Recent Developments in the European Car Market and Auto ABS Issuance Activity

Annual Report 2020

Financial Research
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Creditreform Rating

Management Summary

1.

In 2020, the European auto industry witnessed the deepest downturn since World War II, even worse than that seen during the global financial crisis 2008/09, resulting from the sudden outbreak of Covid-19 in March. The spread of the virus forced governments to introduce severe lockdowns and mobility restrictions that took a toll on the manufacturing and production capacities, leading to adverse supply disruptions in the early stages of the pandemic. The European Union and the UK were hit hard with new sales registration (EU+UK) declining 24.5% to 11.55mn units in 2020, compared to the corresponding period last year. Spain, the UK and Italy led the European pack. By comparison, Chinese markets proved to be more resilient as they emerged successfully from the pandemic earlier than the rest of the world, slipping just 6.8%. Meanwhile, the US was around 17.0% down. However, large-scale government support globally via monetary and fiscal measures in tandem with temporarily eased restrictions helped reverse the downturn in the third quarter of 2020.

2.

The EU (ex-UK) saw the full-year car production fall by 23.3% as lacklustre consumer demand due to the Covid-19 restrictions hurt car retails throughout the region. France suffered the worst decline (-45.8%), while Germany and Spain retained their positions as the largest and second-largest producers of passenger cars despite an overall contraction in the region. In 2020, EU-wide production losses due to Covid-19 amounted to over 4.2mn vehicles, representing more than one-fifth of the total EU production in 2019. The UK also witnessed a material plunge of 29.5% to 918 thousand units.

3.

Although petrol and diesel cars continued to dominate as measured by market share, demand for electric vehicles gained significant traction given the EU's stringent regulatory norms to enable the transition to green options. Electrically chargable vehicles accounted for 10.5% of all EU new car registrations, up from a mere 3.0% in 2019. All alternatively powered vehicles combined represented one-fourth of the EU car market in 2020 and one-third in the fourth quarter. Germany took the lead within the EU's key auto markets. Petrol (48.0% vs. 58.0% in 2019) and diesel (28.0% vs. 32.0%) cars continued to lose their market share to alternative vehicles. Going forward, we expect the demand for electric cars to increase, mainly supported by a substantial

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amount of government subsidies, incentives offered by the dealers, and the expansion of charging and refuelling infrastructure for alternative fuels across EU member states.

4.

The used car markets displayed resilience, evident from rising residual values after the lockdown restrictions were eased by mid-2020. The used car registrations declined by only 2.4% in Germany, while Italy suffered a massive 28.0% decline in 2020. Looking ahead, residual values could witness only limited pressure as uncertainty surrounding the virus could keep demand intact for used cars, as consumers refrain from public transport, and as new car supply might be more negatively affected than initially thought due to rising infections of late and sluggish vaccination progress in Europe.

5.

The European auto ABS market was quite unpredictable in the first half of 2020 as the pandemic largely disrupted capital markets. Issuance volumes, however, picked up with 63% of issuances taking place in the 2H20, ending the year around 5% lower than in 2019. Although most of the issuances originated from Germany (25%), its share halved in 2020 as issuance growth in France (+168%) and Spain (+244%) rose drastically from the previous year.

6.

Somewhat surprisingly, in terms of issuance activities, the captives have outperformed, rising 40% to 18.6bn euros, and significantly higher than their 10-year average of 16.7bn euros (2010-19). The share of captives in the European new auto ABS issuance volume also surged to 71% in the full-year, thus hovering around its historical average of around 70% seen over the last two decades. Renault led the race with 6.3bn euros, followed by Volkswagen, which managed to raise 3.7bn euros, and Daimler at 2.7bn euros. Meanwhile, issuance activity by Fiat completely stalled in 2020.

7.

Demand for higher-rated assets improved during 1H20; however, year-end performance revealed a significant increase in the A (56%) and BBB/Baa-rated (53%) categories, with their market shares increasing to 3.5% and 1.4%, respectively. Meanwhile, issuances printed in the reputed AAA/Aaa-rated segment declined by 3%

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y-o-y to 18.6bn euros in 2020. In terms of market share, this segment captured 70%, remaining well below its decade-long average of fifth-sixth of total rated issuances.

8.

Going forward, the European automotive market and auto parts manufacturers are poised for recovery in 2021, although the ongoing rise in virus cases poses material headwinds in the near-term. We expect a strong recovery in the second half considering the massive fiscal stimulus and accommodative monetary policy to support the economic recovery. Issuance volumes could return to pre-pandemic levels in 2021, with a large part of the improvement taking place in 2H21, as the regional auto players gear up for capex ramp up to support their EVs roll-out plans, and as government and policy support remains firm. Nevetheless, the recovery in the EU and the automotive sector is exposed to significant downside risks which could put a lid on the performance of the auto ABS markets. Risks could emerge from the slow pace of vaccine rollout, uncertainty over the evolution of the pandemic, prolonged partial lockdowns and rising levels of unemployment. However, we believe issuances would recover to pre-pandemic levels.

1. The European Car Market at a Glance

The Covid-19 pandemic led to disrupted dynamics in the international automotive industry, with the sector experiencing a global collapse in demand for new vehicles, evident from new car sales that exhibited the worst decline since World War II. Notably, Europe remained affected more heavily than other regions, ending a long streak of profitable years for the automotive sector. Whilst electric vehicles (EVs), automation, and ride-sharing have been in focus even before the pandemic, the sector was facing more challenges due to temporary shutdowns in car production by original equipment manufacturers (OEMs) prompting for a realignment of priorities to merely stay afloat. Automotive suppliers with thin liquidity or covenant issues remained exposed due to both operational and capital expenditure headwinds. However, measures such as shortening payment terms, and advancing capital for tooling provided the necessary support to get the supply base back on its feet.

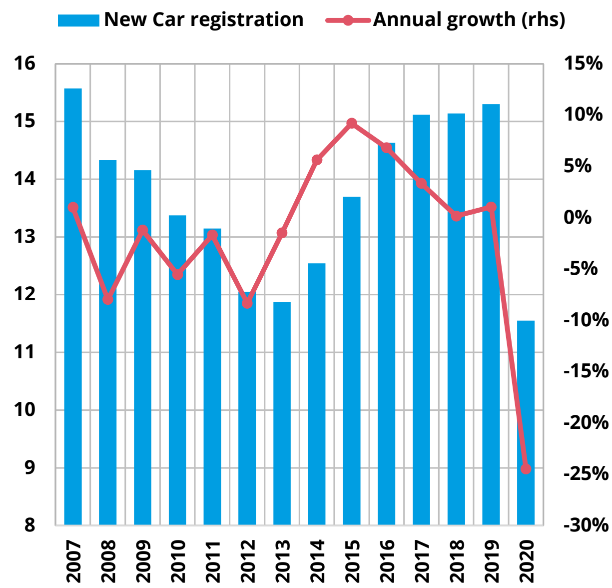
Demand patterns varied across regions through the year, with China being one of the most resilient markets as it successfully emerged from the virus much earlier than the rest of the world. Accounting for nearly one-third of global car sales, China recorded the highest vehicle sales in 2020, albeit nearly 2% lower y-o-y at 25.3mn. Government subsidies for so called new energy vehicles (NEV) and relaxed quota limits for urban areas have supported a sustained recovery in its automobile demand through the second half of 2020. Meanwhile, sales of NEVs increased by 11% to approx. 1.4mn units in 2020. For 2021, China Association of Automobile Manufacturers expects vehicle sales to rise by around 4% to 26.3mn units. In India, car registrations declined by 19% in 2020, with domestic sales turning the corner in July 2020 as monthly declining trends flattened out. New car sales picked up pace in the last year's fourth quarter on the back of festive-related demand. At the same time, other Asian markets such as South Korea introduced a 30% cut in consumption tax on passenger cars until December 2020 that aided the recovery in car sales.

The performance in North America improved in the final quarter of 2020, although remaining 18% below 2019 levels. In the US, car demand slumped by 16.6% to 11.2mn units in 2020. South America, one of the regions most affected by the Covid-19 outbreak saw passenger car demand in the region contract by 29.2% to 2.5mn units during 2020.

In the EU and the UK, new car sales plummeted by 24.5% y-o-y to 11.6mn units in 2020, led by the largest declines in Spain (-32.3%), the UK (-29.4%), Italy (-27.9%), and France (-25.5%). Without the UK, the regional decline in passenger cars posted at -23.7% to 9.9mn units (see Figure 1).

Figure 1: European new car registrations (including the UK) took a massive hit in 2020

New car registrations in million units



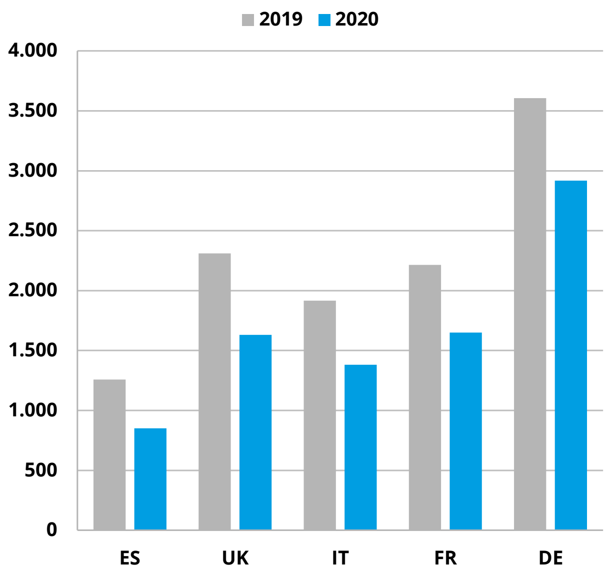
Sources: Creditreform Rating, ACEA

Notably, Germany, the largest market in terms of volume, registered a one-fifth decline to 2.9mn units, though better as compared to its peers (see

Figure 2). Along with a 130bn euros support package that included value-added tax reduction and electric car subsidies, Germany's automotive industry largely benefitted from cooperation with China where the former's top three car manufacturers - BMW, Daimler, Volkswagen - reported an increase in car sales in China. According to a study conducted by the German Centre for Automotive Research, the Chinese market accounted for 38% of global car sales of Germany's three largest car manufacturers.

Figure 2: New passenger car registrations in key European markets

In thousand units



Sources: Creditreform Rating, ACEA

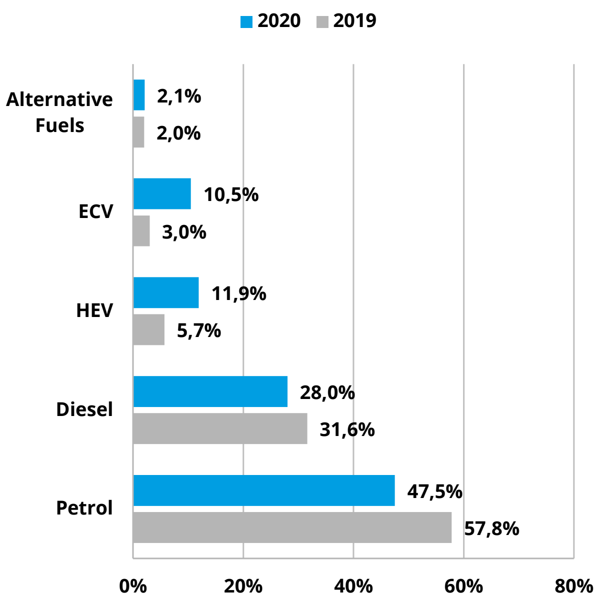
In the UK, new car registrations fell to a three-decade low in 2020, corresponding to a 20.4bn pounds loss in turnover, as per the Society of Motor Manufacturers and Traders (SMMT). With mandatory closures and restrictions, SMMT reported a whopping 97% y-o-y drop in new vehicle sales in April 2020 alone. Just when the industry began recovering around the start of the fourth quarter, the country was forced to re-impose a national lockdown to curb the spread of the new Covid-19 strain, thereby offsetting any progress made. Surprisingly, 2020 turned out to be a bumper year for battery and plug-in hybrid electric cars in the UK, together accounting for over 1 in 10 registrations from around 1 in 30 in 2019. In 2020, Chancellor of the Exchequer Sunak also announced that the Plug-in Car Grant (PiCG), which offers a government discount on the cost of buying a pure-electric car, will continue through 2022-23 after 403mn pounds cash injection. In addition, 129.5mn pounds were set aside for the Plug-in Van, Plug-in Taxi and Plug-in Motorcycle grants over the same period. Apart from this, the 2020 budget announced a 900mn pounds investment part of which would also go towards developing electric vehicles as well as 500mn pounds to support the creation of new rapid charging hubs. Along with exempting electric vehicles from vehicle excise duty, an additional 4.8mn pounds were allocated to support the development of a hydrogen hub, which in the future could potentially serve as a zero-emission fuel for Heavy Goods Vehicles.

Picking up on government aid, Germany's auto industry secured 5bn euros to combat the corona crisis and invest in the transition to electric vehicles. The German government sought to extend cash bonuses for purchasing electric-powered vehicles until 2025, expand the country's charging network, and make payments for topping up batteries easier. The government also offered incentives to replace ageing trucks and help component makers invest in new technology. The auto industry support package included: 1bn euros to extend electric-car buying incentives, 1bn euros for a scrapping program related to trucks, 1bn euros for a fund to support technology investment by suppliers and 2bn euros from existing stimulus funds to help suppliers adapt production lines. In contrast to the German policies that left out broader car-buying incentives, Spain announced a 3.7bn euro support program targeted towards the automotive industry to counter the sharp downturn in the sector. France has also moved to prop up its carmakers, with roughly 8bn euros that include state-backed loans such as 5bn euros slated for Renault.

Against the backdrop of tougher regulations on carbon emissions and the unravelling of the diesel gate scam in 2015, the automotive industry has shifted its focus to alternatively-powered vehicles (APV). Hybrid electric vehicles (HEVs) made up 11.9% of the total passenger car registrations in the EU (ex-UK) in 2020, versus 5.7% in 2019. Likewise, electrically chargeable vehicles (ECV) witnessed a material gain in demand, capturing over one-fifth of the market share based on new car sales in the region as compared to 3.0% in 2019 (see Figure 3). With this, the EU for the first time ever experienced more than one million units of both HEV (1,182,792) and ECV (1,045,831) passenger car sales in 2020. Overall, all alternatively powered vehicles combined represented one-fourth of the EU car market in 2020.

Figure 3: Vivid demand for alternatively-powered vehicles in Europe

New car registrations market share by fuel type in the European Union (ex-UK)



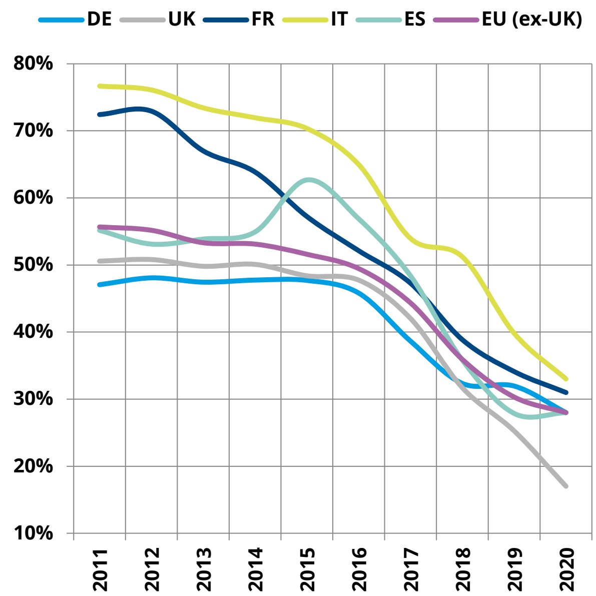
Sources: Creditreform Rating, ACEA

Barring Cyprus, all EU members saw APV registrations pick up, with major gains posted in Germany (+132% y-o-y) and France (+110% y-o-y), among the key car markets. Italy (+35%) and Spain (+26%) also saw the progress in 2020, though below the EU average growth of 70.7% y-o-y. The UK delivered 60.0% y-o-y growth in new APV sales in 2020, which led to capture market share of one-fourth of the UK total car sales.

That said, conventional fuel options continued to dominate EU car sales with about three-fourth of the market share in 2020, although markedly lower than the market share of 89% seen a year before. Within the conventional fuel mix, the market share of diesel-powered vehicles continued to decline, chiefly driven by Italy and the UK with low-double digit percentage points plunges in 2020 (see Figure 4). Germany and France saw a fall of four and three percentage points respectively, leaving the EU average share close to 28%. Notably, Spain and the UK now exhibit a very low diesel car share of 28% and 17% respectively.

Figure 4: Diesel shares continue to dwindle, with the UK and Itay registering the steepest declines in 2020

Share of diesel cars in new car registrations



Sources: Creditreform Rating, ACEA

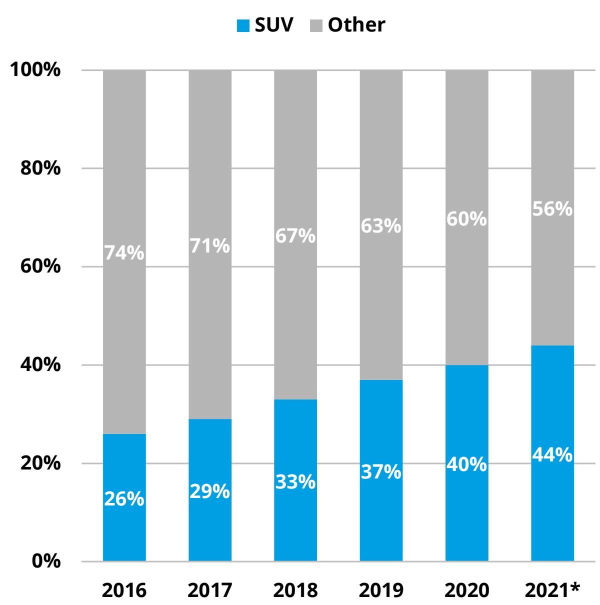
The UK has seen a significant decline in its registrations of petrol and diesel-driven passenger cars

(-40% and -55% respectively), in efforts to meet its goal of a complete ban on the sale of the same by 2030, a decade sooner than initially planned. To fulfil its ambition, the Johnson administration in November 2020 announced 582mn pounds in grants for buying zero or ultra-low emission vehicles and 1.3bn pounds to accelerate the rollout of charge points for electric vehicles across England.

The use of diesel-powered cars despite an impending rise in motor vehicle tax for new high-emission vehicles suggests that drivers of large vehicle types such as SUVs would be the hardest hit segment going forward. The new law starts adding surcharges once cars exceed average emissions of 95 grams of CO2 per kilometre, by adding a surcharge of 2 euros for each additional gram. France and Germany look likely to be affected the most considering they are now ahead of the other key European car markets in terms of diesel vehicles. Currently, SUVs in the European Union are extremely far from meeting the EU regulation, posting 131.5g/km in 2019.

Figure 5: SUV segment has gained traction over the years

EU-27 new car registrations by segment, *) Jan-21 figure

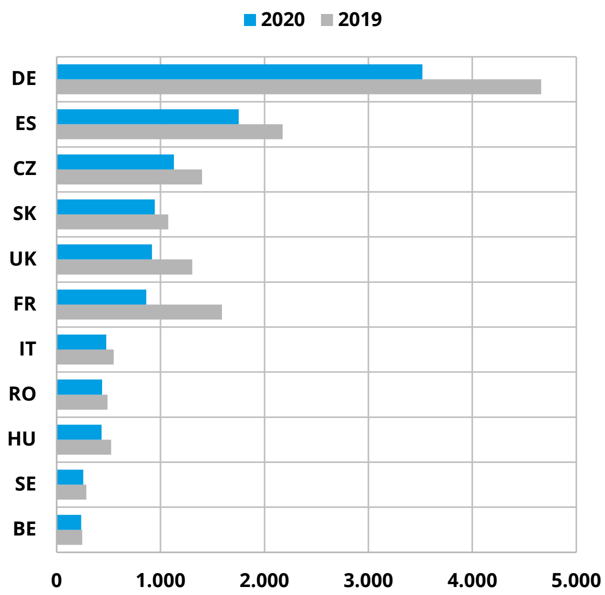


Sources: Creditreform Rating, JATO

After nearly six years of consistent SUV growth in Europe (see Figure 5), OEMs may no longer experience any rapid growth in this segment. However, for OEMs to avoid facing extremely high penalties, the electrification of these vehicles and production of efficient vehicles could be a solution. Moreover, the transition from NEDC to WLTP and the need to comply with lower emission standards have forced car manufacturers to reduce the options they offer. This could be another reason why progress towards the EV segment will remain steady.

Figure 6: Top 10 car producers in Europe in 2020

Data is shown in thousand units



Sources: Creditreform Rating, ACEA

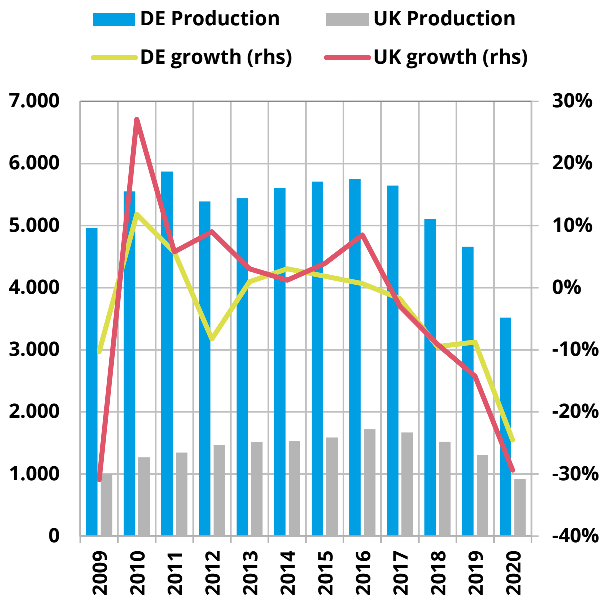
Turning to the production side, 2020 saw production in the EU fall by 23.3% as lacklustre consumer demand due to the Covid-19 restrictions had hurt car retails throughout the region (see Figure 6). However, incentivized demand and the need to rebuild inventory helped kickstart European production in the final months of 2020. France suffered the worst decline (-45.8%), while Germany and Spain retained their positions as the largest and second-largest producers of passenger cars in the EU (ex-UK) despite an overall contraction in the region. In

2020, EU-wide production losses due to Covid-19 amounted to over 4.2mn vehicles (including passenger cars, trucks, vans, and busses), representing more than one-fifth of the total EU production in 2019.

Car production in the UK plunged by 29.4% to 920 thousand units in 2020 (see Figure 7). Most of the losses were due to factory shutdowns from March through May. Although facilities resumed production from June onwards, the operating capacity continued to remain below pre-pandemic levels and lower than operating levels of 80-85% required to ensure profitability.

Figure 7: Germany and UK witnessed double-digit declines in car production

Data is shown in thousand units and change y-o-y



Sources: Creditreform Rating, VDA, SMMT

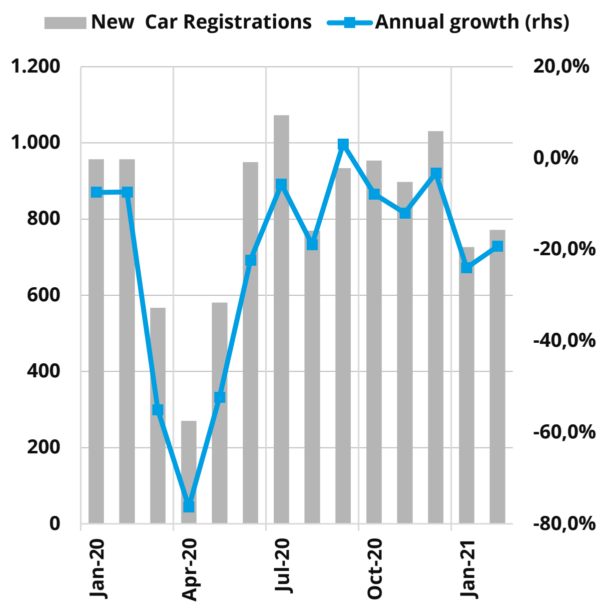
Looking ahead, production levels are expected to emulate consumer demands, though the trajectory of it currently remains uncertain. While global vaccination programs and easing of lockdowns helped bring back some of the production in 3Q20, we believe that the full-scale return of production capacities seems challenging given the severity of the ongoing downturn and the fact that the pandemic continues to play havoc across the world.

Despite substantial support measures, the overall weak performance of the auto sector appears to have spilled into 2021 as extended lockdowns, disrupted supply chains, and with a view to the UK, adjustments to the new trading arrangements following the Brexit transition period continue to affect output.

Going forward, the European Automobile Manufacturers Association (ACEA) expects auto sales in the EU (ex-UK) to rise by 10% in 2021. At this stage, we deem this forecast as rather optimistic considering the fresh Covid containment measures and the concurrent uncertain outlook for the near-term. New car sales have already experienced a sharp fall in January and February 2021 (see Figure 8), yet a rebound may be expected especially from the second half of the year along with the recovery in economic activities.

Figure 8: Recovery in new car sales have stalled in the beginning of 2021

New car registrations in the EU (ex-UK), in thousand units



Sources: Creditreform Rating, ACEA

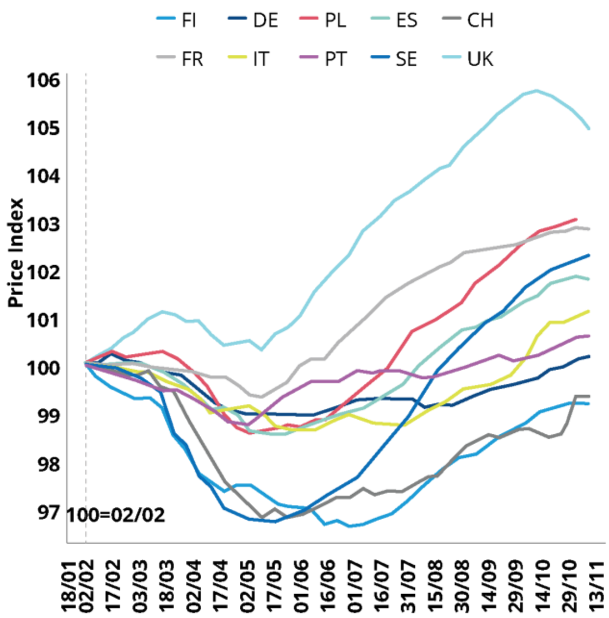
That said, much will be depend on the progress of vaccinations as the third wave of infections is taking a toll on European economies, partly forcing them to fall back on tigher restrictions and lockdowns (see also below). As a result, the risk to the auto industry seems tilted to the downside for now. While the automotive industry has already faced a global shortage of semiconductors, creating pressure on production coupled with supply chain bottlenecks and long waiting periods, fresh lockdowns are likely to exacerbate the demand overhang regarding semicondutors. Feeling the pinch of insufficient availability, the EU outlined plans to develop and produce the world's most advanced semiconductors, accounting for 20% of global share by 2030 and reduce its reliance on foreign companies for the component.

Regarding the used car market, the supply-shortage of vital production material and lack of new cars proved to be beneficial for this market segment. As the crisis resulted in loss of earnings, unemployment, and consequent decline in purchasing power, the downturn in volume of used car transactions was not as dramatic as that of new car registrations in the first half of 2020. Initially, however, higher upfront discounts granted on new cars had a negative impact on residual values (RV).

The used-car market has shown strong signs of recovery across Europe since the third quarter as buyers returned post the relaxation of lockdown restrictions (see Figure 9). This has seen RVs improve, especially for older cars as cost conscious buyers moved away from public transport to limit the risk of infection. Autovista Group's Covid-19 tracker, which tracks 12 European markets, shows that the index of RVs, compared to early February when the measurements began, was back above pre-crisis levels by October 2020 in all major markets. A similar trend was seen across all ages of used cars, except for vehicles up to six months old, that breached pre-pandemic levels in June itself.

Figure 9: RVs have been recovering strongly

Residual values of used cars



Sources: Autovista Group, Creditreform Rating

According to Kraftfahrt-Bundesamt (KBA), the German used-car transactions were just 2.4% lower in 2020 as the disruption of new car supply and demand positively impacted RVs. Meanwhile, France's incentive schemes that subsidised the purchase of used cars became effective in June, driving RVs higher. Apart from doubling premiums for buyers trading older vehicles for cleaner models and offering grants for vehicles with internal combustion engines (ICE), BEVs and PHEVs, the trade-in bonus also applied to used cars. However, the scheme was replaced with a conversion bonus after reaching the vehicle-cap of 200,000 in July 2020, post which RVs in France stagnated. In contrast to the dramatic 29% decline in new car registrations, used-car transactions in Spain declined by 12.8% in 2020. The situation in Spain remains rather benign as a tax rise along with the introduction of WLTP-based emission figures and termination of the RENOVE scrappage scheme could hinder new car demand and push RVs moderately higher.

Given that most European countries have targeted initiatives towards new electric vehicles, the expected pressure on RVs could be higher for this segment. Going ahead, Autovista expects higher pressure on German RVs in the EV space as compared to other markets given the minimal emphasis on stoking demand for used EVs. Additionally, there is the risk that lower company-car taxation will stimulate demand for new car transactions, to the detriment of the used car market. Overall, we believe residual values will face moderate pressure going ahead as ongoing Covid-19 restrictions are likely to support used-car demand.

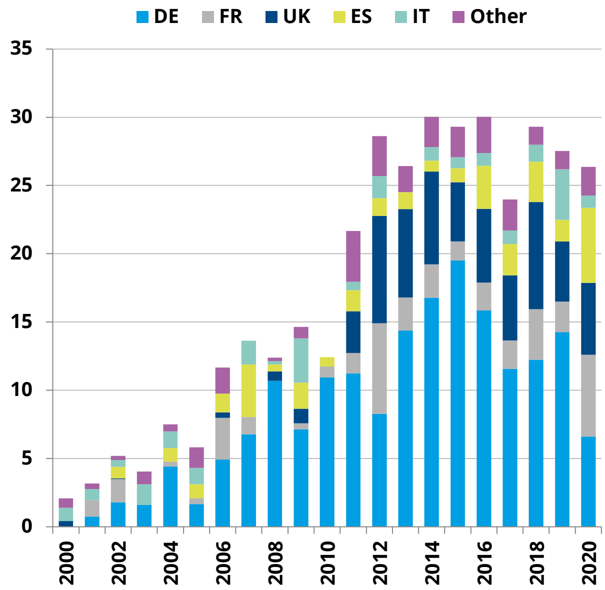
Concurrently, used-car prices in the UK have outperformed other markets given the release of pent-up demand from the lockdown and uncertainty ahead of the expiry of the transition period on 31 January 2021. Additionally, a more notable vehicle supply challenge than in other markets resulted in higher RVs given that demand picked a pace. Values rose from mid-May and peaked at an index value of 106 (6% rise) in October 2020 before receding by the end of the year as supply improved and pent-up demand was met.

2. The Auto ABS Markets in Europe

The Auto ABS issuance volume amounted to 26.4bn euros in 2020, versus 27.5bn euros in 2019. This, however, stands well above the issuance level of 12.4bn euros and 21.7bn euros seen during the global financial crisis in 2008/09 and the European debt crisis, respectively (see Figure 10). After a strong start to 2020, the effects of the pandemic and resulting disruptions made for an uneventful first half with issuances standing at a mere 9.8bn euros. However, the improvement of asset delinquency and loss performance towards the fourth quarter helped the auto ABS market regain lost ground. Forbearance measures and government support policies in the form of payment holidays and furlough schemes aided in the recovery.

Figure 10: Development of the auto ABS issuance activity in key European markets

Volume of new auto ABS issuances in billion euros, by origin of collateral



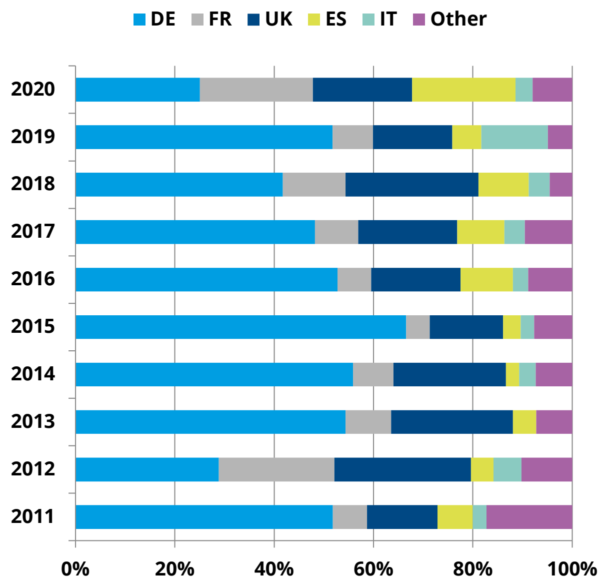
Sources: Creditreform Rating, Refinitiv

The UK's volume jumped by 19.6% to 5.5bn euros, shrugging off Brexit-induced uncertainty and clouded macro prospects – thereby lifting its market share in 2020 to roughly 20% (see Figure 11). Overall, Germany and France remained the top originators of collateral with a combined market share of nearly half of the EU's auto ABS market in 2020 (47.8%), despite the contribution of the former more than halving to 25% in 2020 from a year ago. Total European auto ABS issuances from the year 2000 come to 365.9bn euros.

The European auto ABS market has come a long way from the 2008 financial crisis and has successfully managed to weather the Covid-19 storm. The asset class is now poised to recover given ample credit protection that could steer clear of payment disruptions. Moreover, the government's wage support programmes and low rates have led to a decline in the take-up of payment holidays to manageable levels. As the economic activity gradually normalises ahead, thanks to the start of widespread inoculations, the take-up could see a further decline.

Figure 11: Spain and France's market share of collateral rises significantly, yet Germany continues to lead

Share in auto ABS deals by origin of collateral, measured by annual issue volume

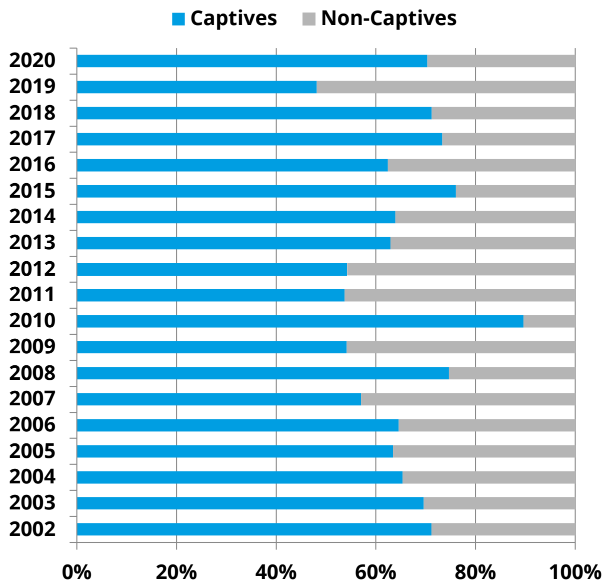


Sources: Creditreform Rating, Refinitiv

captives' issuances took place in 2H20, after a 7.8bn euros in 1H20. The robust performance of captives could be attributed to a rebound in the auto markets in the second half and an improving outlook being envisaged thereafter. In comparison, in the aftermath of the financial crisis, the share of captives stood at a meagre half of the total issuances. Likewise, during the European debt crisis, the share of captives remained low.

Figure 12: Captives continue to dominate

Share in the volume of new auto ABS issues by originator



Sources: Creditreform Rating, Refinitiv

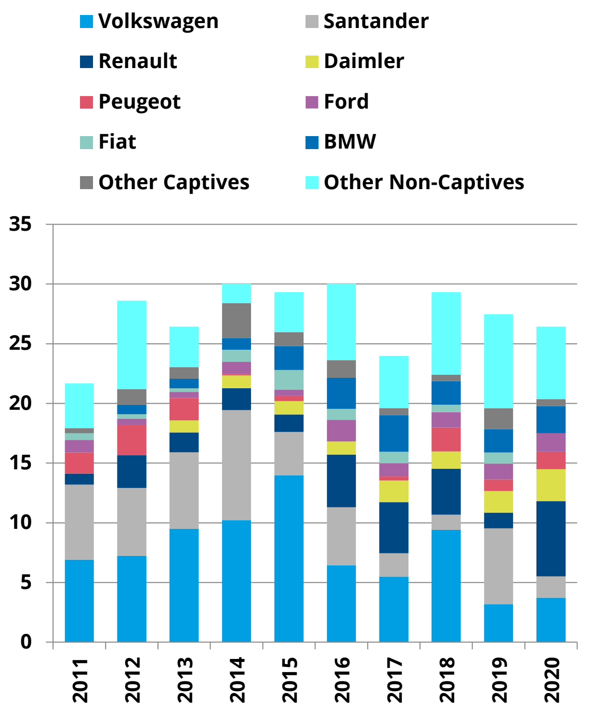
3. Originators of Auto ABS

Over the last two decades, captives (originators affiliated with automobile manufacturers) have tended to underperform in terms of issuance activity during times of extreme economic uncertainty. However, last year, captives have performed relatively well, with their share in the European new auto ABS issuance volume surging to roughly 70% in 2020 from 48% y-o-y in 2019, while beating the 10-year average of 63.7% (see Figure 12). Captives closed 2020 with total issuances of 18.6bn euros as compared to 13.2bn euros in 2019. Over half of the

Following a lacklustre first half of the year, Renault dominated the captive issuance market raising 6.3bn euros in 2020, rising nearly five-fold from 2019 levels and marking its best performance in two decades. This compares to its 10-year average of 2.4bn euros in 2010-19. In terms of market share too, Renault led the captive issuance segment with its share increasing significantly from 4.8% in 2019 to 23.9% in 2020 (see Figure 13). In the first half of 2020, Volkswagen and Daimler's combined share accounted for half the captive issuances. However, Renault ate into their share in the latter part of 2020, overtaking its peers for the full-year. Volkswagen, whose share came to one-fourth of the segment in 1H20, saw its share decline to 14% in the full-year, totalling 3.7bn euros. The full-year performance of Daimler, however, remained upbeat, with its issuance increasing by 47% (to 2.7bn euros), the highst reading since 2000.

Figure 13: French and German captives dominate in 2020

Volume of new auto ABS issuances in billion euros



Sources: Creditreform Rating, Refinitiv

On the flipside, activity remained muted from auto majors like Fiat and Santander. Fiat registered its weakest performance in 2020 as it entirely refrained from tapping the market. Meanwhile, Santander saw its issuances decline 71% y-o-y to 1.8bn euros with its share plunging from 23.0% in 2019 to 6.8% in 2020, also due to base effects.

With stringent emission regulations and the transition to battery-powered vehicles, production and investments are likely to get back on track in the coming year. Renault's working hypothesis for 2021, excluding the component-related shortage, is for sales of electrified vehicles to reach 350,000.

As for non-captives, this segment saw a decrease both in share and in terms of issuance volumes in 2020. The non-captives' resurgence in the total volumes issued by European originators took a hit in 1H20, ending the period with total issuances of 2bn euros. However, activity in the non-captive segment improved in 2H20, as the full-year issuances totalled 6.1bn euros (from 7.9bn euros in 2019), capturing a market share of 23%, lower than 28.7% in 2019.

4. Rating profile of auto ABS markets in Europe

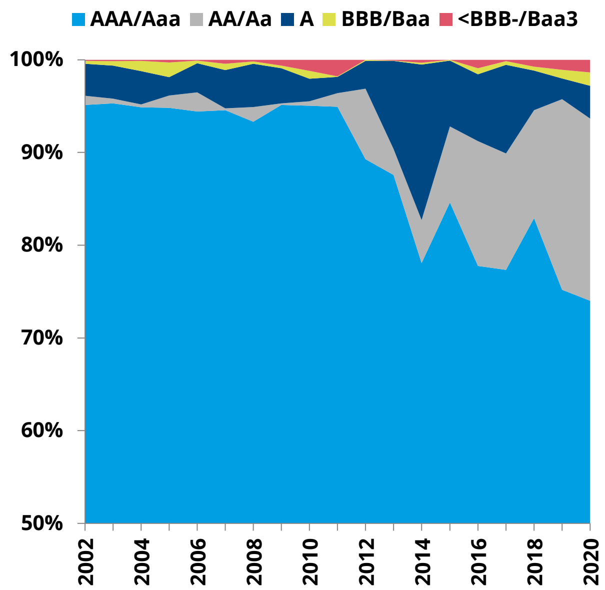
Being a short-term asset, the lack of price sensitivity to changes in the yield curve helps the auto ABS segment pose as a safe-haven asset class to its investors. The segment not only offer a higher yield premium in times of uncertainty and volatility but also provides investment-grade ratings, low credit risk, and liquidity. Additionally, ABS as a segment in itself provides diversification benefits for fixed income portfolios that are vulnerable to corporate and sovereign risks. Against the backdrop of a global pandemic, European securitizations have proved to be a resilient segment.

The volume of rated European auto ABS notes was virtually flat, posting 25.1bn euros in 2020 versus 25.4bn euros a year before. The second-half of 2020 saw a significant rise in rated issuances following a mere 9.1bn euros worth of issuances in 1H20. The overall rating profile of the European auto ABS remained largely unchanged in 2020, with 18.6bn euros issued in the AAA/Aaa category, reflecting a slight 2.6% y-o-y decline, mirroring the low number of issuances. Furthermore, the share registered by AAA-rated issuances in 2020 stood at three-fourth of the total (see Figure 14), compared to a 10-year average of 83% and 95% prior to the Euro debt crisis. Its share was the highest in nearly a decade, at 92.6% in 1H20, reflecting the strong demand for this highly-rated asset class amidst times of extreme economic uncertainty.

The overall share of the highly coveted AAA segment continued on its downward trajectory as the AA/Aa and below rated securities continued to gain traction. Historical data reveals that the AA/Aa rated segment witnessed a significant rise in share since 2014, climbing from mid-single digit to one-fifth in 2020. During the same period, volumes surged 263% to close to 5bn in 2020. The A-rated securities in the auto ABS basket witnessed the largest annual rise of 56% in 2020 to close the year at 887mn euros with its share increasing to 3.5% from 2.2% in 2019. Meanwhile, the share of BBB/Baa securities and sub-investment grade securities rose to 1.4% each, the highest since 2005 and 2011 respectively. BBB/Baa-rated securities witnessed a similar rise of 52%, totaling 358mn euros, the highest volume since 2002.

Figure 14: Auto ABS rating profile remains strong

Initial ratings (S&P, Moody's, Fitch) include senior and subordinate tranches, share in the yearly issuance volume, measured by the issue volume of all rated notes



Sources: Creditreform Rating, Refinitiv

Speaking about the European ABS index spread performance, in absolute terms, the Covid-19-driven sell-off had a relatively smaller impact than that during the global financial crisis (GFC) and the Euro debt crisis. Spreads across AAA/AA/A rated ABS widened by less than a tenth as much as during the GFC. Compared with the euro crisis, the Covid-19 spread widening was between a third and a quarter as severe. The Covid-19 health crisis saw price declines for AAA, AA and A-rated ABS of 1.8%, 3.7% and 6.8% respectively. By contrast, price declines in the aforementioned category were at an average of 9.6% during the Euro crisis and a whopping 42% in the aftermath of the GFC.

5. Perspectives for the issuance of European auto ABS

The European securitization market continued to ride the wave of investor optimism into 2020 on the back of the new 'Simple, Transparent and Standardized' (STS) regulation which enhanced safety and liquidity while including due diligence, risk retention and transparency rules. Despite the turmoil caused by the pandemic since March 2020, the auto ABS segment remained well-supported by forbearance measures that limited a sharp rise in delinquencies. Primary issuances of European auto ABS were significantly hurt during the initial period of lockdowns through the second quarter. However, the auto ABS market came back strongly in the second half to end the year on a positive note. Overall, issuance volumes were higher than during the European debt crisis and the 2008/09 global financial crisis.

Going forward, the European automotive market and auto parts manufacturers are poised for recovery in 2021, although the ongoing rise in virus cases poses material headwinds in the near-term. Nevertheless, we envisage a strong recovery in the second half considering the massive fiscal stimulus and accommodative monetary policy to support the economic recovery. Issuance volumes could return to pre-pandemic levels in 2021 as the regional auto players gear up for capex ramp up to support their EVs roll-out plans.

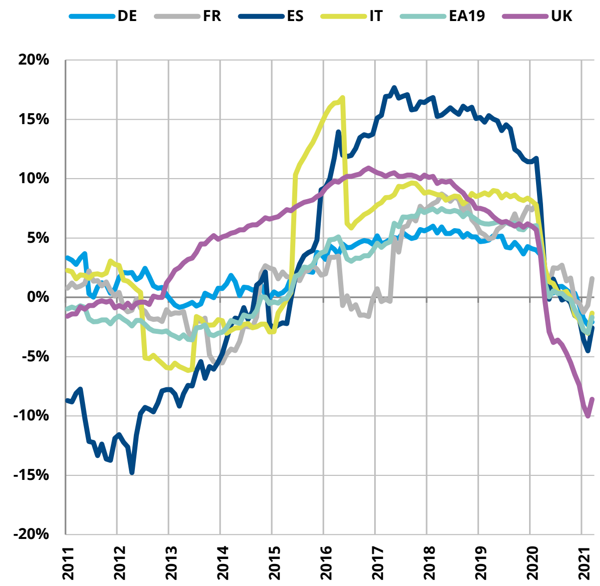
From the regulatory perspective, in light of the Covid-19 economic shock, the European Comission sought to address credit issues ensuring that credit institutions and investment firms are able to channel sufficient funds to businesses to help them absorb the fallout from the Covid-19. In this regard, a proposal to amend the Securtization Regulation, i.e. the Simple, Transparent, Standardized (STS) framework was enacted in July 2020. The most notable aspects of the proposed regulation include credit-granting criteria, risk retention, transparency and due diligence.

In late March 2021, the European Parliament adopted the long-awaited amendments that would (i) remove regulatory obstacles to the securitizations of non-performing exposures (NPE) and (ii) extend the framework for STS to synthetic securitizations. Meanwhile, the European Parliament also passed amendments to the capital requirements regulation (CRR) so as to modify risk weight of securitization positions in line with new securitization rules. In case of NPE securitizations, the senior tranche would be subject to a flat risk weight of 100%, provided the exposures in the pool backing the securitization have been transferred with a non-refundable price discount of at least 50% on the nominal amount of the NPEs. Additionally, with respect to synthetic securitizations, the benefit of the STS risk weights is extended to include senior positions in synthetic securitizations complying with the relevant STS criteria. Given the dire urgency to support economic recovery, the regulation entered into force on 9 April 2021.

Amendments to the securitization regulation and CRR are likely to facilitate the use of securitizations in the wake of the economic recovery by improving institutions' lending capacity to households and businesses going forward. This, coupled with a dovish ECB could play a catalyst role in enabling consumer credit (see Figure 15) as financing conditions are likely to remain conducive to economic growth. However, the UK will not be a part of the changes made to the EU securitization regime, and may choose to introduce its own amendments.

Figure 15: Household consumer credit shows some initial signs of bottoming out in early 2021

y-o-y change in %



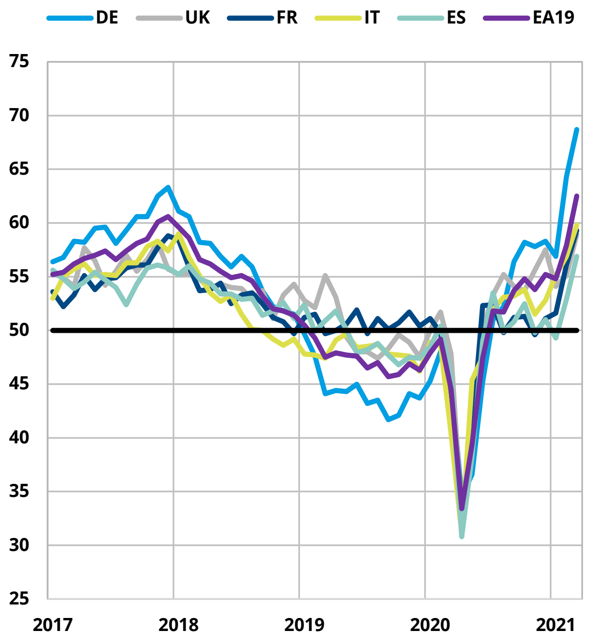
Sources: Creditreform Rating, ECB, BOE

More notably, the European Banking Authority (EBA) is expected to publish a report on the development of a framework for sustainable securitizations by 1 November 2021. The new framework would play an important role in developing securitizations aimed at financing Green Projects (Green Securitizations) and encouraging investment in environmental projects to achieve the EU's green targets.

As regards the macro performance, the EU-27 economy shrank by 6.1% y-o-y in 2020, while declining 0.5% q-o-q in the final quarter of the year. Real GDP in the euro area contracted by 6.6% in 2020, and in the UK by 9.8%. In the final quarter, Southern European countries witnessed a sharp contraction as the resurgence of infections and resulting lockdowns took a hit on tourism-driven economies. In 2020, real GDP in Spain contracted 10.8%. Other key auto markets such as Italy and France saw their GDP dropping by 8.9% and 8.1% respectively. Germany reported a 4.8% slump in economic output in 2020.

Figure 16: Strong recovery in manufacturing

Purchasing Manager's Index, 50 unchanged growth



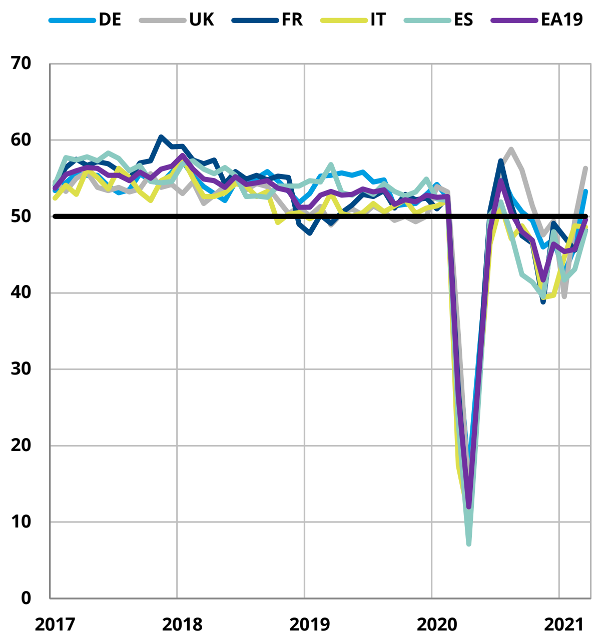
Sources: Creditreform Rating, Refinitiv

On a positive note, European manufacturing picked up pace in the third quarter, moving into expansionary territory. After declining to a multi-year low, manufacturing PMI rose above the 50 mark in July, before ending the year higher at 55.2 (see Figure 16). The rebound in manufacturing is attributed to a large extent to the booming external demand for German goods. The services PMI in the euro area recorded a stellar rebound after falling to 12 in April, rising sharply above 50 in August 2020 (54). However, hereafter, the emergence of a new and highly-transmissible strain of coronavirus led to fresh restrictions that saw the indicator reverse its trend and end the year at a 46.4 (see Figure 17). Communication and information services largely drove the gains in 2020. The upward trend in both manufacturing and services PMI across countries in the region indicates the return of pent-up demand and backlog orders once restrictions were lifted.

Sluggish economic activity spilled into the first two months of 2021 as well, as countries continued to grapple with the pandemic. Figures for March 2021 however have reported an improvement (49.6).

Figure 17: Reimposition of recent restrictions keep services PMI under pressure

Purchasing Manager's Index, 50 unchanged growth



Sources: Creditreform Rating, Refinitiv

Similarly, the German business sentiment tracked by the ifo business climate index ended the year at 92.1, well above the multi-year low of 74.3 seen in April 2020, albeit remaining below pre-pandemic levels. The trajectory into 2021 has however remained positive, rising to 96.6 in March 2021, its highest level since June 2019, on optimism over manufacturing and service activity.

In view of the economic outlook, the intensification of the pandemic has not derailed but only weakened recovery prospects. Overall, we currently expect real GDP in the euro area to rebound by about 4.1% this year, driven by domestic demand and by net exports, although the latter will be harder to achieve by popular tourist destinations. For 2022, we would pencil in growth of about 4.3% at this juncture. Uncertainty remains unusually high, and downside risks continue to relate to any further delay in vaccine availability, or limited effectiveness thereof, also in view of new virus mutations. In such a scenario, an increase in bankruptcies could be higher than envisaged in our base scenario, and would go hand in hand with a higher increase in unemployment, thus likely hampering domestic demand in particular.

The ECB extended unprecedented monetary policy support to ensure the economy gets back on a path of sustained recovery, reiterating its commitment to keep financing conditions favourable. Since our last review, the ECB has strengthened its accommodative stance, increasing its PEPP envelope to a total of 1,850bn euros, while the horizon for net purchases under PEPP was extended to at least the end of March 2022. Besides extended and enhanced refinancing operations (TLTRO, PELTRO), the duration of a set of collateral easing measures was extended as well.

On the fiscal side, national support was flanked by the EU's suspension of the bloc's budget rules. Moreover, consensus over using the 750bn euro Next Generation EU (NGEU) program was achieved towards the end of 2020 after months of negotiations. Additionally, NGEU's largest chunk, the Recovery and Resilience Facility (RRF), is designed to foster the transition to a greener and more digitalized econonmy. The EU agreed that an overall climate target of 30% will apply to the NGEU. On the flipside, domestic political discord over the use of these means, as for instance seen in Spain and Italy, might pose as a headwind to some extent. Ultimately, a lagging recovery would increase the risk of deeper scarring effects and possibly eat into funds otherwise earmarked to foster the greening and digitizing of the economy. Furthermore, this would make it harder to pursue fiscal consolidation in the medium term and present difficult choices to politicians in charge.

Launched in December 2019, the European Green Deal represents a decisive initiative with the potential to significantly accelerate the speed of green transition not only on the automotive industry but all sectors of the economy. More notably, the Covid-19 pandemic did not delay the EU's energy transition plans, as evident from its expenditure plans mentioned above. In the auto industry, attempts are being made to chip away at China's dominance by building EV battery supply chains across the region. Germany has been leading in its efforts, promising 2.6bn euros to the battery business, while hoping to attract foreign players. Aligning with these efforts, Germany recently provided 5.5bn euros for funding electric-car charging infrastructure, after Europe overtook China as the world's largest market for plug-in hybrid and electric cars in 2020. Funds for the same will be made available through 2024. Green initiatives also hope to fulfil the European Commission's target of at least 30mn zero-emission cars by 2030 and its ambition that European factories would cover 90% of the demand for batteries.

With a view to the UK, the adoption of the UK-EU Trade and Cooperation Agreement averted a catastrophic 'no-deal' Brexit scenario. In light of the last-minute deal struck in December 2020, the car industry on both sides of the English Channel breathed a sigh of relief with the trade deal that kept the EU-UK market free of tariffs and quotas. Furthermore, a grace period over rules of origin -- delaying a requirement to declare where parts come from -- has also been cheered. However, this provision is due to expire by the end of 2021.

Tariff and quota-free trade is imperative to resuscitate UK's car market. To qualify for tariff-free access to the European market, the UK would have to limit the value of car components made outside the UK and EU. This implies that the UK would require turning its focus to ramping up battery production to build its car industry amidst the phasing out of petrol and diesel engines. Furthermore, the stark contrast of the decline in petrol and diesel cars and a simultaneous surge in electric vehicles suggests that OEMs with a more innovative and dynamic hybrid and electric offering will benefit the most in a rebound.

Concerns over the impact of non-tariff barriers on supply chains leading to added expenses for carmakers and uncertainty over the UK's relationship with the EU could play spoil the post-Brext party. As car companies contemplate moving away from investing in the UK, any further fallout could have widespread implications on the UK economy, wherein the auto industry employs nearly 860,000 people. Also, with registrations declining for the third straight year, it is unlikely that the domestic market would make up for lost overseas sales.

The UK economy was hit heavily by the pandemic, contracting by 9.8% in 2020. Consequently, labour market conditions deteriorated with the unemployment rate rising, although remaining lower than what it would have been if the government's Job Retention Scheme had not been in place.

On the fiscal front, Covid-19 support measures have exacerbated fiscal sustainability concerns in the UK. Chancellor Rishi Sunak outlined 65bn pounds of new covid support in early 2021, bringing the total since the crisis began to 352bn pounds. The decline in VAT, corporation tax and income tax receipts and waiver of business rates drove tax revenues lower in the 11 months to Feb-21, while large-scale fiscal interventions strained the government's purse strings.

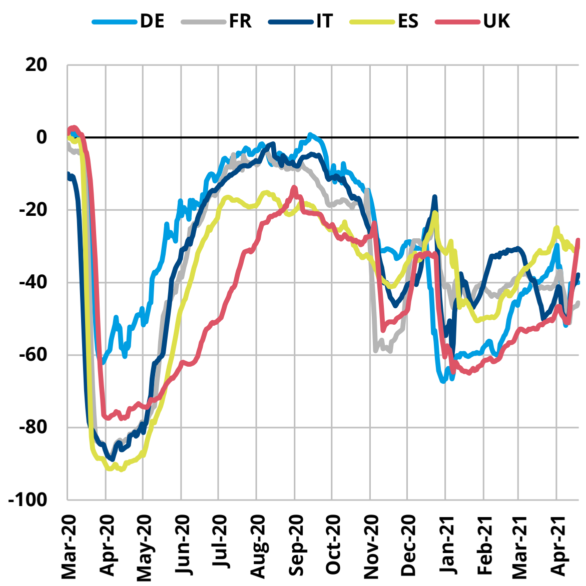
Furthermore, the Bank of England (BOE) stepped up to support the economy through its ultra-loose monetary policy helping workers and corporates get through one of the worst recessions in history. The policy rate remained unchanged at a record low of 0.1% by 2020-end with asset purchases to the tune of 895bn pounds. The UK economic outlook seems brighter in 2021 considering the rapid vaccination campaign and the decision to extend furlough payments through September 2021.

Looking ahead, containment measures might come to end by Q3-21 altogether, if the government follows through on its roadmap on exiting the lockdown, which foresees return to normality by 21 June, conditional on the evolution of vaccination success and infection numbers. Obviously, this remains subject to high uncertainty against the backdrop of the spread of new strains of the virus.

Recent unconventional leading indicators such as Google mobility (see Figure 18) as well as sentiment indicators would back expectations of our baseline scenario for 2021, which foresees real GDP to bounce back mainly on account of rebounding private consumption, with household incomes supported by the extended furlough scheme.

Figure 18: Broader vaccine coverage allowing for easing of restrictions – boding well for a swifter economic recovery

Google mobility indicator for Retail & Recreational, 7-day moving average of percent deviation from baseline



Sources: Creditreform Rating, Google

To conclude, the pandemic continues to take a toll across Europe amidst a rather sluggish pace of inoculations in large parts of continental Europe, while the UK may be coined as a vaccination frontrunners in a global context. The World Health Organisation (WHO) itself has criticised Europe's rollout of coronavirus vaccine as being 'unacceptably slow'.

Speaking of the automotive industry, we expect the immense government support and a gradual revival in demand arising from the accelerated shift to greener options to boost a post-pandemic recovery after a tough year. Nevertheless, uncertainty over how the pandemic unfolds and the possibility of delayed normalisation of economic activity into the latter half of 2021 weighs heavily.

The rising unemployment continues to pose a downside risk to the ABS market. The unemployment rate in the Eurozone stood at 7.8% in 2020. Worryingly, youth unemployment or the number of NEETS (not in education, employment or training) aged 15-29 shot up drastically, with nearly 10 million individuals being referred to as the 'lost generation'. Despite national-level schemes and EU-level backing alongside accommodative monetary policy, the imminent scaling back of support measures suggests unemployment may yet have to peak.

With 2020 being a year of supply chain disruptions, the automotive industry too faces its share of challenges. The shortage of semiconductors across the automotive value chain has highlighted the little clout the industry has with the suppliers of the component. Going ahead, a prolonged supply gap could materially hit production lines even as demand for cars increases. This could in turn also force auto players to rethink sourcing strategies. Secondly, the phenomenal rise in raw material prices including that of steel and precious metals has raised costs for automakers, reversing the gains in margins due to benign commodity prices over the past few years.

Another hurdle for the industry is that of successfully transitioning towards fully digital purchasing options. Although the pandemic drove the shift to online sales, it is unlikely that the significance of dealerships would be taken over as they continue to hold importance even in an online sales journey. Although several brands have begun offering 'online-only' purchasing options, customers may prefer the real-time experience by visiting dealerships and taking test drives, before making an online purchase for the product. That said, with Covid-19 restrictions lasting for some time in 2021, the opportunity for online sales tools to improve customer experience will be critical. A slow pace of vaccine roll-out would have broader impact across economic activities and a cyclical sector like auto remains more vulnerable. At the same time, Europe is gradually coming out of the third wave of infections and restrictions have eventually started easing as cases fall in the region.

In addition, stringent emission-related requirements could pose as a hurdle to OEMs. The increased subsidies and incentives as part of stimulus packages have improved EV adoption and will likely continue until the cost of production of EVs declines. However, as adoption grows, emission regulations will become increasingly significant for automakers as we may see authorities shifting from providing purchase subsidies and tax credits to imposing fines over exceeding emission quotas. Against the backdrop of escalating CO2 emision and fuel standards, OEMs would face hefty fines for non-compliance which could eat into their already slim margins. A new climate law by the EU seeks to impose new, tougher greenhouse gas emissions targets, aiming to cut EU-wide net emissions at least 55% by 2030. Moreover, the 2030 target has set the stage for a major package of EU regulations due in June to cut emissions, which include proposals to revamp the EU carbon market and tougher CO2 standards for cars amidst others.

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