to the global economy. How they will impact borrowers' repayment capacity next year remains to be seen. So, if you are a long-term investor, consider buying RY in multiple tranches.

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