Royal Bank of Canada Stock: Here’s What’s Coming in 2023

Description

Canadian bank stocks notably underperformed the **TSX Composite Index** last year. Although they have started the new year on a positive note, they are not out of the woods yet. **Royal Bank of Canada** (TSX:RY) stock stood tall among its peers, as shares of Canada’s biggest bank lost 5% in 2022. In comparison, TSX bank names lost 13% in the same period.

What’s next for RY stock?

We are in one of the fastest rate hike cycles since last year. The trend that the central bankers have set is expected to continue this year as well. As the days of cheap money have gone, the demand for borrowing has come down. Moreover, since debt repayments have become costlier, bad loans might increase in the short to medium term.

US banks have set the tone for their Canadian peers’ upcoming quarterly earnings. While financial growth has been decent for the latest quarter, provisions have significantly gone up. We might see the trend continuing in Canada when our banks report later next month. Higher provisions mean banks are turning cautious about the future and forecast an increase in bad loans.

RBC: Financial growth and prospects

Royal Bank of Canada set aside $381 million in provisions for the fiscal fourth quarter of 2022. That weighed on its net income as it reported $3.9 billion in profits for the quarter. This represented flattish growth year over year. However, Royal Bank of Canada saw decent deposit and loan growth of 10% and 8%, respectively, in the latest reported quarter. This overall resilient standing in Q4 2022 justifies its recent outperformance compared to peers.

Royal Bank of Canada caters to over 17 million customers. Its diversified revenue base and scale play well for its business growth. The Personal and Commercial Banking segment contributed 46% in total revenues, while Wealth Management forms 33%. Its capital markets and insurance arms contribute the rest.

Bank stocks generally outperform in rising-rate environments. As rate hikes result in higher net interest margins, banks see higher earnings growth in these periods. Royal Bank did witness a higher interest margin of 2.7% during Q4 2022. However, a weaker growth outlook and higher provisions weighed on TSX bank stocks.

Valuation

RY stock has gained 7% this year so far, largely in line with its peers. However, this might not be the start of the long-term recovery just yet. That's because the picture on the macroeconomic front still looks challenging. Continued rate hikes in 2023 and impending recession could overshadow banks' upcoming performance.

As a result, Canadian banks' fiscal Q1 2023 earnings will be important to watch. While net interest margins could still trend higher, provisions will be a key driver for stocks.

Royal Bank of Canada has seen a consistent decline in its common equity tier 1 ratio for the last five consecutive quarters. It currently stands at 12.6%, lower among the Big Six but still way higher than regulatory requirements.

RY stock is trading at 1.8x its book value and looks overvalued. The Big Six Canadian banks have an average price-to-book value ratio of around 1.3x.

Timing the entry

Although Canadian banks might not see a sustained recovery soon, they look well-placed to thrive beyond the challenges. RY might continue to outperform, driven by its stable earnings growth and dividends. With expected rate hikes and a gloomy earnings outlook in the first half of 2023, TSX bank stocks might retest their last year's lows. And that could be a prudent time to get onboard.

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