Market View
Economics and Strategy

NATIONAL BANK OF CANADA
FINANCIAL MARKETS

August 31, 2023 – (Vol. VII, No. 67)

What can the BoC learn from recent bank earnings?

By Warren Lovely & Taylor Schleich

Full disclosure: We are NOT dedicated bank analysts. National Bank has one of the best in the biz in our opinion, in one Gabriel Dechaine. Nor are we corporate credit specialists, our colleague Piper Kerr doing yeoman's work in this sphere. But you don't have to be a bank earnings geek to pick up a key theme from the just-completed Q3 earnings season for Canada's Big-6. Individually and collectively, Canadian bankers sound increasingly nervous, a message that should resonate in the decision-making chamber at the Bank of Canada.

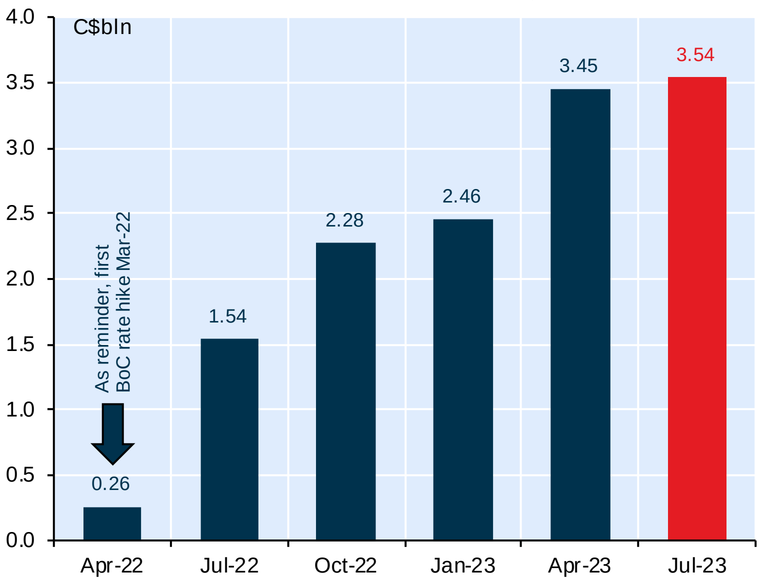
Specifically, provisions for credit losses (PCL) have stepped up big time. Collectively, Canada's six largest banks set aside $3.54 billion in PCLs in the quarter that ended July 31st (Chart 1). That was a second-straight quarter of relatively material provisioning, as key sectors of the Canadian economy appear to be straining under the weight of decisively restrictive monetary policy. During the first nine months of the banking fiscal year (which ends October 31st), total credit loss provisioning ballooned to $9.45 billion, easily more than four-times the amount set aside in the prior YTD period ($2.17 billion). We've no real interest in picking 'winners' or 'losers' but would note that no major Canadian bank appears immune (Chart 2). In many cases, PCL-related colour commentary was hard to miss in Q3 press releases. Again, we'll defer to dedicated bank analysts for more fulsome commentary but to us, the root causes for more recent provisioning looks to more focused on worrisome trends in credit migration and the macro environment, rather than additional credit underwriting.

Before we go any further, let's get the standard Canadian bank platitudes out of the way. Our banks are quite well capitalized, with CET1 ratios generally hovering between 12-15%. Canadian banks likewise boast seemingly ample/surplus liquidity, as evidenced by relatively strong LCR tallies. Were you to add up all reported revenue across the 'Big-6', you'd find that it grew an annualized 10% vs. the prior quarter to stand ~15% higher year-on-year. That doesn't sound too shabby and is presumably consistent with a (surprisingly) resilient North American economy and still-well-functioning financial markets. The point is, the sky isn't necessarily falling on our banks… particularly since most Canadians that want to work have been able to find a job.

To us, however, these fresh quarterly results betray a growing air of anxiety that is broadly consistent with anecdotal evidence of a consumer class under growing strain (to say nothing of a shaky commercial real estate sector). We'll be out with a fresh *Monthly Economic Monitor* in the coming days and at the risk of spoiling a key theme, we believe a material deceleration in Canadian economic growth is *already* in train… GDP growth likely to sour further, the jobless rate likely to move higher (faster than you might think) and vulnerable consumers ultimately validating some of today's PCL-related fears. If the central bank really is cognizant of 'not over doing it'—as Governing Council has recently claimed—the warning signals being thrown up by our banks are perhaps worth taking on board.

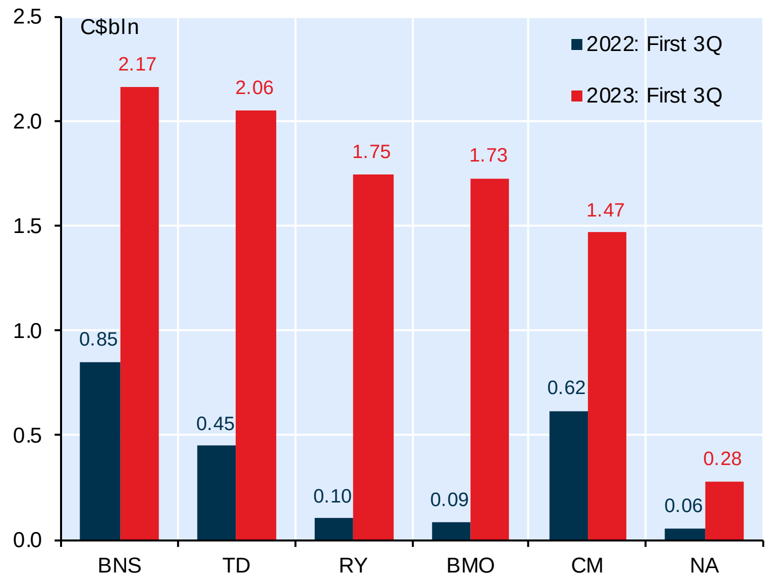
Note: Our colleagues stand ready to distill all the salient points from Canada's quarterly national accounts release (coming Friday, September 1st). A related BoC preview—ahead of the September 6th policy rate decision—is also coming.

Chart 1: Credit loss expectations mount as higher rates bite
Quarterly provisions for credit losses (PCL): Sum of 'Big-6' Canadian banks



Source: NBF, Cdn banks (shareholder reports)

Chart 2: No major Canadian bank immune from PCL pressure
Fiscal year-to-date provisions for credit losses (PCL): 'Big-6' Canadian banks



Source: NBF, Cdn banks (shareholder reports) | Note: Ordered by total '23:YTD PCL

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