STRUCTURED FINANCE ASSOCIATION

Research Corner

October 5, 2020

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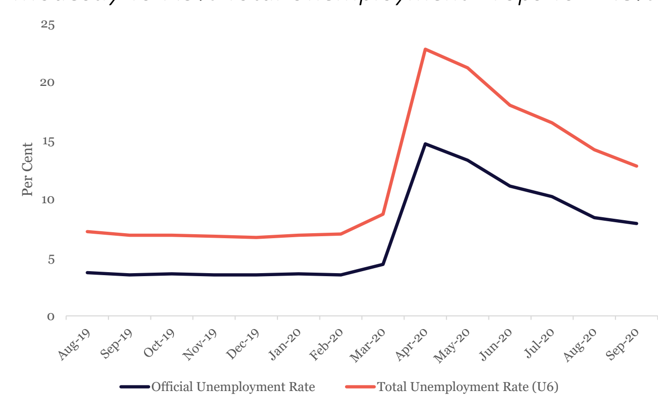
SFA Research Corner: Macro Data Continues To Show a Slowing Recovery as Securitization Market Reports Strongest Month of Activity Since Onset of Pandemic

What We're Watching

"The overall picture is clear, and that is that the labor market has been recovering, but that it's a long way -- a long way from maximum employment."
Chair Powell (September 16, 2020 FOMC meeting)

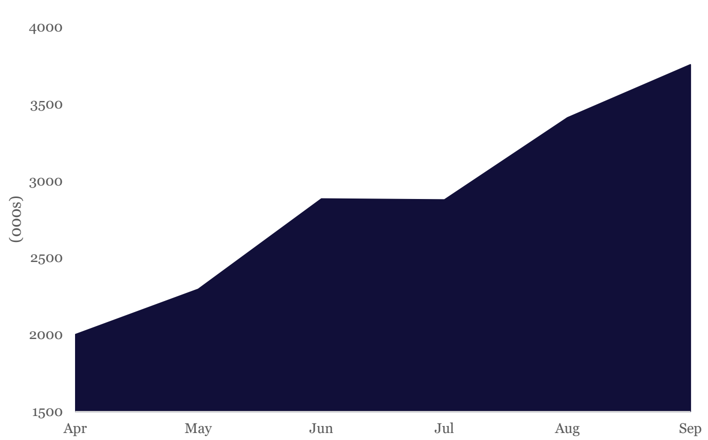
In September 661,000 jobs were added to the economy and there were 1 million fewer unemployed Americans. The headline monthly unemployment rate fell to 7.9%. The Federal Open Market Committee expects this metric to reach 7.6% by year-end. The Bureau of Labor Statistics estimates that the unemployment rate would be 8.3% if misclassified workers are added to the calculation. The total unemployment rate, which includes all persons marginally attached to the labor force, plus total employed part time for economic reasons, dropped to 12.8%. Improvements not withstanding, some underlying trends bear a closer look. The number of long-term unemployed, or those who have been unemployed for 27 weeks or more, increased by 781,000 to 2.4 million. Americans jobless for more than 15 weeks comprise 58% of the total unemployed. Additionally, the number of permanent job losers increased by 345,000 to 3.8 million. This measure has increased by 88% from April.

661k Jobs Added in September; Unemployment Rate Improves Modestly To 7.9% Total Unemployment Drops To 12.8%



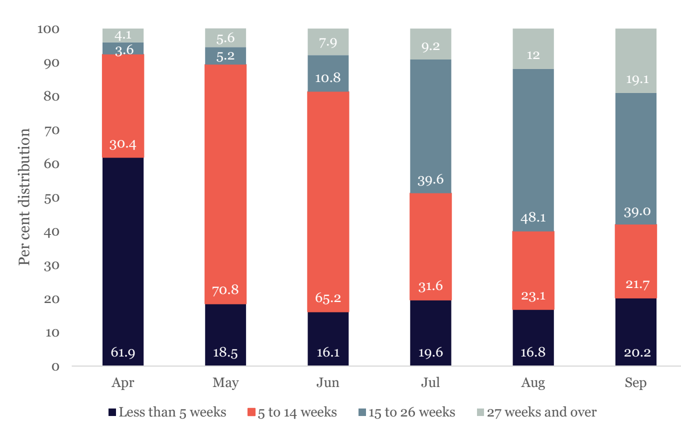
Source: *Bureau of Labor Statistics*

The Number of Permanent Job Losers Has Risen by 88% Since April



Source: *Bureau of Labor Statistics*

Number of Long-Term Unemployed Increased by 781k; 58% of Unemployed Have Been Jobless for More Than 15 Weeks

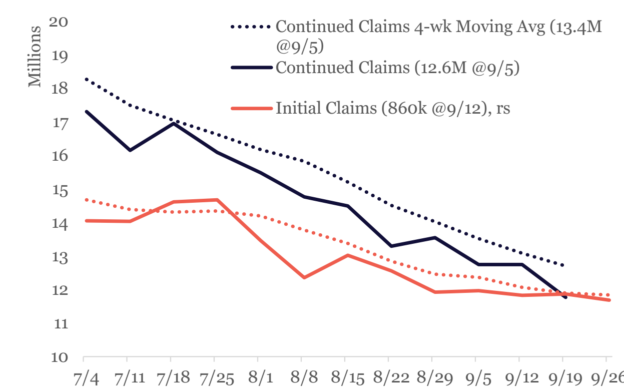


Source: *Bureau of Labor Statistics*

What We're Watching

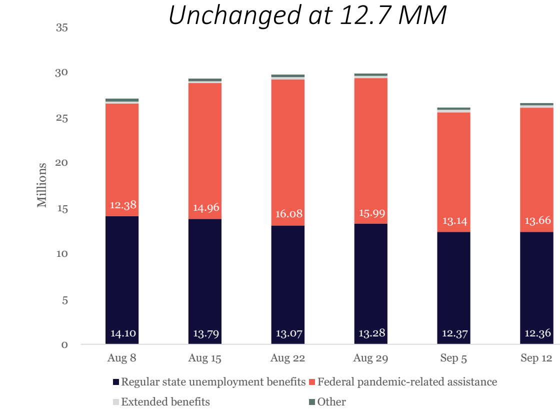
Turning to initial jobless claims, which are reported on a weekly basis and informs us about the unemployment rate going forward — incremental improvements continue. For the week ending September 26, initial jobless claims were 837,000, a 4% decrease from the previous week's revised level. The 4-week moving average improved by 1% to 867,000. For the week ending September 12, over 26 million people were claiming some sort of unemployment insurance benefit across federal and state programs. Of this amount, the number of persons claiming benefits under the two remaining pandemic-related programs, Pandemic Unemployment Assistance and Pandemic Emergency Unemployment Compensation, rose by 513,000 to 13.7 million. It must be noted that Chair Powell has acknowledged that "the actual counting of the [pandemic] claims is volatile and it's very difficult to take much signal about the particular level."

Improvements To Initial Jobless Claims Flatlines Claims Down 36k; 4-Week Average Down by 11k



Source: *Department of Labor*

The Number of Persons Claiming Pandemic-Related Unemployment Benefits Grew by 513k To 13.7 MM; Persons Claiming Benefits Under State Program Unchanged at 12.7 MM

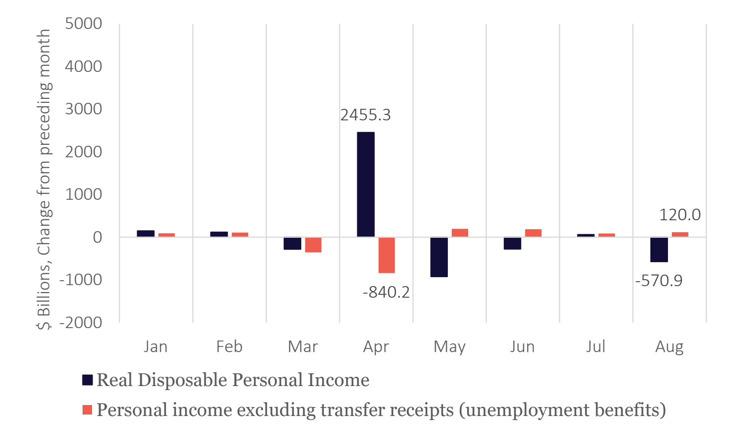


Source: *Department of Labor*

The Bureau of Economic Analysis's personal income and outlays report for August shows that the lifts provided by pandemic-related federal programs is running out of steam. Recall that in April, disposable personal income jumped $2.4 trillion as eligible households received stimulus checks and supplemental unemployment insurance kicked in. With nowhere to go due to stay-in-place orders and heightened economic uncertainty, households wisely squirreled away cash, pushing the personal savings rate, as a percentage of personal income, to an all-time high of 33%. Given that the monthly savings rate was closer to 7% in 2019, the April level was not sustainable. As businesses opened up in May and June, personal spending rose strongly as savings began to decline. In July, spending activity slowed, but remained positive. By August, the consumer retrenched as some supplemental unemployment benefits expired and the labor market recovery slowed. Disposable personal income decreased $570 billion or 3.2% from July (although, excluding the effects of this benefit, personal income grew by $120 billion as employment improved modestly in pockets of the economy). Personal spending rose by $141 billion, up 1% from July. The savings rate dropped to 14.1%, almost 60% below the April high.

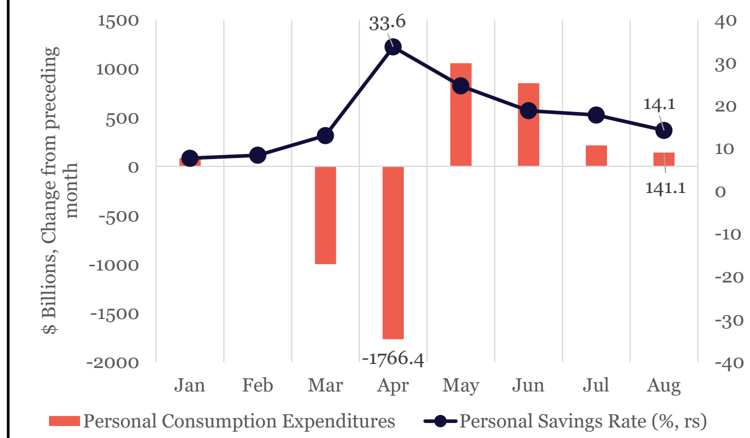
What We're Watching

Disposable Personal Income Down $570 BN in Aug From July as Supplemental Unemployment Benefits Expire



Source: [Bureau of Economic Analysis]()

Personal Consumption Increases $141 BN in Aug From July; Personal Savings Drops for the Fourth Consecutive Month



Source: [Bureau of Economic Analysis]()

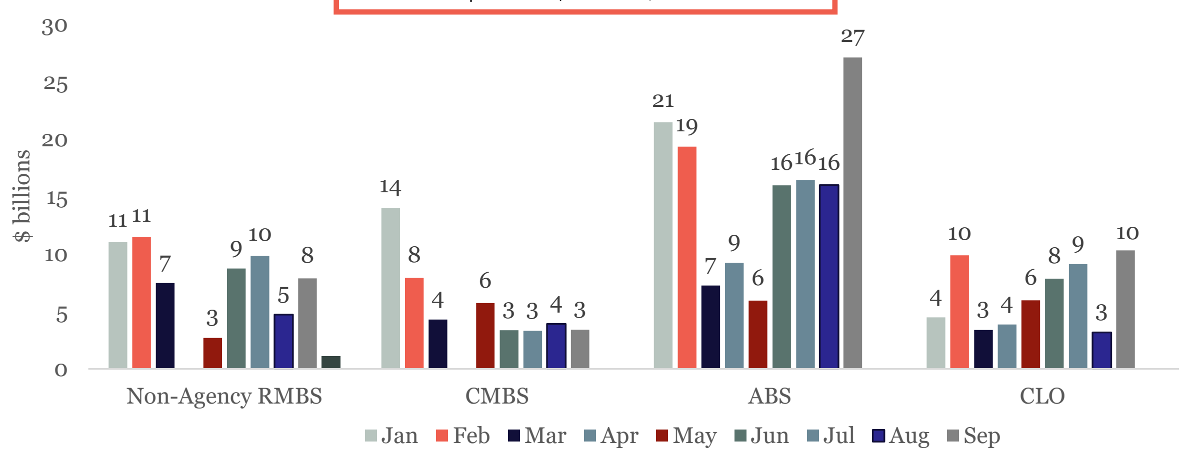
Stimulus checks, supplemental unemployment benefits and a myriad of deferral programs have mitigated the impact that high unemployment and loss of income, would have had on a borrower's ability to stay current on financial obligations. With the recovery slowing markedly, this week's data shows that Americans are once again changing their behavior to prepare for a long haul, which may negatively impact the credit performance of securitized loans and leases.

Market Signals

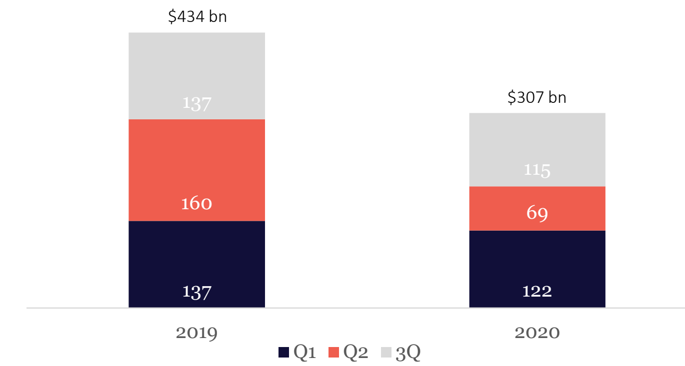
Market summary – In what can only be described as a Herculean effort, $20 billion of new bonds came to the private securitization market. With last week's offerings, September's new-issue volume reached $49 billion, only $1 billion shy of the $50 billion mark recorded in September 2019. Supply was led by $10 billion of ABS backed by consumer and commercial loans and leases. CLOs contributed $7 billion, which represents the highest weekly volume so far in 2020. CMBS contributed $2 billion and non-agency RMBS, $1 billion. Total issuance year-to-date has reached $307 billion. We expect that once new issue activity is tallied for all of September, volume will easily surpass September 2019. This would mark the first time since the onset of the pandemic that monthly new issue volume would exceed monthly volume in 2019.

New Issue Activity

Sept. 2019: $50 bn
Sept. 1- 22, 2020: $28.8 bn



New Issue Activity

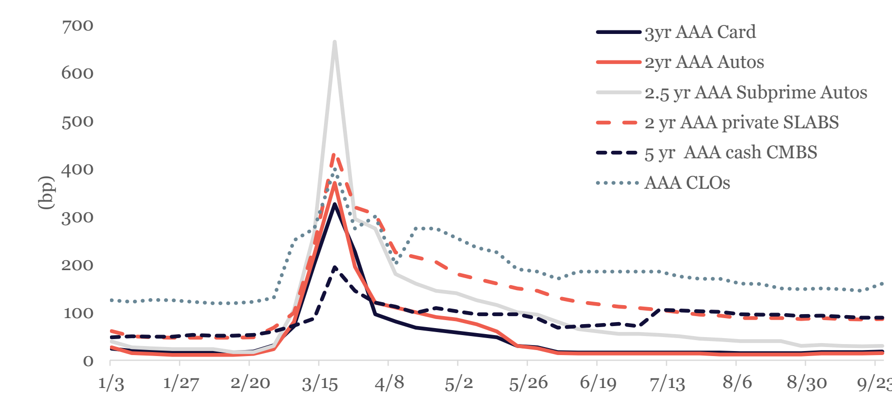


Source: Bloomberg, Deutsche Bank Research

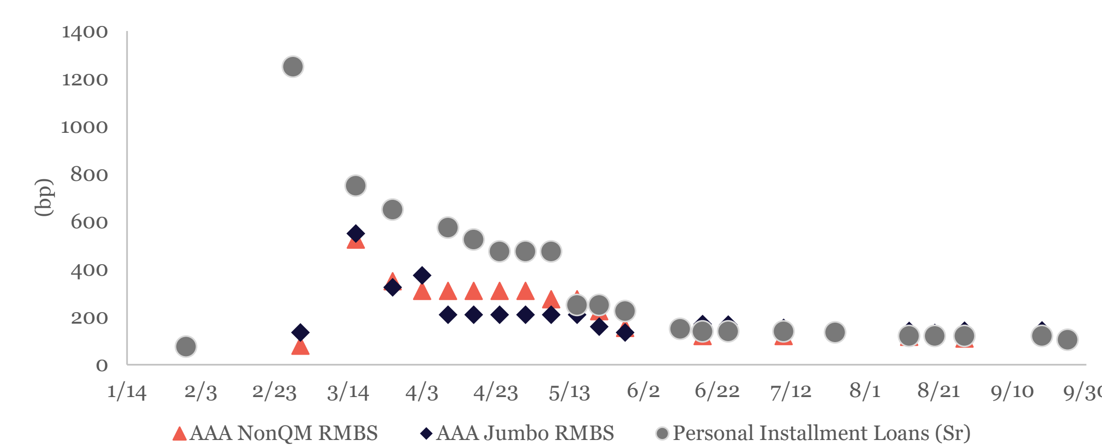
As investors rushed the new-issue market to absorb the flurry of supply, demand in certain sectors of the secondary market softened, lowering bond prices and pushing bid-ask spreads wider. For triple-A rated cards, autos and student loan ABS, the spread widening was incremental at 1bp, on average, while for triple-A CLOs, which saw a record weekly volume of new supply, the spread widening averaged 15bp.

Demand for higher-yielding sectors that did not see a surge in new issue supply pushed bond prices higher, and bid-ask spreads tighter, as the search for yield continues. For example, the bid-ask spreads on senior tranches of personal installment loans tightened by as much as 15bp on the week, while spreads on senior Jumbo RMBS loans were 38bp tighter.

Secondary Market Spreads



Source: Deutsche Bank Research



Source: Market Compilation