STRUCTURED FINANCE ASSOCIATION

Research Corner

October 26, 2020

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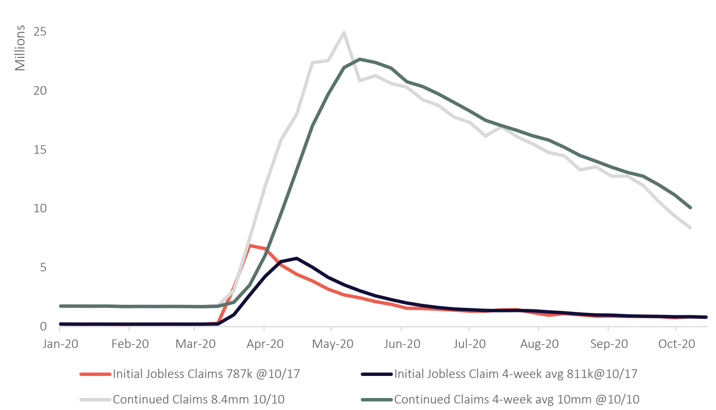
SFA Research Corner: Joblessness and credit scores improve as consumers buckle down

What We're Watching

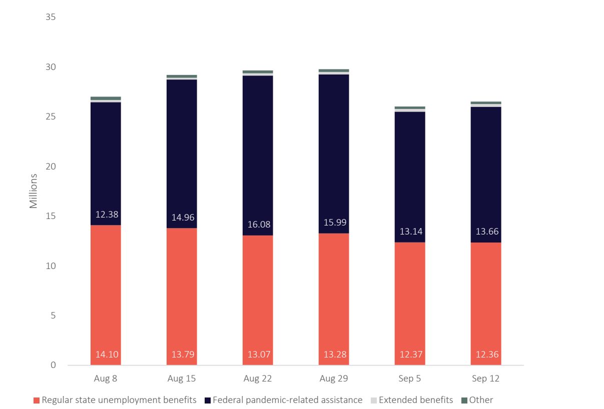
Initial jobless claims improved by 55,000 to 787,000, pulling the four-week average down to 811,250 for the week ending October 17. Continued claims fell by 1 million to 8.4 million. The initial jobless claim metric, which captures regular unemployment claims from state programs and does not include the pandemic-specific federal programs, has improved by about 90% since reaching a high of 6.9 million back in March. Nonetheless, this metric remains about 3 times above pre-pandemic levels. For the week ending October 3, over 23 million Americans were receiving some sort of unemployment assistance. Of this amount, 13.5 million people were receiving federally-sponsored pandemic-related assistance. While improving in absolute terms, this number now represents 58% of the total number of people receiving assistance, compared to 50% at the beginning of September.

Initial Jobless Claims Down to 787k, 90% Below March Levels But Still 3x Above Pre-pandemic Levels



Source: Department of Labor

Pandemic-related Assistance Continues to Fall But Now Comprises 58% of All Unemployment Benefits Received



Source: Department of Labor

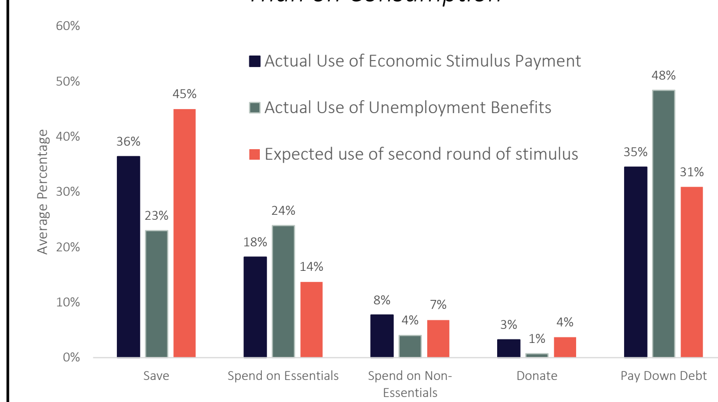
Households have benefited from supplemental government stimulus, unemployment benefits, and lender accommodations. The combination of these benefits has, for some households, equated to greater weekly cashflow than pre-pandemic employment earnings. Savings rates have also increased markedly from pre-pandemic levels and revolving debt (i.e. credit card balances) has fallen. While this is partially due to consumers having fewer options to spend, it is also likely due to a rational shift in preference as consumers prepare for an uncertain future and reprioritize near-term spending.

A recent post from Liberty Street Economics, the blog featuring research from economists at the New York Federal Reserve, shows that households have used more of their government stimulus and unemployment benefits to pay off debt and to build savings rather than on consumption. Using data from a special June Survey of Consumer Expectations, the analysis shows that households saved an average 36% of the economic income payment disbursed in April and an average 35% was used to pay down debt. The remaining 29% was used for consumption with 18% used for essential spending, 8% used for non-essential spending, and 3% for donations. When households were surveyed in August about expected uses of further stimulus payments, the results leaned even heavier towards savings, with an average 45% expected to be used for savings and 31% to pay down debt. Households receiving unemployment benefits used almost half of the benefits received to pay down debt, while 23% was saved. As consumption has been long thought as the engine of economic growth, a shift in preference away towards savings, if continued, may have implications for the broader economy.

What We're Watching

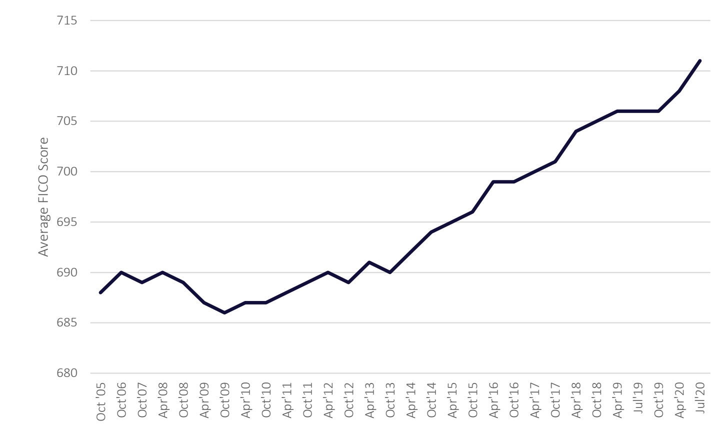
This "unemployment benefit boost" was discussed in a new research brief from JPMorgan Chase & Co. Institute using Chase checking account and credit card data. The report noted that "[t]he unemployed roughly doubled their liquid savings during the four month period between March and July 2020." Although spending during this period increased, spending dropped when supplemental unemployment benefits ceased. The report rightly calls out that "a fall in spending among the unemployed could meaningfully impact aggregate consumption." Additionally, with "somewhere between 12 million and 26 million unemployed individuals according to the most recent data, changes in spending among the unemployed may be large enough to move aggregate consumption statistics."

Government Stimulus and Unemployment Benefits Used Primarily to Pay Off Debt and To Build Savings Rather Than on Consumption



Source: Liberty Street Economics

Average FICO Score is Five Points Higher Today Than One Year Ago



Source: FICO

This preference may also have contributed to the recent rise in credit scores. FICO, the company behind the FICO consumer credit score, reported that the average FICO score in the U.S. now stands at 711, five points higher than a year ago. While the company notes that there is typically a lag between when a major event occurs and when FICO scores reflect subsequent financial strain, as was the case with the 2008 financial crisis and natural disasters, FICO also notes that there are factors specific to the pandemic that are contributing to the increase. These are a decline in missed payments and falling debt loads, as households, using government stimulus and unemployment benefits, stay current on their debt obligations, pay back debt, and limit taking on new debt. Since payment history and amounts owed make up almost two-thirds of the FICO score calculation, any improvements in either will have a strong positive impact on the score. FICO further notes that the average score has been boosted by classifying accounts in deferral or forbearance programs as "current" rather than "delinquent". While this may be helpful for struggling borrowers to come out of the pandemic with their credit scores intact, it may not be painting the most accurate picture of the level of risk currently in bank, non-bank lender, and securitized portfolios – and therefore the broader economy.

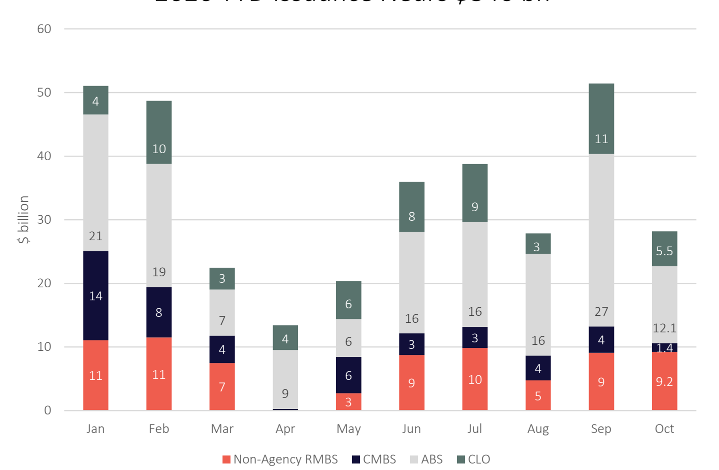
Market Summary

The U.S. securitization market continued its strong run as $28.2 billion of bonds were offered in the first half of October. Leading the charge was ABS backed by consumer and commercial loans and leases, contributing $12.1 billion of the volume, followed by non-agency RMBS with $9.2 billion and CLOs with $5.5 billion. Non-agency CMBS, struggling with rising delinquencies and a sharp pull-back in commercial real estate loans, contributed $1.4 billion to the total. Year over year, non-agency CMBS issuance is down by 33%. Compare this to the volume in the ABS sector, which is lower only by 15%, and the non-agency RMBS sector, which is down by 20%. New issue CLO volume is down by 28% on the year.

Still strong demand for benchmark ABS products easily absorbed the surge of new issue supply without pushing bond prices higher; the bid-ask spreads in the secondary market for benchmark ABS have been unchanged since the beginning of the month. The search for yield continued to push prices higher, and bid-ask spreads tighter, on higher-yielding ABS and non-agency RMBS. The bid-ask spreads for products such as personal installment loan ABS were 10 bp tighter, while senior tranches of subprime auto ABS and private credit student loan ABS were 1 to 2 bp tighter since the beginning of the month.

New Issue Activity

October Issuance to Date at $28 bn;
2020 YTD Issuance Nears $340 bn



Source: Bloomberg, Deutsche Bank Research

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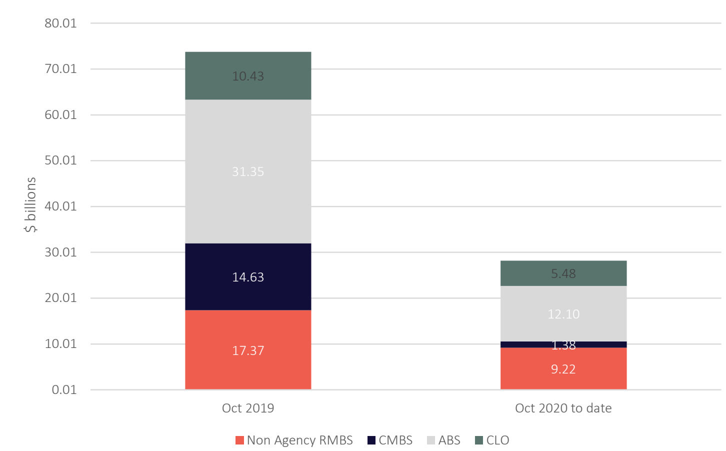
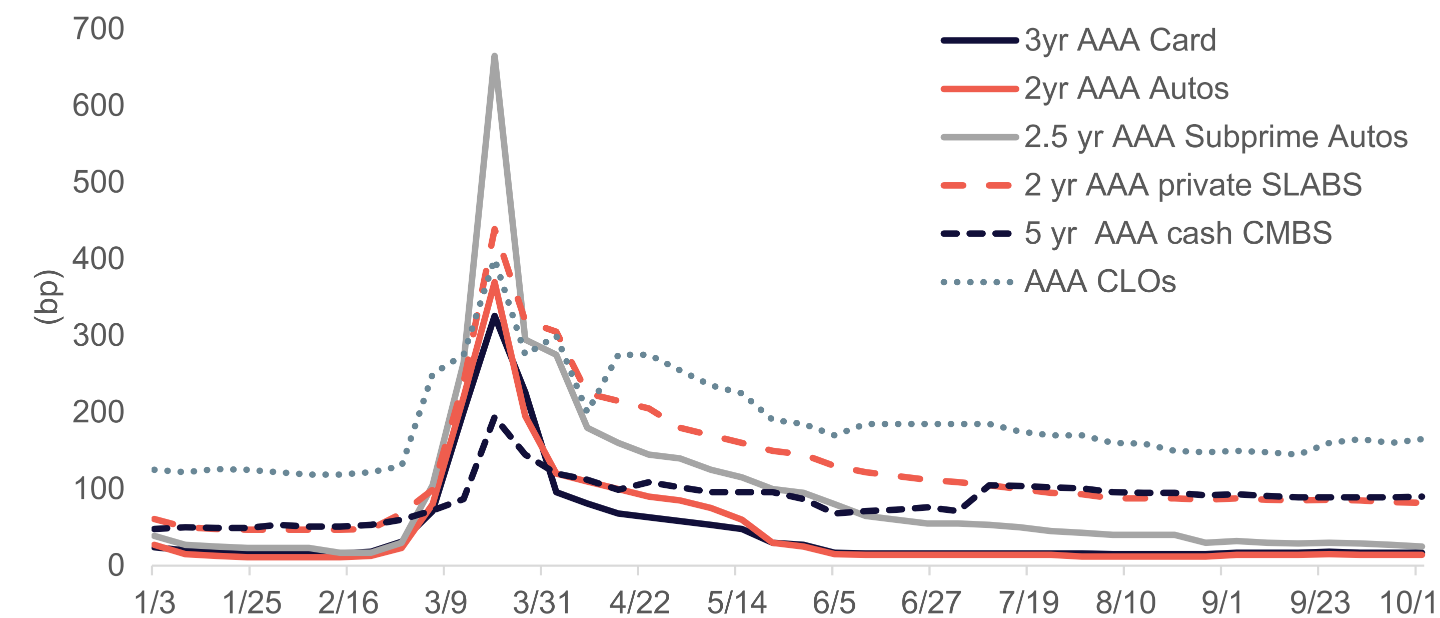
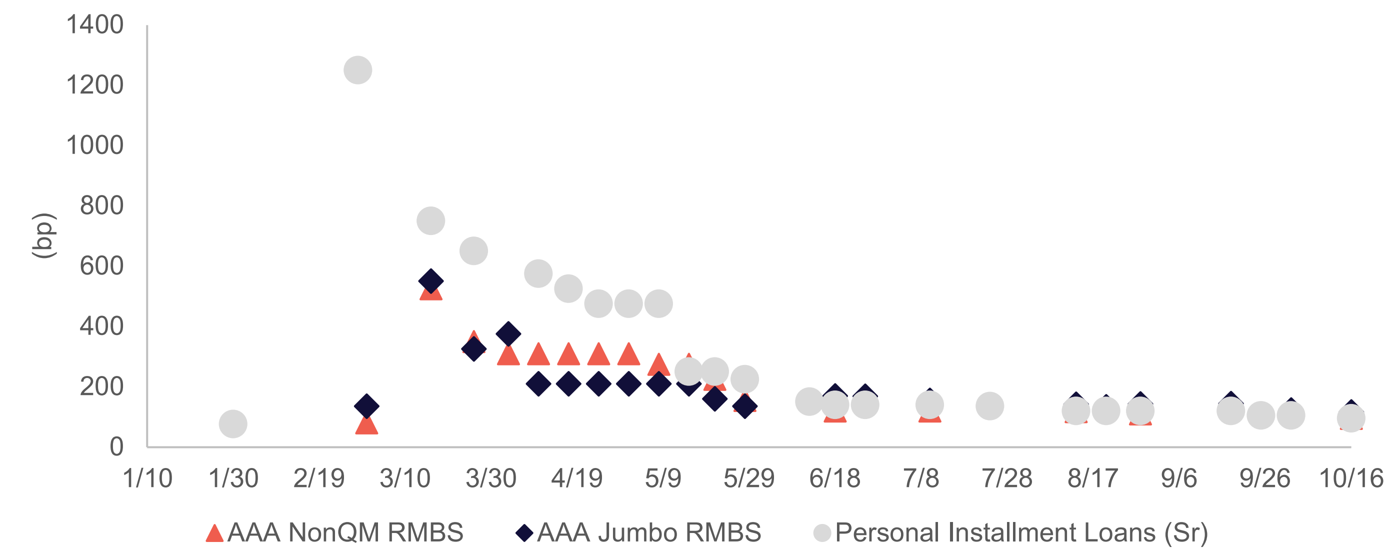


Source: Bloomberg, Deutsche Bank Research

Secondary Market Spreads



Source: Deutsche Bank Research



Source: Market Compilation