STRUCTURED FINANCE ASSOCIATION

SFA Research Corner

The Road Back: Positive Macro Trends Support Auto ABS

November 2, 2020

WHAT WE'RE WATCHING

Third quarter data shows that the economy is coming back strongly but rising COVID cases and the absence of another stimulus package threatens this trajectory. Below, we look at recent macro developments and the impact this has had on auto financing. A prolonged economic slowdown could see a reversal of trends, particularly hard-won labor improvements. Without another round of financial support for already struggling households and businesses and some continuation of lender accommodations, we could see default risk rise across securitized portfolios, endangering investor cash flow and confidence, and ultimately, consumers' access to credit.

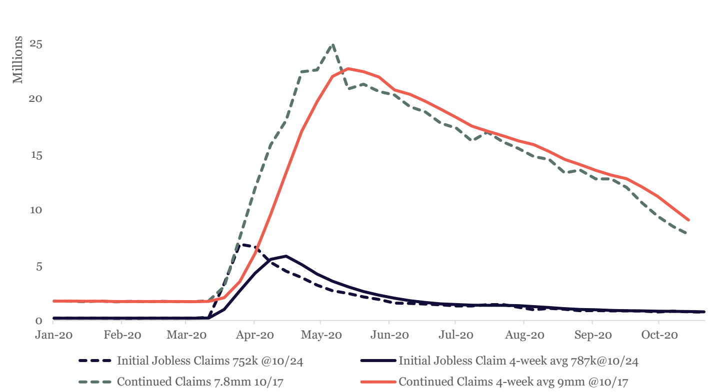
After falling for two consecutive quarters, the U.S. economy expanded by 33.1% in the third quarter driven primarily by an increase in consumer spending and domestic investments. Disposable personal income (DPI) dropped by 16% in the quarter as government social benefits expired. With the drop in income, personal savings, as a percentage of DPI, dropped to 16% in the third quarter from 26%. For the week ending October 24, initial jobless claims declined to 751,000, pushing the four-week average down by 24,500 to 787,750. Continued claims, for the week ending October 17, fell below 8 million for the first time since March to 7.7 million.

The Road Back

	3Q	2Q
GDP	33.10%	-31.40%
Personal Income	-16.30%	46.60%
Personal Savings (as a % of Income)	15.80%	25.70%
Prices of goods/services	3.40%	-1.40%

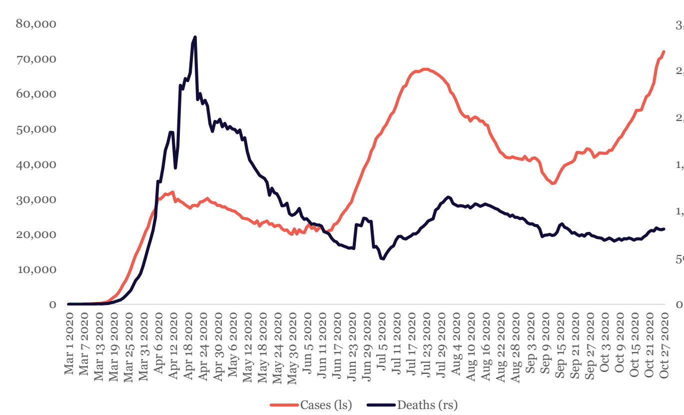
Source: U.S. BEA, Department of Labor

Continued Claims Fall Below 8 Million for the First Time Since March



Source: Department of Labor

COVID-19 Cases and Deaths: 7-Day Moving Average



Source: CDC COVID Data Tracker

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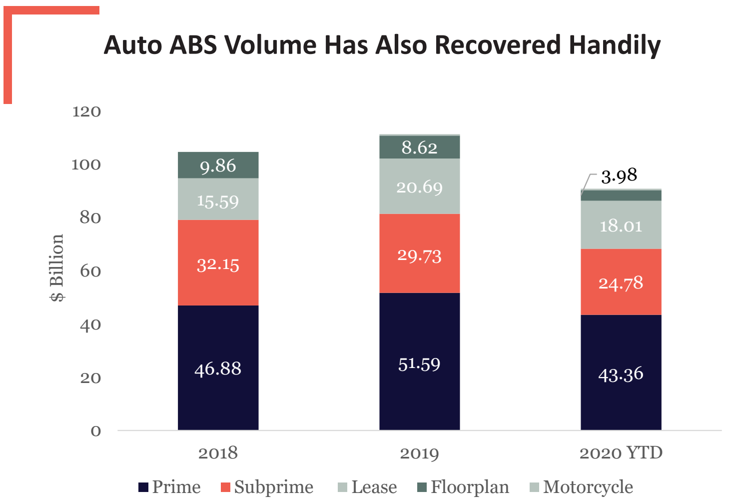
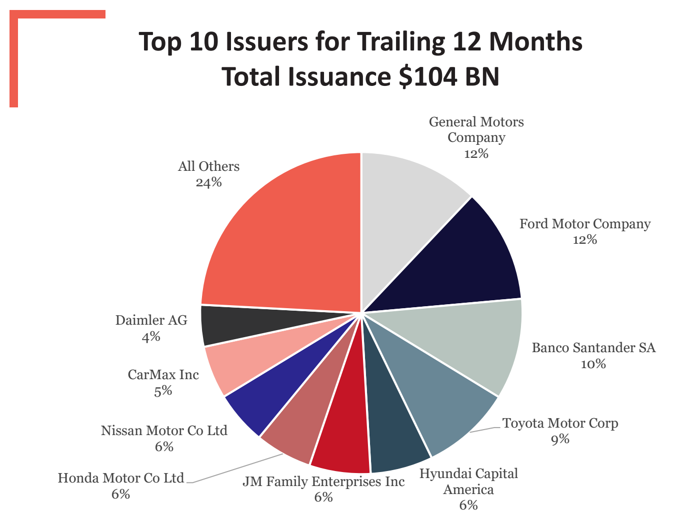
WHAT WE'RE WATCHING

These macro trends are evident in auto sales. Total vehicle sales reached 16.8 million units (seasonally adjusted, annualized) in September, an 85% improvement from the 39-year low of 9 million units reached in April. For some lenders, pent-up demand from pandemic lockdowns pushed origination levels in the third quarter to record highs.

Ford Credit, the finance subsidiary of Ford Motor Company and the second largest auto ABS issuer according to Finsight, reported $1.1 billion in earnings before interest and taxes, their "strongest performance in 15 years." The company reported managed receivables of $141 billion at the end of third quarter, $53 billion (38%) of which was funded through securitizations. The company expects the "ABS mix to increase modestly going forward." Santander Consumer USA, the third largest auto ABS issuer, originated $8.4 billion in loans and leases in the third quarter, a 7% increase from second quarter. SCUSA, the financing arm for Chrysler, funded $3.3 billion of these loans in the ABS market in the third quarter. Other notable results: Ally Financial had the highest quarterly total in five years with $9.8 billion of auto originations while Chase Auto reported "record originations for the quarter of $11.4 billion," up 48% from second quarter and 25% year-over-year. Supported by strong consumer demand for loans, auto ABS volume has recovered handily and already stands at $90 billion, just 19% below 2019's.



Source: *Finsight*



Source: *Finsight*

As demand for auto financing has increased, lenders have been challenged to provide loans safely and responsibly even as the risk of default rises. One way has been to manage the mix of originations. According to Experian's Q2 2020 State of the Automotive Finance Market report, released in September, **subprime originations constituted 22.18% of total originations, down 6% year-on-year. This is the lowest level since 2015 and the largest drop year-over-year**. Prime originations, on the other hand rose to 57.78% of all originations, up 2.5% from the same time in 2019 and the highest level in five years.

We have also started to see this translated to the securitization market. Issuance of subprime auto ABS declined from $32.1 billion in 2018, or 31% of the auto ABS market, to $29.7 in 2019 or 27% of the market. So far in 2020, subprime auto ABS has contributed $24.7 billion to the auto ABS market or 27% of the market. Experian defines subprime as those borrowers with a FICO score between 580 and 669. Individual lenders may define subprime using slightly different parameters depending on their lending strategy. Regardless of the parameters used, subprime loans will typically carry a higher interest rate than prime loans to compensate for a perceived higher level of default risk. With approximately one-third of the U.S. consumers in the subprime range, a further shift away from this demographic may impede the recovery.

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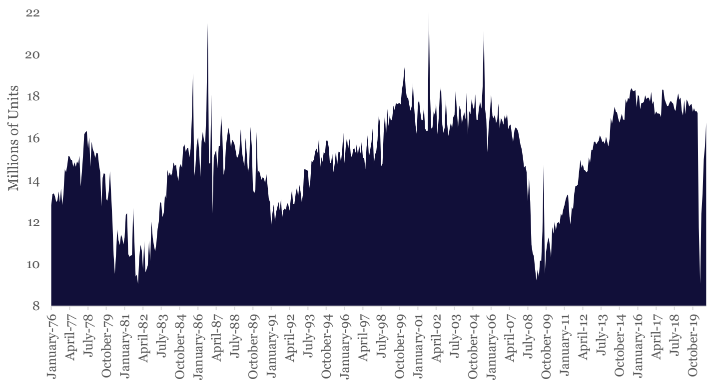
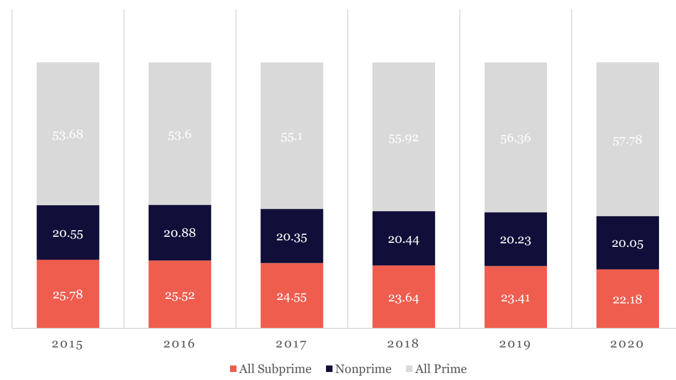
Total Vehicle Sales Have Improved by 85% Since Dropping To a 39-Year Low in April



Source: [U.S. Bureau of Economic Analysis retrieved from FRED]()

In Q2, Auto Subprime Originations Dropped To Lowest Level Since 2015



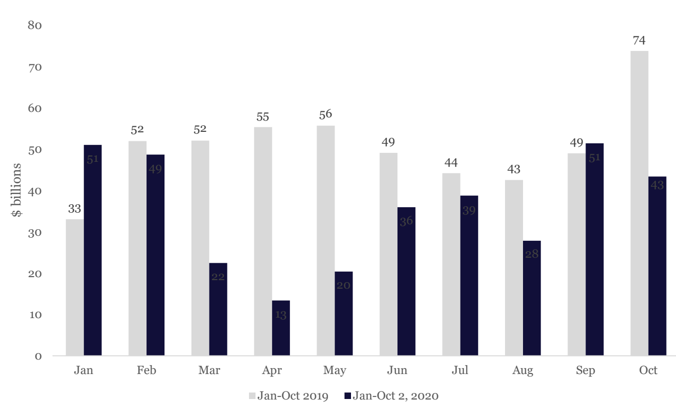
Source: [Q2 2020 State of the Automotive Finance Market]()

MARKET SUMMARY

Over $15 billion of securitized bonds were offered for the week ending October 23, bringing the **year-to-date total to $353 billion, 30% below the same period in 2019**. ABS backed by consumer and commercial loans and leases has contributed $18.7 billion to the volume, followed by non-agency RMBS with $11 billion and CLOs with $8.7 billion. Non-agency CMBS has contributed $5 billion to the month's total, so far. We expect that the final October tally will show that the last week will be equally robust as issuers move to quickly finalize deals ahead of the elections. Despite the surge in supply, strong demand for benchmark ABS products pushed bond prices incrementally higher. Secondary market bid-ask spreads tightened slightly for the benchmark ABS and some higher-yielding ABS and RMBS.

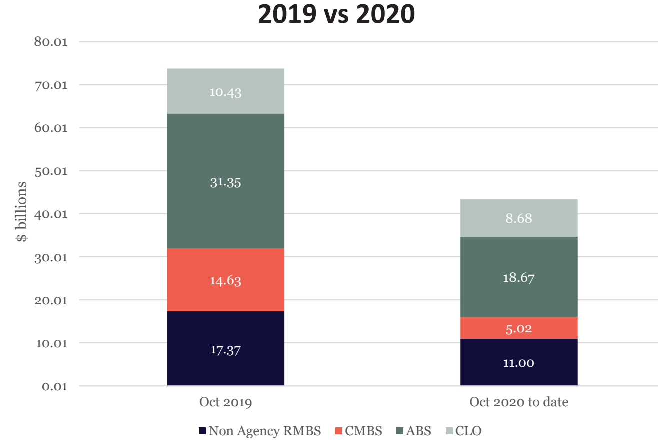
NEW ISSUE ACTIVITY

October Issuance To Date at $43 BN; 2020 YTD Issuance at $353 BN



Source: Bloomberg, Deutsche Bank Research

October Activity 2019 vs 2020



Source: Bloomberg, Deutsche Bank Research

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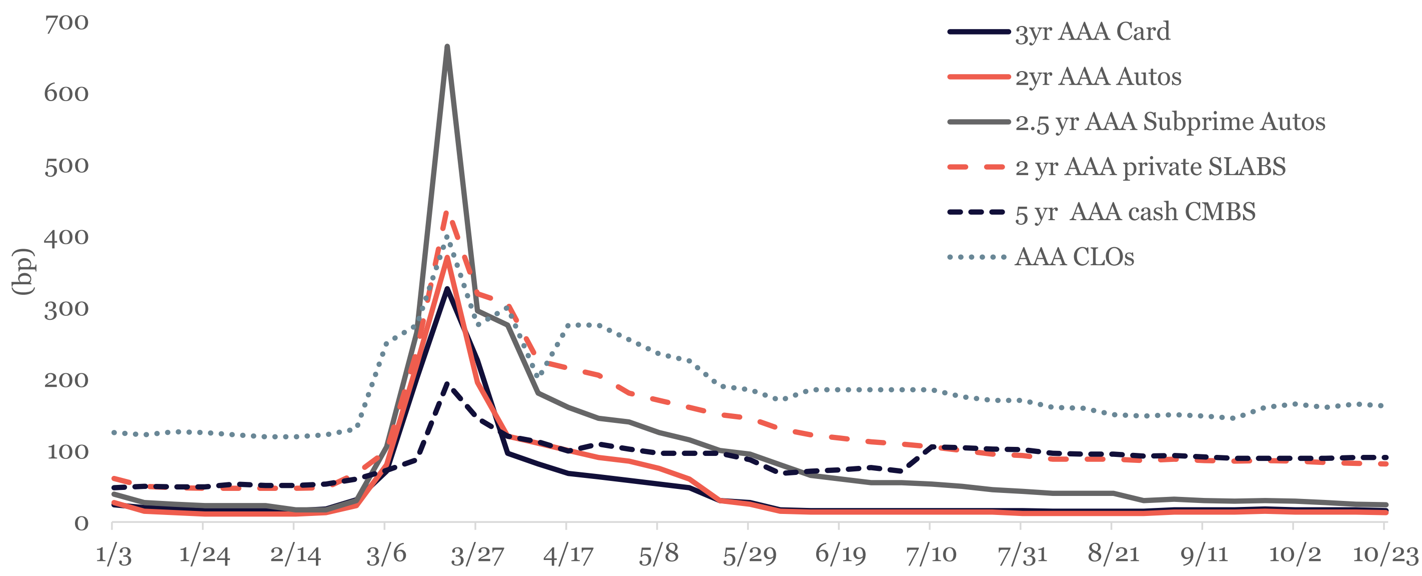
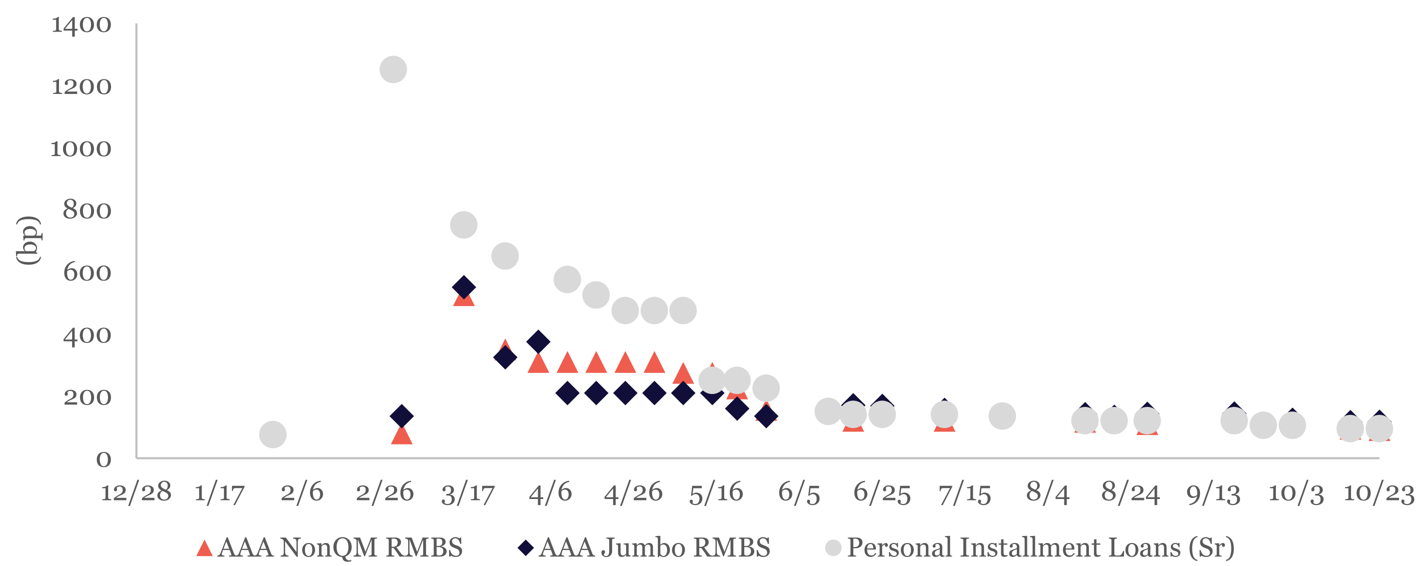
SECONDARY MARKET SPREADS



Source: Deutsche Bank Research



Source: Market Compilation