Auto Finance Insights
October 2017

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Auto lending growth continues to slow. Despite higher pay and solid returns from equity markets, consumers are finding that new cars are losing luster as objects worth their hard-earned cash. The tightening of lending standards has obvious ramifications for the auto industry as a whole, where expansionary credit cycles typically support new vehicle sales.

Michael Vogan, Automobile Economist

Auto Lending Turns a Corner

IN BRIEF

» Outstanding auto loan balance growth continues to slow as auto lending enters the downward phase of its credit cycle.

» Default and delinquency rates for deep subprime loans originated through non-bank channels are rising rapidly.

» Performance deterioration across the industry is driving a tightening of lending standards which contributes to the slowdown in loan originations and new vehicle sales.

» Residual values are under pressure from a supply shock caused by record levels of off-lease vehicles being dumped into the used vehicle market.

» Weak residual values are increasing loan-to-value ratios and losses, especially for consumers who rolled over negative equity into new car loans.

All signs suggest that auto lending markets are cooling off after a period of impressive growth following the recession. Year-over-year growth in outstanding auto loan and lease balances slowed for the last 13 months because of deteriorating credit performance and spent-up new vehicle demand. In the second quarter of 2017, originations from non-bank channels fell by 5.44% from a year earlier, marking the largest decline since 2009.

In September, new-vehicle sales were well above consensus expectations at 18.9 million seasonally adjusted annualized units. Hurricanes Harvey and Irma boosted consumer demand for replacement vehicles. However, despite efforts to move inventory by sustaining high levels of purchasing incentives, new-vehicle sales were below expectations for the first three quarters of 2017. These declines are largely because of falling demand for new vehicles, tightening lending standards, and attractive used vehicle prices. The hurricanes' impact should support strong sales to close the year. New vehicle sales are expected to weaken the rest of the decade as credit tightens and the macro economy enters the late stages of the expansion.

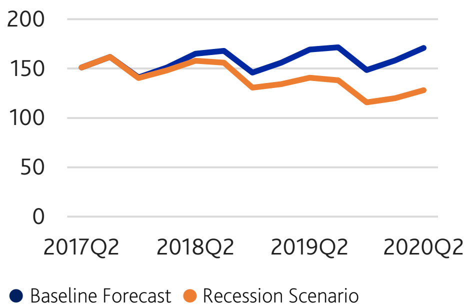
The day of reckoning has indeed arrived for subprime auto loans. Although performance is showing signs of weakness for all types of borrowers, default and delinquency rates are rising much more quickly in the subprime category. The defaults and delinquencies are at the extreme lower bound of the risk score distribution. Subprime credit originated through non-bank channels and for borrowers with low incomes are deteriorating most rapidly compared to other segments of the market. Rising delinquency and default rates have been a primary driver of tightening auto-lending standards. A positive net-percentage of banks reported tightening auto lending standards since the third quarter of 2016, according to the Federal Reserve.

Residual values are falling in response to rising off-lease volumes, along with high incentive levels and favorable financing options spurring demand for new vehicles. Weak residual values, especially in the sedan and subcompact segments, have contributed to rising losses given default and ballooning loan-to-value ratios when consumers roll negative equity from trade-ins into new loans. Overall market residual values are at their lowest level since 2009, according to the used car and truck CPI. However, used truck and SUV prices remain relatively robust because of a shift in consumer preferences and low gas prices.

Analysis by Michael Vogan, Automobile Economist

Outlook: Credit

Auto Total: Originations
Bil. $, NSA



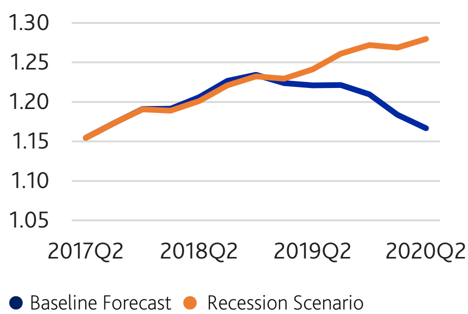
Sources: Equifax, Moody's Analytics

$151 bil.

Originations

Originations slightly declined from a year earlier in Q2 2017 for the second consecutive quarter. As credit tightens, we expect originations to be flat in our baseline forecast. Under a recession scenario, we expect originations to decline to about $100 billion per quarter by 2019.

Auto Total: Total Outstanding Balances
Tril. $, NSA



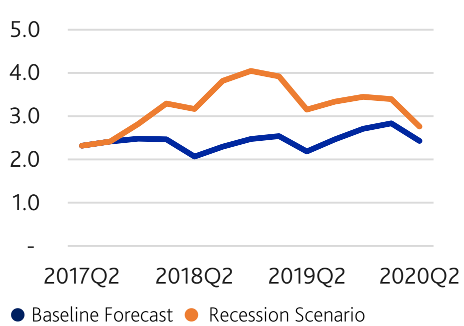
Sources: Equifax, Moody's Analytics

$1.18 tril.

Outstanding Balances

Total outstanding auto balances rose by 4.95% over the past year, reaching $1.18 trillion in September 2017. Under baseline economic expectations, balances should grow to about $1.3 trillion in about three years, albeit at a decreasing rate. Auto balances are expected to contract back to $1.15 trillion under a recession scenario.

Auto Total: Annualized Default Rates
% of $, NSAAR



Sources: Equifax, Moody's Analytics

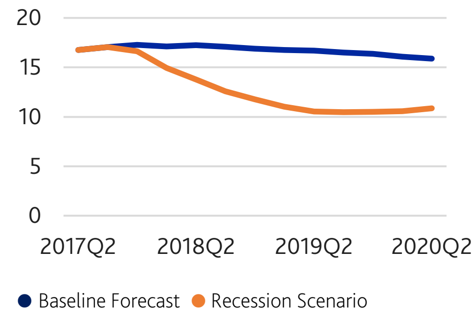
2.52% of $

Annualized Default Rates

Annualized default rates were flat year over year in September. Overall market default rates should stay constant in the future, but are forecast to increase by about one and a half percentage points in the recession scenario.

Outlook: Sales & Residual Values

New Vehicle Sales
Mil. #, SAAR



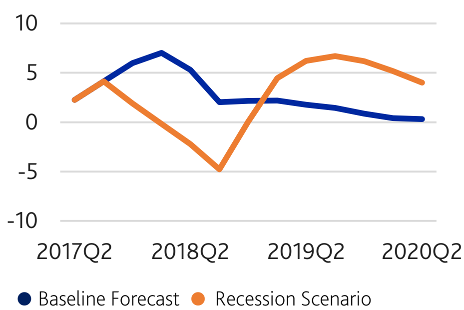
Sources: U.S. Bureau of Economic Analysis, Moody's Analytics

18.91 mil.

New Vehicle Sales

There were 4.85% more vehicles sold in September 2017 compared to a year earlier. New vehicle sales slowed throughout 2017, and we expect convergence to about 16.5 million SAAR units by 2020. A recession scenario would cause new vehicle sales to dip to 10 million SAAR units.

Manheim Used Vehicle Value Index
Jan1995 = 100, SA



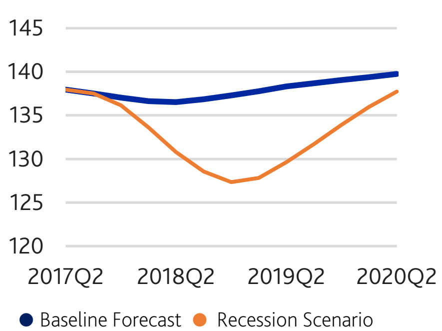
Sources: Manheim Moody's Analytics

6.3% year-over-year

Used Vehicle Value Index

The Manheim Index, driven by new car price inflation, and robust prices in the truck and SUV segments, reached a historic high in September 2017 of 134.9. Growth should decelerate slightly in the future, but a recession scenario would trigger a 5% decline in residual values by 2018.

Used Car and Truck CPI
1982-84=100, SA



Sources: BLS, Moody's Analytics

136.32

Used Car and Truck CPI

The used car and truck CPI reached its lowest level since 2009 in September 2017. We expect residual value pressure to ease in 2018. However, it will likely increase in the truck and SUV segment with a rise in the segment's off-lease volumes. Broad-based residual value declines push the CPI to a low of about 127 in a recession scenario.

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Moody's Analytics provides comprehensive auto finance solutions to manage risks and opportunities stemming from a changing economic and financial market environment.

» Auto Residual Value Forecasts
» Auto Origination & Lending Forecasts
» Auto Lending Risk Models - Loan Level
» Auto Lending Risk Models - Portfolio Level
» Auto Funding Optimization
» Auto ABS

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