Is Now the Right Time to Buy Banking Stocks?

Description

Banking stocks have been portfolio anchors for many years. They've survived many different crises and come out on top time and time again. They are pillars of strength, and, aided by government regulation, they have maintained this strength throughout many decades.

But today, we are faced with many obstacles that even the Canadian banks and banking stocks may find too much to bear.

The barometres of the economy

Inflation has really set in over the last year. Naturally, higher inflation has hit consumers' pocketbooks and has left many struggling to keep up. As a result, interest rates have also been rising rapidly to combat the rising inflation. In fact, rates have steadily risen in the last year and a half. The most recent interest rate increase was a 50-basis-point increase to 4.25%. This new rate compares to the posted 0.25% rate in the summer of 2021. Obviously, things have drastically changed.

For consumers, rising rates have a lot of negative consequences. For example, refinancing mortgages will mean sharp increases in mortgage payments. Also, rising interest rates have driven housing prices lower. Finally, loans of any kind are also significantly more expensive to finance. Therefore, big purchases and/or vacations might be put on hold or even outright cancelled.

For the banks, higher rates are a bit of a mixed bag. The most significant positive impact higher rates have on a bank is higher net interest income. This is the difference between interest paid out to depositors and interest received from the loans outstanding. On the negative side is the economic cooling, or recession, that happens as a result of higher interest rates — lower loan volumes, higher delinquencies, etc.

TD Bank: A case in point

With all these risks that banks are facing, is this the right time to buy banking stocks? Well, let's look at **Toronto-Dominion Bank**

(TSX:TD) stock to see where we stand. Since the stock hit all-time highs in early 2022, TD Bank stock has fallen 17%. Yet the stock is still more than 20% higher than it was five years ago.

But things looked a lot better five years ago. There wasn't a looming recession hanging over the banks. Also, rates were still low, and the economic environment was one that encouraged growth. In fact, it made growth easy just because money was so cheap. Today, things are vastly different. Even a big bank like TD Bank feels it.

Provisions for credit losses (PCL) increased significantly in TD's latest quarter to $617 million. This was $266 million higher versus the prior quarter and $740 million higher than the prior year. This sharp increase reflects the difficult environment out there.

A weakening economy will affect banking stocks

The Canadian economy decelerated sharply in the second half of 2022. In 2023, increasingly higher interest rates will mean increasingly higher borrowing costs. Ultimately, this will certainty weigh on consumer spending. These are headwinds that would serve a big blow to even the best of banking stocks, like TD.

But this crisis is yet another in a long list of crises. It isn't the first and it won't be the last. The one constant in all of this is TD Bank's excellence and resiliency. Actually, we can say the same for the Canadian banking system in general.

For many decades, TD Bank has continued to grow and grow profitably. Its dividend is symbolic of this growth. Since 1995, TD Bank's dividend has grown at an annualized rate of approximately 11%. While in the long run, I'm sure that banks will be just fine, I do not believe that now is the time to establish a position. I will let this play out and be ready to buy on weakness.

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