Fitch Ratings 2020 Outlook: Australia and New Zealand Structured Finance

Stable Outlook as Residential Property Prices Stabilise

Fitch's Asset Performance Outlook: Stable

Historically low interest rates, improving economic growth, low and stable unemployment rates, and continued population growth will support stable asset performance in both Australia and New Zealand well into 2020.

House prices in Australia have stabilised after a fall of 8.4% nationally between November 2017 and June 2019, and have since started to rise again with Sydney up by 5.0% and Melbourne up by 5.5% as of end-October 2019. This should have a positive effect on late-stage arrears in 2020, with rising prices supporting improved recoveries and potentially decreasing the time to recover on loans in default. Property prices in New Zealand are expected to grow moderately in light of the opposing forces of regulatory lending restrictions and low interest rates.

Auto ABS asset performance is expected to be stable across Australian and New Zealand due to robust economic fundamentals, although demand for new vehicles is expected to remain subdued, which continues to support a stronger demand for used cars. Recovery rates on assets in Australia have recently shown some improvement and we expect the slight improvement to continue over 2020 as the economy improves.

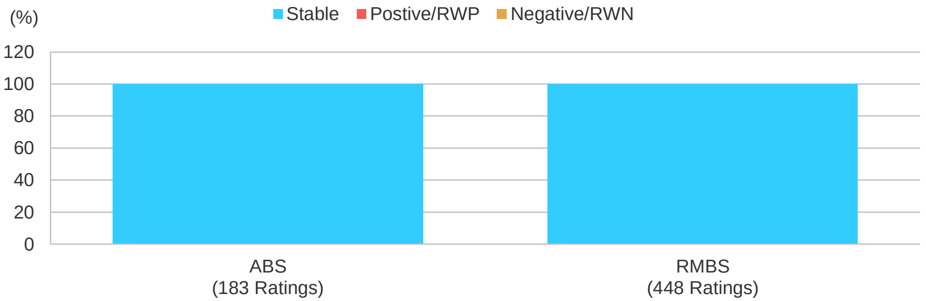
Rating Outlook: Stable

Fitch has Stable Outlooks on all of its Australian and New Zealand structured finance ratings, reflecting the stable outlook on the asset performance, which is supported by both countries' robust economic fundamentals. This is coupled with typical transaction structures across both markets, which enables transactions to deleverage over time.

Natasha Vojvodic, Senior Director

"Fitch forecasts stable ratings and asset performance across all sectors in Australia and New Zealand due to improving economic growth, record low interest rates and property prices returning to growth in Australia and continued growth in New Zealand."

Rating Outlooks



Source: Fitch Ratings

Australia and New Zealand Structured Finance Outlooks

	Asset performance	Change from 2019	Ratings	Change from 2019
Australian RMBS	Stable	➡	Stable	➡
Australian Auto ABS	Stable	➡	Stable	➡
Australian Consumer ABS	Stable	➡	Stable	➡
Australian CMBS	Stable	➡	Stable	➡
New Zealand RMBS	Stable	➡	Stable	➡
New Zealand Auto ABS	Stable	➡	Stable	➡
New Zealand Consumer ABS	Stable	➡	Stable	➡

Source: Fitch Ratings

What to Watch

- **Australian House Prices:** Low interest rates and improved housing affordability will have a positive impact on house prices, and this may lead to an increase in investment lending.
- **Policy Risk:** Regulatory intervention remains a theme for both countries, with mortgage lending practices in focus and the introduction of low down-payment schemes for first-home buyers.
- **Credit Cards Declining:** Credit card growth could remain subdued as a result of changing consumer habits, and more entrants targeting buy-now, pay-later arrangements.
- **Late-Stage Mortgage Arrears:** Late-stage arrears to improve, but drought-affected regions in Australia may lag. Minimal impact on RMBS portfolios given city concentrations.

Australian and New Zealand House Prices

House prices in Australia and New Zealand are set to increase, although we expect prices in Australia to move more sharply, especially in Sydney and Melbourne. Lower mortgage payments due to low interest rates in Australia supports price increases and encourages property investors back to the market.

New Zealand house-price rises are expected to be constrained, but demand for housing is set to remain stable for the next 12 months. This is supported by recent interest-rate cuts, positive net migration and a slight relaxation of the loan-to-value ratio (LVR) regulations.

Policy Risk and Underwriting Standards

Removal of the prescribed loan servicing floor by the Australian Prudential Regulatory Authority (APRA) paired with the lower cash rate has led to an increase of the maximum borrowing power of borrowers. Greater use of policy measures by APRA is likely to limit any systemic risks going forward to counteract loosening underwriting standards. We do not expect the introduction of the government's guarantee scheme for Australian first-home buyers to affect price growth or loan credit risks in 2020, due to the limited availability of the scheme. New Zealand's Reserve Bank is expected to continue with its policy of LVR restrictions, despite the slight relaxation as it sees this policy as important in promoting financial stability.

Credit Cards Declining

Changing consumer habits have led to a reduction in the use of consumer credit products, such as credit cards, with debit cards used more for everyday expenses and buy-now, pay-later payment methods to fund larger expenses. Buy-now, pay-later providers have been gaining market share from a low base and their popularity should grow over the next year.

Late-Stage Mortgage Arrears

Early stage arrears are expected to remain stable, supported by the low interest-rate environment and stable unemployment rate. We expect late-stage arrears overall to improve as house prices stabilise, with increases in Sydney and Melbourne. In drought-affected regions in Australia, late-stage arrears may increase, but any impact will be small because RMBS portfolios are heavily weighted towards properties in major cities.

Potential Disrupting Factors

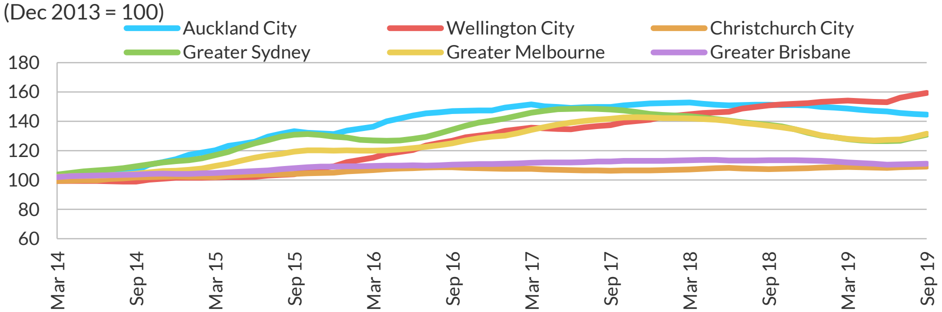
A sharp increase in the lending rates in Australia and/or New Zealand in excess of 4% would have a significant impact on borrowers, given the high household debt.

A sharp rise in the unemployment rate to above 7% (Australia) or 6% (New Zealand) would have a widespread impact on delinquency and default rates.

Slowing growth in China, exacerbated by continuing trade tensions with the US, pose a risk to the economic outlooks for Australia and New Zealand.

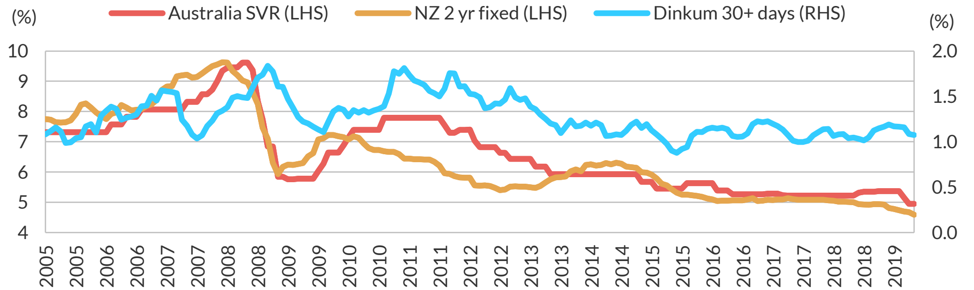
Australia and New Zealand Housing Indices

(Dec 2013 = 100)



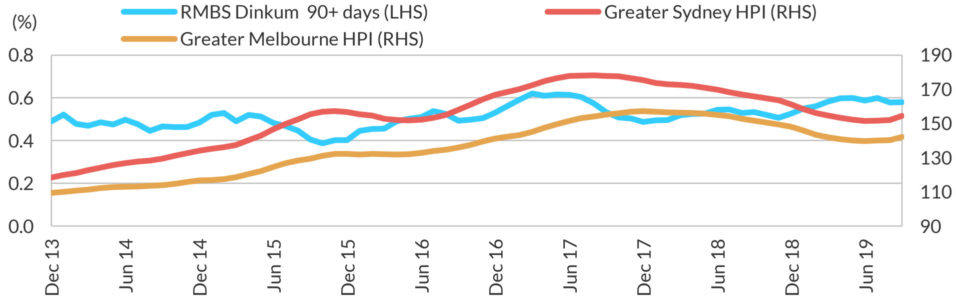
Source: Fitch Ratings, CoreLogic, Quotable Value

Standard Mortgage Rates vs. Dinkum 30+ Days Arrears



Source: Fitch Ratings, Reserve Bank of Australia, Reserve Bank of New Zealand

Dinkum 90+ Days Arrears vs. Housing Indices



Source: Fitch Ratings, CoreLogic

Australian RMBS

Stable RMBS Rating and Sector Outlook

Fitch expects stable Australian RMBS performance and ratings underpinned by its stable outlook for the Australian economy. Fitch expects economic growth of 2.3% in 2020, with stable employment and mortgage rates remaining at historically low levels, which will support households' ability to service debt.

Rebound in House Prices

Fitch forecasts national house prices to continue to grow in 2020, with Sydney and Melbourne outperforming, which will partly offset the recent peak-to-trough decline of 8.4% from November 2017 to June 2019. We expect low interest rates and the reduction in the lenders serviceability interest rate to increase the maximum borrowing power of borrowers and support mortgage credit growth and demand in 2020. We expect the increase in housing turnover and clearance rates observed in late 2019 to continue into 2020, supporting house prices.

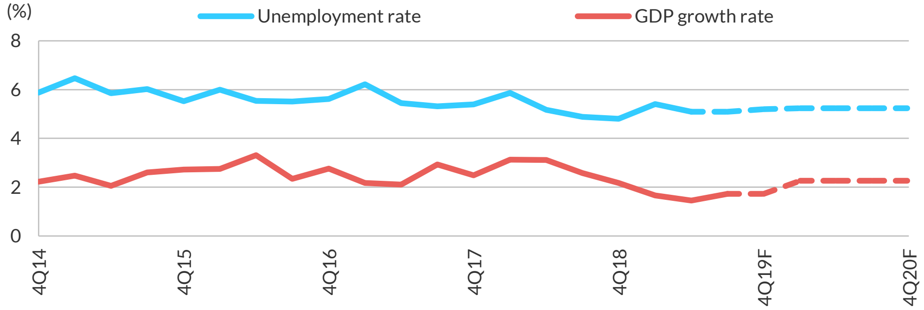
Macro-Prudential Measures Eased

APRA removed the 10% investment loan growth limit and the 30% interest-only mortgage flow limit in April 2018 and January 2019, respectively, but continues to monitor these loan features and high-LVR loans. Origination of investment, interest-only and high-LVR (>80%) loans has remained stable since the withdrawal of the APRA macro-prudential policies and we expect this trend to continue in 2020, supporting a stable mortgage market.

Downside Risks Persist

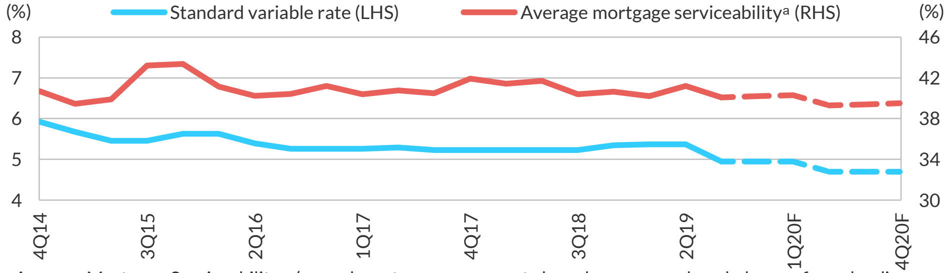
We expect mortgage performance to remain strong and forecast the proportion of loans in arrears for over 90 days to remain between 0.55% and 0.60% in 2020. Sluggish wage growth and elevated household debt levels continue to make Australia susceptible to a labour-market or interest-rate shock. Mitigating these risks is that some households have prepaid their mortgages or maintain mortgage offset accounts that can be used to service debt in the event of a shock, although newer borrowers and financially weaker households could be vulnerable.

Stable Unemployment and GDP Growth



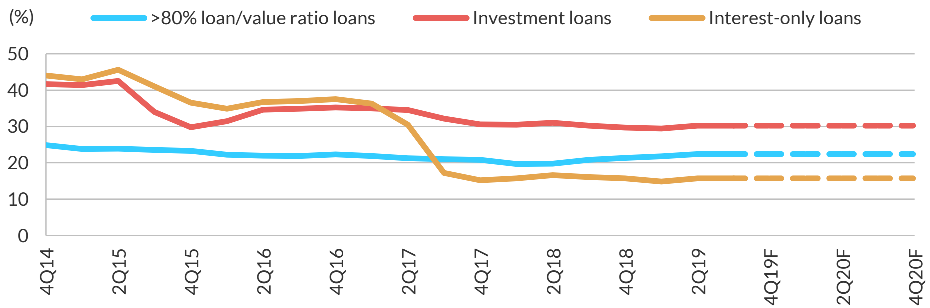
Source: Fitch Ratings, RBA, ABS

Lower Mortgage Interest Rates to Improve Serviceability



[a] Average Mortgage Serviceability - (annual mortgage repayments based on average loan balance of new lendings and the standard variable rate)/average annual income
Source: Fitch Ratings, RBA, ABS

Lower High-Risk New Lending



Source: Fitch Ratings, APRA

New Zealand RMBS

Stable RMBS Rating and Sector Outlook

Fitch has a stable outlook on New Zealand RMBS performance and ratings, supported by its stable outlook for the New Zealand economy. Fitch expects economic growth to pick up to 2.4% in 2020 with stable employment maintaining strong mortgage performance, while historically low interest rates will provide upward pressure to house prices.

Moderate Property Price Growth

Fitch expects national house prices to continue to increase slightly in 2020, following the 3.6% yoy rise in September 2019. Christchurch and Auckland will outperform the national average. We expect the low interest-rate environment to support house-price growth as Fitch forecasts the official cash rate to fall as low as 0.5% in 2020, although we expect a delay in mortgage repricing because most mortgages in New Zealand are on fixed rates (one to five year fixed-rate terms). Low unemployment levels and projected population growth of 1.6% in 2020 will provide further support to house prices in the near term.

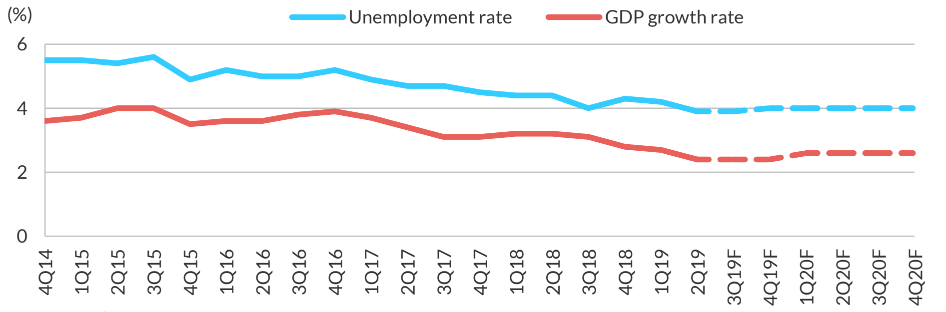
Macro-Prudential Measures to be Maintained

In the current low interest-rate environment, we do not expect the Reserve Bank of New Zealand (RBNZ) to loosen its LVR restrictions (5% new lending flow limit for investment loans with down payment of below 30% and a 20% limit for owner-occupied loans with a down payment of below 20%) in 2020. We expect the LVR restriction to continue to limit credit growth at 5.0% in 2020, and provide an upper limit to house-price growth in 2020. If house-price growth was to accelerate above the level the RBNZ is comfortable with, we expect the central bank to consider further macro-prudential controls to temper house-price growth.

Key Downside Risks

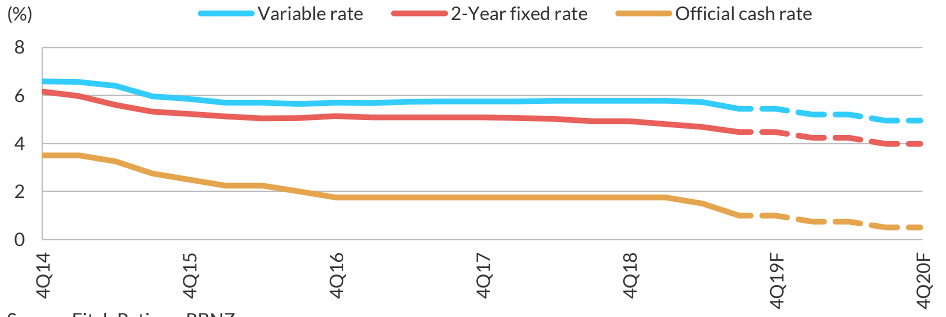
We expect mortgage performance to remain strong with 90+ days arrears of 0.4% in 2020. However, New Zealand is an export-orientated economy that could come under pressure if growth in New Zealand's key trading partners continues to deteriorate into 2020. This could result in an increase in the unemployment rate, which would negatively affect mortgage performance.

Stable Unemployment and GDP Growth



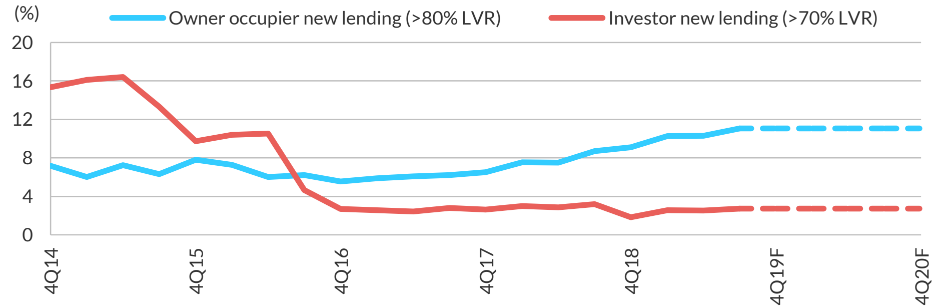
Source: Fitch Ratings, Stats NZ

Mortgage Lending Rates to Remain Low



Source: Fitch Ratings, RBNZ

LVR Restrictions to be Maintained



Source: Fitch Ratings, RBNZ

Australian ABS

Stable ABS Rating and Sector Outlook

Fitch expects strong asset performance and ratings due to a stable economic outlook, strong transaction excess spread and typical transaction structures building credit support.

Auto ABS

New Vehicle Demand to Recover

The composition of new-vehicle sales has changed in Australia, with SUV sales making up a larger proportion. New-car sales have declined since 2018 and will result in lower asset growth for lenders which could, in turn, lead to the relaxation of underwriting standards in an attempt to stimulate growth. However, Fitch has not observed this to date. Given low interest rates and signs of recovery in the property market, we anticipate slow growth in new-car sales into 2020, with higher growth expected towards the end of the year.

Improving Recovery Rates

We anticipate recovery rates to slightly improve in 2020 as consumers who have delayed capital purchases begin to re-enter the auto market following increasing house prices and historically low interest rates. Consumers have held off on car purchases over the past 12 months, coinciding with lower consumer spending leading to a softening of recovery rates. Recovery rates for Fitch-rated transactions in 3Q19 increased to 37.7%, slightly below the five-year average of 39.8%. Fitch continually assesses and adjusts recovery base cases due to market dynamics.

Consumer ABS

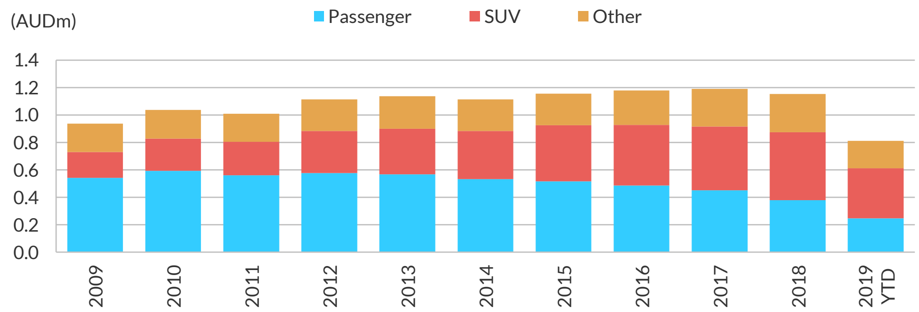
Reducing Consumer Credit Demand

Consumer credit demand is contracting in Australia, with credit-card applications down 10.4% yoy in 2Q19. The decline is driven by tighter underwriting after the introduction of increased responsible-lending requirements, plus the increased use of debit cards. Fitch expects the downward trend in consumer credit to stabilise in 2020 as consumer credit markets adapt to the changing regulatory landscape.

New Market Entrants

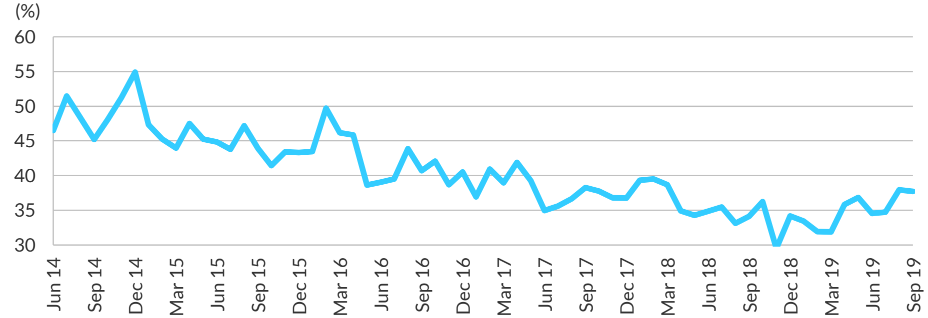
Fitch expects existing providers in the unsecured consumer credit market to become more prominent and new entrants in the form of buy-now, pay-later providers to the market to increase in 2020. The new entrants are also diversifying the offerings available, which extend into the services space. While we do not believe these new market participants are responsible for the decline in credit-card and personal-lending growth because of their small sizes, we do believe that the buy-now, pay-later providers will become increasingly significant in the Australian economy.

Australian New-Vehicles Sales



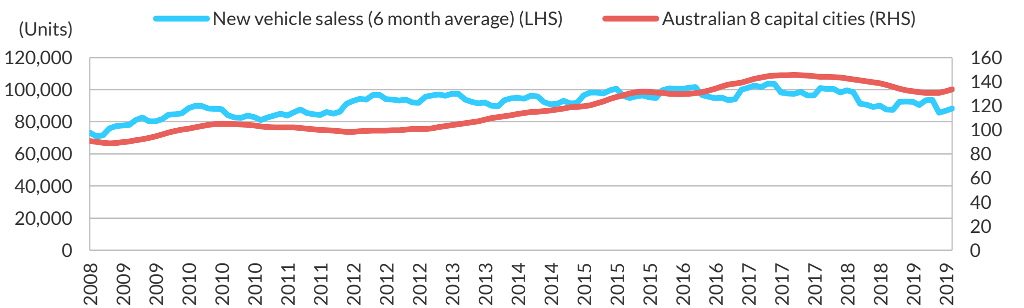
Source: Fitch Ratings, Federal Chamber of Automotive Industries, Haver Analytics

Fitch Auto ABS Dinkum Recovery Rates



Source: Fitch Ratings

Australia 8 Major Cities Property Price Index vs. New-Vehicle Sales



Source: Fitch Ratings, Federal Chamber of Automotive Industries, Haver Analytics, CoreLogic

New Zealand ABS

Stable ABS Rating and Sector Outlook

Fitch expects continued stable economic conditions and the structural features typical of New Zealand ABS transactions, including strong excess spread and credit enhancement build-up, to support stable ratings on all outstanding New Zealand ABS transactions.

Modest Increase in New-Vehicles Sales

Fitch expects that new-vehicle sales to be soft in 2020 with modest growth forecast for the passenger vehicle segment. Subdued growth is driven by both domestic and international economic conditions, despite record-low interest rates, which may stimulate new-vehicle demand.

Recovery Rates Remain Stable

New Zealand's second-hand car market is more robust than that of Australia, which has helped recoveries in New Zealand to remain stable, a trend Fitch expects to continue throughout 2020. Fitch-rated New Zealand ABS transactions exhibit strong recoveries in the second-hand car market, which is expected to persist in 2020.

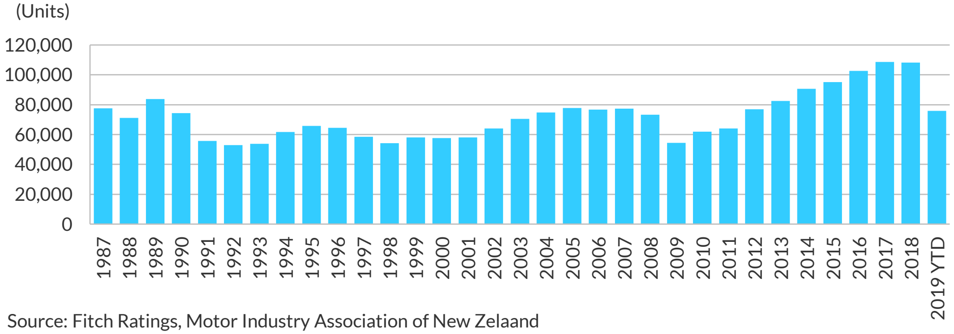
Consumer Confidence Stability

New Zealand consumer confidence indicators exhibit a degree of stability, driven by cautious consumer spending, despite increasing property prices and record-low interest rates. Fitch-rated New Zealand ABS transactions consist mostly of lending to consumers, with a small portion to SMEs and large corporates. Fitch does not expect any performance deterioration in 2020 in light of the stable macroeconomic outlook for New Zealand.

Consumer Lending Landscape

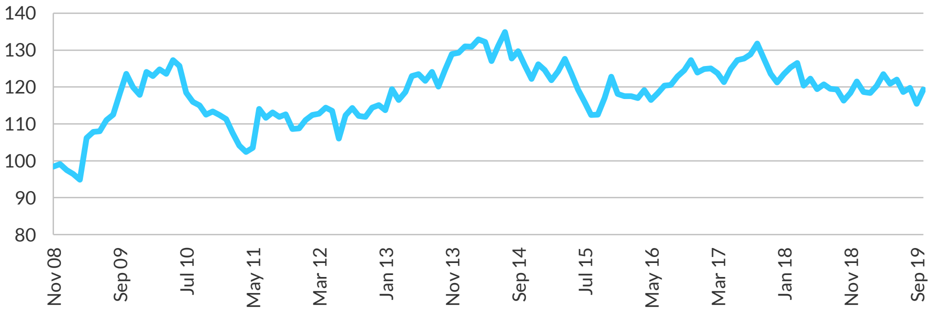
The gradual rise in non-bank lending has benefited from changing regulations and product diversification that allow non-banks to be more competitive with the traditional bank lenders. Non-banks, which have tapped funding via securitisation, have taken advantage of the tighter underwriting imposed on traditional bank lenders to expand. This is a trend we expect to continue in 2020.

New Zealand New-Vehicle Sales



Source: Fitch Ratings, Motor Industry Association of New Zelaand

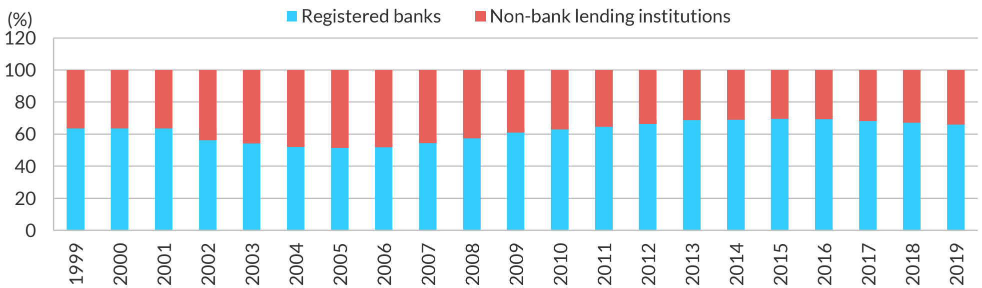
Overall Consumer Confidence Index



Source: Fitch Ratings, ANZ National Bank, Roy Morgan, Haver Analytics

New Zealand Consumer Lending

Bank vs. Non-Bank Lending



Source: Fitch Ratings, Reserve Bank of New Zealand

Outlooks and Related Research

2020 Outlooks
Global Economic Outlook (September 2019)
Mortgage Market Index – Australia: The Dinkum RMBS Index – 3Q19 (November 2019)
Auto ABS Index – Australia: The Dinkum ABS Index – 3Q19 (November 2019)

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