Creditreform Rating

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.

The European car market rebounded strongly in the second half of 2019 as the effects of new Worldwide Harmonized Light Vehicle Test (WLTP) began to diminish and automakers came up with a better product mix and with SUVs and Crossovers continuing to gain traction. Overall, 2019 represented a sixth consecutive year of increasing new car registrations and reaching record-high volumes. This was in contrast to muted global auto performance, which plunged deep into recession, led by China and to some extent India. The US exhibited some resilience owing to solid economic conditions, yet the EU managed to outperform in terms of growth in the latter half.

2.

Within Europe, Germany remained a strong contender registering passenger car registrations rising by 5% in 2019, partly driven by a remarkable 19.5% uptick seen during December. Germany sold over 3.6m units of new cars, the highest since 2009. It's market share also improved by roughly 0.9 percentage points to 23.5%. Some recovery in new diesel car sales left the German diesel market share unmoved, while other key auto markets continued to witness sharp declines. As a result, the share of diesel cars for Europe narrowed to 31% from 36% in 2018, which was mirrored in the share of petrol-powered cars that improved from 57% to 59%. Interestingly, Germany also acquired a lead over Norway in sales of Battery Electric Vehicles (BEV) for the first time, becoming Europe's largest BEV market.

3.

The unabated fall in diesel car sales reflects a shift in perception across the markets. The governments are determined to curb carbon emissions to protect the environment and hence, the strict regulations suggest that they have already turned against diesel cars. Most of the governments have also drawn their plans to gradually phase-out diesel cars. Besides, the industry appears to be unable to provide cleaner engines in this segment. Accordingly, it can be inferred that a further drop in diesel car market share is likely to come, but at a gradual pace from the current levels. A significant shift to electric-based vehicles may be imminent following heavy investments being pumped into research

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and development projects by the industry, as it races to meet the stricter carbon emission norms. Meanwhile, the increased allocation towards infrastructure spending and provisions from the governments, mainly in terms of incentives, can be expected to augment demand for electric vehicles.

4.

As regards residual values in Germany, an increase in new fleet registration volumes created downside pressure on residual values of used cars for both petrol and diesel during the latter half of 2019. In 2020, the used car market may find some relief due to supply constraints amidst the COVID-19 outbreak.

5.

The European auto ABS market witnessed a strong recovery in the second half of 2019. The issuance activity more than doubled, benefiting from fading uncertainty over the new Simple, Transparent and Standardized (STS) regulation and the tight supply of primary issues in the earlier half. For 2019, total issuances reached 29.6bn euros surpassing the 2018 tally by 1.1%.

6.

Defying the historical dominance, the captives underperformed in 2019 issuing just two-fifths of the total new issuance volumes and remaining three-fifths by non-captives. This is mainly attributed to a weak economic environment, which generally transmits into lower issuances from captives. Volkswagen raised 3.2bn euros, followed by Daimler (1.8bn euros) and Renault (1.3bn euros). Amongst non-captives, Santander outperformed the traditional leader Volkswagen by issuing 9bn, which is also a significant improvement from 1.3bn euros in 2018.

7.

Despite facing economic and regulatory challenges, the defensive European auto ABS sector maintained a strong rating profile. Over three-fourths of the issues amounting to 18.9bn euros fell under the basket of the coveted AAA/Aaa category, albeit 13 percentage points lower compared to a year ago. Meanwhile, the share of AA rated issuances recorded a significant increase of 10 percentage points to 21.7% from the previous year, a new historical high. The volumes in the same category increased sharply by 80% to 5.5bn euros.

8.

In our view, the size of the European auto securitization market is expected to shrink sharply in 2020, as new issuance activity grinds to a halt amidst the spread of COVID-19. Despite more clarity emerging on the regulatory front, the COVID-19 pandemic and its containment measures are expected to dominate the performance of the auto ABS market. With the suspension of production in the auto industry and substantial decline in consumption, we may not rule out rating downgrade pressure on auto companies. As a result, the primary market issuances that had stabilized in 2H19 is unlikely to sustain and could see new issue pipelines going dry at least until mid-2020 before starting to gain some ground in the second half. The current situation is reminiscent of 2008-09 financial crisis or even worse as the global economy enters into a recession. For the whole of 2020, total issuances could halve and fall back to levels below 15bn euros seen during the financial crisis. Nevertheless, a marked rebound remains a possibility if the corona pandemic does not extend well into the second half of the year and beyond, and if policy-makers succeed in minimizing the economic fallout.

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1. The European Car Market at a Glance

The global automobile industry continues to face several headwinds and is affected by a myriad of factors including protracted global economic slowdown, tariff disputes, Brexit uncertainty and partly by the downsizing of production as a result of the advent of the electric vehicle era. In this vein, the global auto industry plunged deeper into recession, as new auto sales dropped 4.4% y-o-y to 90.3m units after contracting 0.8% in 2018. The leading car market, China plummeted 8.2% y-o-y to 25.8m units, exacerbated by weak economic growth, trade war and elimination of subsidies. Another huge market, India, saw the passenger car sales nosedive by more than 12% to 3.5m units, the biggest drop in two decades. However, the US auto markets exhibited resilience with 17m units of sales in 2019, a mere 1.6% y-o-y decline, owing to an availability of cheap credit and healthy consumer sentiment.

Fig. 1: New car registrations in the EU ended the year on a positive note

New car registrations in million units

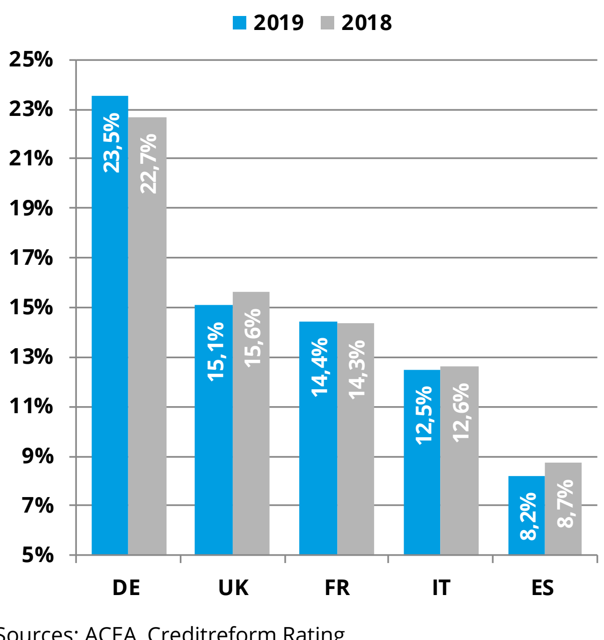
New car registration | Annual growth (rhs)

Source: ACEA, Creditreform Rating

While the global auto industry remained under pressure, some of the key European Union (EU) markets surprisingly experienced some recovery, particularly outperforming in the second half of 2019, as the effect of the Worldwide Harmonized Light Vehicle Test Procedure (WLTP) implemented since September 2018 began to stabilize, as evident from the rebound in the demand for new cars. Admittedly, a strong performance towards the end of the year resulted in the sixth consecutive year of growth with new car registrations rising 1.2% y-o-y to a record volume of 15.3m units (see figure 1).

Fig. 2: Key car markets in the EU

Percentage of market share in the EU based on new car registrations



Sources: ACEA, Creditreform Rating

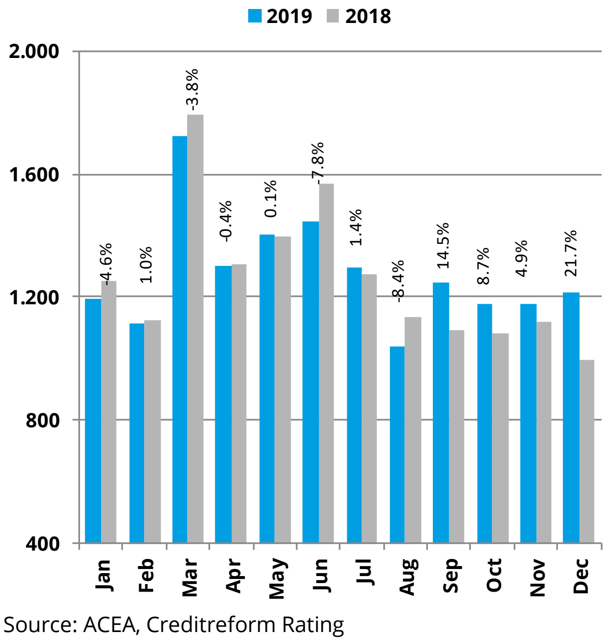
Amongst the five key markets in the EU, Germany remained a strong contender registering passenger car registrations rising by 5% in 2019, partly driven by a remarkable 19.5% uptick seen during December. Its market share improved by roughly 0.9 percentage points to 23.5% (see figure 2). Germany thus outperformed with new car registrations recording the largest increase followed by France (+1.9%) and Italy (+0.3%), while Spain

(-4.8%) and the United Kingdom (-2.4%) saw a decline in demand continuing into 2019. Accordingly, market shares expanded for Germany and France, but decreased in the UK and.

EU's auto sales growth in the second half of the year was boosted by tightening of regulatory standards on carbon dioxide emissions. The new stricter regulations, requiring a 95g/km CO2 emission target came into effect from 01 January, 2020. This had prompted the European carmakers to offer heavy discounts to destock high CO2 emitting vehicles fleet such that they would not be used in calculations for 2020. The boost was more evident in December, as car sales posted an extraordinary growth of 21.7% y-o-y partly reflecting the low base effect and an artificially created pull-forward demand (see figure 3).

Fig. 3: Strong recovery in European car sales in the second half of 2019

New car registrations in the EU, in thousand units, and yearly growth rates

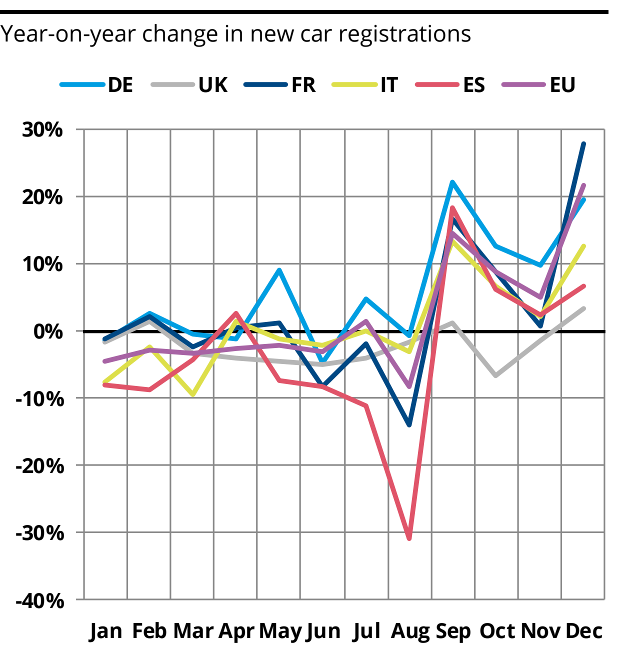


Source: ACEA, Creditreform Rating

In Western Europe, France and Germany witnessed record sales growth of 27.7% and 19.5% in December, respectively (see figure 4). In France, the increase was mainly due to significant amendments to the bonus-malus vehicle taxation scheme announced by the French government in December, which significantly influenced the purchase decisions of the French people. The two key changes into 2020 include tightening of CO2 thresholds in January 2020 to determine the bonus-malus tax such that purchasers of high emitting vehicles will need to pay significantly higher taxes and a second modification to thresholds in March to exactly reflect the CO2 emissions of a vehicle as the country shifts from the former New European Driving Cycle (NEDC) to the new WLTP. The government in its budget also earmarked a bonus, which was increased from €240m in 2019 to €400m for 2020, although remaining restricted to only battery fuel and fuel cell cars. Meanwhile, the Netherlands also demonstrated the steepest rise of +113.9% during the same month, as the government proposed to increase taxation of electric company cars from 4% to 8% effective from January 2020.

Fig. 4: Germany and France performed well in 2019

Year-on-year change in new car registrations

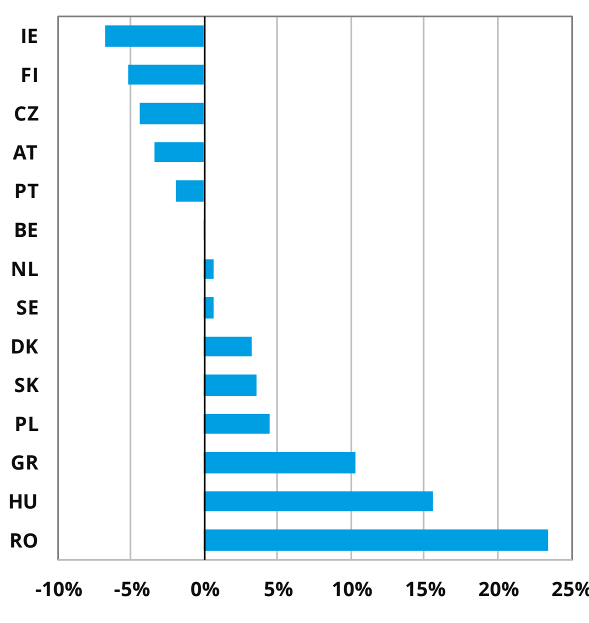


Source: ACEA, Creditreform Rating

During the year, the markets elsewhere in Europe such as Romania and Hungary outperformed with a double-digit growth followed by Greece, Portugal and Denmark (see figure 5). However, remaining countries including Austria, Czech Republic, Ireland and Finland continued to underperform.

Fig. 5: Mixed performance in other EU markets

Year-on-year change in new car registrations in 2019

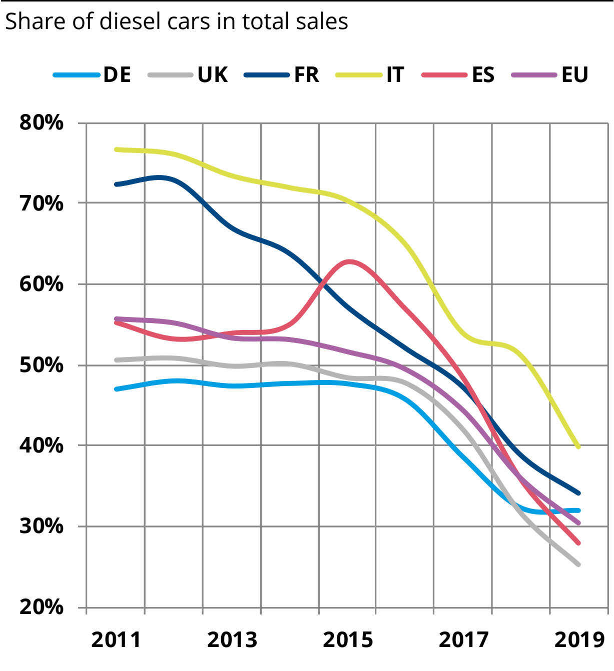


Source: ACEA, Creditreform Rating

Amid the supply disruptions and weak sentiments, Germany continued to retain its leading position in the European Union. Markedly, Germany crossed a milestone by selling over 3.5m units of cars, the highest number of new registrations since 2009. Germany's good performance in 2019 was mainly driven by a significant uptick in demand during the last four months of the year. In 2018, the final four months had been constrained by supply disruptions due to changeover to new WLTP emission regulations that left several manufacturers unable to register cars. Besides base effects, special tax breaks temporarily boosted the new car market in Germany. Of the total new car registrations, the market share of gasoline-powered cars fell to 59.2% in 2019 from 62.4% in the previous year. Meanwhile, diesel-powered cars displayed some resilience, accounting for a share of 32.0%, slightly lower than 32.3% in 2018 (see figure 6), whereas alternative fuel types finished the year on a positive note. Hybrid cars made up for a share of 6.6%, including a 1.3% share for plug-in hybrids and 1.8% share of Battery electric cars. In 2018, the market share stood at around 4%.

Fig. 6: Diesel shares across Europe slide further

Share of diesel cars in total sales



Source: ACEA, Creditreform Rating

In general, negative consumer perception and uncertainty around the diesel-powered cars was witnessed across the European market. Germany was, however, an exception, which saw a recovery in diesel car sales, but with market share merely managing to budge. This was largely due to new car sales by Germany's largest company Volkswagen (VW), which represents a market share of 35% in total. VW's diesel cars that faced issues, while undergoing WLTP tests at 2018-end were released after the necessary paperwork, as a result of which the supplies recorded an uptick in 2019. Therefore, a revival of diesel cars ap-

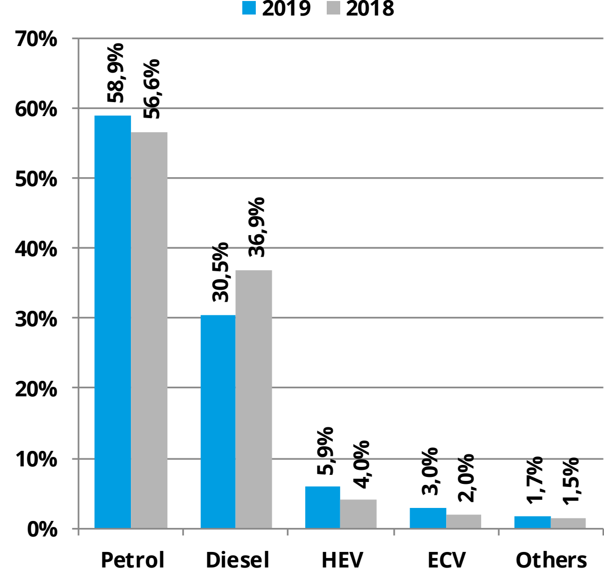
pears to be a temporary phenomenon as demand is likely to fade away with most of the governments withdrawing subsidies and unveiling plans to eventually phase-out diesel cars in the next few years. Therefore, the long-term outlook appears dim for diesel-powered cars.

In contrast to Germany, other economies saw diesel shares continuing on their respective downward trajectories. The share of diesel cars in the UK plummeted from its recent highs and attained one of the lowest figures in Europe of 25.2% for the full year 2019, which dropped further below 22% in February 2020. This was mainly after the UK government announced to ban sales of new diesel and gasoline cars from 2035 and cut carbon emissions to net-zero by 2050. Likewise, a meaningful drop in diesel car registrations in Spain cut market share by 8 percentage points to 27.9%, marking the second-lowest in EU. Meanwhile, Italy which historically represents the highest diesel car market share saw a dramatic decline of more than 11.4 percentage points to 39.8% in 2019. The share has been further compressed to 34.8% in February 2020.

The unabated fall in diesel car sales reflects a shift in attitude across markets. European governments remain determined to curb carbon emissions to protect the environment and hence, the strict regulations suggest that they have already turned against diesel cars. Besides, the industry appears to be unable to provide cleaner engines in this segment. Therefore, it can be inferred that a further drop in diesel car market share is likely to come, but at a gradual pace from current levels. Across Europe, the diesel car market share narrowed to roughly 31% in 2019 from 36% in 2018 (see figure 7). This fall was mirrored in the switch to gasoline-powered cars as their market share expanded to 59% from 57%. Meanwhile, alternative fuel-based car markets continued to represent a smaller portion, but its share also nonetheless increased nearly two-fold from 7.5% to 10.6%, with a significant uptick in demand during the second half of the year.

Fig. 7: Alternatives gaining traction

New car registrations in the EU as a percentage of total sales based on the fuel mix

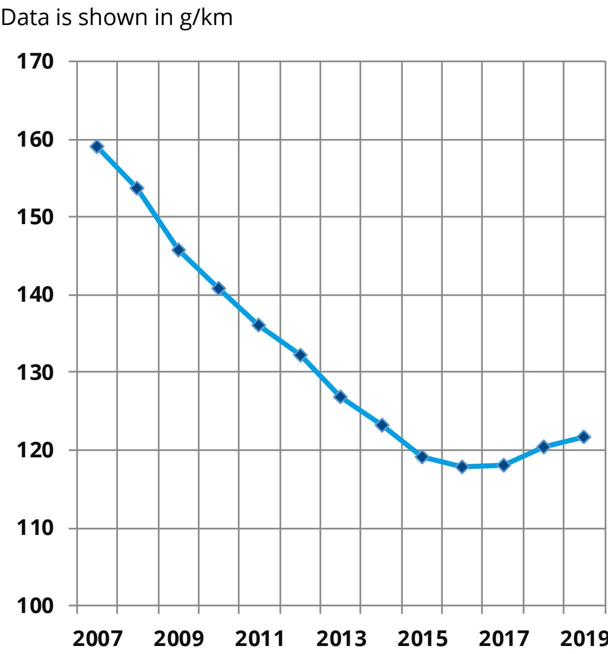


Source: ACEA, Creditreform Rating

While the volume of diesel registered cars across Europe is falling, there is a growing preference for gasoline-powered SUVs across the market. Unsurprisingly, this pivot along with low penetration of new electric cars has continued to impact the total average CO2 emissions in passenger cars, rising for the third consecutive year to 121.8g/km in 2019, i.e. 1.3g/km higher than in 2018. However, comparing the current emissions with 2015, pre Diesel-gate levels, the emissions are not significantly higher (see figure 8). On the other hand, CO2 emissions from electric vehicles (EVs) averaged at around 63.2g/km, nearly half that produced by gasoline and diesel. Yet, given the low market share, it was not sufficient to create a positive impact on overall emissions.

Fig. 8: Rise in average CO_2 emissions by passenger cars in Europe

Data is shown in g/km



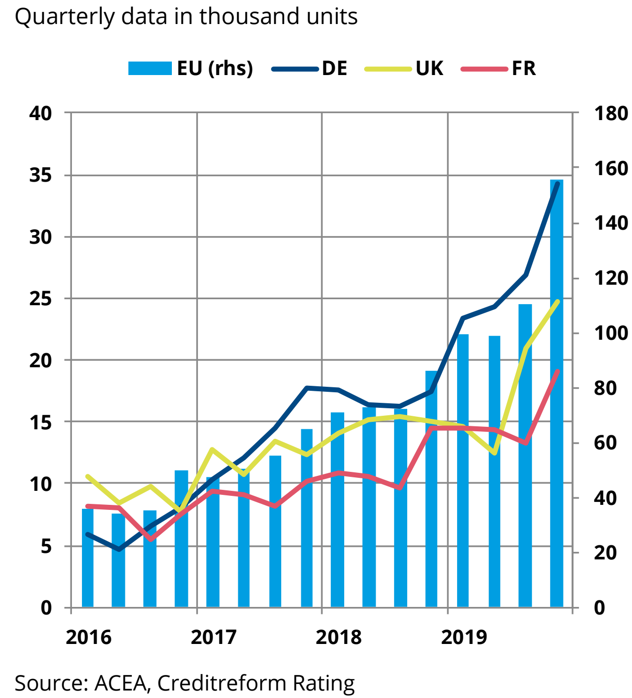
Source: JATO, Creditreform Rating

Looking ahead, carmakers are confronted with challenges abound, as the EU legislation requires them to follow tighter emission targets entering into 2020. Carmakers would be required to cut more than 22% by 2021 from 2019 levels, but individual targets vary by weight from about 91g/km to slightly above 100g/km. The current average emissions do not bode well for car manufacturers as the majority are likely to miss the targets under the new regime. For every 1g/km of CO_2 exceeding the target, a fine of 95 euros multiplied by the volume of car registrations during the year will be charged. These fines would weigh heavily on the profitability of automakers, leaving less for research and development (R&D) of EVs. Moreover, investing in profitable SUVs would increase the CO_2 emissions and very likely could not sustain the ongoing positive momentum in this segment. Hence, electrification remains the key to meet tough carbon emission targets.

Across Europe, carmakers are now overhauling electric sales strategies and simultaneously trying to eke efficiencies out of the petrol and diesel cars. Domestic investments are being scaled up into R&D with a major focus on producing low and zero-emission hybrid and electric models. European authorities have also budgeted stimulus investment packages to encourage consumers to switch to EVs. The government of the UK allocated 500m pounds to support the roll-out of a fast charging network. Likewise, the German government agreed to increase subsidies to consumers and extend the program to 2025. As per Federation of Transport and Environment (T&E), the clean transport campaign group, the number of electric models in Europe is projected to rise threefold by 2021 to 214 from 60 in 2018, providing a wider range of options to the consumers.

Fig. 9: Quantum leap in European EV sales

Quarterly data in thousand units



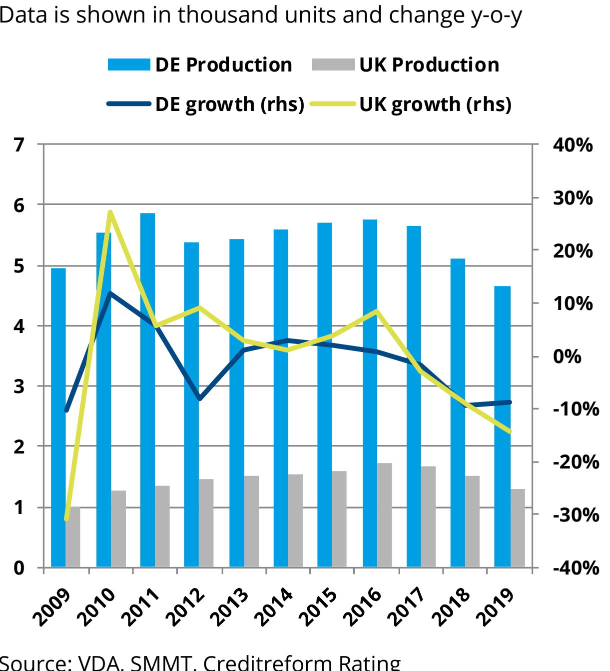
Source: ACEA, Creditreform Rating

Interestingly, Germany acquired a lead over Norway in sales of Battery Electric Vehicles (BEVs) for the first time, becoming Europe's largest BEV market in 2019 (see figure 9). The Nordic country

had sold most electric cars since 2010 with generous fiscal incentives from the government. This offers concrete evidence that the leading German automakers are preparing for a major EV shift, displaying a commitment to a cleaner future.

Fig. 10: Declining passenger car production in Germany and UK

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



Source: VDA, SMMT, Creditreform Rating

In stark contrast to an impressive recovery in domestic sales, the production disruptions cannot be overlooked (see figure 10). Headwinds undermining Germany's production of late include a combination of impending regulatory hurdles, weak global export markets and rising protectionism. German car output contracted for the second year in a row falling 8.7% y-o-y to almost 4.7m units in 2019 (2018: -9.5%), the lowest in more than two decades. However, German auto manufacturers' foreign production surpassed domestic output by more than 140% in 2019, especially with the Chinese production exceeding the domestic levels at 5.08m units. Producing abroad remains a preferred option owing to benefits from the comparative cost advantage, avoiding tariff barriers and capturing a larger pie in the local markets. Moreover, lower wages, corporate tax rates and electricity charges have further encouraged producing on foreign sites over the recent years.

However, the slump in factory output is unlikely to extend over the longer term. Germany might soon pass through the transition phase and as far as producing on foreign sites is concerned it may become challenging given the rising projectionist environment. Meanwhile, German producers are making concerted efforts to overcome the regulatory hurdles and restore consumer confidence such as to secure their global competitiveness. Undoubtedly, this year will be extremely challenging to navigate through for Germany.

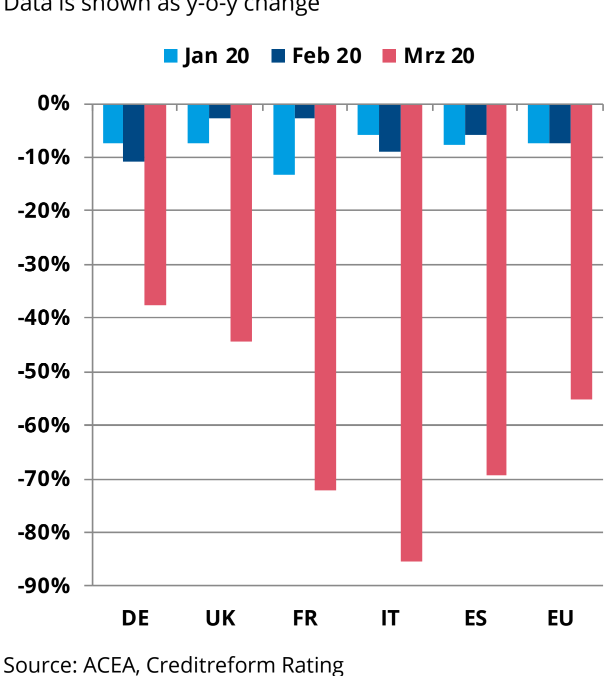
Unlike Germany, the UK failed to show recovery both on demand and supply fronts. New car registrations disappointed, contracting 2.4% to 2.3m units in 2019. More importantly, production suffered the worst decline of 14.2% since 2009 as a result of stalled investments due to Brexit. The threat of no-deal Brexit and election uncertainty had continued to inhibit prospects of the auto industry in the UK during the year. However, the Brexit consensus was finally reached in early 2020 and therefore the future of the UK auto industry now hinges on how trade relationship between EU and UK pans out. In case of any punitive tariffs or barriers, there could be a surge in prices, largely impacting export to the EU, which accounts for more than 50% of the total UK auto exports. Besides, the lack of business confidence coupled with weak demand would continue to weigh on production. Alternatively, under an optimistic scenario in which a free trade deal could be clinched with the EU, it would end prolonged uncertainty and provide a big boost to the market.

We believe the year 2020 will be extremely challenging for the EU auto industry. As the industry shifts gears, regulatory issues would certainly continue to play a dominant role more than any adverse implications from tariff conflict between US and rest of the world. However, while industry's long-term prospects are expected to strengthen with the hope of making a broader environmental impact, the short-term outlook has shockingly turned grim with the outbreak of a new form of virus termed as COVID-19.

The pandemic that spread across the world has put several countries under lockdown, which has already started impacting the supply chain in the automotive industry. The 'ground zero' of the coronavirus, China, which is also an important landmark for leading German car makers, was facing lockdown across its auto plants. In response to the concerns of the outbreak, the auto industry in the EU and US has also announced the temporary suspension of operations.

Fig. 11: Sharp decline in new car registrations due to the impact of coronavirus

Data is shown as y-o-y change



Source: ACEA, Creditreform Rating

As a result, we have already witnessed a sharp decline in sales, supply disruptions and stalled productions (see figure 11). All the European major auto markets took a significant hit with sharp decline in new car demand, led by Italy (-35.5% y-o-y), France (-34.1%), Spain (-31.0%), the UK (-31.0%), and Germany (-20.3%) in the first quarter of 2020. Registrations in Italy and France fell by approx. 85% and 71% y-o-y in March alone. Moreover, with the situation being very fragile it presents unknown operational and financial challenges. The fall in demand for new cars should further extend into 1H20.

As regards residual values of German cars, the increase in the volume of new fleet registrations created downside pressure on residual values of used cars for both petrol and diesel during the latter half of 2019. With a relatively greater supply of petrol cars, their residual values are expected to be impacted more than diesel cars. However, the outbreak of the coronavirus might bring some relief in the used car markets due to supply constraints. The temporary halt in production lines and investment cuts may reduce production capacities, affecting the supply of new cars.

On the other hand, the economic downturn would largely hit consumer spending, which would push buyers rather towards the used car markets. The demand for new cars is likely to suffer more than that for used cars during the economic downturn. Particularly, in the current scenario of corona-led economic disruption, the new car market looks vulnerable from both the demand and supply sides. As a result, the supply of new cars is set to contract in 2020, which might be beneficial to the used car markets and support the residual values. However, much remains contingent upon the severity of the pandemic and duration of the closure of production lines. As per Autovista, lower new supply in Germany will lead to a supply drop in used-car markets for

years 2022-2024 and could have a positive effect on future residual values.

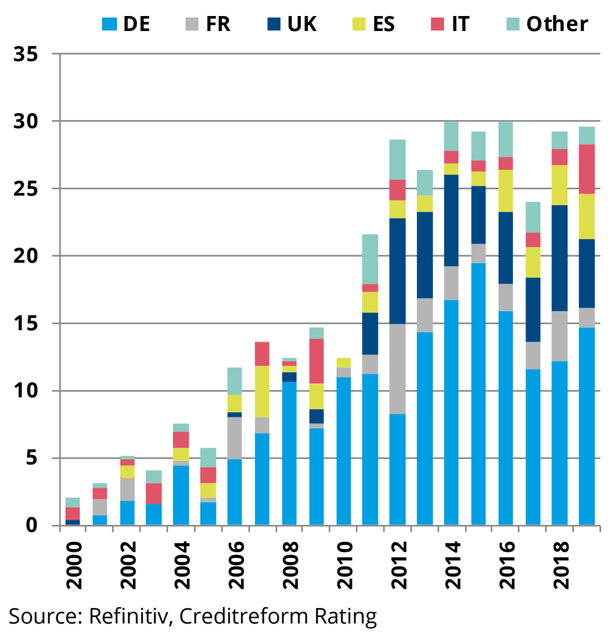
In the UK, the used car market surprisingly made a strong comeback in the second half of 2019, especially in the last quarter that helped compensate the losses suffered in the first half. The growth of 0.9% in used car sales in 3Q19 was followed by even a stronger 2.4% rise in 4Q19. As a result of this, the UK's used car sales remained firm in 2019 with 7.9m transactions (-0.1%). With the plunge in new cars amidst the economic and political uncertainty, used cars continued to benefit with both diesel and petrol versions displaying just 0.6% and 0.3% declines to post 3.3m and 4.5m changing hands during the year as per the SMMT. The demand for used alternative fueled vehicles remained expectedly stellar, evident from the growth of 23.4% and this corresponds to 1.7% of all used car sales. We note that a healthy used car market is ideally required to support residual values and considering the above backdrop, the used car market is clearly outperforming the new car market in the UK.

2. The Auto ABS Markets in Europe

The new issuance volumes in the European auto ABS market have fairly stabilized in the last couple of years after a temporary decline from the record issuances in 2016. In 2019, the issuance volumes marginally surpassed the tally of 2018 by 1.1% y-o-y to reach 29.6bn euros (see figure 12). As expected, this was mainly due to strong recovery in the second half after the volumes observed in 1H19 were the lowest in a decade primarily due to the new EU Securitization Regulation and continued Brexit uncertainty. Overall, the total auto ABS issuance in Europe stood at 341bn euros in 2000-2019.

Fig. 12: Development of the auto ABS issuance activity in Europe

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



Source: Refinitiv, Creditreform Rating

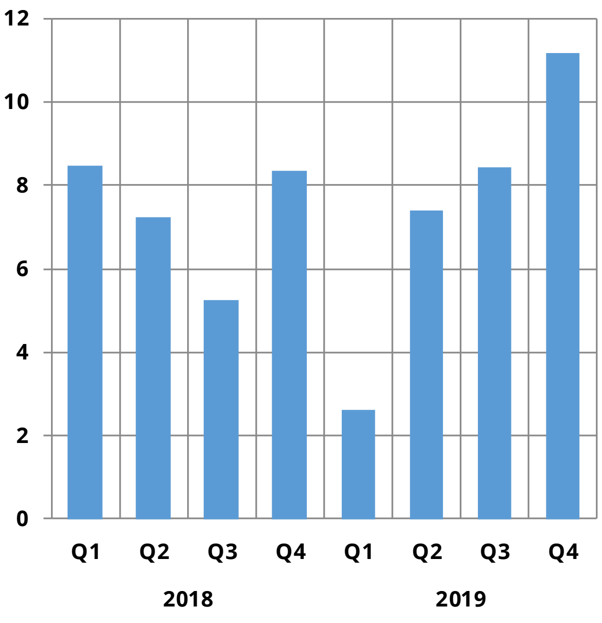
Barring France and the UK, the remaining important European markets displayed a decent growth in primary issuance volume in 2019. Germany, the largest European auto ABS market, witnessed a new issuance volume growth of 20.6% y-o-y to 14.7bn euros in 2019, in line with the increase in new vehicle registration in the country as well as the increase in Volkswagen's issuance volume. Meanwhile, Italy and Spain's issuance volume saw an increase from 1.2bn euros and 3.0bn euros in 2018 to 3.7bn euros and 3.3bn euros in 2019, respectively, partially mitigating the subdued primary activity in France. Notably, the UK's volume shrank by 34% y-o-y in 2019 but remained at a decent level of 5.2bn euros.

The launch of the 'Simple, Transparent and Standardized' (STS) regulation at the start of 2019 marked an important decisive moment in the market. After a slow start in 1Q19, STS compliant issuance activities began to pick up significantly

from Q2 (see fig. 13). Further, the issuance activity more than doubled in the 2H19, benefiting from the tight supply of primary issuances in the earlier half.

Fig. 13: Improvement in the issuance activity from 2Q19 onwards

Volume of new auto ABS issuances in the respective quarters of the year, in billion euros

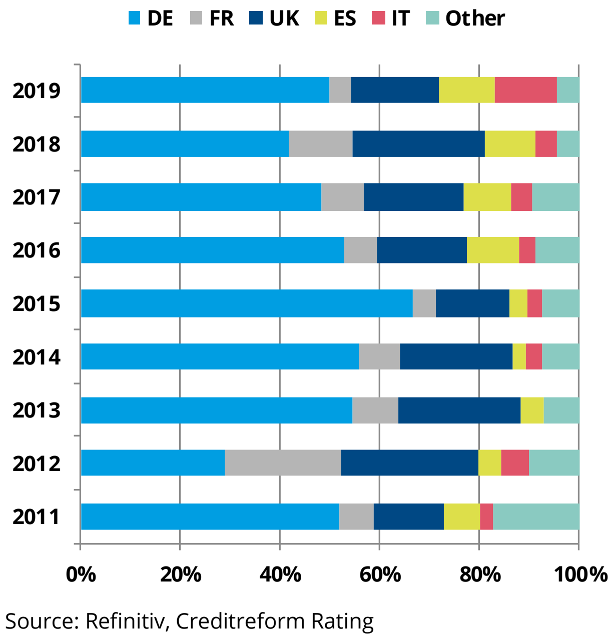


Source: Refinitiv, Creditreform Rating

Meanwhile, Germany and the UK remain the top originators of collateral in the European auto ABS market with a combined market share of roughly 67% during 2000-19, with the former capturing a large portion of around 51%. Germany was back to the business last year, accounting for half of the issuance in the EU versus just over two-fifth in 2018 (see figure 14). The share of auto ABS issuances for all the key markets has largely displayed some improvement except France and the UK. Other key markets such as Italy and Spain displayed gradual growth and contributed 12.5% and 11.2% to the European auto securitization deals in 2019, representing an increase of 8.3 and 1.1 percentage points, respectively. That said, France and the UK lost about 8.2 and 9.3 percentage points to 4.5% and 17.5% last year, respectively.

Fig 14: German collateral continues to dominate

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



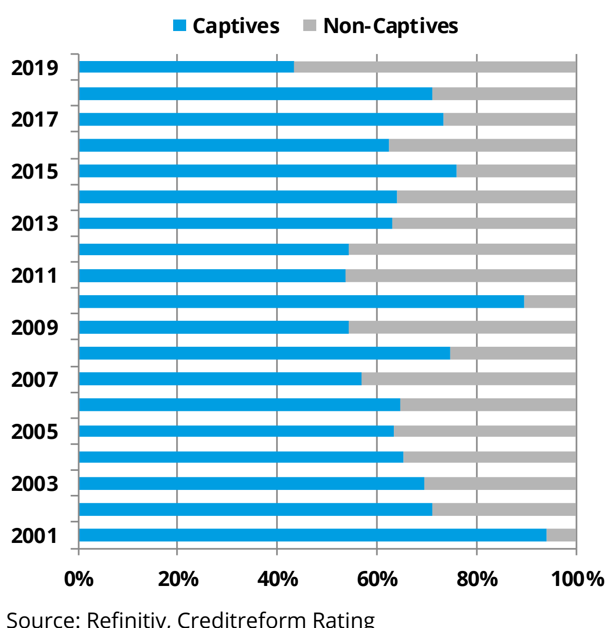
Source: Refinitiv, Creditreform Rating

3. Originators of Auto ABS

The second half of 2019 was in line with the 1H19 performance of auto ABS originators in the captive category and as expected, was dominated by the non-captive originators thus defying the historical dominance of the captives in the European auto ABS market. The captives closed the year with a total issuance of 12.8bn euros in 2019 compared to last year's issuance of 20.8bn euros (see figure 15). This corresponds to a mere 43% of the captives share in the European new auto ABS issuance volumes, representing a significant downturn from the historical average of around 70% in the last couple of decades.

Fig. 15: Captives appear to be more vulnerable to economic distress

Share in the volume of new auto ABS issues by originator



Source: Refinitiv, Creditreform Rating

Whilst the picture seems somewhat blurred by the vivid issuance activity of the non-captive Santander last year (see below), a weak macroeconomic environment has typically translated into a downturn in the automobile industry over the last decades, which appears to transmit into lower issuances from captives. Going forward, the weakness in the automobile industry is likely to persist amidst the current environment of COVID-19 pandemic, which is expected to significantly impact the automotive demand-supply chain. Therefore, the share of captives in the annual total issuance volume could remain under check in 2020, mirroring the performance witnessed during the times of financial and the European debt crises.

Despite maintaining its dominance in the captive issuance category, Volkswagen's share in the total European ABS segment plummeted to 10.8% in 2019 from 32.1% in 2018. Volkswagen raised 3.2bn euros in new auto ABS in 2019, representing a sharp decline from 9.4bn a year ago (see figure 16). Further, 1H20 is expected to be gloomy for the company on the back of suspension in production activities.

Fig. 16: European auto ABS issuances by originators

Volume of new auto ABS issuances in billion euros

Volkswagen
Santander
Renault
Daimler
Peugeot
Ford
Fiat
BMW
Other Captives
Other Non-Captives

35
30
25
20
15
10
5
0

2011 2012 2013 2014 2015 2016 2017 2018 2019

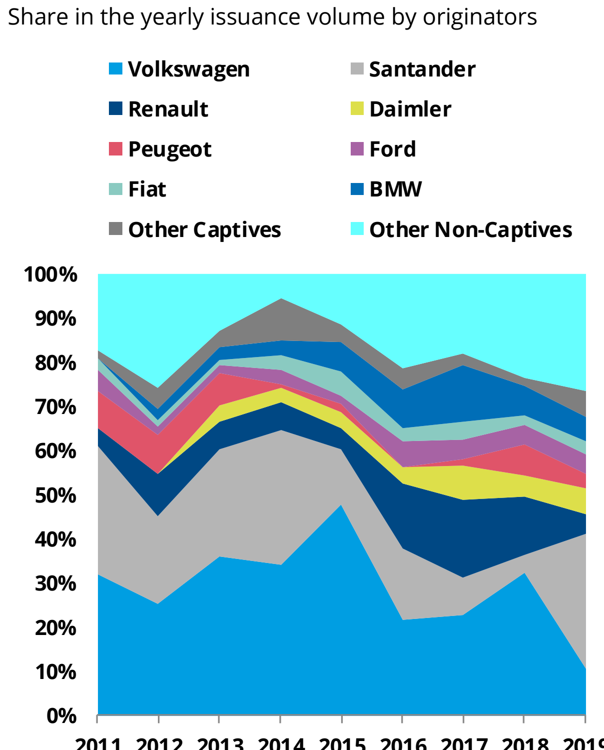
Source: Refinitiv, Creditreform Rating

On the other hand, Daimler occupied the second spot with the issuance of 1.8bn euros, followed by Renault (1.3bn), Ford (1.2bn) and Peugeot (1.0bn). Renault recorded its weakest performance in recent times with more than 50% decline in issuance activity in 2019 and substantial deterioration from its peak of 4.4bn euros in 2016. Likewise, a surprise came from Peugeot's issuance which also halved in 2019 whereas BMW's issuance volume slowed by 16% y-o-y to 1.7bn euros in 2019. Another key player, Fiat outperformed its peer with 44% y-o-y pick up in volumes to close 2019 at 900m euros. Overall, all these data points suggest weak performance by captives into 1H20.

Moving to non-captive issuances, they have continued to show improving performance in 2019, sharing about three-fifths of the total volumes issued by European originators compared to an average of around one-third during 2014-2018. Non-captives are also expanding in the used car market and have outperformed captives by around 4.0bn euros in 2019, as the volumes issued by non-captives reached an all-time high of 16.8bn euros, primarily due to strong performance by the Spanish bank, Santander.

Fig. 17: Santander outperformed the traditional leader Volkswagen in 2019

Share in the yearly issuance volume by originators



Source: Refinitiv, Creditreform Rating

The bank issued 9.0bn euros last year, reflecting 30% of the region's total volumes and a significant improvement from 1.3bn euros in 2018 (see figure 17). The performance of Santander is commendable after having observed the sluggish issuance activity over the recent of years, thus outperforming the traditional leader Volkswagen. In 2019, Santander and Volkswagen together accounted for two-fifths of the European auto ABS market. The issuance volumes by other non-captives increased by 13.6% y-o-y to 7.8bn euros in 2019, which is also the highest compared to the past few years.

4. Rating profile of auto ABS markets in Europe

Given the fragile economic condition, late credit cycle and negative real interest rates in Europe, investors have continued to move up the ladder of safe high rated securities along with the search for positive yield. In this scenario, the defensive European auto ABS sector maintained a strong rating profile, largely spread across the AAA and AA rating categories, despite facing challenges from new fuel and emission regulations.

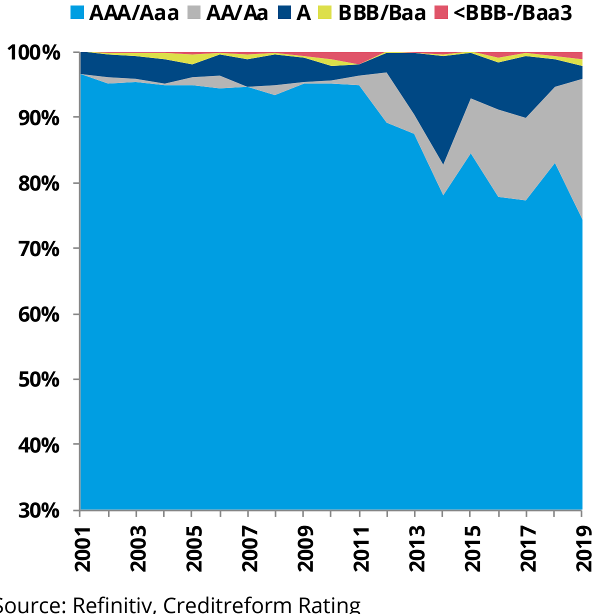
Although the European auto ABS industry saw the primary issuance volumes rated decline 3.1% y-o-y to 25.5bn euros in 2019, they were still higher than 22.2bn euros of volume rated in 2017. Of the total issuances, about 18.9bn euros were rated under the AAA category, reflecting a 13% y-o-y decline. Also, the share of AAA rated issuances in the total new ABS securities was the lowest on record, at 74.3% and 8.7 percentage points less than in 2018 (see figure 18).

Assessing the historic trend, a greater portion of the auto ABS securities have carried the coveted AAA rating, which accounts for an average of 85.9% of total issuances during 2000-2019. However, this share has declined gradually over the past few years. In 2015, around 95% of the ABS securities were rated AAA, which then narrowed down to 77.3% in 2017. However, some improvement was seen in 2018 at 82.9%. In absolute terms, the volumes of AAA-rated auto issuances were the highest at 23.1bn euros, recorded in 2015, and gradually declined to 17.1bn euros by

2017. Nonetheless, issuances in subsequent years were higher with double-digit growth of 27% and 10% in 2018 and 2019, respectively, when compared to 2017.

Fig. 18: Robust rating profile of auto ABS in Europe

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



Source: Refinitiv, Creditreform Rating

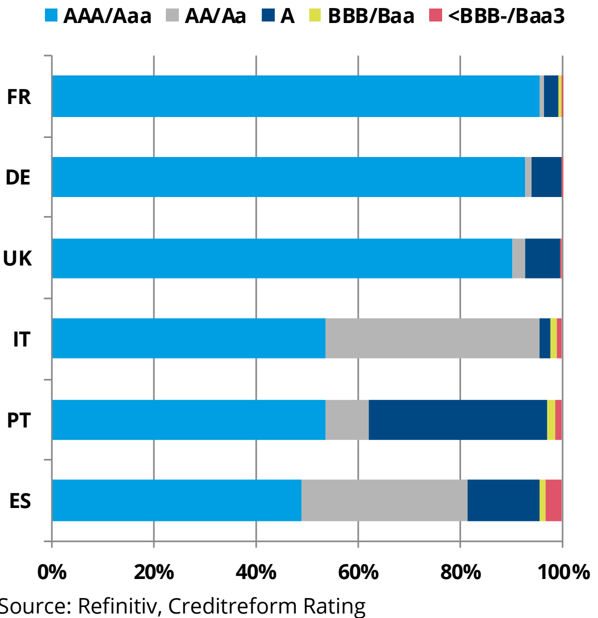
Furthermore, the share of AA rated issuances recorded a significant increase of 10 percentage points to 21.7% from a year ago, which is also historically the highest. More importantly, volumes in the same category increased sharply by 80.4% to 5.5bn euros, which is the highest since 2013.

The proportion of A rated issuances declined from 4.3% to 2.0% in 2019. The volume also more than halved closing the year at 0.5bn euros. Meanwhile, the issuance volumes in lower-rated BBB category appeared to gain traction. The BBB rated issuance was 119% higher at 25m euros in 2019. Its share in the total also increased to 1.0% from 0.4% a year ago, which is the highest so far.

As illustrated in figure 19, the rating profile differs depending on the origin of the collateral. Looking into 2019, France maintains its leading position in terms of percentage of auto ABS notes with the highest credit quality (95.5%). Competing with France are auto ABS securities backed by collaterals from Germany (92.6%), and the UK (90.1%). On the other hand, peripheral countries held a basket of notes with ratings spread across categories. Italy and Portugal both held slightly above 50% of the new issuance volumes under the triple A rated category. Italy held the largest share in the AA category in Europe at 40% of the total volume while Portugal was leading in the A rated category, comprising over 34.7% of its total issuances. Spain held slightly less than 50% of the deals under the AAA rating, followed by AA/aa that comprised 32.4% and single A with about 14.1%.

Fig.19: French auto issues followed closely by the UK and German collateral

Initial ratings (S&P, Moody's, Fitch) include class A and subordinate tranches, measured by the issue volume of all rated notes between 2000 and 2019



Source: Refinitiv, Creditreform Rating

5. Perspectives for the issuance of European auto ABS

Amidst the COVID-19 outbreak, the auto ABS performance is subject to a number of significant downside risks, which may be reflected in rising credit losses and elevated loan delinquencies going forward. These downsides are a function of a spike in unemployment levels, and more so as consumers may prioritize paying loans of mortgages over the auto backed loans with decisions being influenced by the stay-at home orders in the lockdown period. While leasing companies are actively involved in repossessing the cars, the various relief programs forced on the lenders by the governments should help soften the blow to some extent. That said, the new issue activity in the primary auto ABS market has grinded to a halt, especially with spreads widening significantly across the secondary market.

We believe that credit rating downgrades across the auto industry will be limited to speculative grade securities, while several structured credits already possess additional features covering the short and medium term stress, which acts as a cushion against default risk. Looking ahead, the backstop from the central banks to purchase some of the ABS securities combined with government related measures to protect income of consumers, should encourage auto issuers to return to the market.

Moreover, some automakers have already resumed operations of some production lines and are reframing strategies, including incentivizing and calling for scrappage schemes, to help consumers buy vehicles after the containment measures are lifted. However, the timing of the recovery of demand hinges on the spread and duration of the pandemic. We expect issuers to gradually adjust to the new trend and return with a few issuances to the market in the second quarter of 2020. Meanwhile, investors are more likely to closely monitor the health of automakers, especially their balance sheets and their recovery strategies.

Prior to the outbreak of the corona virus, more clarity on elements associated to new Simple, Transparent and Standardized (STS) requirements criteria emerged in November 2019 that had helped improve investor confidence. The Regulatory Technical Standards (RTS) pertaining to homogeneity were published in the Official Journal and entered into force in November 2019. Various other key technical standards providing implementation guidance that were still under development have also now been finalized. These RTS notifications are currently under a three-month extendable period of scrutiny by the European Parliament and Council. If no objections are raised, key standards will be published in the Official Journal and should come into force in the first half of 2020. The STS labelled securitized assets will then qualify as high quality liquid assets in EU bank’s calculation of their liquidity coverage ratio (LCR). Accordingly, the significance of STS label is likely to rise going forward.

Despite growing conviction around the regulatory standards, the COVID-19 pandemic will obviously play a pivotal role in guiding the auto ABS market performance in 2020 as it could build rating downgrade pressure on the issuers. However, the economic impact of COVID-19 and containment measures in effect is hard to gauge at the moment. The IMF acknowledged that the global economy would slip into recession, whilst highlighting a potential recovery in the ensuing year.

The shutdowns across the euro area displaced a large number of workers, typically those working in the manufacturing sector. The European automotive sector, which was already facing structural challenges, is among the most heavily hit. In response to COVID-19, big auto players including

Volkswagen in Europe shut down production facilities to contain the spread of illness. As the sales situation is expected to deteriorate in major markets, automakers have already started to downgrade their second-quarter earnings outlook. Bracing for the further impact of coronavirus, most of the automakers as a pre-emptive measure have suspended production lines to adjust volumes to a potential decline in demand.

However, we believe that it would be a matter of time before the effect of closures feeds through the supply chain. Yet, if weakness in production persists for a prolonged period, recovery would be slow to follow. With a significant increase in the likelihood of sharp downgrades in economic forecasts, credit growth would be adversely hit. Auto loans might see lower volumes and also a reduction in new auto supplies could reduce the number of underlying collaterals for offering new securities.

Nevertheless, the European Central Bank (ECB) has implemented proactive measures to contain the fallout by offering to purchase ABS securities as a part of the stimulus package. This should to some extent limit downside risks amidst challenging market conditions. ECB has also seized measures to keep borrowing costs low and added to the bond purchase scheme to prevent spiraling unemployment levels and prevent an increase in bankruptcies of business which otherwise have been sound. In an emergency response, the ECB announced a Pandemic Emergency Purchase Program (PEPP) with an envelope of EUR 750bn, on top of increased net asset purchases to the tune of EUR 120bn under the existing asset purchase program (APP) until the end of the year, along with a number of measures to provide ample liquidity, among others by offering several longer-term refinancing operations.

The aggressive measures on the fiscal front are also evident across the euro area. European governments have implemented a raft of containment measures to cushion the economies from a sharp economic downturn. The nationwide lockdown has been key for many countries to contain the spread of the virus so far. At the same time, the EU Commission lifted budgetary rules on fiscal balances, permitting governments to increase borrowings to protect household incomes and businesses.

Among key economies, Germany offered a large stimulus package, having adopted a supplementary budget of 156bn euros (4.9% of GDP) and providing guarantees worth about 820bn euros (24% of GDP). Meanwhile, the French government allocated 110bn euros to help companies and workers and also extended guarantees up to 315bn euros. Italy, the epicenter of virus in the euro area, adopted an emergency package worth 25bn euros, suspending loans and mortgage repayments for businesses and individuals and also assured funds to help firms protect incomes of workers that have temporarily lost jobs. This package is complemented by enacted Liquidty Decree which allows for state guarantees of up to 400bn euros (25% of GDP). Spain too was not immune to COVID-19. To tackle the crisis, its government seized a raft of measures totaling 134bn euros, of which 102bn is loan guarantees and 18.6bn euros are geared towards health, the labor market, social measures, and tax deferrals.

Among euro area economies, Italy appears set to be the worst hit and is further seeking help from other fellow EU member states. Fiscal support seems quite meaningful to stem the crisis, but perhaps it may not be sufficient. Deteriorating public finances look inevitable and a possibility of lower double-digit deficits in some countries must not be ruled out. However, the ECB's unconditional backstop would prove to be of the essence. In our view, the benefits of stimulus programs would take some time to start reflecting.

On the whole, we expect the euro area economy to contract by 7.2% this year, before recovering in 2021 (+5.2%). For the pivotal car market Germany, we expect real GDP to fall sharply by about 6.1% in 2020 due to the Corona pandemic and the containment measures taken to mitigate it, which more or less temporarily paralyze parts of the economy, and to rebound by about 4.8% in 2021. The lockdown has largely been extended to 03 May, albeit with some conditional loosening of measures, such as permitting retail shops of a certain size to re-open, for instance. We currently expect the adverse economic impact to be transitory, with the lion's share of the negative impact being visible in Q2, while acknowledging that it is hardly possible to fully grasp the scope of the impact at this stage. This will not only depend on the range and duration of the measures taken to combat the virus, but also on the development of effective medicines.

Fig. 20: Manufacturing PMIs weaken sharply

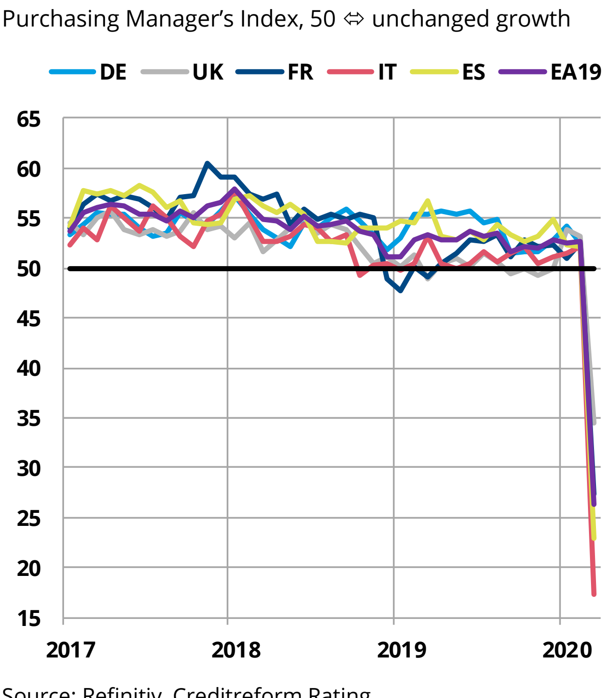
Purchasing Manager's Index, 50 ⇔ unchanged growth

Source: Refinitiv, Creditreform Rating

Assessing the current economic scenario, the effects of COVID-19 have already pushed the euro area economy into recession as data has gradually started to show up the effects of severe containment measures. More generally, the manufacturing sector remains wedged between weak investments, muted international demand and structural bottlenecks in the European economies. The COVID-19 effect has further deepened the crisis as reflected in the steepest contraction in March PMI manufacturing since 2012 (see figure 20). Output and new orders dropped the most since 2009, while employment capacities scaled back. Services sector PMIs too pointed at record contractions (see figure 21).

Fig. 21: Services PMIs in free fall

Purchasing Manager's Index, 50 ⇔ unchanged growth



Source: Refinitiv, Creditreform Rating

The economic hit from coronavirus is also sizing up in the UK. At the end of 2019, the UK economy had already entered into a broad-based stagnation as it limped through the final quarter due to heightened political and Brexit related issues. The dominant services sector, which accounts for over 80% of GDP, faltered in the fourth quarter and factory export orders contracted for the first time in a decade. Investment plans came to a

standstill and household expenditures remained sluggish. Due to COVID-19 containment measures into 2020, the UK's labor market is seeing a surge in new claimants applying for welfare payments, implying a potentially sharp increase in the unemployment rate. The UK manufacturing sector continues to experiment challenging conditions as it falls into contraction territory suggested by March PMI at 47.8. As the UK economy grapples with the virus outbreak, the government has loosened its fiscal policy strings to prop businesses and jobs. A fiscal stimulus to the extent of 18.1% of GDP, including backing for up to 330bn pounds of state loans and guarantees for struggling businesses, has been offered. The package far exceeds the 2% of GDP provided during the Great Recession.

Meanwhile, the Bank of England launched a wave of measures similar to the ECB. The bank slashed its key benchmark rate twice in March by a cumulative 65bps to 0.1% and offered to purchase 200bn pounds in bonds with a commitment for an additional buying if need be. It also introduced a new Term Funding Scheme, with additional incentive to small enterprises. In our opinion, the coordinated efforts of the government and monetary authorities to protect household income and businesses are commendable. However, its efficacy will be known only in the coming months. We see sharp setback in H1, prospectively followed by a more or less V-shaped beginning in the second half of the year, which should nevertheless result in a contraction in real GDP in 2020, coming in at -4.8%, followed by a rebound in 2021 (+4.5%).

To conclude, the primary market issuances that stabilized in 2H19 are unlikely to be sustained and could see new issue pipelines going dry at least until mid-2020 before starting to gain some ground in the second half of the year. The current situation looks likely to be reminiscent of the Great Financial Crisis in 2008-09, or arguably even worse as the global economy enters into a recession. The new issue activity in the primary auto ABS market has grinded to a halt, especially with spreads widening significantly across the secondary market. For 2020, total issuances could halve and fall back to levels below 15bn euros seen during the financial crisis in a rather benign scenario. That said, the assessment and interpretation of economic developments is significantly more difficult than under normal circumstances for the near future, as is the case for other indicators, given the current considerable economic and financial market uncertainty and the very dynamic development of the corona pandemic.

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