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European ABS market Update

ABS Spreads Trading Tighter in Spite of Deterioration in Borrower Credit Situations

It's a bit hard to believe, but we are now more than three months into the COVID-19 crisis. While unprecedented government response has created some stability in financial markets, significant uncertainty around the path to the economic recovery continues to preoccupy investors. At the same time, worldwide COVID-19 infections continue to grow and are now approching the 11 million mark as daily new case reports come in at record levels. As lockdowns across Europe are easing, secondary outbreaks are beginning to flare up and cases are (re) surging in the Americas and parts of Asia. Although monetary policy has provided a floor for asset prices, we are likely close to the limits of a financial asset recovery without a corresponding recovery in the real economy, which will likely take years. This manifested itself in the last two weeks as worldwide equity markets moved lower as new infections and economic uncertainty continued to rise. In fixed income markets, monetary policy has radically changed the market as the ECB expected to buy EUR ~€10 billion/month of corporate bonds until at least June 2021, which could take their total holdings up to ~35% of the eligible universe. On the high yield side, while there has been credit deterioration – significantly so in some sectors – there have been few defaults so far which has continued to drive spreads tighter. IG and HY spreads are now relatively tight at only 52 bps and 192 basis points, respectively, wider year to date.

European ABS issuance rose to EUR 20.9 billion in 2020 YTD, 20% below 2019 YTD. European ABS secondary spreads remained steady to slightly tighter over the last two weeks, as BWIC activity in remained healthy and trade execution remained robust. This technical strength persisted in spite of obvious signs of distress, not in terms of delinquency rates, but reflected by increases in loan forberance and payment holidays. While there is considerable divergence across jurisdictions and asset classes, there is also significant variation of borrower forbearance programs within asset classes which creates opportunities. On one end of the spectrum Dutch RMBS continue to perform well as utilization of programs has remained low in the Netherlands. At the opposite extreme, UK RMBS has seen prices fall as borrower utilization of programs has become widespread due to loose certification requirements, with one deal showing over 50% of borrowers not making full payments.

Below is an overview of the one week spread change in various ABS segments, compared to investment grade and high yield corporate credit as of June 26th, 2020:

	20-2	20-3	27-3	24-4	1-5	15-5	29-5	12-6	26-6	2 Week Change	Ytd	Peak 2007-2009
Iboxx Eur Corporate	100	247	256	205	193	205	176	151	155	4 bps	52 bps	470 bps
Iboxx EUR HY	338	895	802	649	645	665	569	534	542	8 bps	192 bps	1930 bps
Prime/Auto Senior ABS	16	50	60	48	46	44	42	40	38	-2 bps	22 bps	400 bps
Spanish Senior RMBS	38	200	215	165	155	150	150	140	138	-2 bps	25 bps	750 bps
Auto ABS Mezzanine	60	250	275	240	230	210	200	182	180	-2 bps	104 bps	1150 bps
CLO AAA	105-125	300-400	200-300	175-200	175-200	175-200	175-200	175-200	175-200	0 bps	55-80 bps	550 bps
CLO BBB	265-375	600-800	750-850	700-850	650-800	600-750	500-650	500-600	500-600	0 bps	115-215 bps	2300 bps

Source: Bloomberg

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