How Does The Rising APAC Auto Loan ABS Market Compare With More Developed Ones?

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(***Editor's Note:*** *This article is part of a series providing comparative information on the global auto ABS market. For other articles in the series, please see the Related Research section.)*

In the previous article in this series, S&P Global Ratings examined China's auto finance and asset-backed securities (ABS) industry and how it compares to the U.S. and Europe. But what about the next two largest markets in the Asia Pacific region, Japan and Australia? As in China, the U.S., and Europe, securitization remains an important funding tool in the Japanese and Australian markets. However, new issuance across these regions varies in terms of collateral type, loans terms, and vehicle types. Funding sources are therefore diversified by market, catering to the needs of domestic consumers and industry standards.

In terms of market environment, China has tighter lending standards and currently only allows the origination of prime loans predominately through auto finance companies (AFC) and commercial banks, while other markets such as the U.S. and Australia have deals backed by both prime and subprime borrowers. Following a record high in 2016, China's auto loan ABS issuance volume reached another all-time high of 109 billion Chinese renminbi (RMB) in 2017. Over in Australia, new issue volume of auto loan and equipment ABS was 4.8 billion Australian dollars (A$), down from A$5.7 billion, while Japan's auto loan ABS market issued ¥901 billion, up from ¥771 billion. U.S. auto loan ABS issuance was $71 billion in 2017, up from $67 billion in 2016. Issuance in Europe was also down in 2017, to €14.6 billion from €18.1 billion in 2016.

Key Takeaways

- Auto ABS issuance globally has been strong in recent years, particularly in China, and better macroeconomic conditions are supporting stable collateral performance.
- Across all five markets, captive finance companies support auto financing in addition to competition from banks and other consumer credit financiers.
- Consumer credit quality and vehicle type vary, while underwriting processes differ depending on the availability of consumer credit data and vehicle price information.
- Analytical approaches to rating auto ABS transactions are similar across the markets, with credit analysis based on our review of the originator, collateral characteristics, historical performance, and macroeconomic factors.

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Auto Loan Financing Across The Markets

All five markets have a similar structure whereby captive finance companies support auto financing, while also facing competition from banks and other consumer credit financiers (see table 1). Origination practices are also generally the same, with dealerships originating the auto loans at the point of sale and using a central approval mechanism. All five markets rely on automobiles for transportation, and auto loans are full-recourse to consumers.

Captive finance companies and commercial banks are the key supporters of auto financing in all markets, with similar product offerings but to different borrowers.

Table 1

Auto Loan Financing Comparison

	China	Japan	Australia	U.S.	Europe
Auto loan financiers	Captive auto finance companies	Captive auto finance companies	Captive auto finance companies	Captive auto finance companies	Captive auto finance companies
	Commercial banks	Commercial banks	Commercial banks	Commercial banks	Commercial banks
	Consumer credit lenders	Consumer credit companies	Finance companies	Finance companies	Consumer credit lenders
				Direct-through-dealer loans	
Consumer credit quality	Only prime borrowers	Only prime borrowers	Prime borrowers	Prime borrowers	Prime borrowers
			Subprime borrowers	Subprime borrowers	
				Nonprime borrowers	
Vehicle type	New cars dominate market	New and used cars	New and used cars	Mix of new and used cars	New and used cars
	Used cars gaining in popularity				
Typical loan terms	Level	Amortizing	Amortizing	Amortizing	Amortizing
	Balloon	Balloon	Balloon	Balloon	Balloon
		PCP*		Level	PCP*
Loan tenor	18-36 months	36-84 months	48-60 months	60-72 months	36-72 months

*PCP, or personal contract purchase, is a balloon loan type with the right to return the car at the end of the loan at a fixed price.

In terms of borrower credit quality, in China, Japan, and Europe, the focus is solely on prime borrowers. Regulators in China do not allow the origination of nonprime or nonconforming auto loans. Financiers in China extend both level and balloon term options at the point of sale. In the U.K. and Germany, contract types with rather low regular payments, like balloon contracts or personal contract purchases (PCPs), are the predominant loan type. In Japan, financiers extend level, balloon, and PCP term options at the point of sale. The U.S. and Australia show a slightly different picture, originating auto loans to a wider variety of consumers including subprime and nonconforming in addition to prime borrowers, and offering amortizing, balloon, and level payment structures. Typically, lenders in these markets extend loans for new and used cars, with new cars being the lion's share of each market.

Availability of different customer access channels offers greater variety in underwriting techniques across the industry. In China, AFCs' underwriting is based on a more intimate knowledge of the vehicles and the purchasers they finance, similar to the U.S. and Australia. They also have better access to potential customers because the dealers can present a vehicle price and financial proposal right when a customer decides to buy. Banks rely on the customer's overall creditworthiness to assess credit quality--rather than relying on knowledge of the financed vehicles--because they may have a more comprehensive picture of borrowers' current financial conditions. Driven partly by the regulatory environment, financiers in China have recently put more effort into risk management skills and prudent underwriting, becoming more proficient in using the nationwide obligor credit information database and identity check systems for fraud prevention.

The credit screening process is slightly different in Japan, where lenders including AFCs focus more on borrower creditworthiness in their underwriting. Borrowers are evaluated on the ratio of down payment to the loan amount, the applicant's annual income, age, years of continuous employment, the industry that the applicant works in, other consumer debt, debt servicing ability, and information available from a personal credit database. Generally, captive AFCs may lower credit standards to boost their parents' sales promotions.

Securitization As A Common Funding Tool

Auto loan ABS issuance has been gaining momentum in China in recent years, with new auto loan ABS transactions exceeding RMB231 billion between 2008 and 2017. Like in the U.S. and Europe, China, Japan, and Australia have all seen repeat ABS issuances. Among the 25 AFCs in China, 14 have issued at least one transaction and 11 have issued at least two transactions, suggesting that securitization has become a common funding strategy. But the idea of balance sheet and risk management through securitization goes beyond the AFCs. Six Chinese banks issued 12 auto-related receivables securitizations between 2014 and 2017--totaling RMB45 billion, or about 20% of total auto loan ABS issuance during that period.

In comparison, Japan utilizes AFCs and consumer credit finance companies to issue auto securitizations. According to 2016 credit statistics compiled by Japan Consumer Credit Assn., Japan's 17 credit companies (excluding banks and including consumer credit companies and captive finance subsidiaries of auto manufacturers) extended about ¥4 trillion of automobile-related credit. Those consumer credit companies and captive finance subsidiaries are major originators in auto loan securitization in Japan, raising about 20% of funds from securitizations.

In Australia, major financers are a mixed bag. It is a largely fragmented market, but similar to China in that there is a mix of auto finance companies and commercial banks. Securitization utilization for auto finance in Australia has been low compared to residential securities--the country's largest market--but has been increasing. New ABS issuance in Australia totaled A$8.4 billion in 2017, of which around $A4.8 billion were auto and equipment ABS transactions. Demand for these products has been strong, with bigger pools and tighter spreads.

The U.S. market, however, remains a more developed environment for auto securitization, where commercial banks and captive auto finance are the primary source of auto loan financing options. Retail auto loan ABS issuance in the U.S. was $71 billion in 2017, up from $67 billion in 2016, with roughly 65% backed by prime receivables (US$45 billion), while overall auto ABS issuance exceeded US$89 billion. Overall securitization utilization is about between 15%-20%, as measured by the size of the outstanding auto ABS market (approximately US$195 billion as of fourth-quarter 2017), divided by auto loans outstanding (approximately $1.1 trillion as of fourth-quarter 2017).

In Europe, the auto market is dominated by German and U.K. captive originators. Even though auto ABS issuance was down in 2017--mainly because German originators issued less--it still represents more than 60% of the European ABS market. Spreads on these deals tightened further in 2017 and are now very close to pre-2007 levels for the major players.

Table 2

Auto Loan ABS Issuance

	(Bil. US$)				
Year	U.S.	Australia	China	Japan	Europe
2012	67.0	3.9	0.3	7.2	20.7
2013	61.0	2.8	0.0	6.4	21.3
2014	68.0	2.5	2.6	7.4	22.5
2015	68.0	3.4	6.8	5.4	21.5
2016	67.0	4.5	9.6	7.1	20.0
2017	71.0	3.8	17.4	8.0	16.5

Source: Bloomberg.

Analytical Assumptions: How We Treat Each Market

We use our global consumer credit criteria to evaluate all auto loan ABS ratings. Our general analytical framework for structured finance securitization ratings includes five key areas: the credit quality of the securitized assets, cash flow mechanics and payment structure, operational and administrative risk, counterparty risk, and legal and regulatory risk. Our methodology for assessing the credit quality of consumer receivable pools is based primarily on our review of the originator and servicer of the receivables, the obligor and collateral characteristics, historical performance of similar pools, macroeconomic factors and business conditions, and country risk factors. Our base-case assumptions incorporate our forward-looking view of the expected performance of the securitized pool. To develop rating-specific stressed cash flow assumptions for each pool, we estimate the impact of various economic scenarios (corresponding broadly to the 'B' through 'AAA' rating categories) on pool performance.

China

To rate Chinese auto loan ABS transactions, we use multiples that are slightly above the typical stress multiples set out in our criteria (e.g. 6.0x for a 'AAA' scenario and 3.0x for a 'BBB' scenario) because China's auto loan securitization market is fairly young, and we have yet to see any real macroeconomic stress due to the benign economic environment of the past two decades. We therefore apply higher multiples to gauge the potential risk of unexpected significantly deteriorating credit quality in the future.

We use a generally more conservative assumptions set, including rating multiples, recoveries, and commingling loss, when analyzing Chinese transactions due to limited

On the other hand, we apply very low recovery rate assumptions to reflect our view of the lower likelihood of recovering the loan amount through vehicle repossession. Despite its rapid development, the secondhand car market remains less organized and the function of fair vehicle pricing is still developing in China. For instance, more than 75% of pre-owned cars offered in the market are more than three years old, while most vehicles repossessed due to loan defaults are within three years due to how loan tenors are designed. The more complex legal process (loans may need to be re-registered under the securitization issuer's name if the originator becomes insolvent) and the difficulty to repossess vehicles in a big country like China also lower our expectation of loan recovery.

operating history.

In China's auto ABS market, most deals are offered at RMB3 billion-RMB4 billion. Most of the auto ABS issuance in China has adopted simple payment hierarchies, with two or three classes of notes issued. Most transactions repay notes in a sequential order from senior to junior notes. Pro rata pay mechanisms between senior and junior notes have been used, but are not common. Credit enhancement can take the form of subordination, overcollateralization, and excess spread, all of which are commonly seen in other markets.

Most borrowers in China repay their auto loans using direct debit to the lender's account. In some cases, payments can be concentrated at particular times of the month. When a loan pool is securitized, the securitization issuer relies on the servicer, which is often the seller, to collect loan proceeds and transfer them to the issuer account within an agreed-upon timeframe. During this collection period, the issuer is exposed to the risk of asset collections being commingled with a servicer's cash. Under normal circumstances, the collections are identifiable through accounting and typically cause no transfer delays to the issuer. However, if a servicer were to go into bankruptcy while holding the collections, then the commingled fund could be caught up in the bankruptcy proceedings and delay the payments to the issuer. In China commingling risk is commonly mitigated through a commingling reserve mechanism combined with advancing payment collections from a servicer if its creditworthiness deteriorates. Some of these mitigating factors have been widely adopted by other markets.

Because of brand competition, it's unlikely that another captive finance company would take over the job of the original servicer, unless the newcomer would buy out all assets, including those not securitized, from the outgoing servicer. However, China has many commercial banks with nationwide branch networks that could assume the servicing role. These banks also provide auto loans and consumer loan products, and are able to take over as servicers.

Japan

We incorporate the outlook for Japan's economic conditions, together with the historical performance of auto loans and attributes of the pool of loan receivables the originators provide, to determine the base-case loss. Auto loans have been a part of the Japanese securitization market since 2000, and auto loan ABS performance has only weakened slightly, even during the financial crisis. The default rate has also remained relatively low. Given that a higher multiple applies for assets with low base default rates according to our global consumer criteria, we typically apply a stress multiple at the upper range of criteria. For example, we assume about 5x of base-case losses for prime auto loans under our 'AAA' stress scenario. In contrast to our assumptions regarding auto loan ABS in most other jurisdictions, we generally do not expect recoveries from defaulted receivables in Japanese auto loan ABS.

When entrusting an auto loan, although the originator transfers its withheld ownership of the relevant purchased vehicle to the trustee, the withheld ownership is not registered in the trustee's name mainly because complicated and cumbersome administrative procedures are needed. Most Japanese auto loan ABS incorporate a mechanism that triggers the delivery of defaulted receivables to the holders of subordinate classes before the servicer passes recoveries from vehicle repossession and sales to the trustee. We do not credit recoveries from defaulted receivables from this feature, too.

Typical Japanese auto transactions apply sequential payment structures, and auto loan pools are usually static. The number of tranches in Japanese auto is determined on a deal-by-deal basis.

A majority of loans are repaid by automatic withdrawal of funds from borrowers' accounts, under account transfer agreements. Many borrowers adopt repayment schemes with additional payments when they receive their bonuses, leading to increased payment amounts during those periods while reducing monthly payment amounts.

Funds collected by a servicer are transferred to trusts and bank accounts held in the issuer's name on a monthly basis. The proceeds are applied to trust fees, servicing cost, dividends on rated notes, and principal repayments in the order set out in the agreement.

Australia

The loss multiples applied in Australia for closed pool transactions are generally in line with the typical multiples set out in our criteria. However, higher multiples may be employed for revolving pool transactions, depending upon the stringency of the eligibility criteria and portfolio parameters that govern the composition of the collateral pool, as well as the mandatory amortization events.

Credit to recovery is applied in Australia for prime pools and some subprime and nonconforming pools. Recovery rates are based on the originator's historical net loss and gross loss data, and are discounted when developing rating stress scenario cumulative net loss rates. There is an established legal process in Australia for repossessing and selling vehicles within a reasonable period of time. Our stressed recovery period assumption is generally nine months.

Transaction structures typically start sequential and can pay pro rata if documented tests are met. The payment structure generally reverts to fully sequential when the collateral pool balance reaches 10% of its original amount or pool performance deteriorates significantly. The majority of pools are static, with a smaller portion revolving. We also consider that there is a ready market of potential replacement servicers for prime auto loan servicing in Australia. To date, there have been a limited number of Australian auto loan originators that have issued ABS; however, transaction performance has been strong, with low levels of arrears and losses. Upgrades have exceeded downgrades.

Common forms of credit enhancement in auto loan ABS transactions include note subordination and asset overcollateralization. Credit enhancement levels are determined based on loan performance history as well as expectations of future macroeconomic conditions and industry evolution.

Typically loan contracts in the underlying pools are fixed-rate and securities issued are floating-rate. Fixed-rate swaps are used to hedge interest rate risk. Asset-level liquidity is generally provided by a cash reserve that is either funded via note overissuance or by the originator at transaction close.

Europe

The credit analysis in European deals is very comparable to the other developed markets. Based on historical data and considering a forward-looking view of key macro variables, we derive the gross loss base case, or our expectation for defaults in the portfolio over the transaction's life. The multiples between the base case and the stressed ratings scenario gross loss assumptions are in line with the multiples in our European auto ABS criteria. Also, based on historical data we derive the recovery benefit we can give in a stressed environment. There is currently no market for securitization of subprime or near-prime borrowers in Europe.

Whereas European ABS transactions and originators are generally similar across countries, the differing legal regimes influence our analysis. One example is recovery proceeds, which might not include proceeds from selling the vehicle (the case in Italy), or certain legal rights for the consumer to terminate their loan contracts early ("voluntary termination" rights under U.K. consumer protection law).

It is not uncommon in Europe to see revolving auto ABS transactions, with typical revolving periods between one and three years. Revolving transactions typically have (all else being equal) higher credit enhancement levels to account for the greater uncertainty stemming from the longer risk horizon and potential adverse shifts in portfolio composition.

The typical loan types are PCP contracts (in the U.K.) and balloon loans (mostly Germany). Both types show lower regular installments, with one large payment at the end. These contracts mimic the economics of a lease where the borrower pays for the use (and depreciation) of the vehicle during the contract term rather than owns it. PCP contracts differ from balloon contracts in that the borrower can also hand back the car at loan maturity rather than paying the final installment. This feature adds direct residual value risk to a transaction.

U.S.

In the U.S., auto loan securitizations generally entail the selling of a pool of auto loan receivables to a special purpose entity (SPE) and granting a security interest in the receivables to the indenture trustee for the noteholders' benefit. The assets are generally financed with asset-backed notes that may be tranched into senior and subordinated notes, which are in turn repaid from the monthly loan payments received from the borrowers and credit enhancement.

S&P Global Ratings generally considers the base-case loss level it derives to be consistent with a 'B' stress scenario. We therefore consider the loss expectation to be based on the assumption that economic and business conditions won't deteriorate beyond current expectations. We then associate each successively higher rating category with successively more stressful scenarios that we believe are less likely to occur. For example, if our expected base-case level of losses is 2% for a new pool, our 'AAA' scenario may envision cumulative net loss (CNL) rates that are significantly higher (e.g., 10%) because the portfolio would be subject to an extreme economic environment similar to the Great Depression. In that scenario, we believe CNLs could reach levels that are approximately 3.75x- 5x the losses observed in mild economic conditions for a comparable pool from the same issuer.

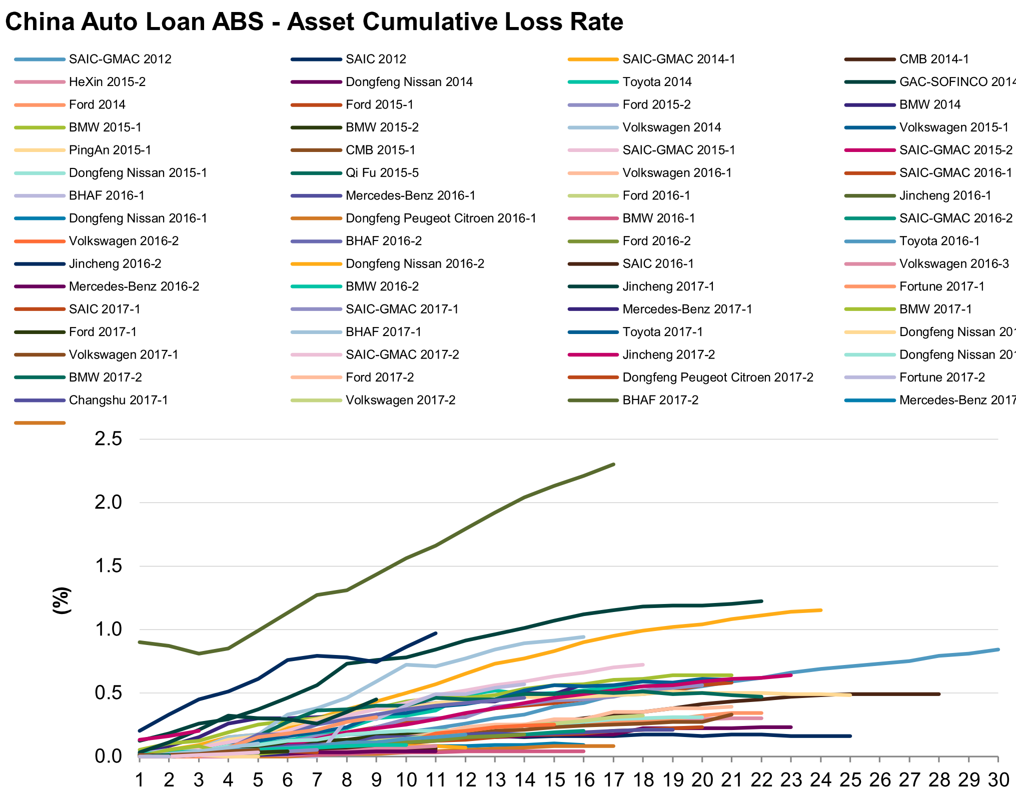
For subprime pools, the relationship between the base-case loss expectation and those of more stressful rating scenarios tend to be confined to a tighter range. For a 'AAA' scenario, for example, we would generally run losses for a subprime pool at levels that are 2.5x-3.5x our expected loss level for the pool under mild economic conditions. (The multiple would be closer to the higher end of this range for issuers with base-case losses of approximately 10%-13%. Conversely, the multiple would be at the lower end of the range for pools with expected net losses of 18%-20%).

Deal Performance Update

China

Transaction performance, measured by assets' payment delinquency and pool payout speed, has been quite stable in auto loan ABS in China. The cumulative default rate is generally below 1.5% of a pool's initial balance and the CNL rate is mostly below 1%. The severe payment delinquency rates in most securitizations are lower than those in the seller's aggregate pool. We believe this is probably due to stricter asset eligibility criteria and loan seasoning in securitized pools.

Chart 1



Note: Data as of Sept. 30, 2017. The definition of cumulative net loss rate may be different from deal to deal. Source: Trustee reports published on Chinabond's website.

Japan

The cumulative default rates of Japanese auto loan ABS we rated as of the 36th month after closing have generally ranged between 0.5% and 1.0%. The deterioration of Japan's economy in line with the global financial crisis affected auto loan performance in 2007; however, the impact on defaults has been limited. We believe this is because most auto loan borrowers in Japan have relatively stable income and purchase automobiles based on financial plans that consider maintenance expenses. Furthermore, the inclusion of auto loans with large, term-end balloon payments in the underlying pools of some transactions since 2007 has not affected loan performance. The two-month delinquency rate has been hovering at about 0.2% since 2012.

Australia

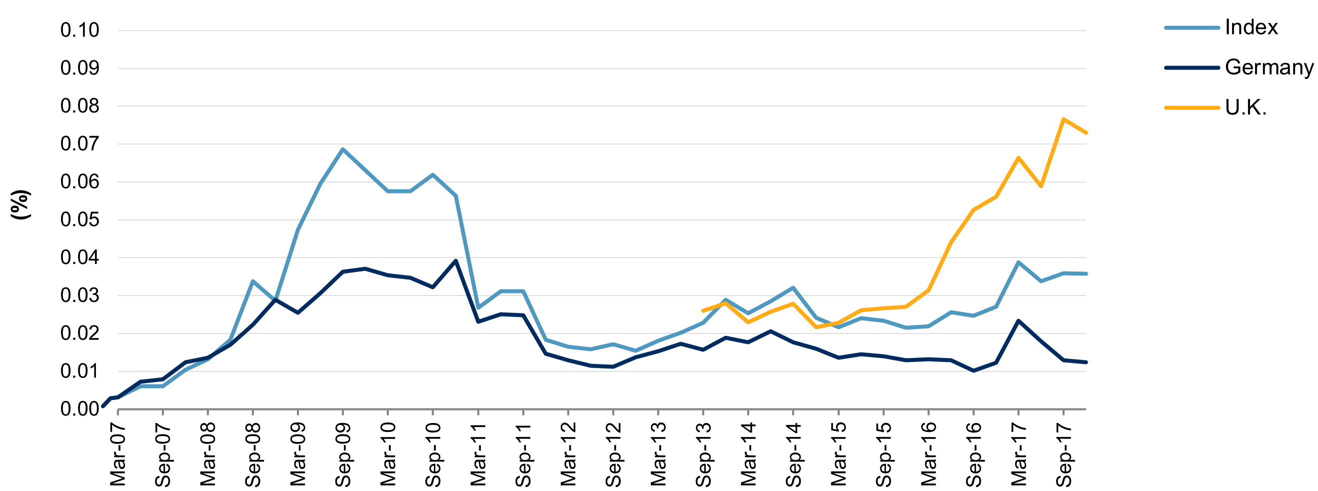
The collateral performance of Australian auto loan ABS transactions is stable, reflecting a prolonged period of relatively benign macroeconomic conditions. For most vintages of Australian auto ABS transactions, CNLs are below 1%. Historically, ABS ratings have demonstrated the strongest ratings performance across Australian structured finance asset classes, with upgrades exceeding downgrades every year since mid-2013. This reflects the shorter weighted average lives of auto loan ABS transactions--which limit their exposure to economic cycles--and the strong build-up in credit enhancement since many deals pay down relatively quickly.

Europe

Overall, European auto ABS performance has been positive for multiple years. Quarterly net losses in our European Auto ABS index have been consistently below 0.04% for the past six years. The U.K. market has shown increasing losses for the past year due to the weak U.K. auto market and increasing economic pressure after the Brexit vote. Still, actual default levels are fairly stable in the U.K., with any negative impact on losses coming mostly from vehicle value risk.

Chart 2

Periodic Net Loss Rate Quarter Average
By country

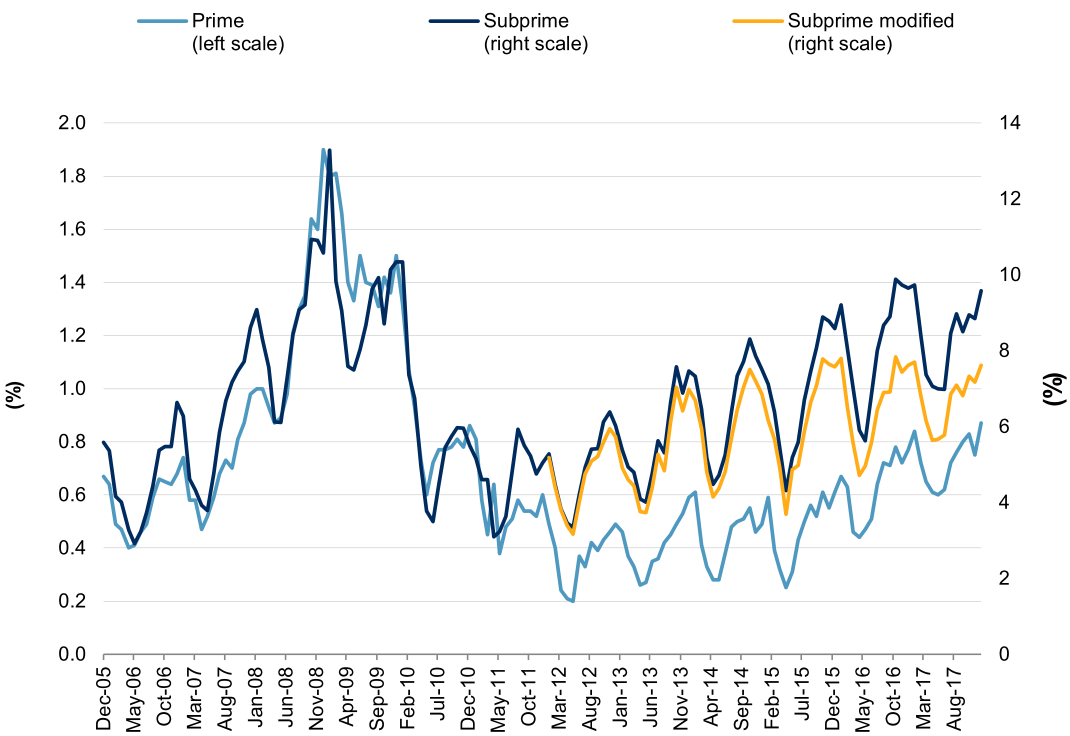


U.S.

Looking back at 2017, auto loan ABS performance showed a few encouraging trends. In our latest edition of our monthly U.S. auto loan ABS tracker, both prime and subprime yearly average net loss rates increased in 2017, albeit more slowly than in 2016. Specifically, the average yearly prime net loss rate rose to 0.73%, up from 0.63% in 2016 and 0.47% in 2015. The average yearly subprime net loss rate increased to 8.32% in 2017, up from 8.13% in 2016 and 6.87% in 2015.

Chart 3

U.S. Auto Loan ABS Net Loss Rates



The rate of deterioration in recovery rates was also less steep than it had been. Prime recoveries declined 6% to approximately 55% in 2017, which was on par with the 6% drop in 2016 to approximately 59%. Subprime recoveries declined 6.5% to approximately 40% in 2017, after slipping 7% in 2016. In our view, auto lenders' tighter credit standards for writing loans and the improved collateral mix of their securitizations is starting to pay off.

Current Conditions And Outlooks

China

In China, the slowdown in macroeconomic growth, effect of economic rebalancing, and pressure on business operations in some industries raise uncertainties over future auto loan performance. That said, we expect transaction performance to be robust in the next one to two years, thanks to mild competition in the auto loan industry and resultant stable product offerings, as well as the structural arrangements of the transactions. In addition, Chinese households' comparatively low debt leverage and increasing income levels will continue to support loan performance as borrowers' debt serviceability strengthens.

The mild competition in the auto loan industry could be attributed to the relatively low penetration

Conservative product

of auto financing, low rate of vehicle ownership, and continued growth in passenger car sales during the past few years. This provides little incentive to auto financiers to significantly loosen their underwriting quality to compete for business. Besides, most of the auto loan securitizations issued in China have been originated by captive auto finance companies and most of them only support the financing of their own brands. This has reduced competition among auto finance companies. However, competition and underwriting challenges could arise with the participation of nontraditional financiers, increased vehicle sales to second- or third-tier cities, and financiers entering the used car market. The performance of deals should become clearer in the next few years, following more deal issuance and data history.

offerings, stable employment, and and higher incomes currently support loan performance in China.

Japan

Employment and income conditions affect the performance of auto loan receivables. Japan's unemployment rate has been improving since 2010, and is currently under 3%. We forecast in our base case that Japan's unemployment rate will drop to 2.6% in 2018. The active jobs-to-openings ratio has been rising since exceeding 1.0x at the end of 2013 and improved to about 1.5x in 2017. In addition, total wages have been increasing in recent years, albeit at a very slow pace. We have seen moderate improvement in the macroeconomic indicators for Japan's employment and wage conditions, and see little possibility of employment and income conditions drastically changing in 2018. As a result, we expect performance such as default rates of auto loan receivables to remain low.

Australia

Improving macroeconomic conditions including forecast declines in the unemployment rate and modest improvements in GDP growth will help support stable collateral performance across the Australian auto loan ABS sector. High household debt, subdued wage growth, and rising interest rates may somewhat offset these trends, but the shorter duration of auto loan ABS transactions and fixed-rate nature of underlying loan contracts provides some insulation from these economic headwinds.

Strong brand competition in the Australian auto sector and relatively low interest rates will continue to help drive growth in auto sales in 2018. The utilization of securitization to finance this growth will depend on pricing conditions in securitization markets. Similar to the Australian residential mortgage-backed securities market, primary market spreads for ABS were tighter in 2017 compared to 2016.

Europe

Whereas most of the major European markets have neutral to positive economic outlooks for consumer lending, the U.K. is the noteworthy exception. It ranks in the lower tier among major European economies for expected GDP growth, and is at the same time the country with the highest consumer debt and debt service ratios. The U.K. auto market is also the weakest among the major European countries, which will hurt both issuance levels and performance.

A potential problem for European auto ABS could come from softer resale values of diesel vehicles, including potential bans of diesel cars from inner cities in various European countries. In our view, car buyers' deepening uncertainty about diesel vehicles may constrain their marketability (see also "German Diesel Ban Brings Bad Air For Carmakers And Auto ABS," Feb 28, 2018). At their peak in 2011, diesel vehicles represented more than 50% of all new car registrations in Europe and represented a correspondingly high share in typical European auto ABS pools; this number dropped to nearly 40% in 2017. Still, the big picture is that European auto ABS is performing well, with deals being better able to bear risk and typically short transaction lives, reducing risk exposure.

U.S.

As consumer lending has increased in the U.S., so has securitization in the auto sector. Full-year 2018 issuance is expected to reach US$75 billion, up from US$71 billion in 2017 and $67 billion in 2016. In the U.S., favorable investor demand and low issuance costs supported auto loan ABS growth in 2017 and offset the effects of slightly lower auto sales of approximately 17 million units, down from 17.4 million in 2016.

In our view, collateral performance will continue to feel the effects of lower recovery rates. We anticipate that the value of used vehicles will continue to fall by about 5% in 2018 as the supply of used vehicles increases due to record off-lease vehicle volume. Prior years' higher loan-to-value ratios and the continuing trend of longer loan terms have further exacerbated recovery rates. Several lenders have tightened their lending standards, particularly their LTVs and in some cases their FICOs, and we believe that these actions are starting to offset the effects of lower recovery rates, especially in the prime segment. So while prime 2015 and 2016 CNLs continue to trend up year over year, so far, with nine months of performance, the first-quarter 2017 vintage is reporting slightly lower CNLs than 2016.

Table 3

Macroeconomic Trends That May Affect Future Performance

Factor	China	Japan	Australia	U.S.	Europe
Economic fundamentals	GDP growth remains at or above 6% before 2019; consumption's contribution to economic growth may increase; the current credit-fueled growth poses downside risk	GDP expected to grow 1.3% in 2018	GDP expected to grow 2.8%-3.1% in 2018	GDP growth at or below 2.8% in 2018; monetary policy expected to remain accommodating in 2018	GDP expected to grow in 2018 between 1% (U.K.) and 2.7% (Spain), with the large countries to be below 2%
Interest rate trends	Official benchmark lending rate remains stable, but market interest rate could be volatile; the risk of a significant deterioration in loan performance due to interest rate hike is remote because of the relatively low balance of each loan	Reflecting the BOJ's monetary policy, interest rates have remained low and are unlikely to see a material increase in 2018	Official interest rates are expected to increase in 2018; lending rates have increased out of step with official interest rate increases	The U.S. Federal Reserve is expected to raise the benchmark interest rates 75 bps in 2018	Policy rates by ECB and BOE are expected to stay stable at current levels in 2018, with ECB potentially rising rates 2019 and beyond
Unemployment rate	Labor market conditions are stable for now	Overall labor market conditions will remain favorable with an expected unemployment rate of less than 3% in 2018	Unemployment rate is forecast to decline to 5.6% in 2018	There remains some slack in the labor market; unemployment rate at 4.1%	Unemployment expected to mildly fall across the large economies, except for the U.K. (due to negative Brexit effects)

Table 3

Macroeconomic Trends That May Affect Future Performance (cont.)

Factor	China	Japan	Australia	U.S.	Europe
Household debt and disposable income	Relatively low leverage and increasing household incomes continue to support debt serviceability	The ratio of total loan repayment amount to disposable income moved around 30% in 2016	Household debt to income ratio is high, increasing borrowers' sensitivity to future interest rate rises and deterioration in economic conditions	Household debt has steadily declined since the financial crisis; disposable personal income has continued to gain momentum	Debt service ratios declined in recent years for most European countries; U.K. still shows the highest levels compared to other large economies in Europe and is more stable than falling
Passenger car sales volume	Annual growth of 2%-4% in 2017-2019; future growth supported by upgrade demand in higher-tier cities and auto penetration into lower-tier cities	The number of car sales increased slightly by around 5% in 2017 from 2016	Strong growth in motor sales in 2017 were supported by stable economic conditions, low interest rates, and strong competition between brands	Light vehicle sales could weaken slightly to 16.9 million units in 2018	European demand for cars grew 3.4% in 2017 to more than 15 million new cars; from the five largest markets only the U.K. saw a decline (for the first time in six years)
Regulatory framework	Regulators remain supportive of auto financing and securitization; regulatory requirements have helped financiers to improve underwriting and risk management	The revised Installment Sales Act prevents multiple debtors and excessive credit sales from occurring	Regulators remain supportive of auto financing and securitization; implementation of the mandatory positive credit reporting regime in 2018 will facilitate greater competition as more lenders will have access to consumers' credit histories	Regulators remain supportive of auto financing and securitization; regulatory requirements have helped financiers to improve underwriting and risk management	Regulators remain supportive of auto financing and securitization; regulatory requirements have helped financiers to improve underwriting and risk management
Penetration of auto financing	Penetration of auto financing will continue to increase; each small increase in penetration can create a considerable amount of new auto loan demand due to the size of the new car market	Auto financing market is stable and current financing companies will keep their position and share for the time being	Penetration of auto financing will continue to increase as strong brand competition and relatively low interest rates help drive demand	Independent finance companies have been able to penetrate greater market share, benefitting from banks curtailing auto lending activity	Auto financing market is stable and current financing companies will keep their position and share for now
Future development	The market will see more variety in the future, such as new assets (add-on value loans, used car loans, etc.)	Due to low interest rate environment, auto financiers will be able to provide borrowers with auto loans with relatively low interest, which will increase competition	Expect to see more auto loan ABS issuance as investors seek to diversify away from RMBS	Many prime and subprime issuers seemed to tighten underwriting standards in 2017, and we expect some of these efforts will compensate for lower auction values and help stabilize performance in 2018	Current economic conditions and interest rate levels support positive credit performance for most the large economies; notable exception is the U.K., where fast-growing consumer credit raises some concerns

Bps--Basis points. BOE--Bank of England. ECB--European Central Bank. RMBS--Residential mortgage-backed securities. ABS--Asset-backed securities. BOJ--Bank of Japan.

Related Research

- German Diesel Ban Brings Bad Air For Carmakers And Auto ABS, Feb. 28, 2018
- An Overview Of China's Auto Finance Market And Auto Loan Securitization, Feb. 27, 2018
- Is Consumer Loan Growth Creating A Systemic Risk?, Oct. 26, 2017
- Fast-Growing U.K. Consumer Credit Should Raise Red Flags For Lenders, Oct. 24, 2017

- How Will Auto ABS Pools Perform Through A Credit Cycle?, March 14, 2017
- Exploring The Differences And Similarities Of Auto ABS In China And Other Developed Markets, Feb. 8, 2017

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