SCOTIABANK

Q1 2023 EARNINGS CONFERENCE CALL

FEBRUARY 28, 2023

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Additional information relating to the Bank can be located on the SEDAR website at www.sedar.com and on the EDGAR section of the SEC's website at www.sec.gov.

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PRESENTATION

John McCartney – The Bank of Nova Scotia – SVP of IR

Good morning, and welcome to Scotiabank's 2023 First Quarter Results Presentation. My name is John McCartney. I'm Head of Investor Relations here at Scotiabank.

Presenting you this morning are Scott Thomson, Scotiabank's President and Chief Executive Officer; Raj Viswanathan, our Chief Financial Officer; and Phil Thomas, our Chief Risk Officer. Following our comments, we'll be glad to take your questions.

Also present to take questions are the following Scotiabank executives: Dan Rees from Canadian Banking; Glen Gowland, from Global Wealth Management; Nacho Deschamps from International Banking; and Jake Lawrence from Global Bank and Markets.

Before we start, and on behalf of those speaking today, I'll refer you to Slide 2 of our presentation, which contains Scotiabank's caution regarding forward-looking statements.

With that, I will now turn the call over to Scott.

Scott Thomson - The Bank of Nova Scotia – President & CEO

Thank you, John, and good morning, everyone. We appreciate you joining us today. Given this is my first quarterly investor call, I would like to begin with sharing some early observations on the bank after 4 weeks in the CEO role.

My approach has always been about transparency and partnership, and I'm committed to working with the investment community in this manner. I've had the opportunity to spend time with the leadership team as well as to meet with many employees and customers across Canada and in Mexico, Chile, Peru and Colombia. I have been energized by meeting our teams across the bank.

Our people are highly engaged, proud and committed Scotiabankers. In addition to a rock-solid foundation, a diversified revenue base last year of approximately $32 billion and net profits of over $10 billion, we have many competitive advantages, unique areas of strength, and opportunities for growth in the bank, including the credit quality of our loan book, our Scene+ loyalty program, which will be a key enabler in diversifying our Canadian P&C business mix.

The long-term commercial banking growth opportunity across our platform, an outstanding wealth management franchise, the GBM platform across the Americas, and our performance in Mexico and the upside potential by improving the connectivity across Canada, the U.S. and Mexico. But we have not delivered the level of total shareholder return that our shareholders should expect of us.

To drive better shareholder returns, my focus will be on delivering profitable and sustainable growth through an even stronger customer orientation by building our solid foundation, aligning on enterprise-wide focus areas, and consistently executing with operational excellence. And I really do want to underscore the words consistent execution, as that is what we expect to measure ourselves on, with established milestones and targets.

To do this, I'm aligning our leadership teams around 3 areas of focus: first, purposely allocating capital. We need to build more discipline in our approach to capital allocation, and we need to view this through an enterprise-wide lens.

Second is focusing on long-term deposit growth, increasing our core deposits is critical. The current environment of rapidly rising rates and an inverted yield curve highlights the challenges with the structure of our balance sheet. Increasing deposits not only reduces funding costs, but it deepens our relationships with our customers, allowing for a more detailed understanding of their needs, thereby enhancing the multiproduct opportunity.

Payroll and cash management capabilities, as an example, could be an area that becomes a higher priority across the platform.

Third, we will improve our business mix and profitability. Building towards profitable and sustainable growth means leading less with the balance sheet alone, but also a focus on prioritizing long-lasting, multiproduct, mutually beneficial relationships that enable our customers to succeed. This journey will take time and will require a shift in orientation. From the way we reward our people to how we collaborate among our business lines, to how we allocate our capital to customers and segments.

Encouragingly, we have a great foundation to build upon as our customer relationships are strong, and our leadership team recognizes the opportunity in front of us. I am convinced that with an enterprise-wide focus, combined with our continued lean and agile approach to expense management, we will strengthen our results and deliver the performance our shareholders deserve.

Turning to our Q1 results. The bank's financial performance in the first quarter of 2023 reflects both the merits of a diversified platform, but also the continued relative pressure on our profitability given our funding profile. Going forward, we must be consistent and deliberate in our long-term deposit strategies to continue our journey to reduce our reliance on wholesale funding.

Rapid loan growth, coupled with high cost funding sources has adversely impacted profitability. And going forward, we will be cognizant of the need to pace loan growth, particularly in less profitable product segments.

The negative operating leverage in the bank certainly warrants attention. Higher personnel costs and spend on certain technology projects primarily drove the expense growth in the quarter. We will be even more thoughtful about expense control across the bank for the remainder of the year.

In the Canadian business, I was pleased to see the continued progress with our commercial customers and encouragingly, deposit growth of 10% outpaced 9% year-over-year loan growth. Dan's vision of diversifying Canada's revenue mix beyond mortgages and autos is the right one and will pay dividends over time.

Turning to International Banking. I was encouraged by the performance this past quarter, driven by strong results in retail, commercial and our GBM business as well as positive operating leverage. Nacho, Jake and, I were in the region recently and the businesses we have built in LatAm are impressive, with a digital-first mindset that will increasingly facilitate better customer and employee experience at a lower productivity ratio.

However, while we've allocated significant capital to our international bank in the last few years, the returns are not commensurate with our expectations in certain countries. I see areas of strength, and I also see segments where we were underpenetrated like commercial, affluent retail and other high-value segments that have a good profitability and risk profile. We are in the process of assessing our international business mix so that going forward, we allocate our capital to customer segments, where we can get appropriate returns for our shareholders.

Global Wealth Management saw resilient results in the face of volatile markets and continued industry-wide funds flow challenges in the asset management segment. Glen and the team have built a very strong franchise and it's nice to see the quarter-over-quarter uptick in net income and strong operating leverage performance.

I'm also pleased to see the continued momentum in the International Wealth Management business. GBM also delivered a solid quarter. I was particularly pleased to see the contribution from Capital Markets revenue with a close to equal split between business banking and capital markets. Record GBM contribution inclusive of GBM LatAm demonstrates the continued progress in our efforts to build an Americas wholesale platform.

Lastly, we continue to observe strong credit metrics across our portfolios.

I will now turn the call over to Raj for a more detailed presentation on the financial results.

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Thank you, Scott, and good morning, everyone. This quarter's net income was impacted by the $579 million income tax expense payable for the Canada recovery dividend of $0.48 of earnings per share and about 12 basis points in the common equity Tier 1 ratio, and this was recorded in the other segment.

So all my comments on the banks and the other segment that follow will be on an adjusted basis for this item, and the usual acquisition-related costs.

I will now review the performance for the quarter on Slide 5. The bank reported quarterly adjusted earnings of $2.4 billion and diluted earnings per share of $1.85. The return on equity was 13.4%. All bank pretax pre-provision profit decreased to 8% year-over-year, driven mainly by the impact of higher funding costs. Revenues were down 1% year-over-year, driven by lower noninterest income, which was down 8%, driven primarily from lower wealth management revenues and underwriting and advisory fees, although banking revenues were up a strong 11%.

Net interest income grew 5% as a result of strong asset growth across all business lines, offset by a lower net interest margin. However, quarter-over-quarter, net interest income was down a more modest 1%. Net interest margin declined 5 basis points year-over-year. Interest expense grew $6.5 billion or over 300%, while interest income only grew 105%. The decline in margin was mostly driven by higher funding costs and higher balances of high-quality, low-margin liquid assets.

Looking ahead, we believe that we are at the tail end of rate increases and expect to see margin expansion when interest rates stabilize. I'll elaborate further on the higher funding costs in my comments in the Other segment.

The PCL ratio was 33 basis points for the quarter, in line with our outlook. Year-over-year, adjusted expenses increased by 6% or 4% excluding the impact of the unfavorable impact of foreign currency translation, primarily driven by higher personnel and technology spend to support business growth.

The productivity ratio was elevated at 55.7% this quarter, resulting in the bank generating negative operating leverage of 6.7%. We will be even more thoughtful about expense control across the bank for the remainder of the year.

Slide 6 provides an evolution of the common equity Tier 1 ratio over the quarter as well as the quarter changes in risk-weighted assets. The bank reported a common equity Tier 1 ratio of 11.5%, unchanged from the prior quarter. Internal capital generation of 5 basis points, combined with 9 basis points from revaluation of securities offset the 12 basis point impact of the Canada recovery dividend.

Risk-weighted assets grew $9.1 billion or $6.5 billion, excluding foreign exchange. This was driven largely by lending risk-weighted asset growth in retail of approximately $1.9 billion and business lending of approximately $2.3 billion.

The adoption of Basel III reforms in Q2 2023 is estimated to benefit capital by approximately 20 to 30 basis points. Our priority remains to deploy capital to support profitable organic growth initiatives, while prudently managing capital in the face of a less certain economic outlook.

Turning now to the business line results, beginning on Slide 7. Canadian Banking reported earnings of $1.1 billion, a decrease of 10% year-over-year, largely driven by higher provision for credit losses. Pretax pre-provision profit grew 7% year-over-year, driven by revenue growth of 10%. Net interest income increased 12% year-over-year as loans grew 9%, while deposits grew 10%. The net interest margin grew 7 basis points year-over-year due to higher deposit spreads, reflecting the 425 basis points of Bank of Canada rate increases, partly offset by lower spreads across all loan products.

Loan growth moderated to 9% year-over-year, driven by a 22% increase in business loans and 7% increase in residential mortgages. Loans grew a modest 1% quarter-over-quarter. Deposits grew a strong 10% year-over-year, driven by a 13% increase in personal deposits and a 4% increase in nonpersonal deposits. Noninterest income decreased by 5% year-over-year, driven by higher private equity gains and higher banking revenue.

Expenses increased 13% year-over-year, driven by higher personnel and technology costs to support business growth. The PCL ratio was 19 basis points, an increase of 4 basis points compared to the prior quarter or 22 basis points compared to the prior year.

Turning now to Global Wealth Management on Slide 8. Earnings of $392 million declined 6% year-over-year, primarily due to lower fee income and the impact of elevated seasonal performance fees in the prior year. Revenue declined 7% year-over-year due primarily to lower fee income, driven by a decline in trading volumes and lower assets under management, partly offset by strong loan growth in private banking and higher deposit margins.

The division had positive operating leverage this quarter as expenses declined 7% year-over-year, driven by prudent expense management. The productivity ratio improved to 59.9%. Assets under management decreased 7% year-over-year to $322 billion, primarily due to market depreciation, while assets under administration increased 1% to $607 billion. We saw strong growth in our key international markets with double-digit earnings growth across the Pacific Alliance and the Caribbean Wealth Management businesses.

Despite investment funds in Canada seeing 10 consecutive months of net redemptions, we continue to be ranked #2 by assets in the Canadian retail mutual fund industry. Investment results continue to be strong with 69% of 1832 Asset Management funds in the top 2 quartiles over a 5-year period.

Referring to Slide 9. Global Banking and Markets generated earnings of $519 million, down 7% compared to the prior year, but up 7% compared to the prior quarter. Results were driven by strong loan and deposit growth as loans grew 33% year-over-year, while deposits grew 12%. Revenue increased 7% as net interest income grew 22% year-over-year, driven by solid business banking performance with strong loan and deposit growth and improving margins.

Noninterest income grew a modest 2% as higher trading and banking revenues were partially offset by lower investment banking revenues. Expenses were up 15% year-over-year due mainly to higher personnel costs, cost to support business growth and regulatory initiatives and the negative impact of foreign currency translation.

GBM Latin America, which is reported as part of international banking, reported record earnings of $301 million, up 50% year-over-year with another quarter of strong results from Chile, Mexico and Brazil.

Slide 10 highlights this quarter's strong international banking results. My comments that follow are on an adjusted and constant dollar basis. The segment reported net income of $661 million, up 18% year-over-year. Pretax pre-provision grew 11% year-over-year with the Pacific Alliance growing 5% and the Caribbean and Central America up a strong 36%. Year-over-year, loans grew 13% with mortgages up 14% and commercial loans up 13%, while personal loans and credit cards also grew 9%.

Revenue was up 8% year-over-year, driven by higher net interest margin and strong net fee and commissions. The net interest margin was 400 basis points, up 13 basis points, mainly from asset mix and spread expansion, offset by the impact of lower inflation. The margin was down 8 basis points compared to the prior quarter, entirely due to lower inflation, primarily in Chile. The provisions for credit loss ratio was 96 basis points for the segment.

Noninterest expenses increased 6%, driven by business growth and inflationary impact, partially offset by strong digital progress.

The tax rate of 19.7% for the quarter benefited primarily from higher inflationary adjustments in Mexico and Chile and changes in earnings mix. We expect the tax rate to continue to increase, in line with reduction in inflation.

Turning to Slide 11. The Other segment reported an adjusted net loss attributed to equity holders of $334 million. This was due mainly to lower revenues of $663 million, partly offset by lower expenses and taxes.

Approximately 3/4 of the lower revenue relates to treasury activities due mainly to higher funding costs and lower income from hedges, reflecting the bank's interest rate position to benefit from declining rates. This was partially offset by higher income from liquid assets.

Also contributing to the lower revenue was lower income from associated corporations and lower investment gains. Quarter-over-quarter, approximately half of the lower revenue relates to lower treasury activities, due mainly to lower funding costs and lower income from hedges, partially offset from higher income from liquid assets.

I'll now turn the call over to Phil to discuss risk.

Philip M. Thomas - The Bank of Nova Scotia - Chief Risk Officer

Thank you, Raj. Good morning, everyone. As I outlined last quarter, we expect to be in the mid-30s PCL range for fiscal 2023. Our outlook remains the same as our credit -- strong credit practices and high-quality portfolio position us well during this time of economic uncertainties.

Overall, the performance of our loan portfolios remain strong, and we are seeing a continued normalization of credit trends as customers adjusted to a higher inflation and borrowing costs.

In our commercial and corporate book, we see healthy demand for credit as underwriting opportunities for high-quality borrowers during this quarter were strong.

In retail, low levels of unemployment across most of our core geographies is a driving factor for the stability of household incomes despite inflationary pressures.

Turning to Consumer health. We note that our customers are responding to a higher cost of living by making trade-offs to manage their spending habits. Spending for customer is down approximately 2% quarter-over-quarter as customers are increasingly moderating their discretionary spending on travel, dining and entertainment, which saw a decline of 3% quarter-over-quarter, notably over the holiday period. This was partially offset by grocery, where spending is up 3% quarter-over-quarter and 10% year-over-year. Despite variable rate mortgage customers seeing higher payments with a cumulative 425 basis point rate increase, given the structure of our variable rate product, deposits for this group remain above pre-pandemic levels. Variable rate mortgages remained stable at 37% of our total mortgage portfolio.

International Banking, geopolitical tensions, inflation and rising rates have resulted in softer GDP growth. However, we see positive employment trends in our major markets. Average core deposits per customer increased 2% quarter-over-quarter, while term decreased 2% quarter-over-quarter, while term deposits decreased 3% quarter-over-quarter as Pacific Alliance customers drew down savings to adapt to inflationary pressures.

For our Canadian and International retail portfolios, 90-day delinquencies for all Canadian mortgages are still at historic lows of 11 basis points or approximately half pre-pandemic levels. International retail overall continues to perform well and much better than pre-pandemic. However, normalization continued in Q1 as delinquency increased by 5 basis points, quarter-over-quarter driven by Chile unsecured portfolios.

Turning to credit performance during the quarter on Slide 15. Our PCL ratio was 33 basis points or a provision of $638 million. Our impaired PCL ratio was 29 basis points or $562 million. We added $76 million in performing loans to reflect volume growth and the impact of a less favorable macroeconomic outlook.

Total PCLs increased $109 million quarter-over-quarter, driven by portfolio growth and higher retail formations in both Canada and international. Canadian Banking retail PCLs increased quarter-over-quarter, primarily driven by automotive, as we see the normalizing of this portfolio. The increase in international banking and retail PCLs was driven by Chile and Colombia as consumers adapt to the inflationary environment. Impaired PCLs and GBM declined from the prior quarter while performing PCLs increased due to a less favorable macroeconomic outlook.

Allowances for credit losses increased $169 million to $5.7 billion, mostly in Stage 1 and 2. And the ACL ratio was stable quarter-over-quarter despite net write-offs increasing slightly quarter-over-quarter to 29 basis points, we remain well below pre-pandemic norms of 54 basis points.

We remain comfortable with our ACL coverage given the high-quality retail portfolio and focus on investment-grade lending and business banking.

Finally, we continue to see resilience in our customers. Our highly secured portfolios with strong credit and underwriting fundamentals and higher quality customer mix have positioned us well to manage uncertainty across our core markets. The credit portfolio remains strong and well provisioned, and we are well equipped from a collections perspective to work with our customers. We continue to monitor economic indicators and the health of our customers.

With that, I will pass the call back to Scott.

Scott Thomson - The Bank of Nova Scotia – President & CEO

Thank you, Phil. We remain cautiously optimistic on the 2023 operating environment in our key geographies, anchored by a resilient employment and proactive monetary policies that are having the desired impact on inflation. The interest rate tightening phase appears to be nearing its conclusion in Canada, which should lead to more favorable consumer sentiment and a continuation of the relatively high business confidence we see from our corporate and commercial customers.

In the Pacific Alliance countries, growth is moderating in response to the historically aggressive tightening that characterized 2022. Inflation in the region is slowing with GDP growth expected to continue to be modestly positive this year throughout the region, except for Chile, where a modest slowdown in 2023 is expected to be followed by a rebound in 2024. We have been encouraged by the economic resilience of the region and our own credit performance throughout this period of interest rate and political volatility, which has been instructive as we consider how to best position this business for the future.

As we look forward, our leadership team and I, are underway on a collaborative review of the strategy that will result in enterprise-wide objectives and business line initiatives in support of these shared goals. Our intention is to provide a formal strategy update to investors and the analyst community before the end of the calendar year.

In the interim, a few notable near-term focus areas. From an all-bank perspective, achieving a 12% CET1 ratio by fiscal year-end is important. 11.5% was a good outcome for the quarter, and we will continue to see internal capital generation throughout the year as well as the benefits from Basel III implementation next quarter.

However, to be prudent, we have introduced a 2% DRIP discount given changing rate expectations and our desire to support business growth once we have aligned on our priority organic growth initiatives.

From an all-bank perspective, we will also be focused on better matching our growth in loans with our growth in deposits. In our Canadian business, we'll be focused on the acquisition of primary multiproduct customers. New to bank acquisition in Canadian Banking is accelerating with the Scene+ program, which is already delivering meaningful impact. The percentage of customers entering the Canadian bank as Scene+ customers doubled versus a year ago and a significantly higher percentage of those customers enter the bank with 3 or more Scotia products.

Over time, we will also see continued expansion of our commercial banking business to our natural share in Canada, resulting in a larger contribution to the Canadian bank. We will also pursue targeted commercial growth within the international banking footprint in the coming years.

Our total wealth model, which leverages our capabilities across private banking and wealth advisory will enable us to capture greater value within the expanding high net worth client segment across our Americas platform. We will continue to leverage our footprint and grow fee revenue to improve profitability and expect to continue to see double-digit growth in our International Wealth Management business.

We will also continue to build our GBM Americas capabilities throughout the U.S. and Latin America to fully capitalize on our sector expertise and the established Scotiabank brand. We are particularly focused on improving the underwriting and advisory revenue to lending revenue ratio as we work to close the gap to our peers.

In summary, our results this quarter are a reminder that while we have a powerful banking franchise, we also have opportunities for improvement, which are highlighted in this current rate environment. We have a strong senior leadership team and over 90,000 Scotiabankers across our footprint who are passionate and committed to delivering for our customers, communities and each other and importantly, our shareholders.

Although I remain cautious on our near-term earnings outlook, I'm confident we'll come out of this year with a strong balance sheet and refresh priorities, supported by a macroeconomic backdrop that will allow us to deliver profitable, sustainable growth for you, our shareholders.

John McCartney – The Bank of Nova Scotia – SVP of IR

Thank you, Scott. We will now be pleased to take your questions. Operator, can we have the first question on the phone, please.

QUESTIONS AND ANSWERS

Operator

The first question is from Mario Mendonca from TD Securities.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

Scott, you talked about deposit focus being important going forward. Now presumably, this was an -- this issue was understood, like the wholesale funding issue was understood at Scotia for some time.

Could you talk a little bit about what you expect to do differently now going forward? Or is really just the goal now just to squash loan growth so that it just matches up with deposit growth going forward? Are you going to do something more active on the deposit front?

Scott Thomson - The Bank of Nova Scotia – President & CEO

Yes. So thanks, Mario. So a couple of things. One, I do think the wholesale funding ratio over time, we've made some progress. So I guess that would be point one. So it is a point that the team has recognized, but I've also seen great opportunities for improvement in terms of how we go to market to capture those deposits and how we reward our people, how we incent our people, how we engage with our customers. And so it was encouraging this quarter, for example, in Canada to see deposit growth of 10% and loan growth over 9%. But we still got work to do across our portfolio.

And I think -- let's pick a couple of segments, small business, right? We're underpenetrated in small business. We know that has 4x the deposit growth relative to other segments. Commercial, we know we're underpenetrated. We're making a lot of progress. That has good deposits as well. Now those aren't as cheaper deposits, but they are -- it's deposits corporate. We know we lead with our loan in a lot of cases, our balance sheet. And there's an opportunity to increase deposits there.

So I do believe that there's an opportunity for us to be more focused, more deliberate, more consistent on how we go to deposits. And that will be a big opportunity for us going forward. So I don't see it fully coming through the loan side.

That being said, on your loan side, we do have to have a better matching of deposits to loan growth. We can't be wholesale funding on one hand at really high costs, and then growing the loan book at a rapid rate in profit -- with profit margins in segments that aren't appropriate. So there will be an adjustment on both sides, both on the deposit side and the loan growth side.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

Let me just squeeze in one other here. So Scott, it sounds like Scotia is going to change in the next little while. The bank is going to change. There's a lot of things you want to do. You're talking about revisiting business mix and IB deposits, there's just so much that's going to change at this bank over the next, say, 12 to 24 months.

My experience that when there are big changes like this, that the analysts get earnings wrong an awful lot, myself included or maybe even myself especially. So I think it would be helpful then if you are very clear on guidance like earnings guidance -- earnings growth guidance for 2023 and '24. Is that something you can offer now? Or is that something you'll do at the Investor Day later this year?

Scott Thomson - The Bank of Nova Scotia – President & CEO

Yes. So I guess a couple of things. One, Mario, I actually saw you got the earnings pretty close to where we ended up. So I thought that was interesting. Point one.

Point two, we will be more explicit with milestones and targets and guidance, but we will wait until we get through the strategy work at the end of the year to do that. I think what we're saying now, we're pretty clear that we're cautious about the next quarter in terms of earnings, but we're also recognizing we're at the bottom here in terms of NIM or close to the bottom in terms of NIM compression. So that is good news.

I think as we come out of the year, we'll give you more targets, more clarity, more transparency which once we've aligned around the growth objectives, we'll have a strong balance sheet, we'll have refreshed priorities, and we'll give you those types of targets that you're asking for.

Operator

The next question is from Doug Young from Desjardins Capital Markets.

Doug Young - Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst

Just on the corporate loss, Raj, can you unpack a little bit more about what's going on? And I guess I struggle a little bit because at the divisional level, the results look good. And then I look at Other and there's this big negative in. And so I'm hoping you can unpack that.

Maybe if you can talk a little bit about what the outlook is going to be for corporate. And when corporate losses are de minimis, I'm not too fast, but when corporate losses become big, I start to distress my divisional outlook just because I'm not sure how much of this corporate loss should be allocated out to the divisional side. So can you help me just kind of put some parameters and thoughts around this?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Sure, happy to do that. When there is a level of interest rate volatility like we're seeing now, the impact of that volatility for our bank shows up in the Other segment. So what you're seeing, the $334 million loss is obviously an outsized outcome, but it's reflective of the interest rate environment and the velocity of changes that have happened in the interest rate environment. But what it relates to is really is how our transfer pricing methodology works, and it's purely intended to remove interest rate volatility from the businesses.

So to your question, does it relate to a business segment, I'd say simply, the answer is no. Go back to 2019 or even 2020, for example, when we had actually big benefits in the Other segment. We didn't push it to any of the segments because this relates to how we manage the interest rate risk, how we fund ourselves and eventually how the interest rate situation plays out.

So it's very consistent with how we have done it when it's been the opposite way in the Other segment. So it's not specific to any business line. But if you want to really attribute I can tell you, like I said before, it does not relate to the international banking business because their treasury operations is within that segment.

When you talk about outlook, yes, I think for this year or immediate quarter, the funding cost is going to remain elevated as we know. We have had interest rate increases, hopefully, the last in Canada from what you've heard from the governor. So that should have a full quarter impact in the second quarter. The fed rate increases will also have an impact for us. So I think the Other segment will look somewhat similar to what you're seeing this quarter. It's not going to improve too much.

But eventually, I think as rates stabilize and eventually when rates start declining, it could happen later in the calendar year or into 2024, we don't know for sure. We will see the benefits starting to accumulate in the Other segment as well.

So that's how I see it evolving and then eventually getting back to some sort of normal range, right, whatever that might be, and we can talk about it towards the end of the year. But for the rest of this year, you should assume that the Other segment loss will be somewhere in this range.

Also remember that prior, I'm talking about 3, 4 years back, we used to have a lot of the investment gains that went through this sector as well. The loss relating to net interest income in 2019 was a little over $900 million for the whole year. So it's not unusual for us. I think the quantum is a bit unusual because of the velocity and magnitude of rate changes that have happened in a very short period of time.

Doug Young - Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst

So just to summarize, like this is all interest rate related. It probably continues through this year, so others going to kind of seem out kind of outside normal. It's all more related to Canadian P&C banking. And there's nothing else unusual in here, outside of that interest rate impact. Is that a fair kind of characterization of this?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Yes, I think it's a fair characterization. The only thing I'd probably add to the Canadian P&C business comment you made. There's probably 3 different components when you think about where was this investor, if that's where you're going.

The Canadian bank definitely is a component. Our Global Banking and Markets is a component, and likewise, our investment securities. We hold high-quality liquid assets, which tend to be lower margin. So as much as the term funding goes to fund the growth in those assets as we improve our liquidity ratio, that will also be a component that impacts the outcome in this segment.

Operator

The next question is from Gabriel Dechaine, National Bank Financial.

Gabriel Dechaine - National Bank Financial, Inc., Research Division - Analyst

I'd like to just explore the comments about the IB segment there with regards to returns not being commensurate to the risk. And I think that's open and honest statement. I just want to know what the -- what are you looking at in particular?

I know over the past couple of years, there have been some businesses like some unsecured consumer that you've been downsizing or deemphasizing. Wondering, I guess, geographically, what are the product lines you might be looking at? And what the expected impact is from a sustainable, lower PCL level to a lower capital required, stuff like that.

Ignacio Deschamps - The Bank of Nova Scotia - Group Head of International Banking & Digital Transformation

This is Nacho. Let me start. I think it's important to what you are saying. We are disclosing ROEs for international banking in a more granular level both for the Pacific Alliance countries and for the Caribbean and Central America.

What I would say is, overall, we are pleased to see that International Banking ROE this quarter is 13.6% increase compared to -- 12.4% last year. And in some -- the way I summarize the situation we are, we have 3 geographies with high return on equity, above IB and all-bank ROE, which are the English Caribbean, Mexico and Peru, and we have seen consistent improvement in these countries, driven by organic growth.

And we also have 2 countries, which are relatively small within International Banking, where we acknowledge that we need to improve performance and profitability, which are Colombia and Central America. And in these countries, we have developed specific business plans that we expect will gradually improve their performance and close the gap in profitability.

Gabriel Dechaine - National Bank Financial, Inc., Research Division - Analyst

So those are -- and then kind of what's -- I mean these aren't strategies that are implemented in a quarter time. Like what's kind of the timeline of turnaround for those Colombian and Central American businesses.

Scott Thomson - The Bank of Nova Scotia – President & CEO

David, it's Scott. So we're working with the teams right now. I mean this is part of the whole strategy review and there's a combination of deposits and there's a combination of business mix. And we need to make sure we allocate our capital to the areas where we're going to get the highest return on risk-adjusted -- risk-weighted assets. And so that's the process that we're going through right now, and we'll have more to say on that at the end of the year.

Gabriel Dechaine - National Bank Financial, Inc., Research Division - Analyst

Okay. And I echo the comment that, if there are changes in quantifying the impact so we can get a better handle on our modeling and expectations, that's pretty important.

Operator

The next question is from Paul Holden from CIBC.

Paul David Holden - CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research

So I guess my question relates to the PCL guidance for mid-30s. You hit 33% this year, which is actually already in mid-30s. And I think we're -- like my perspective is we're kind of closer to the beginning of the normalization and impairments versus midway through or near the end. So I'm just wondering what it is that gives you comfort that the PCL ratio won't be increasing significantly from Q1.

Philip M. Thomas - The Bank of Nova Scotia - Chief Risk Officer

Yes. Thanks, Paul. I appreciate the question. Phil here. We're going to -- as I said in my prepared remarks, we're standing behind our mid-30s guidance for the year. And what gives me comfort is the shift in business mix that we've had, both in Canada and international. Certainly, from -- in the international perspective, the move to 73% secured and then in Canada move to 95% secured.

And we've been spending a lot of time on the -- just really focused on high-quality acquisition in our international portfolio, focused more on affluent as well. And that's making a big difference in terms of what I'm seeing in the numbers coming up.

And so -- and then finally, as I go through portfolio by portfolio, like we're starting to -- we really see a lot of the continued low delinquency rates, continued low net write-offs coming out of some of our major portfolios. We are starting to see some of those indicators starting to tick upwards. But those are in particularly in GIL this quarter, but those tend to be in areas such as Canadian mortgages, Canadian auto, which are sort of secured, which have a good collections rate on them. So we don't usually flow into Stage 3.

And then in the commercial side, we're seeing -- continuing to see resilience and strength. We were up slightly in GILs this quarter, but that was 1 Canadian commercial credit that we already have, letters of intent for. So if I look at the portfolio holistically, we're in really good shape. But having said that, I think as I look at my business partners here, we're not going to turn away healthy growth for the sake of the PCL ratio. And we'll be thoughtful and over collectively with my partners here to see how we go throughout the year.

Operator

The next question is from Mike Rizvanovic from KBW Research.

Mehmed Rizvanovic - Keefe, Bruyette, & Woods, Inc., Research Division - Research Analyst

Quick question for Raj. Just wanted to get some color on the rate impact since quarter end. Obviously, rate expectations have moved a little bit in terms of the forward rate curve. Are we looking at a situation where you could see pressure once again next quarter at your -- on your margin at the all-bank level. Sure, if you've covered this already, but I may have missed your comments.

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

No worries, Mike. Happy to clarify that as well. Yes, I don't see any material margin compression looking forward into Q2. A lot of the forward rates are already built into our positions, I think, and our own estimates and outlook. We might have something marginal, I would say, but certainly not to the extent you saw this quarter, the 7 basis points.

I'm actually quite confident that if Q1 is not at the bottom, Q2 will likely be the bottom and then we're going to start seeing our margins expand and therefore, contribute to the profitability.

Mehmed Rizvanovic - Keefe, Bruyette, & Woods, Inc., Research Division - Research Analyst

Okay. Appreciate that. And if I could just sneak one in. I think this one is very important. I get asked this question often by investors. So will you -- and maybe better for Scott. But when you think about capital allocation, and it sounds like divestitures are certainly something that you could potentially do. When you think about that dynamic between maybe taking a hit on capital because your carrying values are higher than what you could sell these assets, these businesses for versus just the natural benefit you get on reducing your risk-weighted assets, maybe some higher risk-weighted asset density type lending. Can you talk about that trade-off? And what I'm wondering is, do you have any low-hanging fruit, where you could maybe sell some of these higher risk lending businesses off and not actually have to take a hit to your CET1?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Let me start there, and Scott might have a comment or 2 on this, Mike. I think our divestiture program or our repositioning is done. I think that's the simplest way you need to think about it. There will always be something which is housekeeping. And like Nacho commented, there's a couple of countries where we feel like we're not getting the appropriate returns for the capital we've invested in.

Our first plan and generally our first plan is saying how can we improve the profitability of these operations. And that's what we're going to be focused on. These are not bad operations. We like the places where we are in. We want to ensure that we're able to deliver to our shareholders.

Divestitures, I think, is the last option. I'm not saying we won't exercise it at some point in time, but this is not the time. And I suspect that Scott will be able to clarify more, when we talk about it at the Investor Day.

And eventually, performance drives actions, and we expect to start performing in these regions or in certain products, even in other parts of our business. If you're not getting the appropriate returns, we're going to be laser focused on getting a return on risk-weighted asset or return on equity more than we have done in the past, particularly in light of we know capital, liquidity, all these are going to be constraints either based on market events or just based on regulatory changes that are coming, including Basel III, and we're going to evaluate all that in the context of how we set our strategy for growth going forward.

Scott Thomson - The Bank of Nova Scotia – President & CEO

Yes. I'd just add on, I mean, profitable growth, this is the pivot, right, from growth to profitable growth and return on risk-weighted assets is a big component of that. So we're going through the portfolio right now and making sure and from our customer lens as well, right, making sure we have the appropriate return on risk-weighted assets for the capital that we deploy. And that's going to be the challenge that as a team we're all going to go through here over the next few months.

Operator

The next question is from Lemar Persaud from Cormark Securities.

Lemar Persaud - Cormark Securities Inc., Research Division - Research Analyst

And for my question here, maybe I'll turn to Raj on all-bank expenses. Would it be fair to suggest that this quarter would be in the high watermark for expense growth? And what I'm referring to is expense growth on a year-over-year basis. And then if that's true, where you see expense growth ending for the full year?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Thanks, Lemar, for the question. I think expenses is going to be one of the most important topics this year. And we all know inflation, we all know some of the personnel costs that has gone up when we think about year-over-year, all the base salary increases and so on, which has been widely publicized. So it's definitely going to have an impact.

Our bank's philosophy, as many of you know, is always based on 2 principles of how we manage expenses. One, we prioritize. We want to be sure we're continuing to invest in the business. It doesn't matter what the environment is.

And second comment also relates and is probably indifferent to the environment is we'll always look to manage our expenses in line with how we see our revenue evolving, not quarter-by-quarter, but as we think about it over a certain period. So that doesn't change and that will not change. But you're right, I think the year-over-year comps get a little better as we go through the rest of the year compared to what it has been in the beginning of last year because the inflation started really kicking in and the started growing only in the second half of last year.

But as I said in my prepared remarks too, Lemar, we'll be even more focused on expenses as we think through the rest of 2023, lots of moving parts, inflation. We've invested a lot in our businesses, and we want to be sure we're in a position to invest as we start formalizing our strategy for growth going forward and expense cannot be a constraint over there. We want to have the right resources. We want to have the right technology, and we want to be positioned right so we can continue to grow these businesses. But it should get better when you think about year-over-year for the rest of the year.

Lemar Persaud - Cormark Securities Inc., Research Division - Research Analyst

Okay. And just to leave it with the comment, if you guys could provide some guidance on that front, given the amount of changes you're -- we're kind of thinking about here, that would be very helpful.

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Sure, Lemar. I think as we've said in the November call relating to '23, we thought expenses will not be the 2% that we saw '22 versus 2021. We knew it will be elevated. I think achieving an expense growth of 4%, excluding FX, even for this quarter, I would say it's quite a good achievement for this bank. FX is not something that we can forecast. But if we can settle down around the mid-single-digit range, call it 4%, 5%, we'd be quite pleased for the whole year.

Operator

The next question is from Scott Chan, Canaccord Genuity.

Scott Chan - Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst

Yes. More follow-up on your comment on managing RWA growth and maybe pertaining to mortgages and auto. Clearly, mortgages are struggling, where change in originations in on Vancouver quarter-over-quarter and year-over-year basis. So just kind of curious on what you're kind of seeing.

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Sure, Scott. It's Raj. So I'll start, and any of my colleagues can add on if, Dan, you want to pitch in.

As you saw mortgage growth has slowed down. And that's a market, it's a market we all live in. I think we know it quite well. Rate increases have been a big component of the slowdown in the RWA growth, in the loan growth and therefore RWA growth.

Auto has actually gone the other way. We actually saw expansion in our auto loan book by about $1 billion in Canada. This quarter, that's quite nice because auto is something we've been waiting for some time for all the reasons that, again, many of you know, which is about supply chain issues and memory issues and all those stuff.

Auto is higher RWA density as we know compared to mortgages. There's also going to be a lot of moving parts, Scott. If you caught up with the changes that are coming through from a Basel III perspective, we know that risk weights are going up on many, many products as they tend to focus more on the floor, standardized calculations, those kind of things, which is going to continuously increase the risk-weighted assets and therefore, the capital requirements on all products, not necessarily mortgages.

So we're going to be thoughtful about it. I think for the rest of the year, I would suggest that what you've seen in the mortgage growth is likely an indicator of what might happen, but I'll leave Dan to clarify on few other thoughts you might have on the loan growth. Dan?

Daniel Llewellyn Rees - The Bank of Nova Scotia - Group Head of Canadian Banking

Yes. I just confirm the outlook that you're giving with regards to our intentionally slowing the mortgage portfolio, even in light of the fact that the market has been slow. I think that trend will continue.

Part of the reason for that is liquidity and risk-weighted assets, as Raj mentioned, but also the emphasis on profitable growth through cross-selling and retail. And to give you some comfort, a year ago, 18% of new mortgage customers had the -- they account that's now up to 23%. So deepening with existing customers off the loan portfolios is going to continue to be a prominent story going forward.

Auto loans did see good growth this quarter. That is a relatively higher margin business for us on the loan yield side, so that was encouraging. It is RWA dense and does not offer as much cross-sell opportunity. So as we do the portfolio review that Scott mentioned, we will be bearing that in mind in particular.

And I would just take the opportunity to reinforce our commitment to commercial profitable loan growth and profitable growth period. The NIR in commercial has been really encouraging, and the cross-sell ratios continue to be good as it relates to referrals into wealth management. That loan portfolio does carry higher risk weights, particularly in a forward Basel environment. And so in the same way that you saw us grow below the market in Q1, even before adjusting for our smaller loan size, you will continue to see us be diligent and deliberate about RWA managing the commercial loan growth from here forward with an emphasis in particular, on segments in commercial that offer noninterest revenues and feed the rest of the franchise.

Operator

The next question is from Sohrab Movahedi from BMO Capital Markets.

Sohrab Movahedi - BMO Capital Markets Equity Research - Banks Analyst

Just I guess, a cynical question here, Raj. If for whatever reason the anticipated rate environment doesn't evolve the way that would be kind of helpful to you. Is there anything you can do to kind of stop the bleeding in the corporate segment?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Thanks, Sohrab. It's Raj. I think interest rate risk management has got multiple factors attached to it, right? It's not just single dimensional. Our balance sheet continues to evolve, how we lend, how we borrow as an impact as the months go forward.

Our positioning, you would have seen even from the 100 basis points impact has dropped from $340 million negative to $304 million negative. That's just the evolution of the balance sheet, which is also going to help. We are very focused on how we manage our interest rate risk, as you know, and we know we are positioned differently compared to most of our peer banks, if not all of them here.

We'll take the necessary actions. I think the bulk of the rate increases are in our numbers, so to speak. The assets are continuing to reprice, albeit at a slower pace, and we disclose at least 1 asset class, which is the mortgage book, how it's going to evolve. There are many components that will drive the outcome in the event that we continue to see significant rate increases.

Now the situation is obviously, if there's going to be 50 basis points, 100 basis points increase from the Bank of Canada or from the Feds. Yes, definitely, that will have an impact to us because of the way we are positioned.

But I think the bulk of it is already there. And based on the forward rate curves that we see and some of the interest rate stress tests that we do, we feel like we can manage the outcome, Sohrab, fairly well. And I don't think we should see significant margin compression or significant negative outcomes from the Other segment as we see it today.

Sohrab Movahedi - BMO Capital Markets Equity Research - Banks Analyst

Okay. And if I can just sneak one more in for Scott. A year or so ago, it was talked that maybe it would be helpful to have a bit of an international or a U.S. kind of receiving entity as an added acquisition in the Global Wealth Management business.

As you think about all the things that are on the go right now, is capital deployment through an acquisition, a high-priority item, Scott? Or is that a little bit further on the back burner now?

Scott Thomson - The Bank of Nova Scotia – President & CEO

Yes, thanks. We're going to focus -- I mean, this is going to be an internal operational excellence agenda in terms of setting milestones, setting targets and executing. And so in my mind right now, there's not a big M&A agenda here.

And I think we will, through time, prove out that we can improve the profitability, and at the same time, improve the growth and improve our credibility.

As you asked about international wealth, I do feel but the need to create some synergies across this platform, the Americas platform is important. And I see it working in wholesale. I see a small business in wealth, but growing at double-digit rates. And I also recognize that high net worth folks are going to want to be able to operate in Canada, U.S. and international. But I don't see it as an M&A agenda right now. And maybe, Glen, just pass it to you for any comments.

Glen B. Gowland - The Bank of Nova Scotia - Group Head of Global Wealth Management

Sure. Yes. Thanks, Sohrab. I think it's important because, obviously, with the acquisitions of Jarislowsky Fraser and MD, those are very opportunistic. MD was a very unique business model. Jarislowsky Fraser filled a significant gap we had on the institutional space.

But -- they've been very active in our international business, which has been helpful. And our real focus is on organic growth. So -- in the U.S., we would have some wealth management that gets utilized. Certainly, our trust structuring business in Miami has been very successful. But the priority is really on organic growth. And we've seen, as Scott mentioned, strong double-digit growth in international, which we think will continue.

And the Canadian businesses and the advisory businesses continue to grow strongly and gain market share. And that's actually something we can export into international. It's not the exact same markets, but certainly the needs of the client's environment. And so we've had good success in terms of building up the capabilities in partnership with Nacho's team and Jake's team with the clients that we have in international. So we think there's very good runway there on the organic side.

Operator

The next question is from Nigel D'Souza from Veritas Investment Research.

Nigel R. D'Souza - Veritas Investment Research Corporation - Senior Investment Analyst

Just a quick point of clarification on your NIM outlook and putting a finer point on it. It sounds like your expectation is that once rates peak and stabilize, you'll be able to deliver margin expansion, you don't require policy rate cuts for margin to expand. I just want to make sure I understand that correctly.

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Yes, it's Raj, Nigel. Absolutely, you're right. It's actually quite simple. If rates stop rising, our term funding cost, which tends to be exposed to the short end of the curve will stop rising and our assets continue to reprice. So yes, if they stabilize, we should start seeing NIM benefiting from it NII, benefiting from it and obviously will benefit much more when rate cuts start happening.

Nigel R. D'Souza - Veritas Investment Research Corporation - Senior Investment Analyst

Got it. And just a quick question on the auto portfolio. Just your thoughts on what you're seeing this quarter. Is that idiosyncratic? Is that how you think about it? Or do you think it's a potential leading edge indicator for better experience in the Canadian retail portfolio?

Philip M. Thomas - The Bank of Nova Scotia - Chief Risk Officer

Yes. It's Phil. I'll start, Nigel, and if Dan wants to jump in. We have a big auto portfolio. We're outsized in that versus where we would be versus peers in credit cards. And so as a risk manager, I always use this portfolio as a bit of a bellwether.

So I would say if there's stress coming through the portfolio, it's mostly on the used car side, that's where we're seeing a little bit of tension. I'm watching the portfolio carefully as we look at potentially how residual values trend.

But having said that, because we're not seeing a lot of new vehicles, especially the Japanese and German manufacturers, there's a little bit more on the American auto side. It's keeping used car values higher than they would have been obviously pre-pandemic.

But if I go back to the numbers, again, delinquencies, net write-offs, gross impaired loans in this portfolio are still well below pre-pandemic levels. And I would probably close by saying through the pandemic, we did a lot of investment in our collections space in the -- particularly in the auto book, and that remains in place today. So we -- there's big investments in analytics, in dialer technology, in people, in loss mitigation tools and training. So I'm pretty confident that we're in good shape in auto in terms of managing sort of future trends. Dan?

Daniel Llewellyn Rees - The Bank of Nova Scotia - Group Head of Canadian Banking

Yes. The only thing I would add is, I don't see it as a front-runner for credit risk -- in the credit card book either, which is obviously normally a contributor to net credit loss dollars.

You haven't seen pay down rates or revolve rates on the interest-earning receivable balances and credit cards, sort of reemerge as an issue. We're still way below pre-COVID levels, and the majority of the growth in credit card accounts and balances continues to be purchase volume transactor style. So you don't see that tending to flow through the credit line.

And I think, Phil, on a mix basis, our super prime concentration has gone up at least 500 basis points year-over-year based on our focus, particularly with the advantage of the Scene program. So we're focused on auto for the time being, and the growth has been good and the credit risk is being well managed.

Operator

The next question is from Mario Mendonca at TD Securities.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

Raj, on several times during this call, you referred to liquidity as potentially being a constraint or a binding constraint. Now I don't think you were overstating it, but you did mention it a few times.

So obviously, I went and looked at your LCR and your net stable funding ratio, both of which look no different from your peers and are pretty strong relative to regulatory requirements. So am I reading too much into it? Like, why are you mentioning liquidity as the binding constraint going forward?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Thank you, Mario, for the question. I think we think of liquidity and capital as one and the same in many, many respects. I think a lot of airtime is given to capital because it's better understood by our external audience, I think.

But liquidity is a big component of how we manage what we call financial resources. And for us, particularly now, I think Scott talked a lot about our wholesale funding exposure and how the balance sheet is positioned. That's all about liquidity, that's probably why I probably overemphasized on a few questions when I answered, it's not just about capital. Capital is actually well understood, and we've got a lot of data from 25 years, and we know how to manage it. Liquidity has also got to be part of the conversation. That's how it goes.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

Okay. Can I just squeeze one more then related to that.

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Sure.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

When liquidity comes under pressure, let's say, because deposits are running off, in a very, very simplistic way. Couldn't a bank just go and raise longer-term wholesale funding to cope with that sort of arithmetic impact on your liquidity coverage ratio.

And the point you're making here that while that is an obvious solution to deal with declining liquidity coverage ratios, that's not something Scotia wants to do today. Is that the reason why liquidity is more relevant now?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

No, I think it's 2 points, Mario, and I think you're probably right. One is cost of liquidity will continue to go up the more times you access the market. And we talked a little bit in this call and you heard us talk more about profitable growth.

So eventually, the more times you go to the wholesale funding market because you pay a credit spread on it. It's always cheaper to go down the deposits route and maintain your spread, so to speak. And the more times you access the market, I think it's going to be more difficult to manage what we would call as a wholesale funding ratio on the bank. It has been well managed, right? It used to be at 29% 4, 5 years back, we are at 22% now. So we like it.

But we want to be even lower because that helps with profitable growth. That's why we're focused on liquidity as well. It's not about adequacy of liquidity or availability of liquidity. I think with the franchise value we have, we can access liquidity at any time. It's about what are you willing to pay for and what is that you're going to deploy it into so you can actually produce profitable growth.

Operator

There are no further questions on the phone lines at this time.

Scott Thomson - The Bank of Nova Scotia - President & CEO

Great. Thank you, operator. On behalf of everyone here today, I want to thank you all for participating in our call. I look forward to speaking with you again at our Q2 '23 call in May. Have a great day.

Operator

Thank you. The conference has now ended. Please disconnect your lines at this time, and we thank you for your participation.
