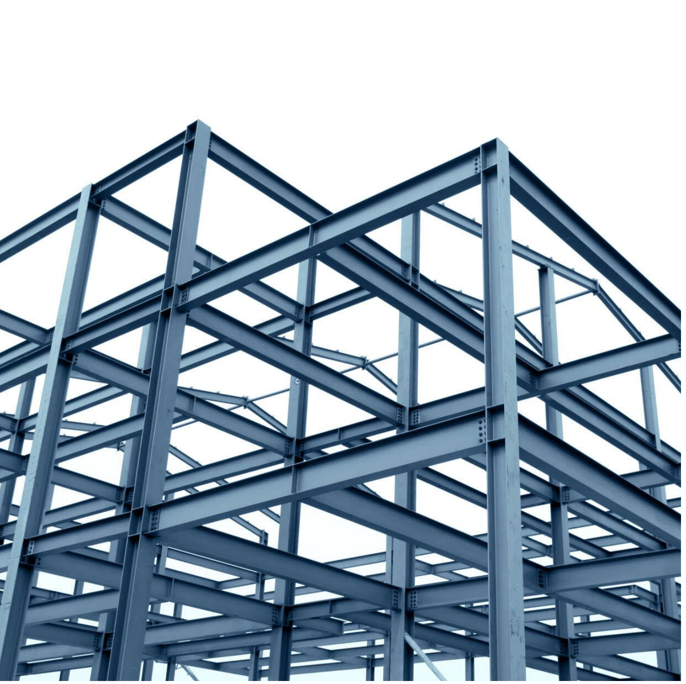
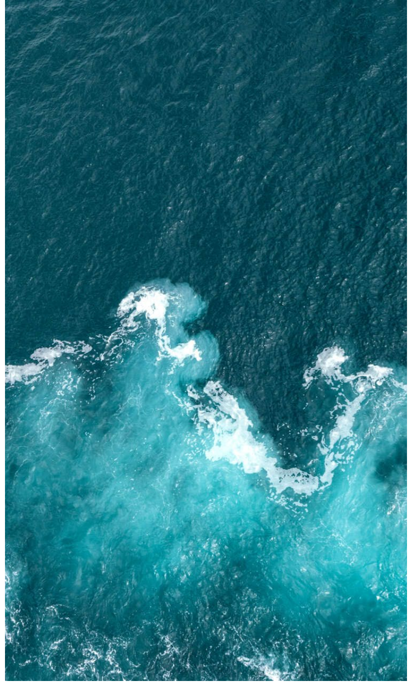
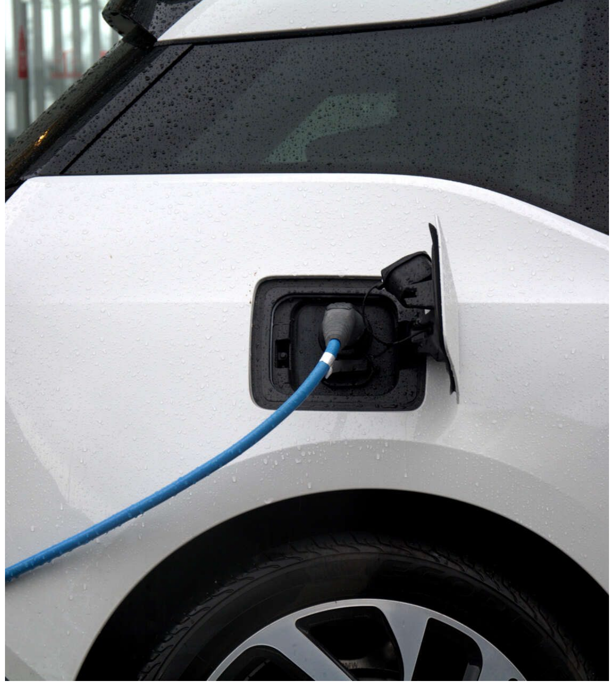





2024 Structured Finance Outlook: Australia And New Zealand

Quiet optimism amid uncertainty

S&P Global Ratings

Jan. 25, 2024

This report does not constitute a rating action

Australian Macroeconomic Environment

Looking beyond a soft landing

Sector Well Prepared For Challenges Ahead

- Most households have demonstrated resilience despite the strains on their finances caused by back-to-back rate rises and persistent inflationary pressures. Household savings, spending reprioritization, and low unemployment have saved the day.
- Despite the challenges, arrears and losses across consumer asset classes have remained low, and ratings stable, with upgrades exceeding downgrades.
- We're not out of the economic woods yet; we forecast unemployment to increase as the delayed effect of rate rises flows through the economy. This is unlikely to cause any material pressure for the structured finance sector, provided unemployment remains low.
- Low, albeit rising, unemployment will keep defaults low, underpinning our stable outlook for the Australian structured finance sector.
- Tailwinds, including the downstream effects of strong population growth, will create momentum on several fronts by increasing demand for consumer goods and housing.
- These tailwinds will help to offset the broader effects of dwindling savings, which have been eroded by rising interest rates and cost-of-living pressures. The household saving ratio is 1.1% as of Sept. 30, 2023, a far cry from its pandemic peak of 24%.
- Property price growth is still in play, but moderating, as affordability continues to be a major hurdle to many prospective homeowners. This is keeping a lid on demand, for now.
- While the cash rate is nearing its peak, we expect its decline to be gradual, keeping rates higher for longer. This will provide some relief to households, but a cautionary approach to household finances will still be a necessity for some as savings buffers are eroded.

What To Look Out For

Arrears yet to peak

We expect RMBS arrears to drift higher as unemployment rises. Arrears increases are likely to be modest while unemployment remains low.

Prepayment deceleration

The “great refinance” is moderating as the fixed-rate conversion nears its completion. We expect prepayment rates to move close to longer-term averages as refinancing competition eases.

More people, more lending

A recent population surge could propel consumer lending as recent migrants fuel demand for cars, personal goods, and houses. This will add momentum to lending growth.

New lenders emerge

Nonbanks are likely to further extend their reach into niche lending segments and more specialized product offerings as larger lenders focus on prime lending segments.

S&P Global Ratings Economic Outlook: Australia

	2024f	2025f	Outlook	Effect on credit quality
Real GDP forecast (% year over year)	1.4	2.3	We forecast weaker economic growth in 2024 because of the lagged effects of monetary policy and global economic conditions. But the general resilience of the Australian economy underpins positive, albeit weaker, GDP growth.	**Neutral.** Strong balance sheets across the household and business sectors have underpinned household resilience so far. But there is growing divergence among households, depending on income profiles and savings buffers
Unemployment rate (year average; %)	4.1	4.3	We forecast unemployment will continue to rise, but levels should remain low by historical standards and below pre-pandemic levels.	**Negative.** Strong labor market conditions have kept defaults low, but rising unemployment will put pressure on debt serviceability for some borrowers.
CPI (%)	4.0	3.3	Inflation is likely to remain high before falling back within the 2%-3% target range in 2026.	**Negative.** Inflationary pressures erode real income. This affects lower-income households disproportionately. Inflation's stickiness will dampen household budgets. This is more likely to affect prepayments than arrears.
Policy rate, end of year (%)	4.1	3.35	Interest rates are likely to remain higher for longer as returning inflation to its target range could take longer than initial expectations, given inflationary stickiness.	**Negative.** The higher variable-rate exposure across the RMBS sector means it is more sensitive to interest rates. Low unemployment should temper the transition from arrears to default.

f--Forecast. CPI--Consumer price index. Source: S&P Global Ratings.

Australian RMBS Outlook

Resilience underscores “relative value”

Australian RMBS Performance Outlook

- Mortgage arrears defied expectations in 2023. Prime arrears have increased from their historic pandemic low of 0.58% to their current level of 0.91%. While arrears are yet to peak, we do not expect them to increase materially from their current levels.
- This resilience has been underpinned by low unemployment, savings buffers (for some), and an abundance of refinancing opportunities. Borrowers also have been prudent in curtailing expenditures to service their debts.
- This resilience will be tested in 2024, with the household saving ratio now around 1%--a far cry from its pandemic peak of 24%.
- Cumulative gross losses across most vintages remain low and are unlikely to increase significantly above these levels, given the sector's modest LTV profile and our expectation of moderate property price growth of around 4% in 2024.
- We expect prepayment activity to slow to a long-term average of 20% (for prime) as fierce competition by banks for borrowers looking to refinance their expiring cheap fixed-rate home loans subsides. Falls in nonconforming prepayment rates are likely to be more pronounced, given these borrowers are likely to face tougher refinancing conditions.
- This will close some of the gap between bank and nonbank prepayment rates, which diverged by more than 10%--even higher for some transactions , as nonbank borrowers refinanced onto competitive home loans offered by banks.
- While we expect unemployment to rise, forecast increases are still below pre-pandemic levels. Modest property price growth also affords existing homeowners' greater agency in self-managing their way out of any financial stress.
- These factors will enable most households to remain current on their mortgages. Ongoing cost-of-living pressures and depleted household savings will add further strains to household budgets for a small proportion of borrowers who are more highly leveraged. For these borrowers, property price growth will help to curtail potential losses.

Predicting Arrears Movements

Q4 2023	Q1 2024	Q2 2024	Q3 2024	Q4 2024	Q1 2025

Prime arrears around long-term averages at 0.91% as of Nov. 2023. Nonconforming arrears at 3.65%

Arrears are likely to continue to drift higher as unemployment rises. Increases will be tempered by modest falls in rates (forecast later in the year) and property price growth

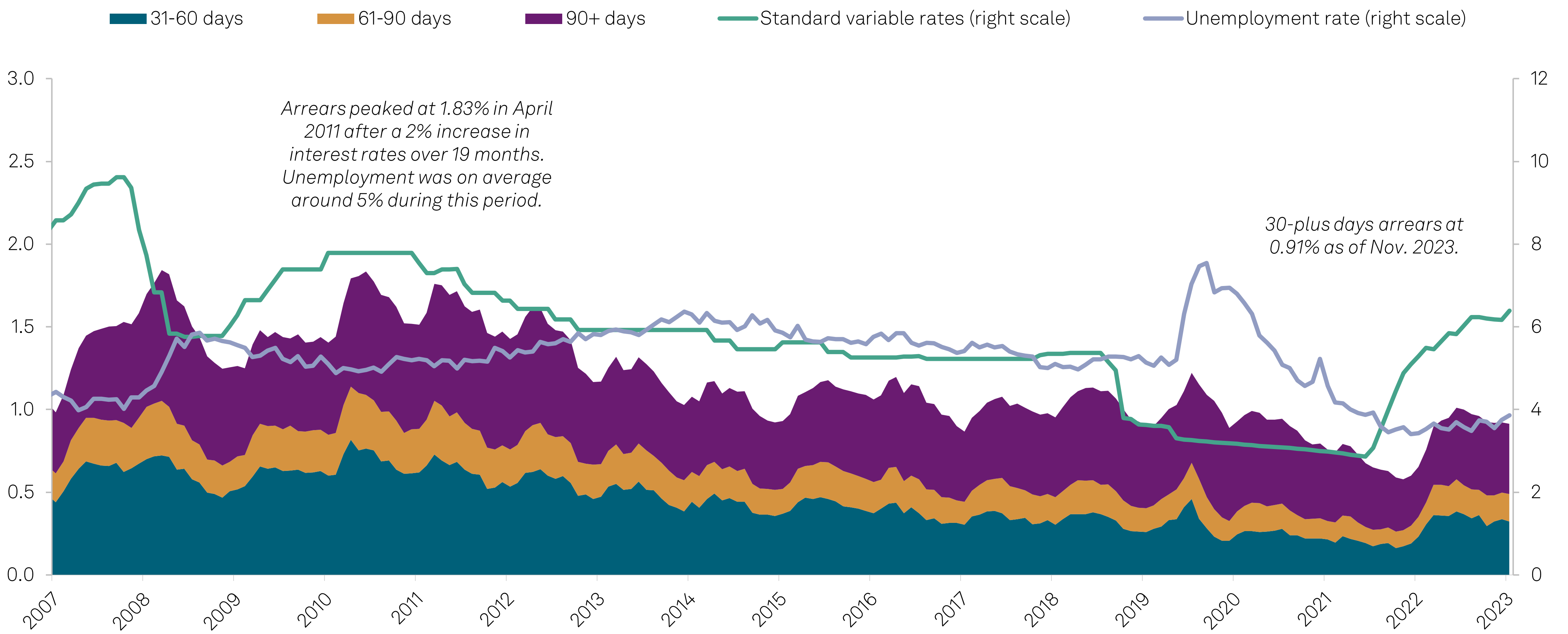
Since May 2022, the cash rate has increased by over 400 basis points **to 4.35%**

Rates on outstanding mortgages during this period have increased around **3.10%***

We forecast unemployment to increase to an average of 4.1% in 2024 and 4.3% in 2025. We expect the cash rate to decline to 4.1% by year end. This gradual decline will alleviate debt serviceability pressures, but this will be offset by rising unemployment

*This is based on variable lending rates for outstanding owner-occupied mortgages, all institutions (latest period available Oct. 2023). Sources: Reserve Bank of Australia. S&P Global Ratings.

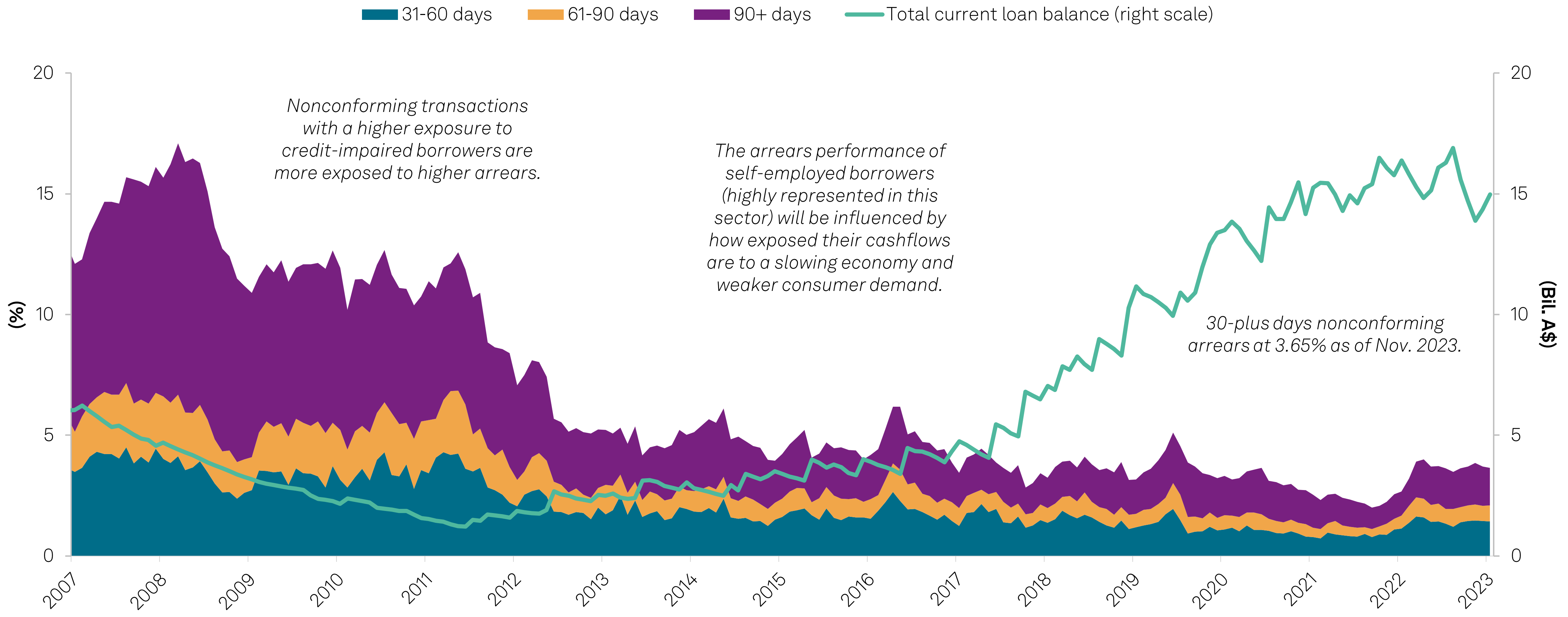
No Sign Of Material Stress As Prime Arrears Rise (%)



Prime data SPIN shown excludes noncapital market issuance transactions. Prime RMBS arrears exclude noncapital market issuance transactions. Sources: Reserve Bank of Australia. S&P Global Ratings.

S&P Global Ratings

Nonconforming Arrears Steady As Property Prices Rise



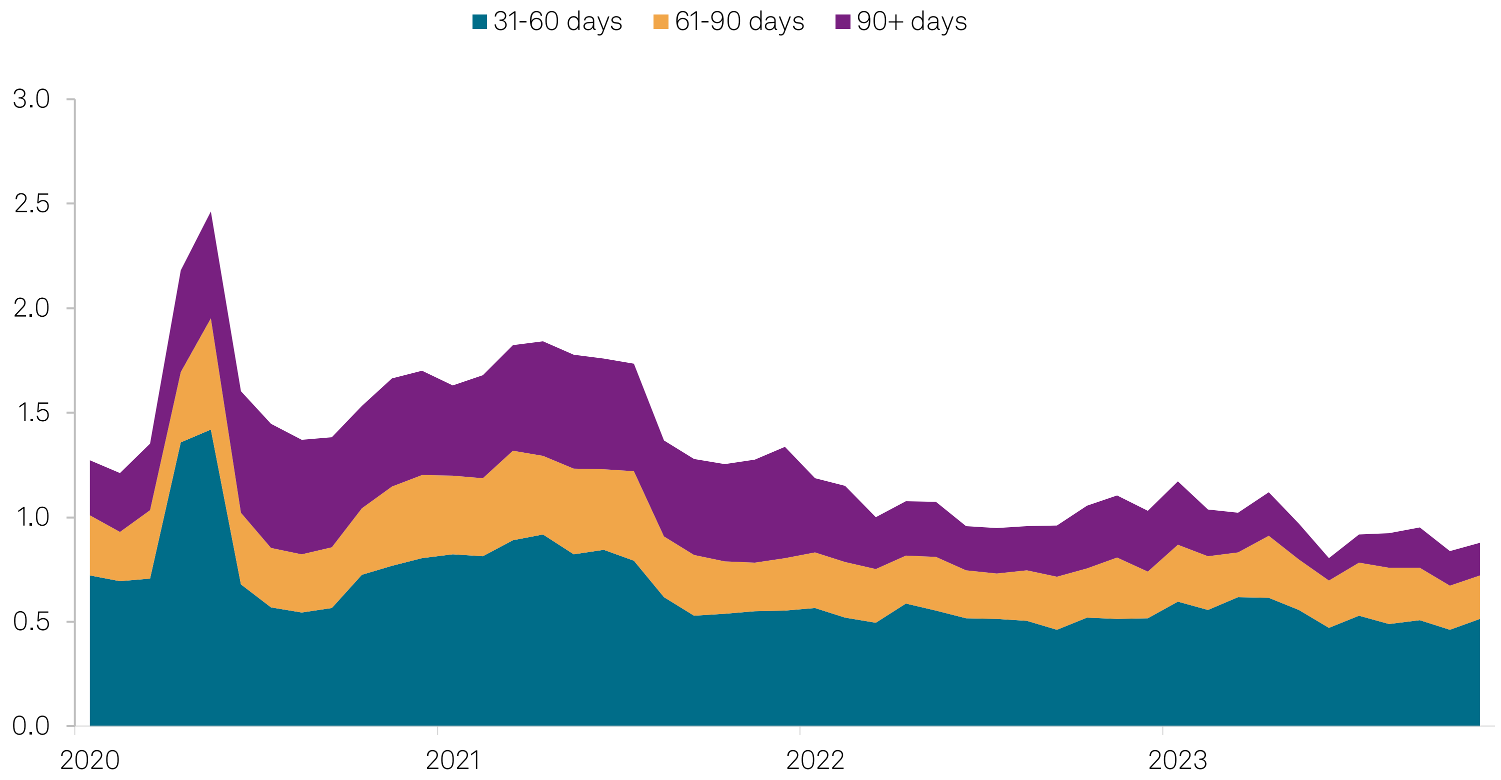
Bil.--Billion. A$--Australian dollar. Source: S&P Global Ratings.

Australian ABS Outlook

Better than expected

Auto ABS Arrears Steady

Australian auto ABS SPIN (%)



Arrears

The Standard & Poor's Performance Index (SPIN) for Australian auto asset-backed securities (ABS) and mixed auto pool arrears increased in November. The SPIN rose to 0.88% from 0.84% a month earlier. Arrears overall remain low. We expect arrears to increase moderately into the early part of 2024 due to "higher for longer" interest rates, seasonal holiday spending, and the increased cost of living pressuring consumer budgets.

Ratings Outlook

Stable. Senior tranches are benefitting from the buildup of credit support. Structural features are also enhancing ratings stability in many transactions.

The Australian auto ABS SPIN comprises closed pool transactions in which the receivables in the underlying asset pools are secured 100% by motor vehicles or mixed pools in which most are backed by motor vehicles. Mixed pools may include some equipment or leisure-type assets such as caravans. The Australian auto ABS SPIN measures the weighted average of arrears more than 30 days past due on receivables in publicly rated, closed pool, Australian ABS auto and mixed pool transactions. The indices identify the proportion of loans 31-60 days, 61-90 days, and 90-plus days in arrears. S&P Global Ratings calculates the SPIN monthly, using information provided by the issuers of ABS transactions.

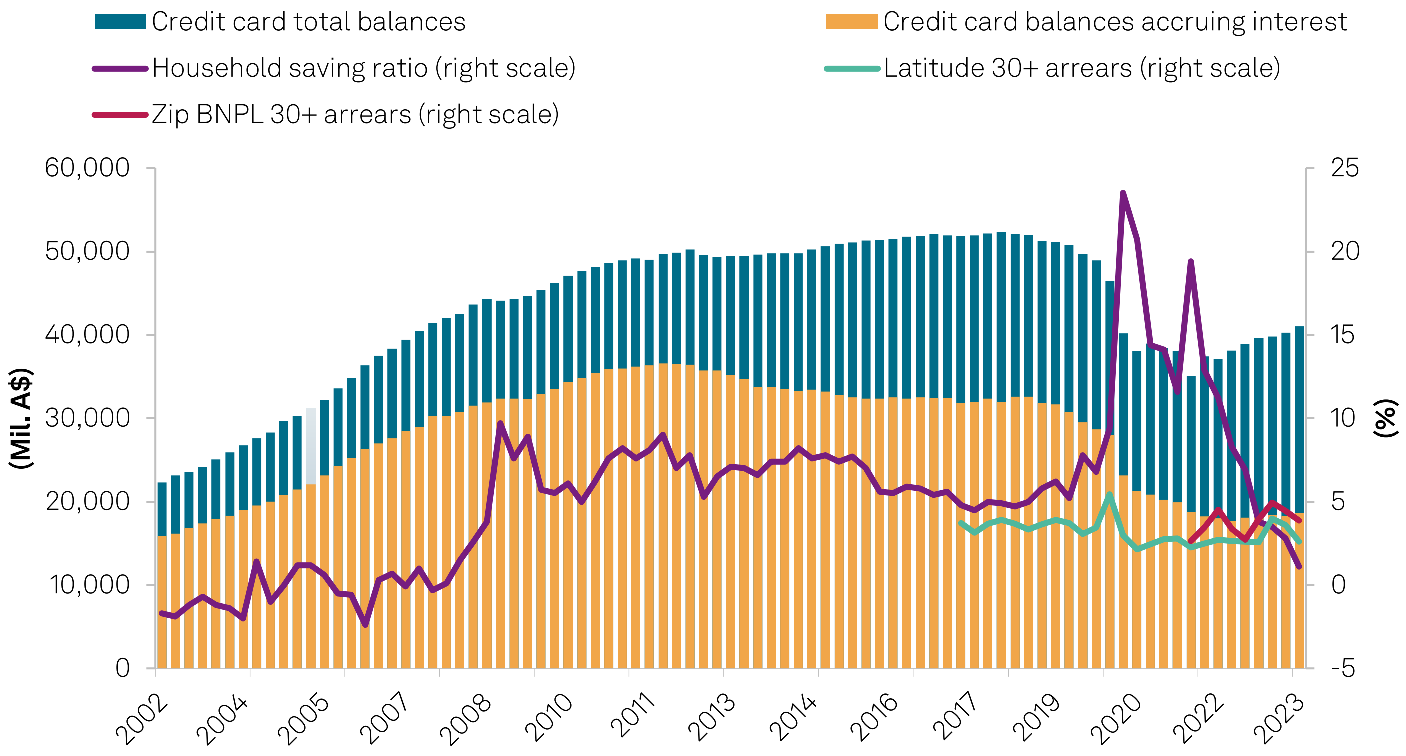
Source: S&P Global Ratings.

Australian ABS Performance Outlook

- Low unemployment has kept defaults low and ratings stable for ABS transactions. Our forecast of low but rising unemployment underpins our stable outlook for the sector.
- The higher prevalence of fixed-rate loan contracts in the auto ABS sector has also provided a hedge against inflationary and rising interest rate pressures.
- Given the greater heterogeneity of many auto ABS transactions--they often comprise auto, equipment, light commercial and other loans--performance can vary across issuers, reflecting the differences in portfolio composition.
- The absence of more prescriptive regulatory guidelines around underwriting for auto loans means that lending standards are generally less uniform than the mortgage market, where there is close alignment between regulatory guidelines and lending policies.
- Small ticket CMBS have been largely resilient to rate rises and the collapse of several construction companies. Rising property prices across commercial and residential portfolios have minimized losses.
- But the sector is more highly correlated to the construction sector, given the high obligor exposure to the construction industry in many of these transactions.

Unsecured Consumer ABS Holding Up Surprisingly Well

Credit card balances rise as savings fall



Sources: Reserve Bank of Australia, Australian Bureau of Statistics, S&P Global Ratings.

- Unsecured consumer credit transactions have demonstrated a reasonable level of resilience in this tightening cycle.
- Despite the higher credit risk associated with these loans, arrears have remained low across most transactions due to low unemployment.
- Arrears spiked temporarily across Latitudes securitizations following a cyber attack. Collateral performance has since normalized, with arrears now trending around long-term averages.
- Total credit card balances have ticked up as the household savings ratio declines.
- We expect this to continue while cost-of-living pressures and higher interest rates prevail because some households rely on credit more to pay expenses.
- Despite these headwinds, low unemployment will keep arrears in check and ratings stable for most transactions.

Ratings Movements

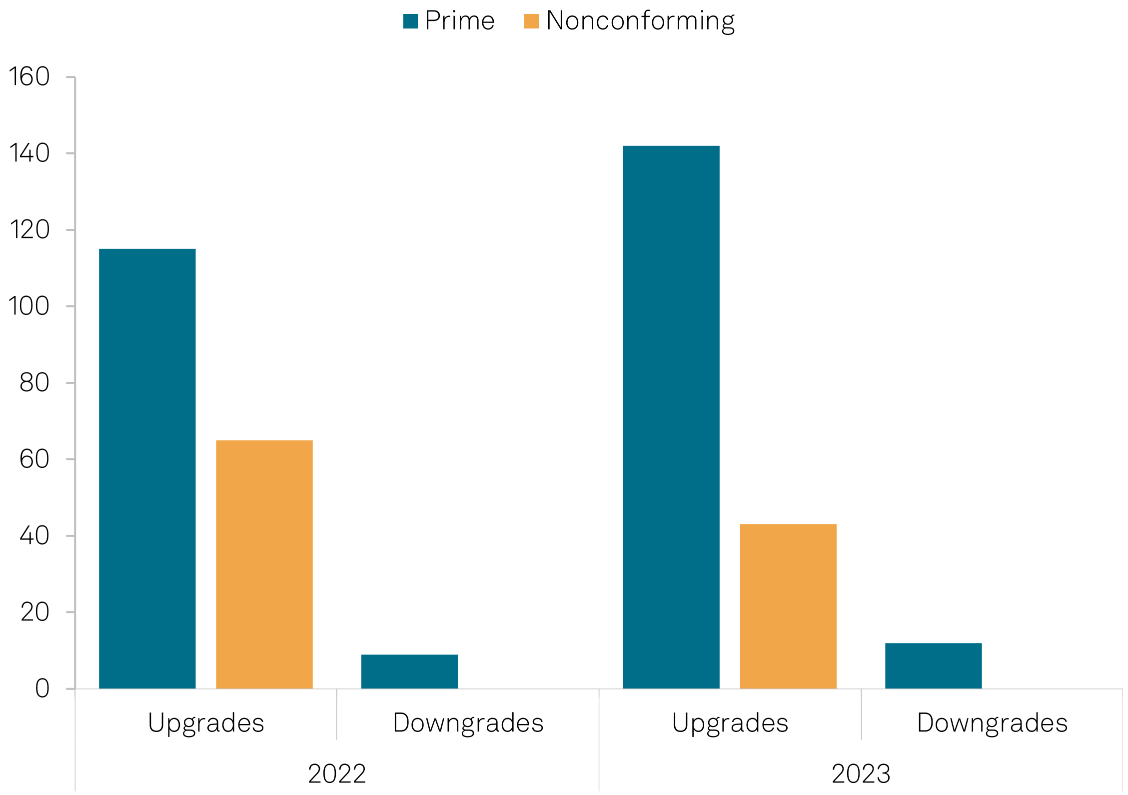
Upgrades in 2023 again exceed downgrades

2024 Ratings Outlook

- Forecasts increases in the unemployment rate could slow the rate of upgrades for some transactions as more subdued economic activity weighs on debt serviceability for some borrowers.
- Despite a rapid rise in interest rates, there have been no rating downgrades due to collateral deterioration. We expect this to continue in 2024, given the structural supports in transactions and ongoing credit support build up.
- We expect credit support build up to slow in 2024 as prepayment rates trend lower toward long-term averages.
- Ratings upgrades exceeded downgrades in 2023, and the number was higher than in 2022 for prime RMBS and ABS, but lower for nonconforming RMBS.
- Ratings downgrades were all in the prime RMBS sector. These pertained to transactions that are now small pools with increased borrower concentration and tail-end risk.
- Ratings upgrades were due to a buildup in credit support and stable collateral performance. Higher prepayment rates in many transactions accelerated credit support buildup, particularly for nonbank transactions.
- There have been no rating defaults recorded for Australian RMBS ratings since its inception.
- The deleveraging in RMBS structures due to the initial sequential pay period creates a positive rating bias for lower tranches as credit support builds, provided asset performance is stable. Structural features such as reserves that trap excess spread add more support and this can enhance positive rating bias.

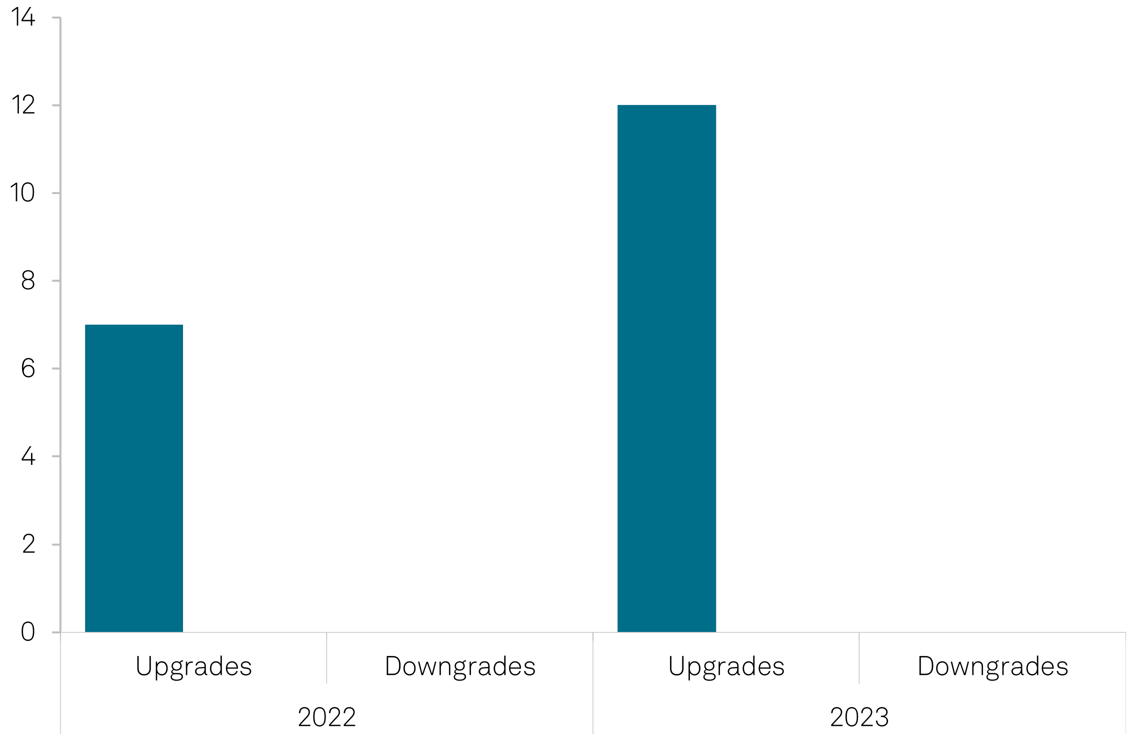
Rating Bias Remains Positive; Pace Likely To Slow

RMBS: Number of upgrades vs. downgrades



Source: S&P Global Ratings.

ABS: Number of upgrades vs. downgrades

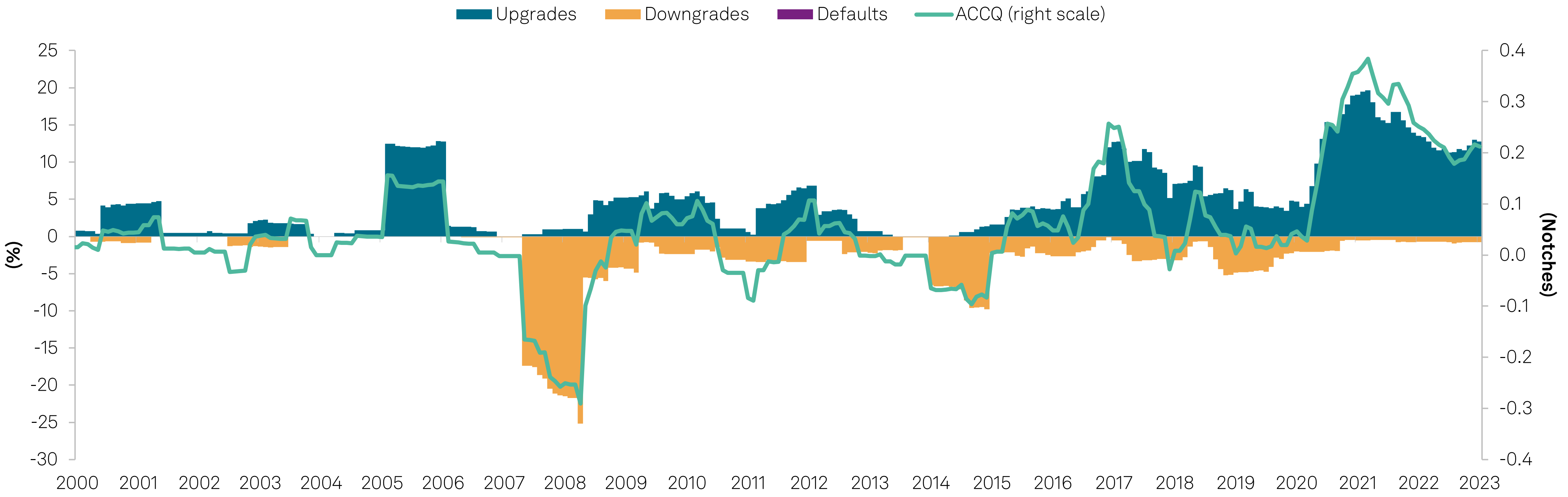


Source: S&P Global Ratings.

RMBS Ratings Demonstrate Positive Rating Bias

Average change in credit quality

Trialing 12-months ACCQ RMBS



ACCQ--Average change in credit quality. Source: S&P Global Ratings.

New Issuance

Momentum will build as the end of rate rises nears

2024 New Issuance Outlook

- We expect total new issuance in Australia for structured finance, to increase by around 5% in 2024 off the back of a strong finish in 2023, with new issuance levels reaching over A$52 billion, a post-financial crisis peak.
- We are forecasting only modest (single-digit) growth in global structured finance issuance volume to roughly $1 trillion in 2024. Regulations, mainly in the form of Basel IV, have the potential to sway issuance volumes, alongside interest rates.
- Issuance in Australian in 2023 was buoyed by sustained global and domestic interest, reflecting the sector's longstanding "relative value" credentials.
- While a "higher for longer" interest rate policy will weigh on affordability for new home loans, low unemployment and renewed demand for housing will see mortgage lending continue.
- Combined with structural shifts in the auto sector, this is likely to keep structured finance new issuance on the go in 2024.
- Sustained issuance will be underpinned by the predominance of nonbank originators in this market and their reliance on securitization.
- With the cessation of the term funding facility, ADI issuance is likely to pick up from its pandemic hiatus, but nonbank issuance will continue to be the main event.
- Banks' increased focus on prime lending will see nonbanks continue to expand their footprint into specialist and more niche lending products.

2024 New Issuance Outlook Continued...

- The bulk of new issuance in 2023 was RMBS. But ABS issuance gathered pace, with auto and equipment ABS issuance more than doubling from the previous year.
- This reflects structural shifts in the auto lending space following large banks' withdrawal from auto financing.
- This has created a unique opportunity for nonbanks to fill the void, resulting in several nonbank auto ABS issuers coming to market in 2023.
- Australian automotive sales had a strong year in 2023, with over 14% growth (year over year). S&P Global Mobility forecasts automotive passenger sales to increase by around 2.3% in 2024 (year over year), given the expected moderation in economic growth as unemployment rises.
- Despite this slowdown, we expect auto ABS issuance to maintain its momentum as the proliferation of new and established auto ABS issuers fosters a regular issuance cadence to fund growing auto loan portfolios.
- This will help with benchmark pricing alongside a track record of consistent performance by regular issuance.
- Unsecured consumer lending also marked its presence in 2023. Given the higher credit risk associated with this type of lending, we expect new issuance for this burgeoning asset class to gather momentum once the cash rate is on its way down.

2024 Global Structured Finance Issuance Forecasts

2024 forecast vs. 2023 actual

CANADA
US$9 bil.
↓ 18.2%

UNITED STATES
US$547 bil.
↑ 7.3%

LATIN AMERICA
US$29 bil.
↑ 11.5%

EUROPE
US$104 bil.
↑ 6.1%

CHINA
US$264 bil.
- 0%

JAPAN
US$39 bil.
↓ 2.5%

AUSTRALIA
US$33 bil.
↑ 5.0%

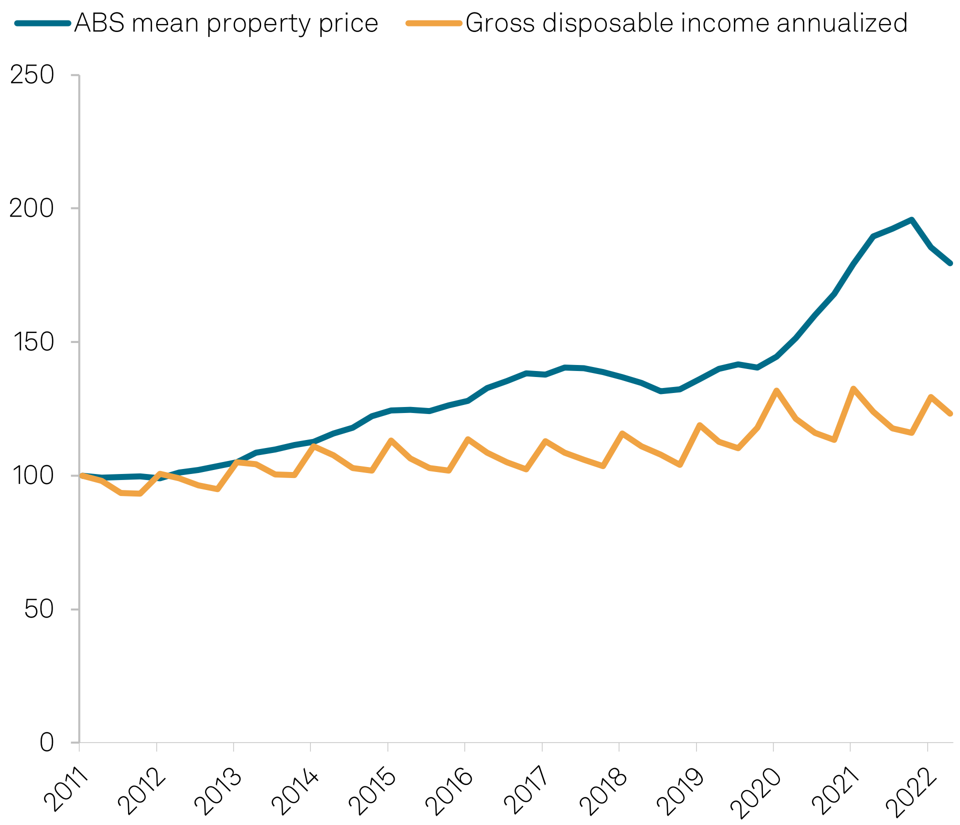
Source: S&P Global Ratings. Note – Australian new issuance figures for 2023 are as at Oct. 2023.

In Focus

Housing affordability, EVs, and wild weather

Housing Affordability

Income versus property price growth (Index: 2011 = 100)



Sources: Australian Bureau of Statistics. S&P Global Ratings.

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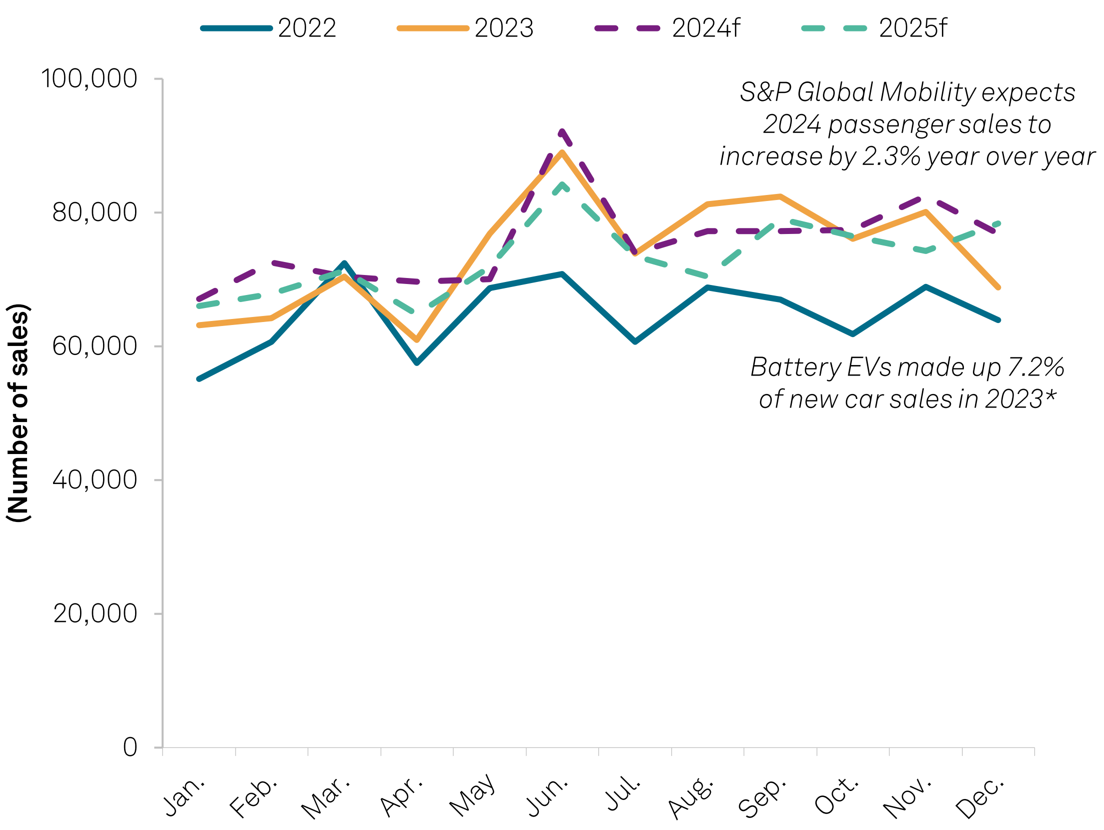
- Residential property price growth has outstripped income growth for some time, but the gap has widened since the pandemic.
- Housing supply has failed to keep pace with demand for housing due to high construction costs, labor shortages, tough financing conditions, and bad weather.
- These imbalances are unlikely to improve anytime soon, with recent record population growth occurring amid acute rental shortages.
- The anticipated reduction in interest rates could add further buoyancy to property prices by easing hurdle rates for housing finance and boosting market sentiment again.
- These dynamics will put home ownership increasingly out of reach for many younger borrowers by pricing them out of the market.
- High property prices relative to income add to economic imbalances, which are elevated in Australia given its high household debt.
- Wages in Australia tend to be stickier than some other countries, such as the U.S. We expect wage growth to continue in 2024, though moderating.

EVs Make Inroads In Car Sales

Car Sales 2022-2025



*Based on Federal Chamber of Automotive Industry Data. f--Forecast. Source: S&P Global Mobility.

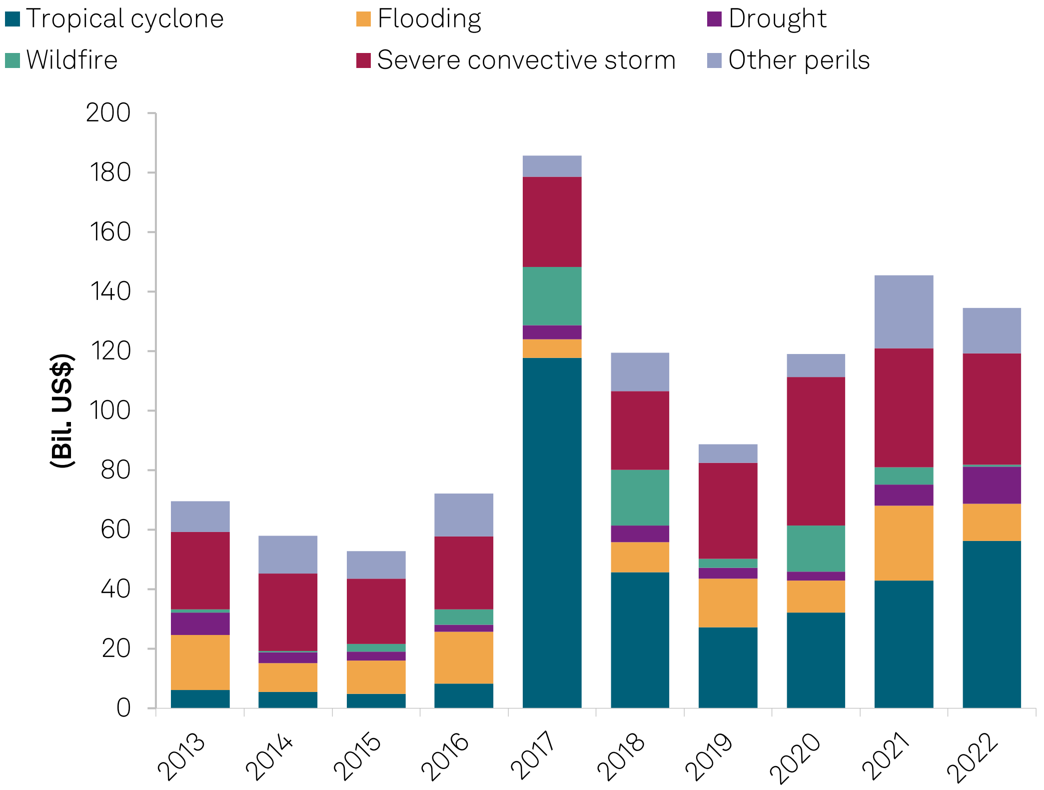
- S&P Global Mobility expects the global EV share of light vehicle sales to rise to between 39% and more than 50% in 2030, from an estimated 17% in 2023*.
- Battery electric vehicles accounted for 7.2% of new car sales in Australia in 2023, according to the Federal Chamber of Automotive Industries .
- The increasing penetration of EVs in new vehicle sales will see more EVs in future auto ABS transactions.
- The fringe benefits tax regime in Australia has also incentivized EV take up through novated leasing channels.
- Concerns over EV battery health, charging infrastructure, and the range of older EV models are hampering consumer demand for used EVs in some markets.
- This may influence residual values for EVs in the short term.
- We expect this trend to change in the coming years as more EV models enter the market and consumer confidence increases.

See: "The Journey To EV Adoption", Look Forward, Funding the Future, Volume 4, January 2024

Wild Weather

Rising global insured losses leading to changing insurance coverage

Tropical cyclones remains primary climate hazard underpinning losses



Source: Aon PLC.

- Australia's recent wild weather has seen many parts of the country affected by cyclones, floods, and fires this, Summer.
- Given the geographic diversity of most RMBS transactions, these events are unlikely to cause ratings pressure.
- Adequate insurance coverage is a key loss-severity risk for weather-related events in RMBS transactions.
- Property insurance is a perquisite for loan approvals, but risks over insurance currency and amount of insurance coverage remain.
- This risk is coming into sharper focus, given the rising cost of insurance premiums and higher building replacement costs.
- Rating mitigants include geographic diversity, credit support and liquidity features to help alleviate cash flow pressures caused by higher arrears following natural disasters.
- Adaptation strategies to minimize property losses include better land-use planning, improved building codes, and increasing the resilience of existing buildings.

New Zealand

Inflationary pressures persist

Strong Population Growth Could Add To Inflationary Pressures

- Higher interest rates are reducing aggregate demand. But inflation is still above its target band, keeping rates higher for longer.
- Nontradable inflation is easing gradually. While core inflation is on its way down, it is still elevated.
- Population growth has eased demand for labor, but the effects on aggregate demand could add to inflationary pressures.
- House prices are stabilizing with strong immigration and rising disposable incomes, offset by higher debt servicing costs.
- Credit demand remains subdued due to higher interest rates. The Reserve Bank of New Zealand expects the share of disposable income going to debt servicing to increase to 19% from 15% currently as mortgage rates continue to rise.
- Despite the risks, arrears and losses remain low in the New Zealand RMBS sector.
- New issuance has been more of an ABS affair, with only one RMBS transaction issued in New Zealand in 2023.
- Higher interest are likely to weigh on credit demand as affordability becomes a higher barrier for many prospective homeowners, potentially restricting new RMBS issuance in 2024.
- Subdued consumer spending due to higher interest rates may also slow ABS issuance. But the short tenors of ABS securities means a more frequent cadence of issuance is possible.

S&P Global Ratings Economic Outlook

	2024f	2025f	Outlook	Effect on credit quality
Real GDP forecast (% year over year)	1.4	2.5	Higher interest rates are dragging on consumer demand. This is being offset by high net migration	**Neutral.** Slower economic growth is being buttressed by strong labor market conditions, helping to keep arrears and defaults low.
Unemployment rate (year average; %)	4.9	4.7	Labor shortages persist, but positive net migration is helping to fill labor gaps.	**Neutral.** Low unemployment is credit positive because loss of income is a key cause of mortgage default. Higher interest rates will cause unemployment to rise, though off low levels.
CPI (%)	3.5	2.6	Inflation is sticky. We do not forecast inflation to return to its target range until 2025.	**Negative.** Higher inflation erodes real wages. Wage increases will support debt serviceability, but this will be offset by rising mortgage rates.
Policy rate, end of year (%)	4.75	4.0	The Reserve Bank of New Zealand in May 2023 raised the cash rate to 5.5%, where it has remained.	**Negative.** New Zealand's higher exposure to fixed-rate loans indicates that the adjustment to higher rates still has some way to go. Rising interest rates can put pressure on arrears for more highly indebted households.

f--Forecast. CPI--Consumer price index. Source: S&P Global Ratings.

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