Canadian D-SIBs' Outlook 2025:

Strong balance sheets position D-SIBs well, but policy uncertainty could put a damper on returns

Lidia Parfeniuk

Daniel Da Silva

Devi Aurora

Stuart Plesser

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S&P Global Ratings

This report does not constitute a rating action

Contents

Key Takeaways

Key expectations

- S&P Global Ratings expects 2024's slow economic growth will persist into 2025 as the lagging effect of high interest rates works through the economy and growth will begin to accelerate in the latter half of 2025.
- We believe home prices will rise in 2025 as housing activity increases.
- We expect that demand for both household and corporate credit will increase in 2025, spurred by a more favorable interest-rate environment and improved consumer and business sentiment, and that private-sector debt, as a percentage of GDP, will rise modestly in 2025.

Key assumptions

- Elevated unemployment and a weak economy likely will keep inflation low, setting the stage for further rate cuts in 2025.
- We believe that the Bank of Canada (BoC) policy rate could reach 2.25% by year-end 2025, down from 5.00% in April 2024, and GDP growth will accelerate to 1.7% in 2025.
- We expect 2025 profitability will be neutral to slightly more favorable than in 2024, reflecting flat provisions, higher loan growth adding to revenues, and moderating expense growth.
- We do not expect any material changes in Canada's regulation or supervision.

Key risks

- S&P Global Ratings views macroeconomic uncertainties around trade tariffs as a key source of risks to the Canadian banks, which could significantly slow economic growth and hurt banks' operating performance.
- Risks to banks could increase if, contrary to our base-case expectation, significant tariffs lead to a recession and lower-than-anticipated immigration flows stall loan growth affecting banks' revenues and profitability more than we expect.
- That said, we believe Canadian banks are well positioned, from a capital and liquidity point of view, with strong balance sheets to manage through these risks.

Canadian D-SIBs' Rating Outlooks Are Stable

	Anchor	Business position	Capital and earnings	Risk position	Funding and liquidity	Government Support	SACP	Systemic importance	ICR/outlook
Bank of Montreal	a-	Adequate	Adequate	Strong	Adequate and adequate	+1	a	High	A+/Stable
Bank of Nova Scotia	bbb+	Strong	Adequate	Strong	Adequate and adequate	+1	a	High	A+/Stable
Canadian Imperial Bank of Commerce	a-	Adequate	Adequate	Strong	Adequate and adequate	+1	a	High	A+/Stable
National Bank of Canada	a-	Adequate	Adequate	Adequate	Adequate and adequate	+2	a-	High	A+/Stable
Royal Bank of Canada	a-	Strong	Adequate	Strong	Adequate and adequate	+1	a+	High	AA-/Stable
Toronto-Dominion Bank	a-	Strong	Adequate	Adequate	Adequate and adequate	+1	a	High	A+/Stable

Note: Notching for Very strong: (+2), Strong: (+1), Adequate: (0), Moderate: (-1), Constrained: (-2), and Weak: (-5). SACP--Stand-alone credit profile. ICR--Issuer credit rating. CRA--Comparable ratings analysis adjustment.
Source: S&P Global Ratings.

Key Risks For Canadian D-SIBs

Geopolitical
risks creating uncertainty

Elevated home prices
vulnerable to a correction if base case not met

More scrutiny
around non-financial risks (AML)

Potential changes
to domestic policy

Challenges from fintech,
cybersecurity, and digital transformation

Trade, tariffs could
slow the economy more than we expect

Credit Conditions | Canada

S&P Global Ratings Canada economic forecast

Key indicators	2019	2020	2021	2022	2023	2024f	2025f	2026f	2027f
Annual average % change									
Real GDP	1.9	-5.0	5.3	3.8	1.3	1.2	1.7	2.0	1.7
Change from Sept. (percentage point)						0.0	-0.3	-0.1	-0.2
Domestic demand	1.1	-5.4	6.8	5.2	-0.1	1.2	2.0	1.9	1.8
Consumer spending	1.6	-6.3	5.1	5.1	1.7	2.1	2.0	2.0	2.0
Nonresidential fixed investment	3.2	-12.4	8.6	3.9	-0.9	-1.2	3.5	2.8	2.0
Residential investment	-0.8	2.9	14.6	-12.1	-10.3	0.4	3.0	0.9	0.0
Government consumption	1.1	1.3	5.4	3.2	1.6	2.5	2.3	1.7	1.6
Real exports	2.3	-9.0	2.7	3.2	5.4	1.0	1.8	1.7	1.5
Real imports	-0.1	0.7	8.1	7.6	0.9	0.6	2.3	1.4	1.7
CPI	2.0	1.1	3.4	6.8	3.9	2.4	1.9	2.0	1.9
Core CPI	2.1	0.6	2.4	5.0	3.9	2.6	2.1	2.2	1.8
Annual average levels									
Unemployment rate (%)	5.7	9.7	7.5	5.3	5.4	6.3	6.5	6.0	5.8
Exchange rate per (US$)	1.33	1.34	1.25	1.3	1.35	1.36	11.38	1.33	1.30
Housing starts ('000s)	207.4	218.9	273.3	262.7	240.8	243.6	228.9	215.2	215.9
Bank of Canada policy rate (%, year-end)	1.75	0.25	0.25	4.25	3.25	3.25	2.25	2.00	2.25
10-year government bond (%)	1.58	0.74	1.38	2.8	3.33	3.33	2.84	2.60	2.59

Note: All percentages are annual averages, unless otherwise noted. Core CPI is Consumer Price Index excluding energy and food components. f--forecast.
Sources: Statistics Canada, Bank of Canada, S&P Global Market Intelligence, S&P Global Ratings Economics' forecasts. Data is as of November 2024.

- While we kept our 2024 estimate intact, we lowered our 2025 forecast given the changes to the federal government's immigration targets. The balance of risk to our GDP forecast is squarely to the downside.
- The key risk for Canada's economy is that a U.S. pullout of the United States-Mexico-Canada Agreement could leave Canada subject to U.S. import tariffs.
- A substantial deceleration in population growth next year could counter any boost to the economy from lower borrowing costs. Stalling population growth will simultaneously reduce aggregate demand and the labor supply.

Canada Forecast | Profits Could Be Higher Though Uncertainty Could Derail

Worsening — Neutral — Improving

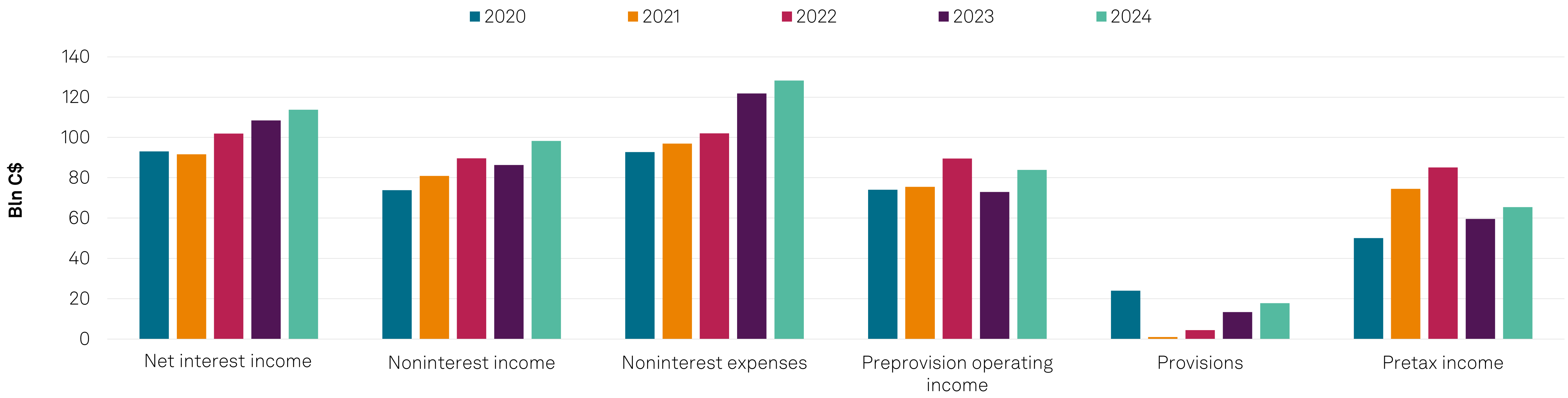
Revenues	Net interest income (NII) growth could pick up as loan growth picks up due to declining rates while cost of funds are dropping. Fee income is highly reliant on the performance of equity and capital markets. Continued favorable market conditions could incrementally add to noninterest income although exceeding the strong 2024 performance might be a challenge. Overall revenue growth should be in the mid-to-high single digits in 2025 compared with 9.4% in 2024, although that reflected acquisitions.
Expenses	Expense growth will further moderate to below the mid-single digits for 2025 versus an average of 5.3% in 2024 because banks are managing expenses by reducing discretionary costs and full-time employees, although they continue to invest in growth and technology, particularly to mitigate risks associated with cyber attacks, anti-money laundering (AML) activity, and other noncredit risks.
Profitability	Profitability to be neutral to slightly higher, with provisions for loan losses relatively flat. We expect an industry return on common equity of potentially 13%-15%, modestly higher than the average of 12% in 2024. Geopolitical uncertainly, domestic policy changes, and tariffs could result in lower profitability than our base case.
Credit quality	We are forecasting an average of 35-40 bps of net charge-offs (NCOs) in 2025 versus 33 bps in 2024. We expect further deterioration in credit quality metrics before declining rates begin to translate into lower NCOs.
Capital	D-SIBs will continue to prudently manage capital due to an uncertain geopolitical environment, soft economic growth, and deteriorating asset quality until the trend reverses.
Funding and liquidity	Funding will remain well diversified, and banks will continue to access global funding markets. Liquidity metrics are likely to remain around current levels due to geopolitical and macroeconomic uncertainties. Growth in higher-rate savings products, such as GICs, is stabilizing. More maturities are likely to move into the banks' asset and fund management businesses as rates decline and term deposits become less attractive.

Note: Forecast for next 12 months. Source: S&P Global Ratings.

Lower Interest Rates Should Boost NII Growth, But Uncertainties Linger

- NII growth may result as lower interest rates spur more demand for loans, offsetting pressure on banks' net interest margins (NIMs). Revenues could also surprise to the upside should fee income be better than expected. Slower expense growth should help profitability somewhat.
- Because the U.S. economy is in better shape than the Canadian, we expect the banks' U.S. businesses will outperform their Canadian businesses. Macroeconomic uncertainty could drag profits lower than our base case.

Canadian D-SIBs' operating performance

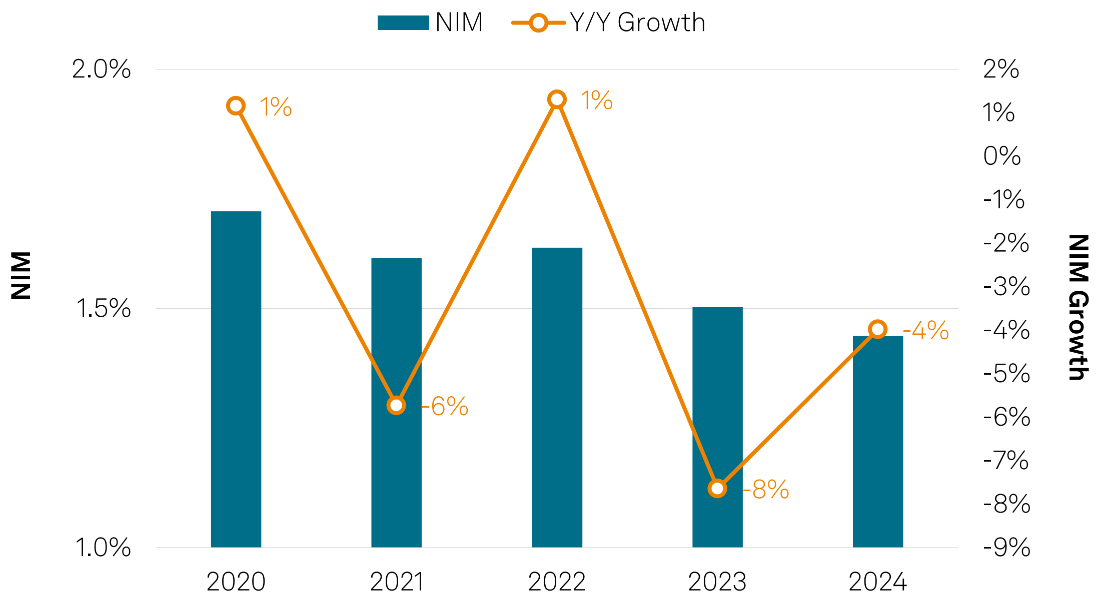


Sources: S&P Global Ratings, company filings.

D-SIBs' NIMs Will See Modest Pressure

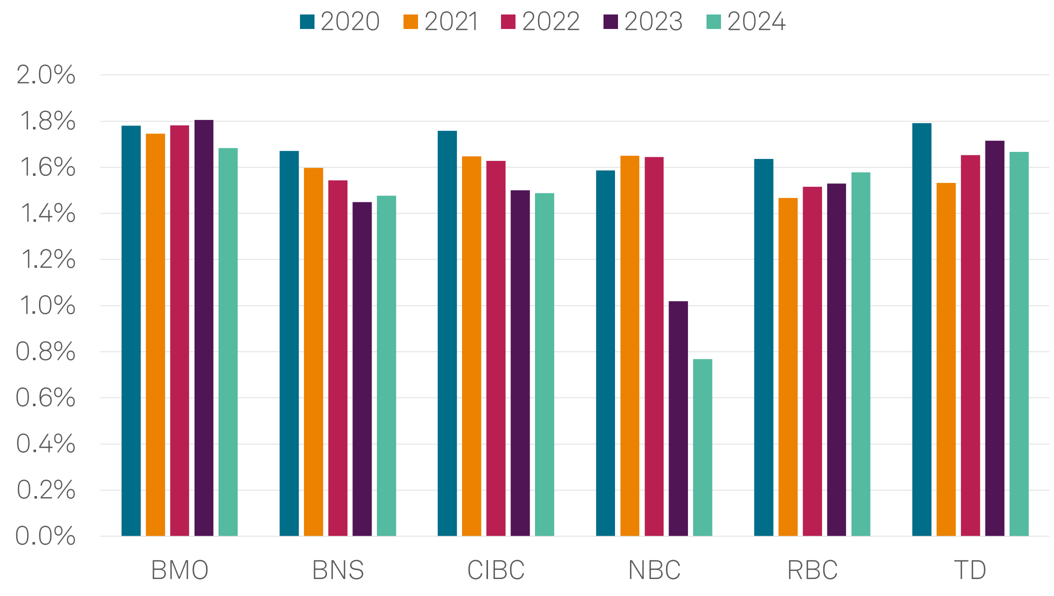
- Easing monetary policy will modestly pressure banks' NIMs. Growing core deposits remains a challenge. We expect banks will rely slightly more on wholesale funding to fund loan growth.
- Meanwhile, earning asset yields may not improve meaningfully if economic momentum is weaker than we expect.

Average D-SIBs' NIMs



Total banks' NIMs including trading. NIM—Net interest margin. Sources: S&P Global Ratings, company filings.

NIM trends by bank

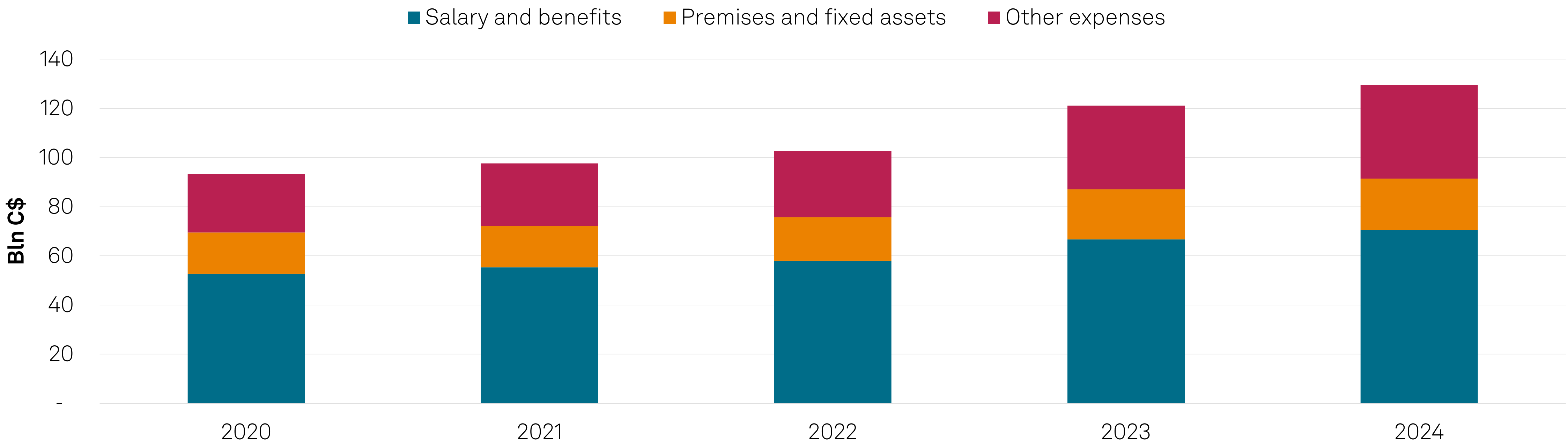


NIM—Net interest margin. Sources: S&P Global Ratings, company filings.

Operating Expense Growth Is Moderating

- Lower inflation and moderating wage growth are helping to slow expense growth.
- Also, banks continue to look for ways to cut expenses by reducing employee count and managing discretionary expenses; however, they continue to invest in their businesses and in IT, including digitization, and to bolster cybersecurity and AML programs.

D-SIBs' non-interest expenses

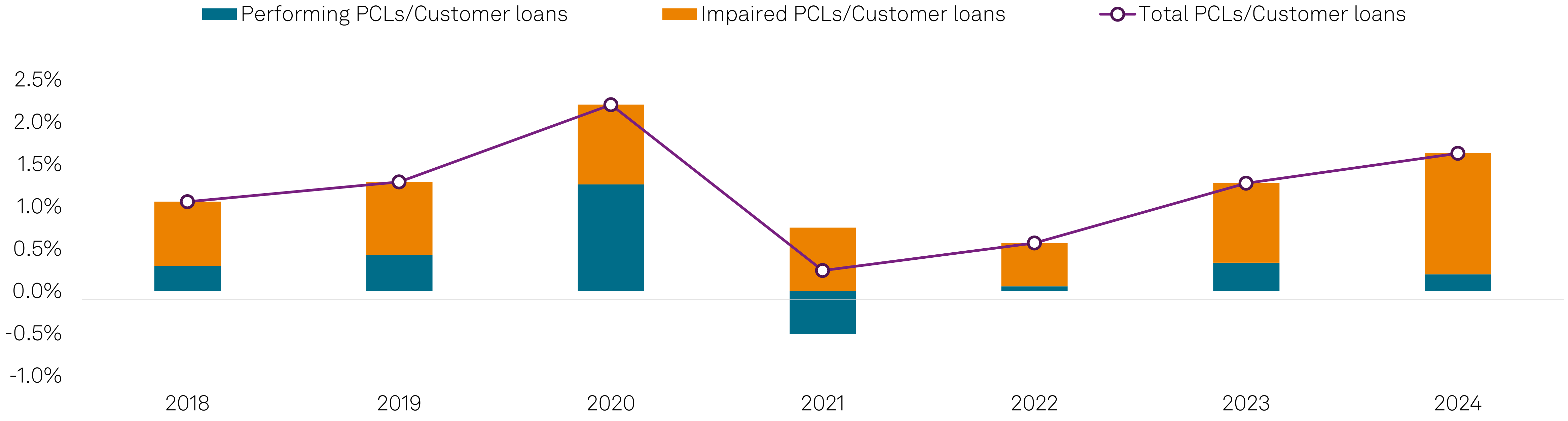


Sources: S&P Global Ratings, company filings.

Provisions For Loan Losses To Be Flattish

- As macroeconomic and credit conditions improve due to declining interest rates, we expect provisions for loan losses to be flattish in 2025, although uncertainties around macroeconomic issues could lead the banks to increase provisions in anticipation of the negative impacts on the economy and higher loan losses.

D-SIBs' provisions for loan losses

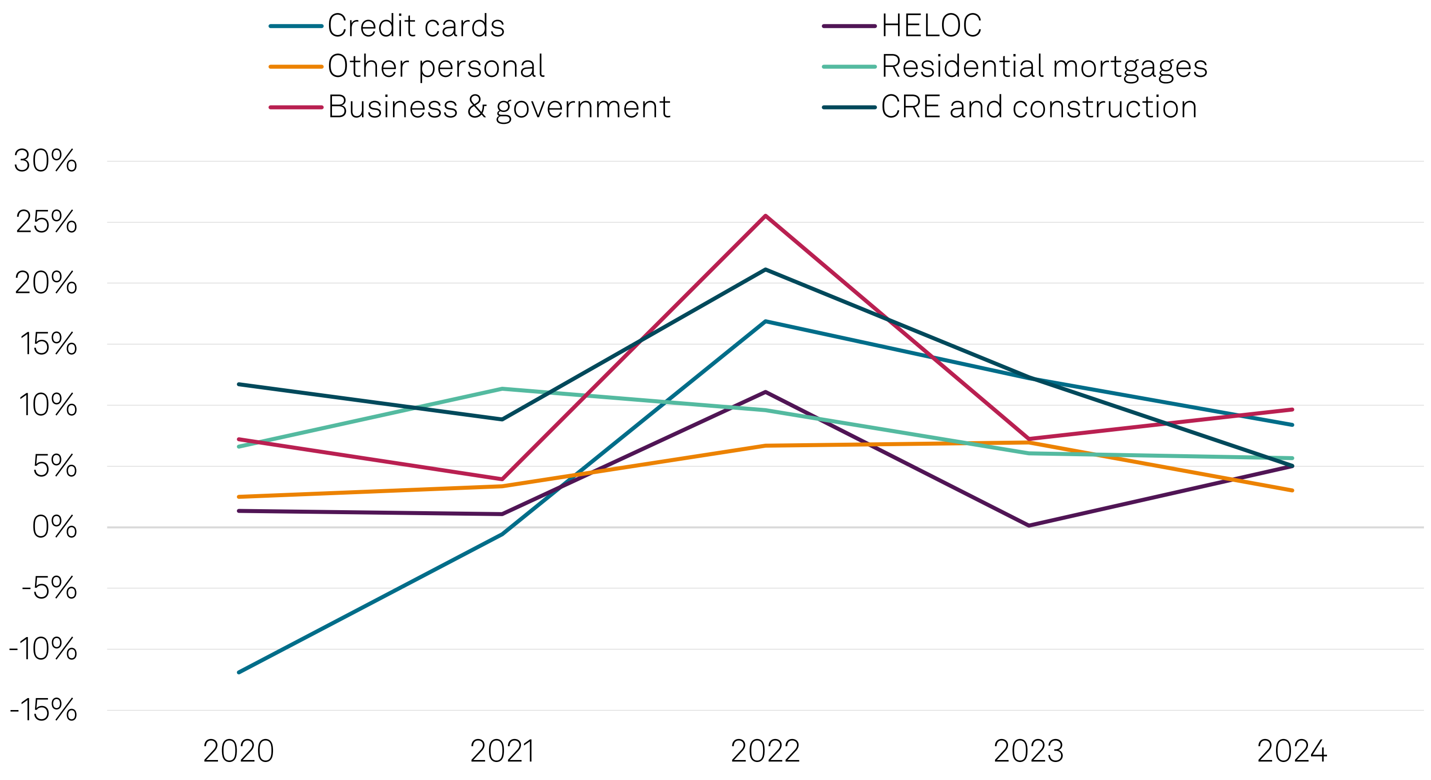


Note: PCLs--Provisions for loan losses. Ratios and amounts are D-SIB averages. Sources: S&P Global Ratings, company filings.

S&P Global Ratings

Loan Growth Could Accelerate If Lower Rates Spur Demand For Credit

D-SIBs' loan growth



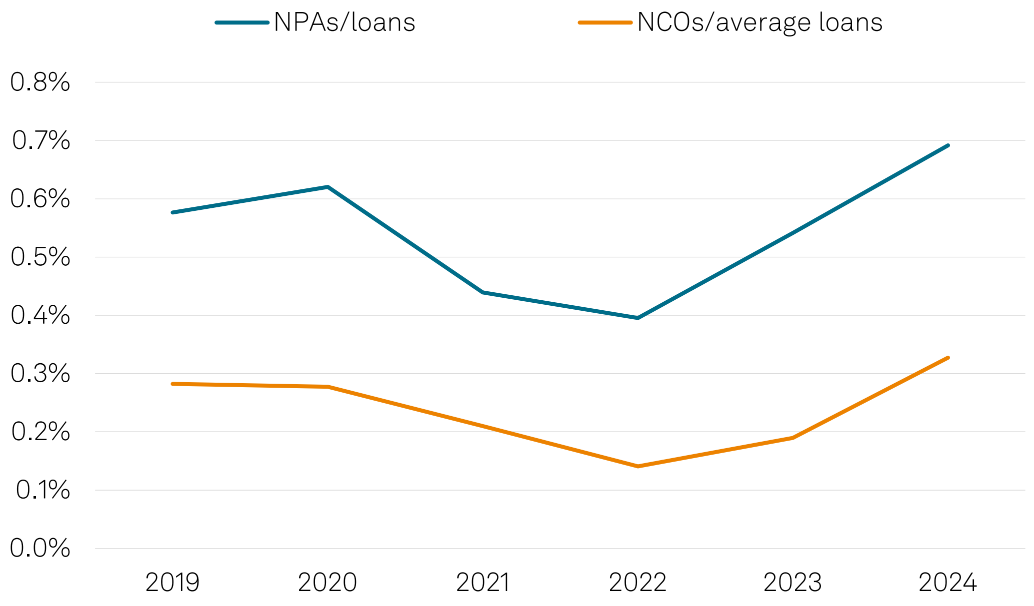
Note: Other personal excludes credit cards. HELOC – Home equity line of credit. CRE—Commercial real estate. Sources: S&P Global Ratings, company filings.

- Lower interest rates could spur further demand for credit. Overall, we expect loan growth of 6%-7% in 2025 from an average of 5% in 2024.
- Mortgage loan growth in particular should pick up because borrowers have been sitting on the sidelines waiting for rates to decline.
- Other personal loan could also grow as disposable incomes rise due to contained inflation and interest rates.
- Business loan growth should be relatively decent although it could be dampened if trade tariffs were to materialize.

Asset Quality To Deteriorate Modestly

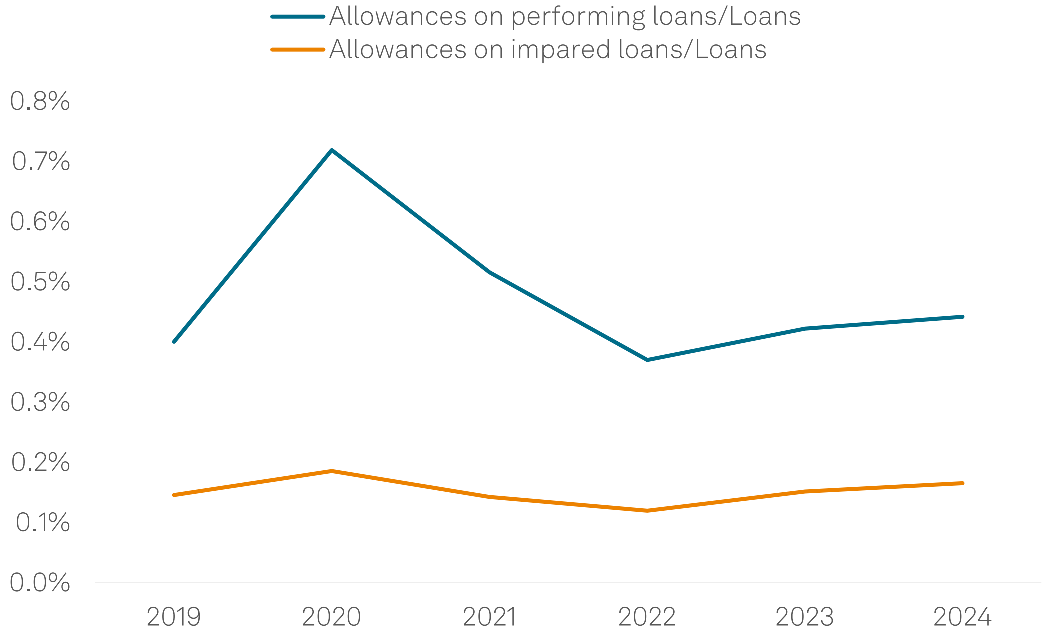
- We expect modestly higher nonperforming assets (NPAs) and NCOs in 2025 compared with 2024 as the lagged effect of higher rates negatively flow through credit in the first half, though the latter months could see a turnaround as borrowing costs fall.
- We continue to monitor the performance of credit cards, auto, uninsured mortgage, and office commercial real estate (CRE), in particular.

D-SIBs' asset quality metrics



NPAs--Nonperforming assets. NCOs--Net charge-offs. Sources: S&P Global Ratings, company filings.

D-SIBs' allowances to loans

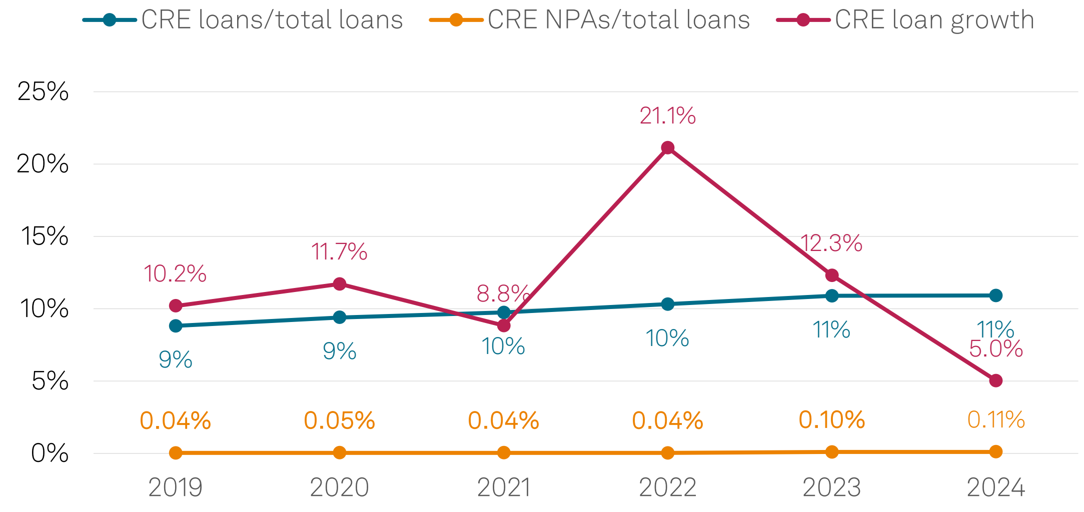


Sources: S&P Global Ratings, company filings.

CRE Office Segment Remains Under Pressure, Although Exposure Is Manageable

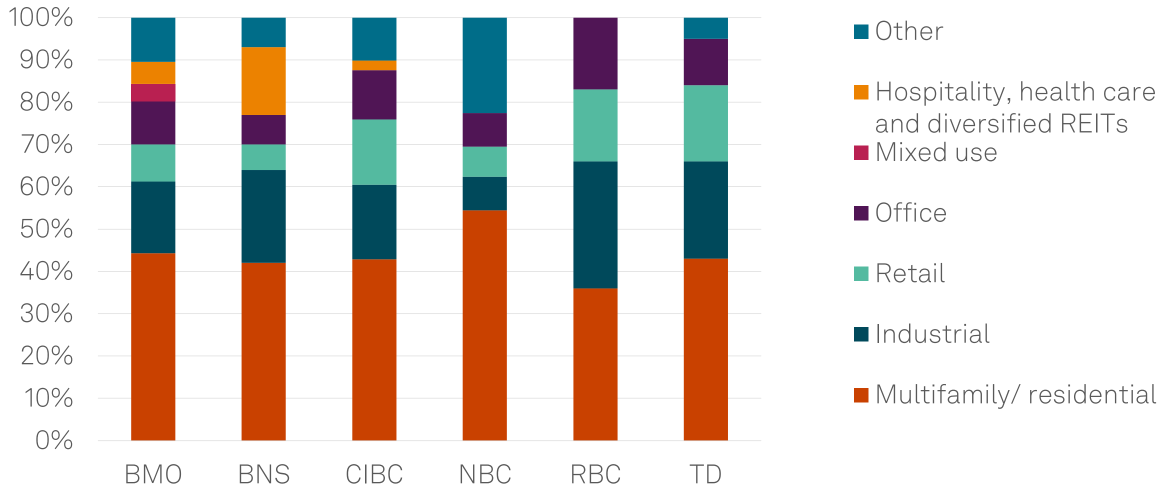
- CRE and construction loan exposures represent, on average, 11% of D-SIBs' total loans, which is manageable.
- Generally conservative loan-to-value ratios, good diversification geographically and by property type, and recourse are somewhat mitigating the impact of CRE loan losses; however, recourse in the banks' U.S. CRE portfolios is not as strong as it is in their Canadian CRE portfolios.
- The office segment remain pressured, although the banks' exposure to this asset class is only 1%-2% of total loans. Banks have been increasing their exposure to the insured multifamily residential sector, given the housing shortage in Canada.

D-SIBs' exposure to CRE and construction loans



CRE--Commercial real estate. NPAs--Nonperforming assets. Source: S&P Global Ratings, company filings.

CRE exposure by property type



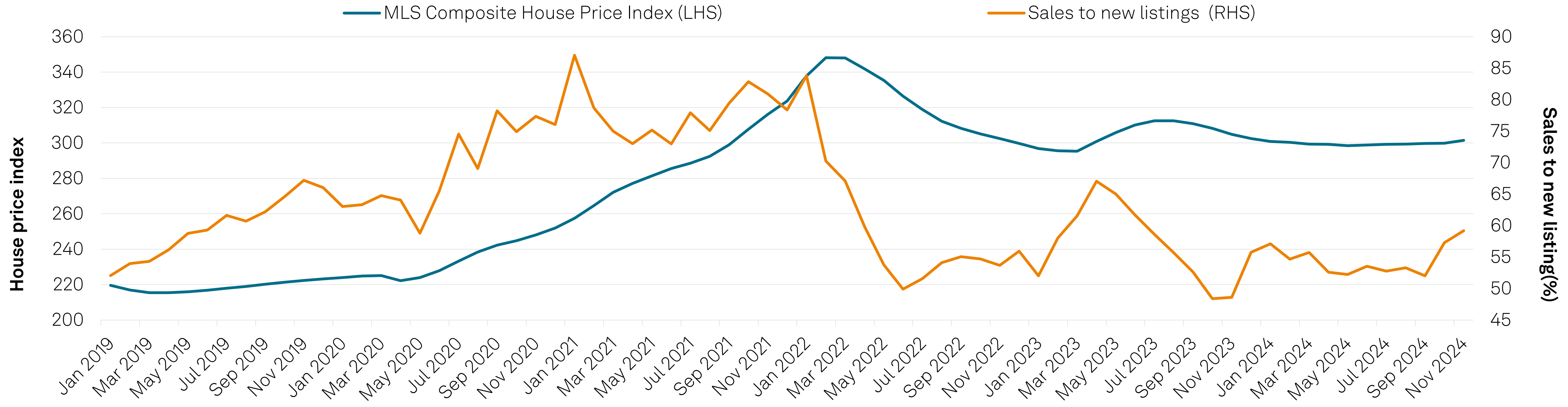
Source: S&P Global Ratings, company filings.

S&P Global Ratings

Home Prices Are Likely To Rise

- Home prices fell on average 13.4% (median price) from their peak in February 2022 through November 2024. S&P Global Economics expects home prices will increase modestly in 2025. The condo market might take longer to come back due to the supply glut.
- Immigration (although levels are lower than in previous years), home supply constraints, and more favorable mortgage rules for borrowers will continue to drive up home prices. Affordability issues are easing somewhat because rates are falling.

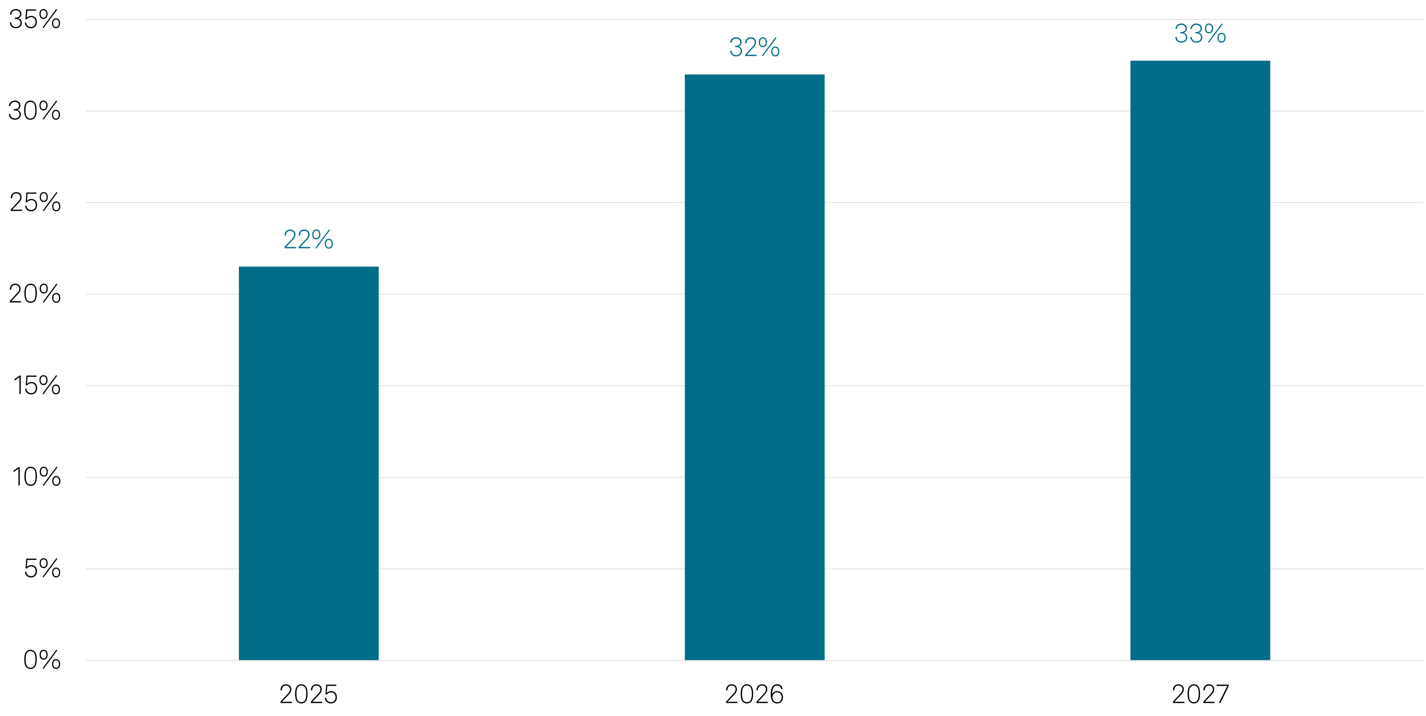
Housing market statistics



Note: Seasonally adjusted data. 2005 baseline. Source: The Canadian Real Estate Assn.

D-SIBs' Mortgage Renewals Are Elevated But Manageable

D-SIBs' percentage of mortgage renewal balances*



*Percentage of balances renewing within one year. Source: Banks' investor presentations including BMO, BNS, CIBC, and RBC. TD and NBC are not reflected here, given their more limited disclosure on mortgage renewals.

- Typically, mortgages in Canada are renewed every five years or less even if the amortization period is longer. The five major D-SIBs' mortgage portfolios are about 25% government-insured while NBC has a higher proportion of insured mortgages. This helps to somewhat mitigate loan losses in addition to conservative loan-to-value ratios.
- The level of D-SIBs' mortgage renewals is elevated yet manageable. Although borrowers will be renewing at higher rates and facing higher mortgage payments, rates are lower than they were one year ago, which will help limit losses.
- We expect more rate cuts to further alleviate pressure on borrowers.

What Changes Has The Government Made To The Mortgage Rules?

New mortgage rules came into effect Aug. 1, 2024, which will likely spur mortgage growth as the rules make homeownership more affordable. The rules include:

- Allowing 30-year insured mortgage amortizations for first-time homebuyers purchasing new builds. This will create more demand for mortgages from a younger cohort.

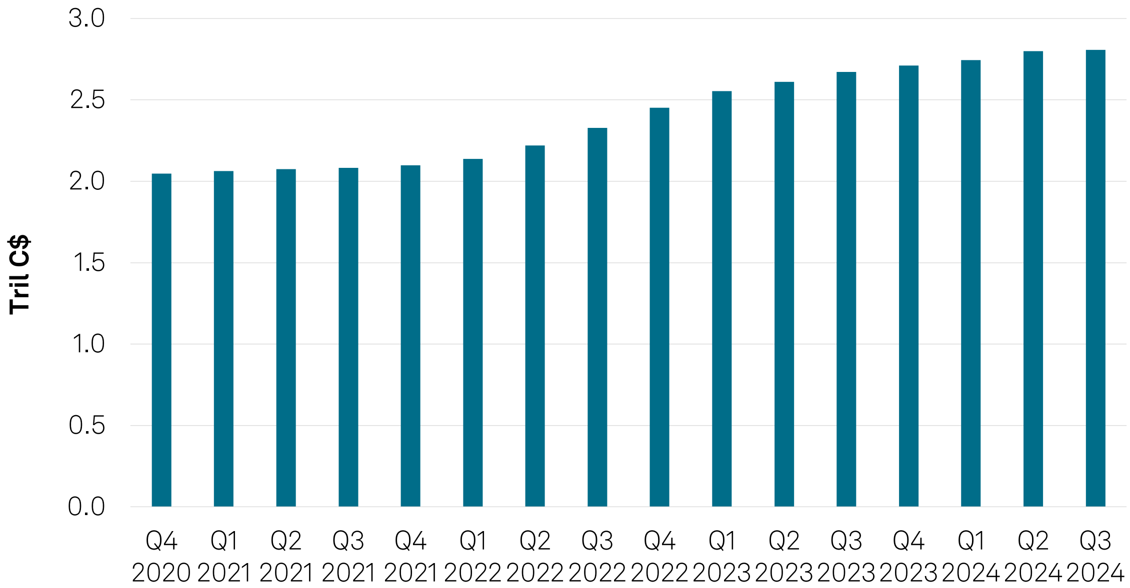
- Increasing the $1.0 million price cap for insured mortgages to $1.5 million. This will allow borrowers to make a smaller down payment and increase the percentage of banks' mortgages that are government-insured, reducing credit risk.

- Also, insured mortgage holders can switch lenders at renewal without being subject to another mortgage stress test. The mortgage stress test helps qualify a potential borrower at a higher rate than the benchmark rate, which is a useful tool to ensure a borrower's ability to continue to pay mortgage debt in a higher interest-rate environment. We view this rule as somewhat weakening mortgage underwriting standards, though we would expect the banks to continue to qualify borrowers using internal measures.

Debt Balances Could Rise Further

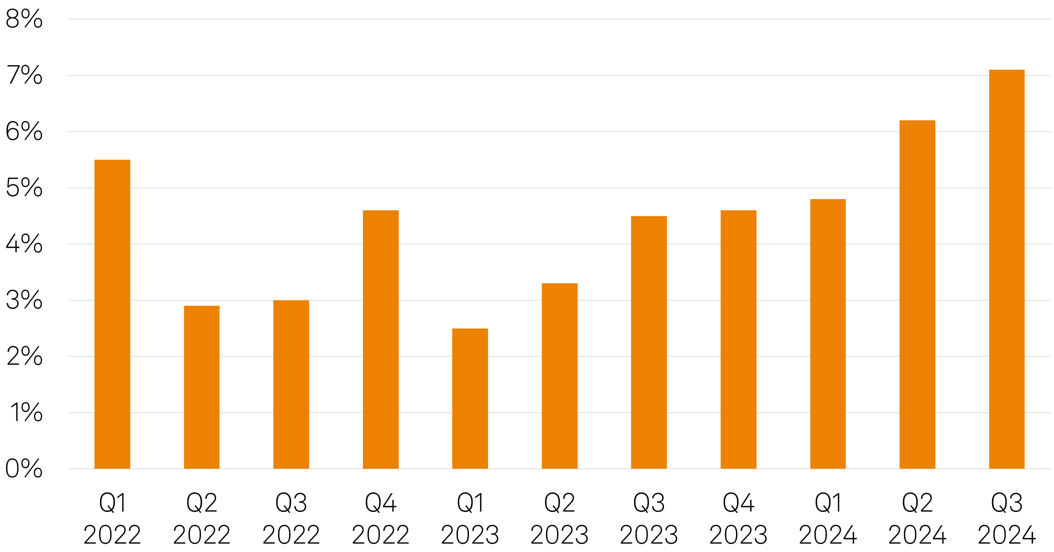
- Canada's household sector is highly leveraged, with household debt to disposable income at 170% plus. Higher mortgage rates have lifted the costs of mortgage debt service, leaving households more vulnerable. Declining rates will provide some relief although it may encourage more debt accumulation.
- That said, the household savings rate has been rising since the end of 2023 as consumers have been reining in discretionary spending.

Household debt



Sources: S&P Global Ratings, Statistics Canada, TransUnion, and Bank of Canada.

Household savings rate

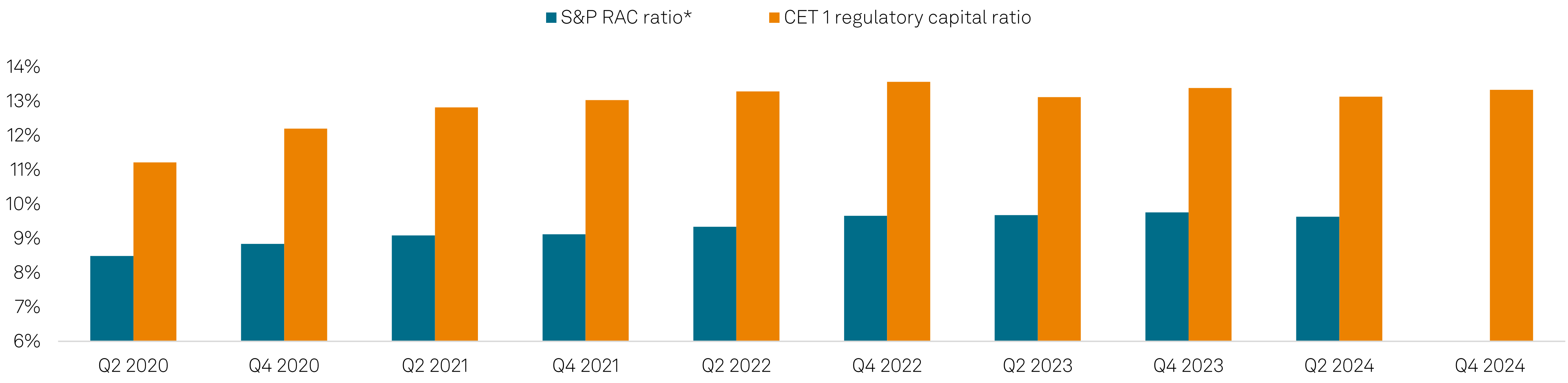


Note: In Canada, personal saving is defined as personal disposable income less personal expenditure on consumer goods and services, less current transfers from persons to corporations and to non-residents as a percent of disposable income. Source: Statistics Canada.

Capital Ratios Will Remain At About Current Levels

- We could see higher risk-weighted asset (RWA) growth in 2025 and slightly stronger internal capital generation. Mergers and acquisitions activity will likely be muted in 2025 following several acquisitions by Canadian banks over the past couple of years.
- Canadian banks were early adopters of the Basel 3 Reform with minimal impact on their regulatory capital ratios.
- We expect D-SIBs average risk-adjusted capital (RAC) ratios will remain at the high end of our adequate range of 7%-10% (average was 9.6% at second-quarter 2024).

Canadian D-SIBs' capital metrics

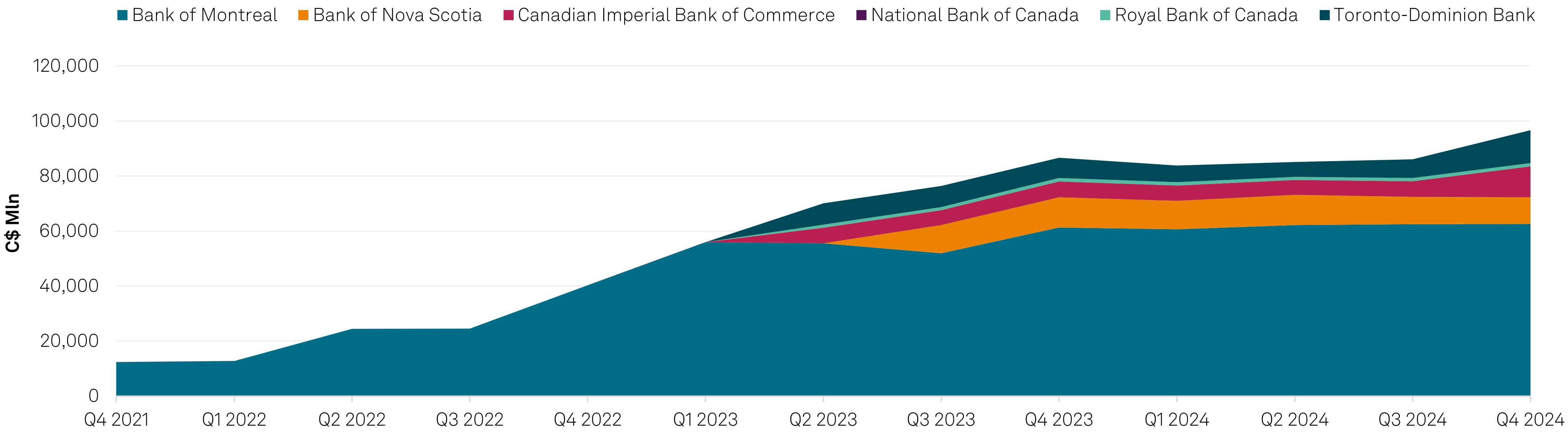


*S&P Global Ratings RAC ratio not yet available for fourth-quarter 2024; RAC/CET1 ratios are averages of the Big 6 banks. RAC--Risk-adjusted capital. CET1--Common Equity Tier 1.. Q--Quarter. Sources: S&P Global Ratings, company filings.

Synthetic Risk Transfer Activity Is Growing From A Low Base

- The large Canadian banks use synthetic risk transfers (SRT) as a way to offload part of the risk of credit losses and to free up capital. These structures typically use corporate loans as reference pools.
- BMO has been the biggest player among the large Canadian banks. National Bank is not a player in the space.

Wholesale synthetic securitizations in the banking book--bank acts as originator

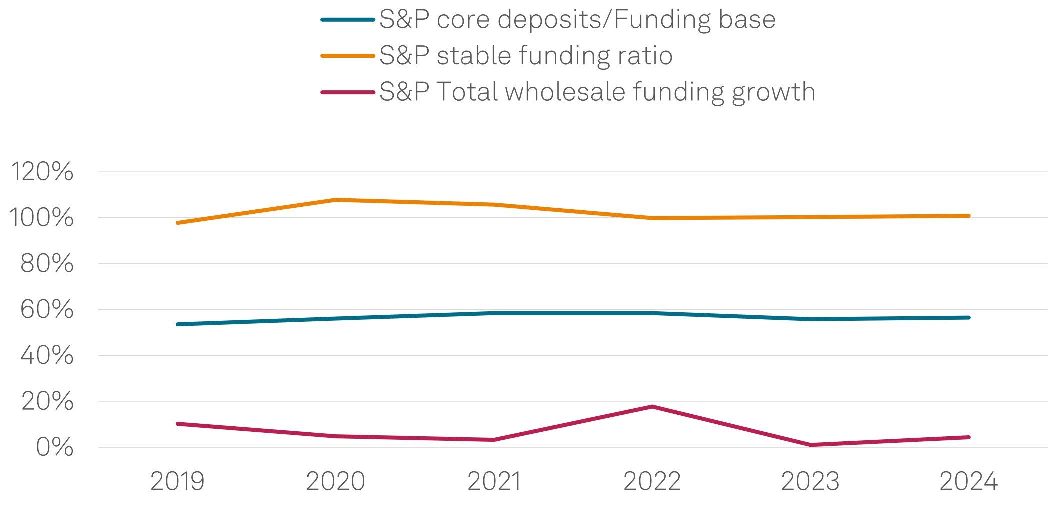


Source: Supplementary regulatory capital disclosures of Big 6 banks.

Funding And Liquidity Metrics Will Remain Relatively Unchanged

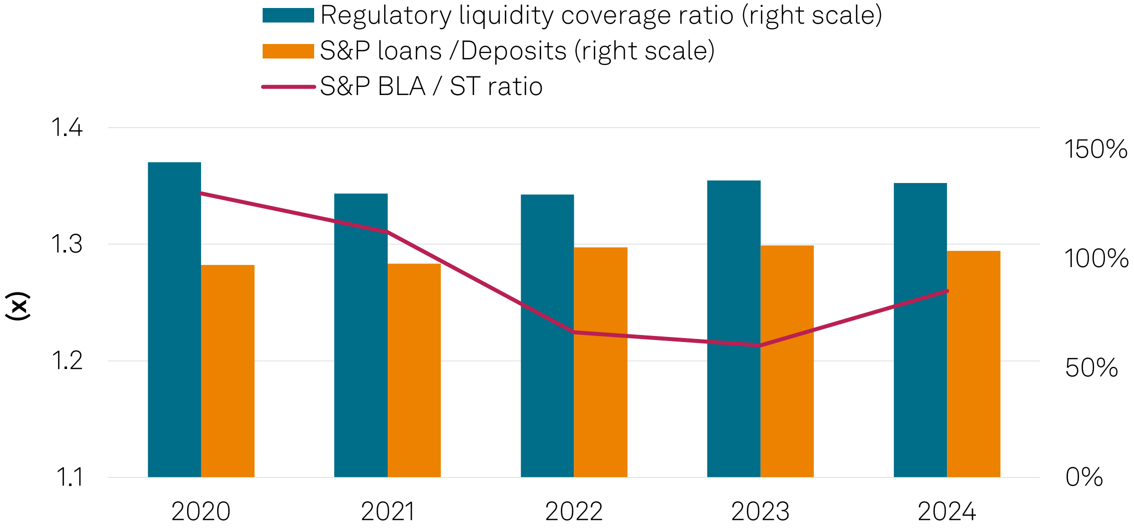
- We expect the banks' overall funding and liquidity metrics will be relatively unchanged. D-SIBs' regulatory liquidity coverage ratio, which was on average 135% at year-end 2024 (compared with an average of 136% at year-end 2023) could decline but at the margin. Liquidity is expensive for banks to hold; however, we expect that D-SIBs will manage liquidity carefully as geopolitical and economic uncertainties remain.
- Loans-to-deposits ratio could modestly deteriorate as loan growth could outstrip deposit growth, contrary to 2024 when deposit growth outstripped loan growth.

D-SIBs' funding metrics



Source: S&P Global Ratings, company filings.

D-SIBs' liquidity metrics

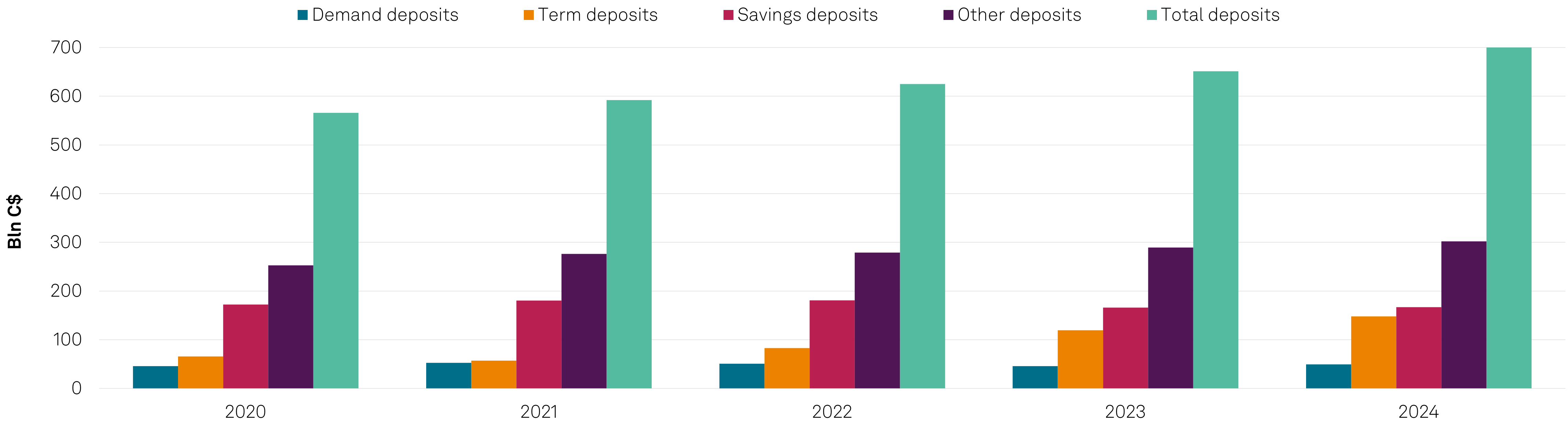


Note: BLA/ST--Broad liquid assets to short-term wholesale funding. Source: S&P Global Ratings, company filings.

The Composition Of Deposits Could Change At The Margin

- Term deposits continued to increase in 2024 but at a slower pace than the previous year. Although rates were falling in 2024, term deposits still provided more favorable returns versus other deposit products.
- Term deposit growth has likely peaked. Some deposit renewals are purchasing term deposits though bank clients are also looking for higher returns in a declining rate environment and are turning to wealth management and mutual fund products.

Canadian D-SIBs' average deposits by type

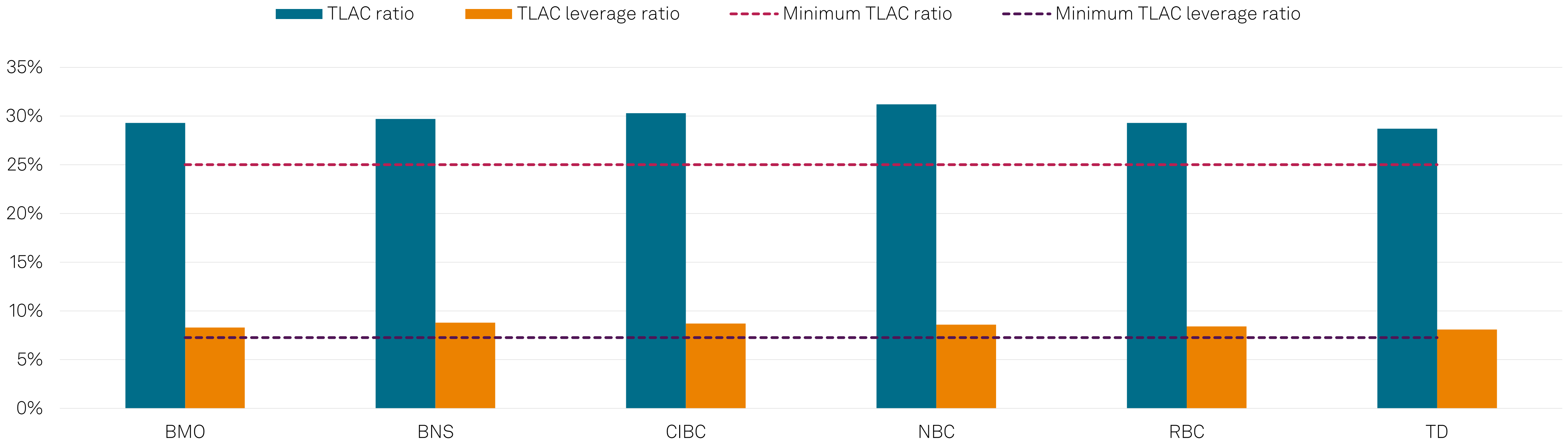


Source: S&P Global Ratings, company filings.

Banks' TLAC Ratios Are Well Positioned

- At year-end 2024, D-SIBs' average regulatory TLAC (of RWAs) and TLAC leverage ratios were 29.8% and 8.5%, and above the regulatory minimums of 25.0% and 7.25%, respectively. D-SIBs qualify for ALAC (S&P Global Ratings' definition of additional loss absorbing capacity) uplift, but extraordinary government support is still the main factor for ratings uplift.

Regulatory TLAC and TLAC leverage ratios*



*As of October 2024. TLAC--Total loss-absorbing capacity. TLAC ratio--TLAC as a percentage of risk-weighted assets. TLAC leverage ratio--TLAC as a percentage of leverage. Sources: S&P Global Ratings, company filings.

Related Research

- Economic Outlook Canada Q1 2025: Immigration Policies Hamper Growth Expectations
- Global Banks Outlook 2025: Cautiously Confident
- Global Banks Country-By-Country Outlook 2025: Cautiously Confident
- Banking Industry Country Risk Assessment: Canada
- Canada Full Analysis

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Analytical Contacts

Lidia Parfeniuk

Director
Toronto
+1-416-507-2517
lidia.parfeniuk@spglobal.com

Daniel Da Silva

Associate Director
Toronto
+1-647-480-3517
daniel.da.silva@spglobal.com

Devi Aurora

Managing Director & Analytical Manager
New York
+1-212-438-3055
devi.aurora@spglobal.com

Stuart Plesser

Managing Director & Sector Lead
New York
+1-212-438-6870
stuart.plesser@spglobal.com

spglobal.com/ratings

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