Scotiabank expects credit losses to worsen with over $200B in mortgages coming up for renewal by 2026

Steve Huebl || November 28, 2023

Scotiabank saw a rise in mortgage delinquencies in the fourth quarter and said it's bracing for further credit losses due to higher-for-longer interest rates and a wave of upcoming mortgage renewals.

The bank saw the percentage of its mortgage portfolio that is now 90+ days delinquent rise to 0.16%, up from 0.14% in the third quarter and just 0.09% a year ago.

Across all of its credit portfolios, the delinquency rate has risen to 0.25%, up from 0.15% in 2022.

"Delinquencies continue to trend up across all products in Canada," noted Chief Risk Officer Phil Thomas. "Quarter-over-quarter, we saw a deterioration in HELOCs and auto, increasing 9 basis points and 6 basis points, respectively."

As a result, the bank increased its provision for credit losses (PCLs), which are funds financial institutions set aside to cover any loan losses that may arise.

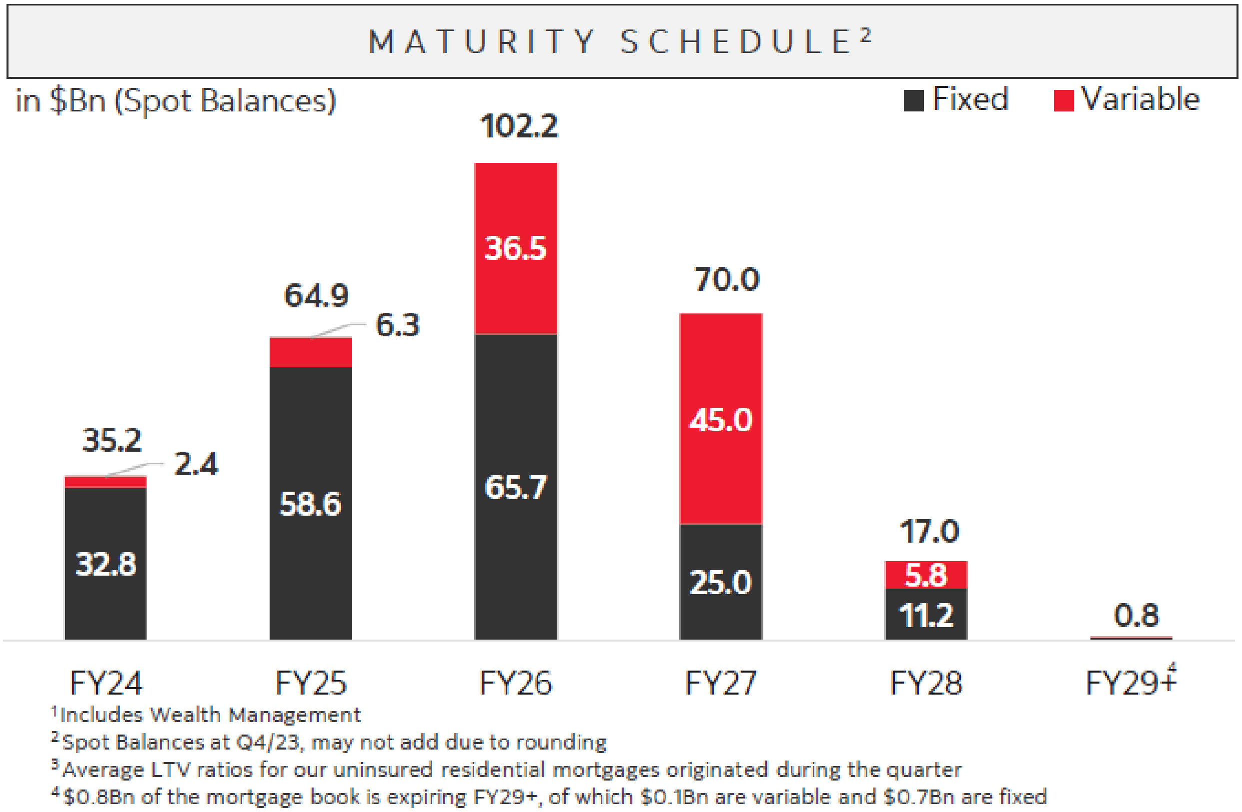
The bank set aside $1.3 billion in PCLs in the quarter, up $437 million or 53% from the last quarter.

"Given the macroeconomic backdrop of higher unemployment levels, higher-for-longer interest rates and upcoming renewals of fixed-rate mortgages in Canada, we have focused on strengthening the balance sheet," said Thomas. "It is important to note that while delinquencies are still within historical norms, consumer health in Canada continues to weaken, and we expect households may continue to experience financial pressure through 2024 with the build in [PCLs] addressing this."

He said that includes "looking forward in terms of how fixed-rate mortgage customers are going to start to reprice in the Canadian environment over the next year or two years."

Scotiabank confirmed that over $200 billion worth of its mortgage portfolio will be coming up for renewal by 2026.

"We're very conscious of the fact that in 2024 we have about 10% of our fixed-rate portfolios repricing," Thomas said. "And that moves into 20% in 2025 and another 20% in 2026."



As part of its forecasting for future credit losses, the bank assumed the unemployment rate rising to between 7% and 8% over the next 12 months. The unemployment rate is currently at 5.7%, up from 5% where it started the year.

"[The] unemployment rate has a significant impact on our models, but I would also look at the interest rate impact and that's the result of higher-for-longer, particularly on some of the retail models," Thomas added.

Variable-rate customers "feeling the pinch"

Scotiabank confirmed it has been monitoring its variable-rate mortgage portfolio "very closely" in the wake of the Bank of Canada's rate hikes.

Unlike some of the other big banks, Scotiabank is the largest mortgage lender that offers adjustable-rate variable mortgages, which means its borrowers see their monthly payments increase every time the Bank of Canada's overnight target rate rises.

It found that its variable-rate clients had been cutting back on discretionary spending (-11% year-over-year) to a greater extent compared to its fixed-rate clients (-5%).

"What we're seeing is those customers are feeling the pinch now and they're making trade-offs," said Thomas.

He also noted that the clients generally still have a savings buffer that is so far helping them cope with higher monthly payments.

"Despite the fact that we've seen…savings buffers decreasing, there's still a two-times payment buffer on the variable-rate mortgage portfolio today," he added.