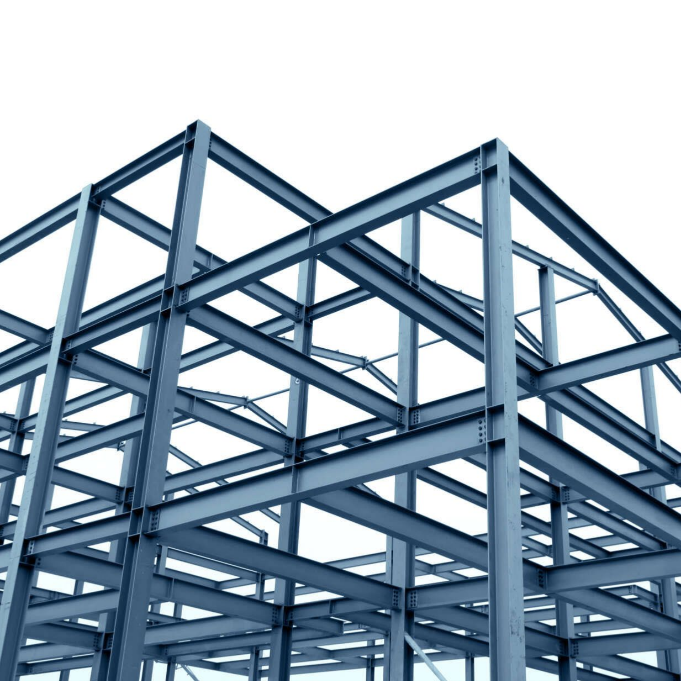
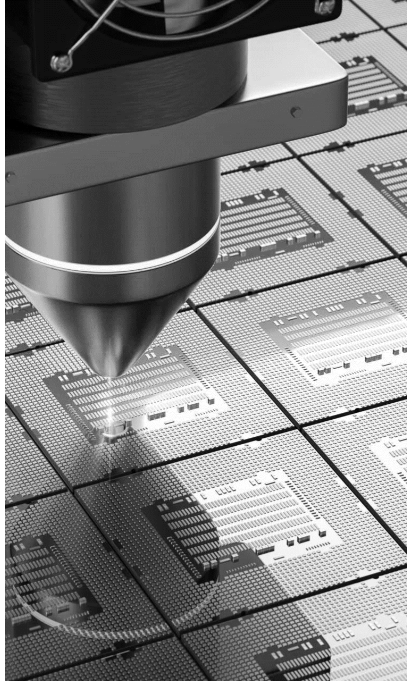
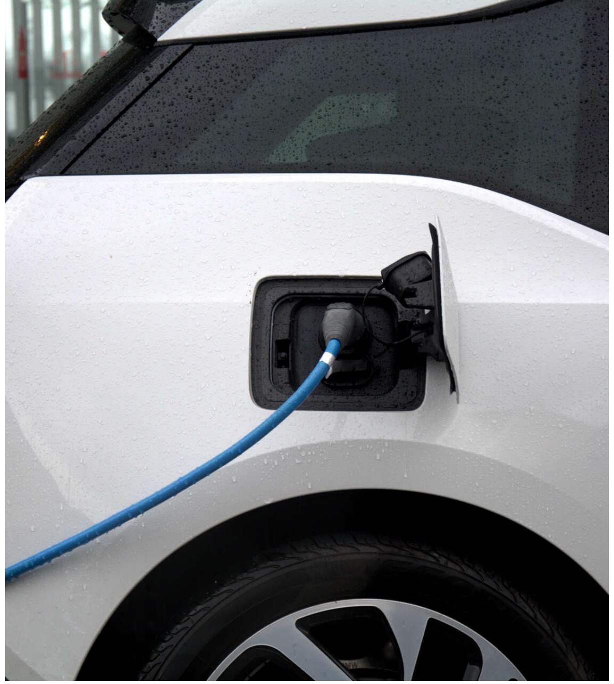





# 2025 Structured Finance Outlook: Australia And New Zealand

## Exploring new horizons

**Jan. 22, 2025**

S&P Global Ratings

*This report does not constitute a rating action*

# Australian Macroeconomic Environment

## The waiting game

# Australia | S&P Global Ratings Economic Outlook

| | 2025f | 2026f | Outlook | Effect on credit quality |
|---|---|---|---|---|
| **Real GDP forecast (% year over year)** | 2.1 | 2.2 | A resilient labor market and buoyant government spending have kept the economy moving. We forecast GDP growth to improve in the wake of lower interest rates. | **Positive.** Households continue to prioritize debt commitments over discretionary spending, putting a drag on economic growth. But lower rates will help boost consumer spending. |
| **Unemployment rate (year average; %)** | 4.4 | 4.6 | We forecast unemployment will continue to rise, but levels should remain low by historical standards and below prepandemic levels. | **Negative.** Strong labor market conditions have kept defaults low, but rising unemployment will put pressure on debt serviceability for some borrowers. |
| **CPI (%)** | 3.1 | 2.9 | Energy rebates have temporarily lowered inflation, however this impact will run off in 2025. We expect the decline in headline inflation to take time and is unlikely to fall back within the 2%-3% target range until 2026. | **Neutral.** Inflationary pressures erode real income. This affects lower-income households disproportionately. |
| **Policy rate, end of year (%)** | 3.85 | 3.35 | We expect the cash rate to be lowered in the first half of 2025. Rate cuts are likely to be gradual as the Reserve Bank exercises caution in lowering rates. | **Positive.** Reductions in interest rates will ease debt serviceability pressures, given Australia's mostly variable-rate mortgage market. This is positive for arrears but will be offset by rising unemployment. |

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

# Households Cautious Amid Investor Optimism

- Despite some economic headwinds, 2025 is poised to be another year of strong collateral performance and buoyant new issuance, underpinned by a mostly resilient household sector, low unemployment, and cautious optimism.
- Strong demand for yield and increasing risk appetite will further expand lenders' product horizons and funding options. Australia's sophisticated and established securitization landscape is fertile ground for exploring new products and transaction structures.
- Interest rate cuts are likely to spur lending competition, bolstering demand for mortgages. But increasing competition could see some deterioration in underwriting standards as lenders seek to grow market share.
- More competition will foster innovation in lending products as nonbanks seek to diversify their product offerings and find new niches.
- 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.
- Rising property prices have also given borrowers who are more at risk a way out of financial pressure by enabling voluntary sale of properties. This has also kept losses low.
- While higher unemployment, when it arrives, will elevate arrears and defaults, it is unlikely to cause any material ratings impact for the structured finance sector, provided unemployment remains low overall.

# What To Look Out For

### Arrears to remain low

Arrears have stabilized with interest rates on hold. While rising unemployment will put pressure on arrears, this will be offset by lower interest rates, which will help keep arrears low overall.

### Lending standards in focus

The prospect of rate cuts is likely to stimulate lending competition. This could lead to some deterioration in lending standards. Areas of focus include documentation standards, credit to variable income sources, and interest rate buffers.

### Refinancing reignites

Refinancing could be reenergized when rate cuts take effect. Lenders may seek to capitalize on improving consumer sentiment by offering competitive mortgage rates, thereby stimulating refinancing and accelerating prepayment rates.

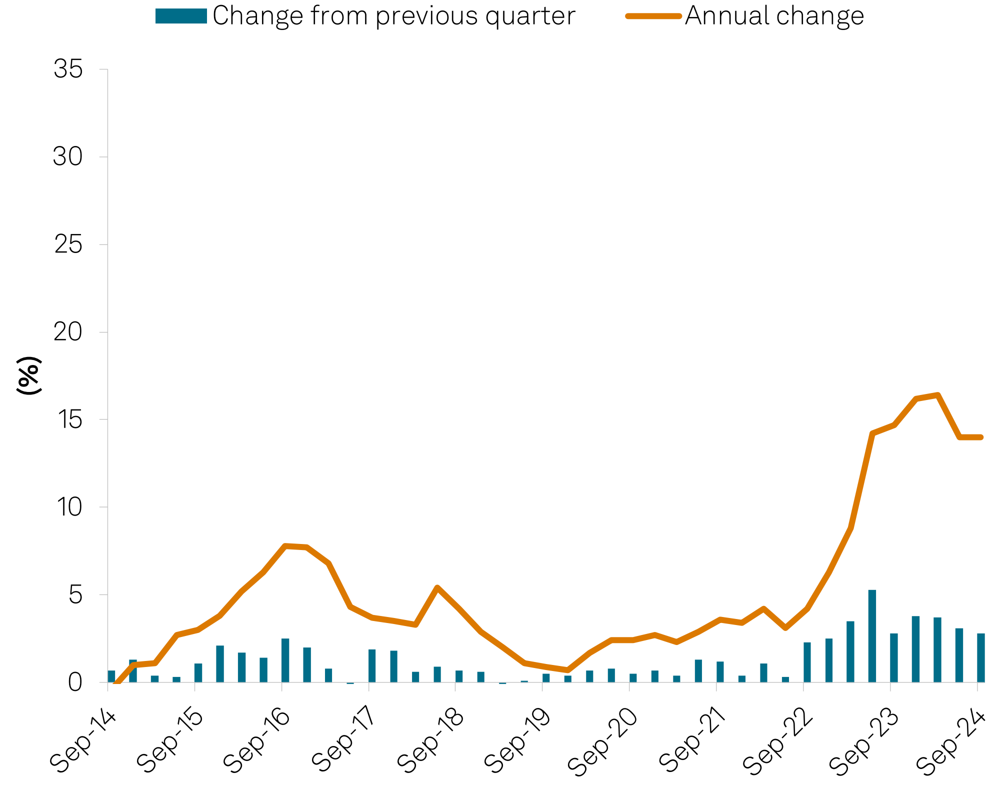
### Nonbank diversification

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.

# In Focus

# Severe Weather Strikes Again

## Quarterly, annual movements in Australian insurance costs

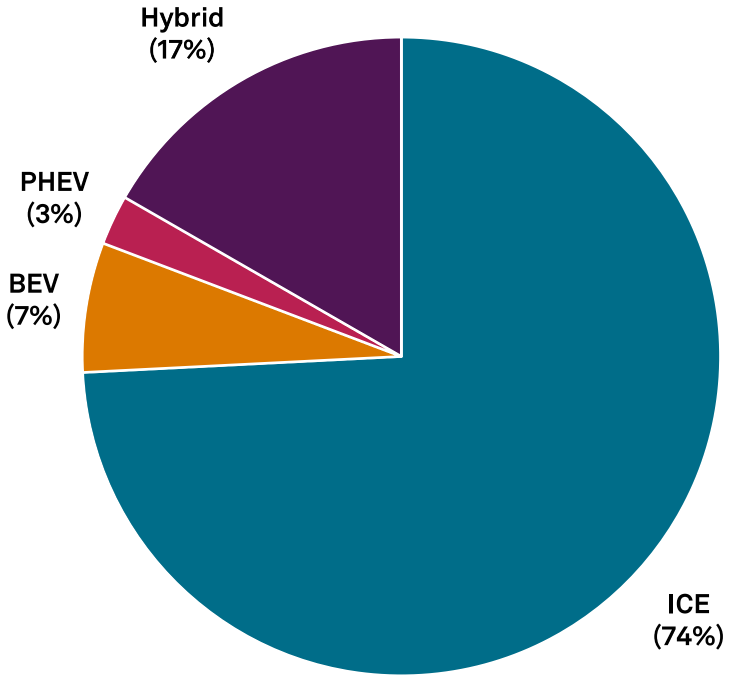



Sources: Australian Bureau of Statistics, Consumer Price Index, Australia September Quarter 2024.

- California's devastating wildfires, exacerbated by climate change, urban expansion and prolonged drought conditions, have reached unprecedented levels.
- More frequent and severe weather events could mean higher catastrophe-related claims. The expansion of development into higher risk areas can also increase losses.
- Higher building replacement costs due to rising construction costs and more stringent building codes can lead to underinsurance, particularly in higher-risk areas.
- The reduced affordability of natural catastrophe risk coverage has led to greater public intervention to close the insurance protection gap. The Cyclone Reinsurance Pool in Australia is one such example.
- Property insurance is a prerequisite for loan approvals but risks over insurance currency and amount of insurance coverage remain.
- Rating mitigants include geographic diversity, credit support, and liquidity features to help alleviate cash flow pressures caused by higher arrears after severe weather events.
- In Australia, insurers are continually working with government to strengthen planning selection and rebuilding codes.

# EV Sales Growing

## New light vehicles sales % by fuel type



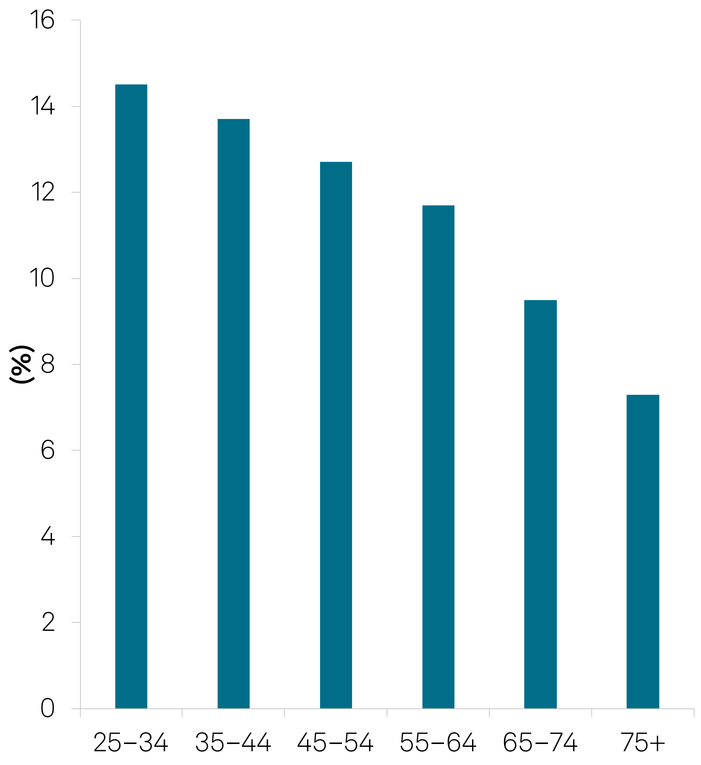

Data is based on share of new light vehicles sold by fuel type between 1 July 2024 and 30 September 2024. EV--Electric vehicle; ICE--Internal combustion engine; BEV--Battery electric vehicle; PHEV--Plug-in hybrid electric vehicle). Sources: Federal Chamber of Automotive Industries, EV Council, Australian Automobile Association.

- Electric vehicle (EV) demand is growing, thanks to government incentives.
- The fringe benefits tax regime in Australia has incentivized EV take up through novated leasing channels.
- The Electric Vehicle Council of Australia expects that Australia will need over 50% of all new car sales to be EVs by 2030 to meet climate targets.
- The New Vehicle Efficiency Standard, which starts in 2025, will help to increase the number of EV models available in Australia, increasing supply and broadening consumer demand.
- The exposure to EVs across Australian auto loan ABS transactions varies, with higher exposures in transactions with more novated leases. EV exposures in some transactions are as high as 17%.
- Concerns over EV battery health, charging infrastructure, and the range of older EV models are hampering consumer demand for used EVs.
- More competition for EVs has led some manufacturers to slash new vehicle prices to maintain market share. This is influencing residual values in many markets.
- Additional haircuts to recovery assumptions may be applied to transactions with higher exposures to EVs to reflect this risk.

# An Aging Population Could Lead To More Reverse Mortgages

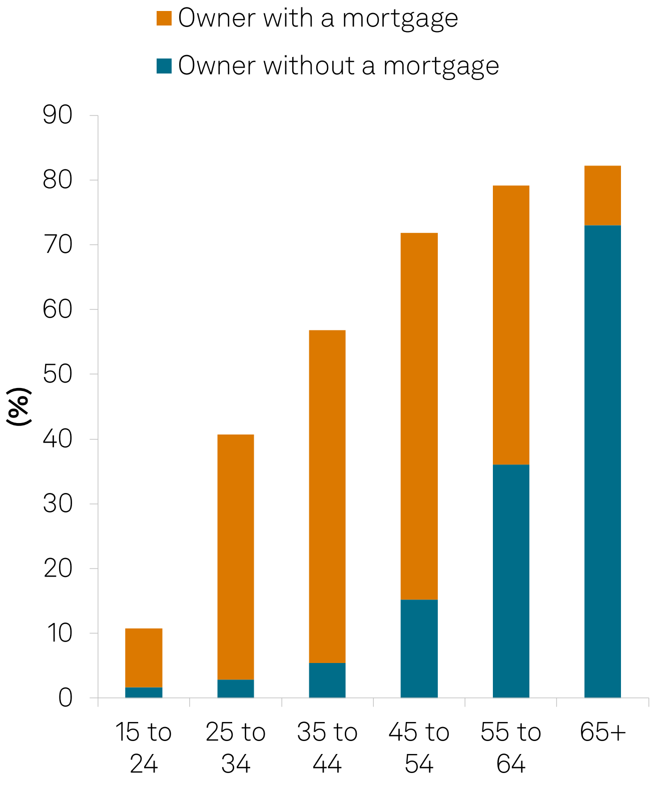
- Australia's population is aging as fertility rates decline and people live longer.
- Prolonged periods of rising property prices mean many older households have built up considerable equity in their homes.
- Reverse mortgages enable retirees to unlock this equity, enabling people to stay in their homes longer and access additional financing in their retirement.
- With reverse mortgages, different paths of interest rates and home price appreciation can lead to varying rates of home equity erosion, posing risks to both the lender and borrower.
- We have established criteria for rating new transactions of reverse mortgages in the U.K. and we would likely borrow these to rate similar deals in other countries. This would involve a consideration of regional variation in housing finance and regulations along with key risks.

## Population distribution, 2021 Census




Source: Australian Bureau of Statistics.

## Home ownership by age cohort

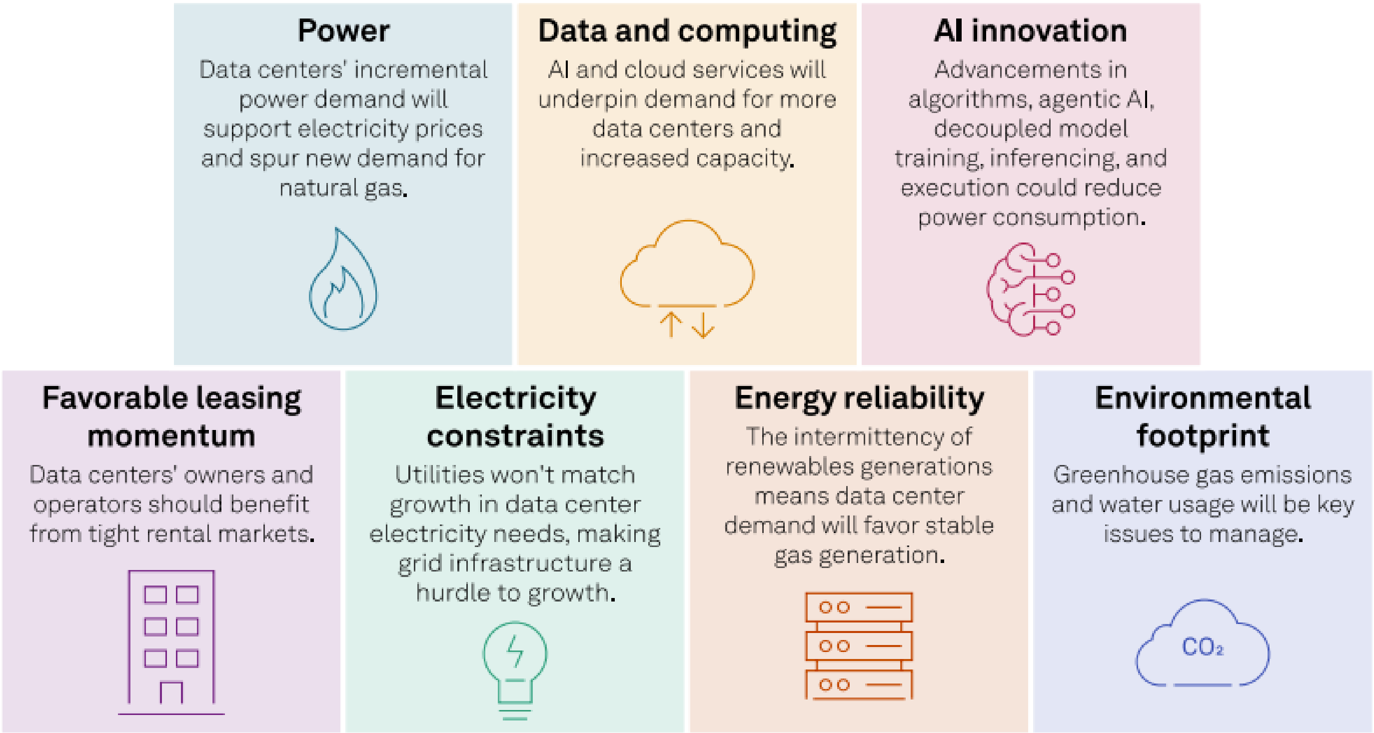



Source: Australian Bureau of Statistics.

# Data Centers Power A Digital Future

- The growth potential in the data center sector is significant, fueled by the surge in cloud computing and AI.
- In South Asia and Southeast Asia, we anticipate that data center capacity will increase at a compound annual growth rate of 10%-25% over the next few years, spurring investments and funding opportunities.
- Market participants in Australia also believe this sector has a long way to run.
- There are four main approaches for rating data center financings: corporate, project finance, CMBS, and ABS.
- Under the ABS approach, S&P Global Ratings has established criteria for rating data center securitizations that projects cash flows from leasing income and property sales in determining whether there are sufficient funds to pay principal and interest on securities.

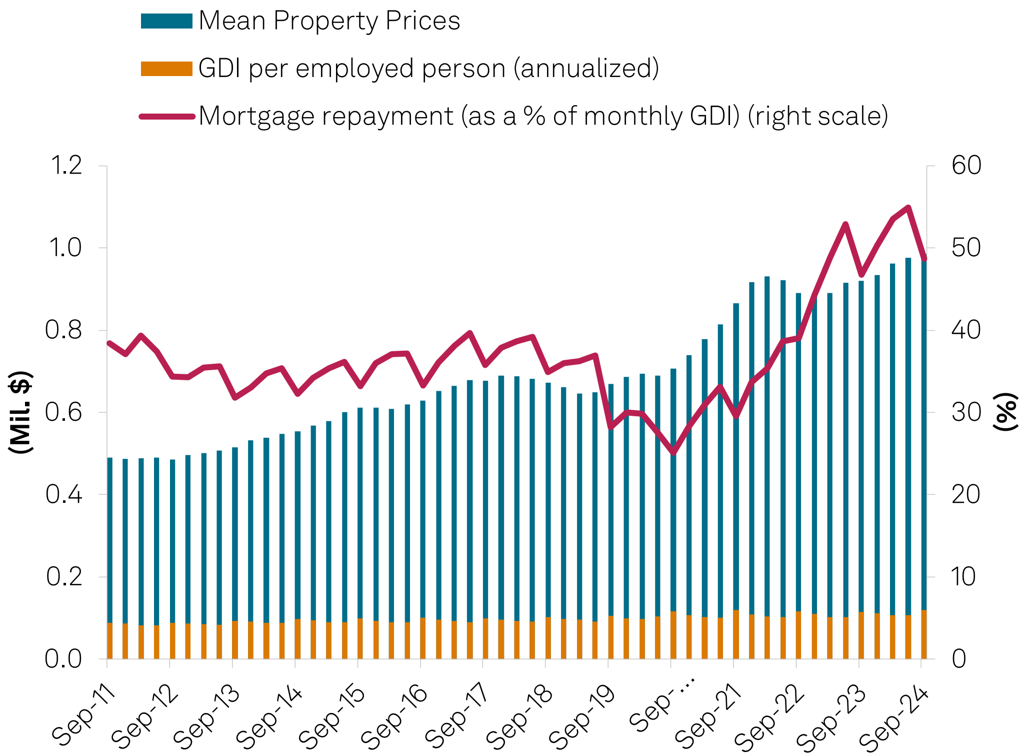
## Data center growth: Key considerations




Source: S&P Global Ratings.

# Price-To-Income Gaps Persist

## Property prices, gross disposable income, mortgage costs




Mortgage repayment costs as calculated assuming an LTV of 80% of median property prices , standard variable mortgage rates, amortising loan profile and 30-year term. GDI--Gross disposable income.
Sources: Australian Bureau of Statistics, S&P Global Ratings.

S&P Global Ratings

- Residential property price growth has outstripped income growth for some time, but the gap has widened since the pandemic.
- These imbalances are unlikely to improve anytime soon, with housing demand, underpinned by strong population growth, outpacing housing supply.
- Mortgage servicing costs as a proportion of disposable income have also grown, alongside rising property prices and higher interest rates.
- 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.
- While higher interest rates are restricting affordability, this easing in property prices is unlikely to last for long when lower rates stimulate demand for property 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.

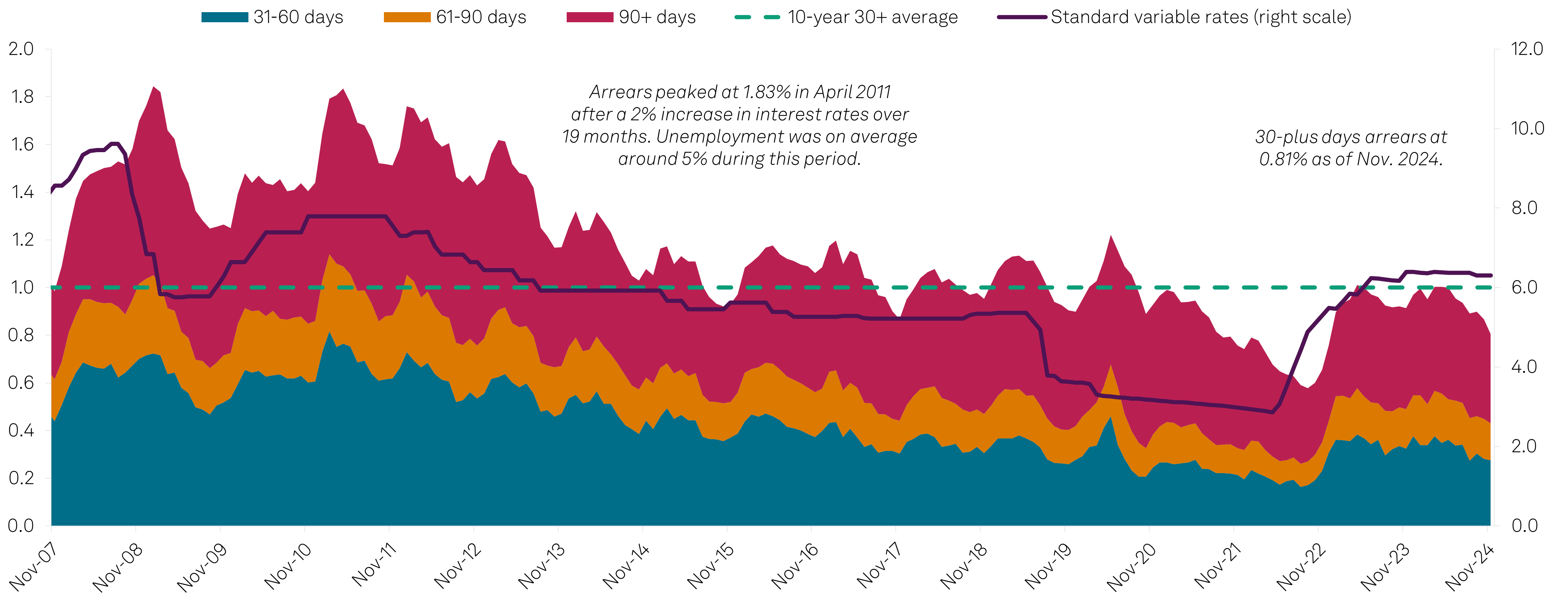
# Australian RMBS Outlook

## Resilience underscores “relative value”

# Australian RMBS Performance Outlook

- Mortgage arrears defied expectations again in 2024. Prime arrears remain low at 0.81% and have stabilized with interest rates on hold. Nonconforming arrears have also proven resilient, reaching a modest 3.85% in November 2024.
- In theory, arrears are yet to peak, with unemployment forecast to rise in 2025. But any further rises are likely to be modest, with rate cuts on the horizon.
- This resilience has been underpinned by low unemployment, rising property prices, savings buffers (for some), and an abundance of refinancing opportunities. Borrowers also have been prudent in curtailing expenditures to service their debts.
- 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 6% in 2025.
- Prepayment activity could accelerate again in 2025, with expected rate cuts likely to reignite refinancing activity. This could widen the gap between bank and nonbank prepayment rates, which have recently narrowed, as nonbank borrowers refinance onto competitive home loans offered by banks.
- While we expect unemployment to rise, forecast increases are still below prepandemic levels. Modest property price growth also affords existing homeowners greater agency in self-managing their way out of any financial stress. This is also helping to keep longer-dated arrears low.
- 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, lower interest rates--when they arrive--and property price growth will ease debt serviceability pressures and help to curtail potential losses.

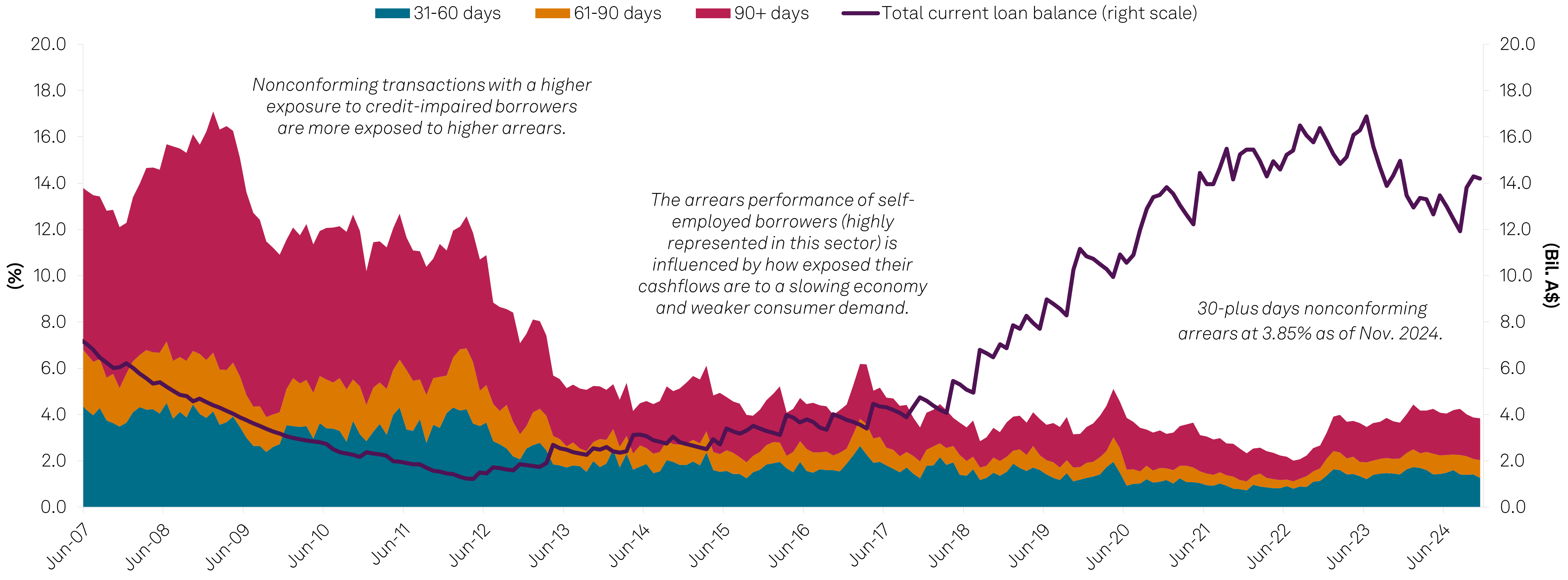
# Prime Arrears Stabilize As Interest Rates Remain On Hold




Prime data SPIN shown excludes noncapital market issuance transactions. Prime RMBS arrears exclude noncapital market issuance transactions. Standard variable rates are based on outstanding mortgages.
Sources: Reserve Bank of Australia. S&P Global Ratings.

S&P Global Ratings

# Nonconforming Arrears Hold Steady




LTV--Loan to value ratio. Bil.--Billion. A$--Australian dollar. Source: S&P Global Ratings.

# Australian ABS Outlook

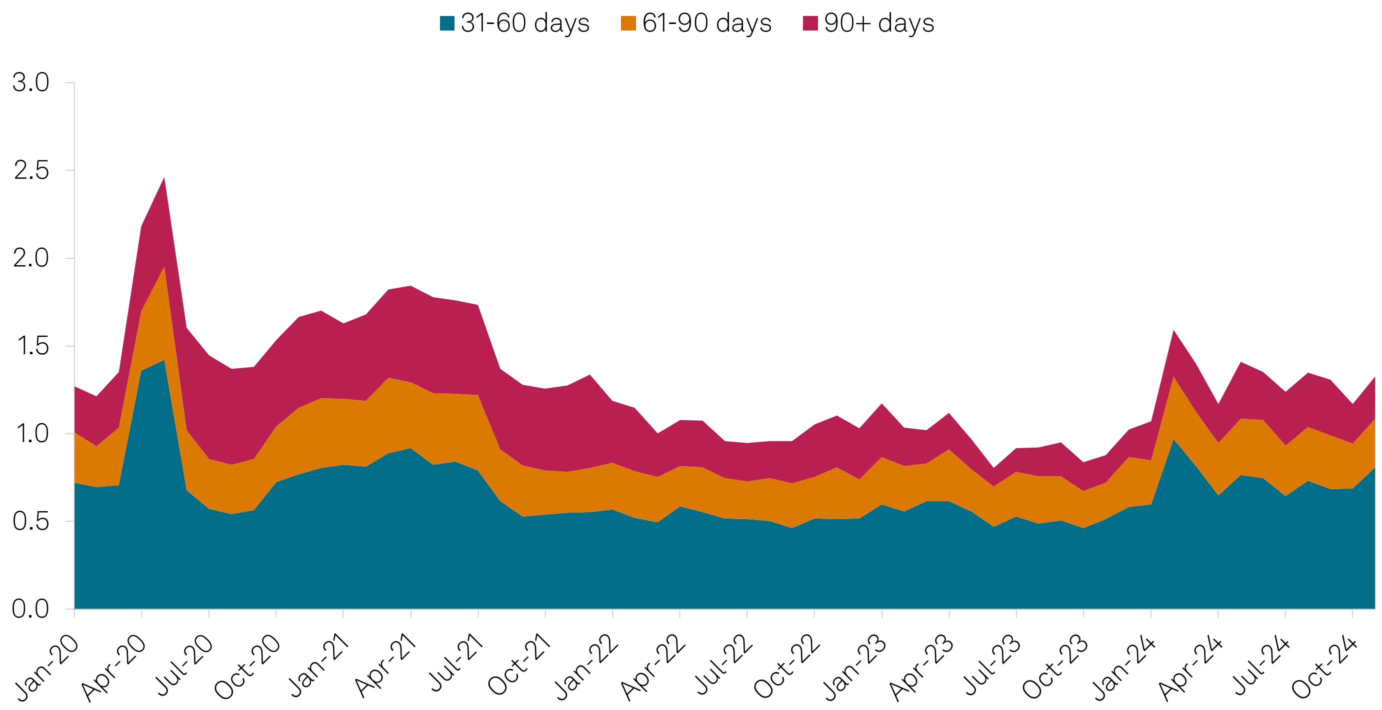
Better than expected

# 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.
- Many auto ABS transactions are more heterogenous, often comprising auto, equipment, light commercial, and other loans. This means 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.
- In larger markets, the normalization in new vehicle supply has caused used-vehicle values to fall. This has affected more recent vintages that were underwritten during the pandemic, when used car prices peaked due to supply chain constraints.
- 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.

# Arrears Statistics

## Australian auto ABS SPIN (%)




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.

**Arrears**

The Standard & Poor's Performance Index (SPIN) for Australian auto ABS and mixed auto pool arrears increased to 1.33% in November from 1.17% a month earlier.

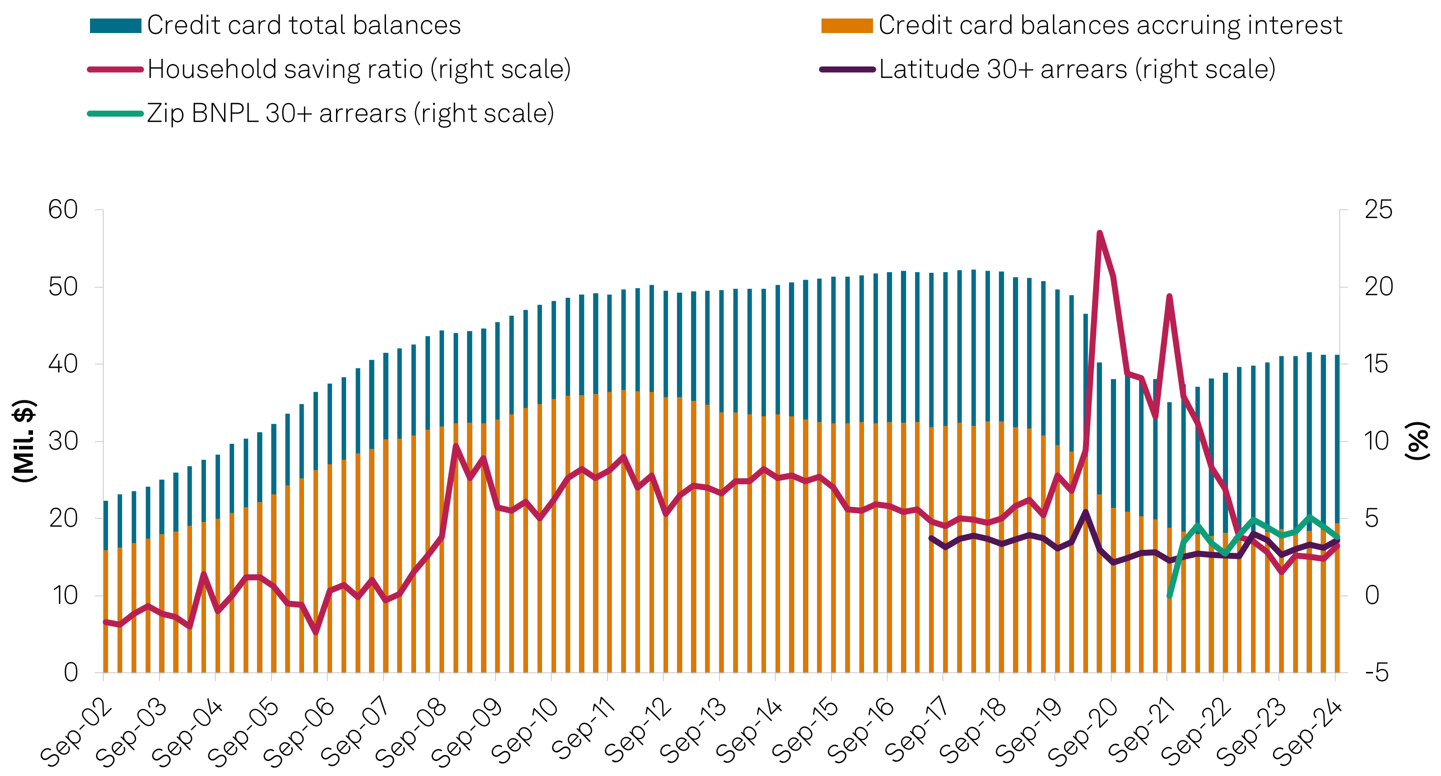
Although arrears increased across all originators in November, we attribute part of the rise in the SPIN to technical arrears due to the processing of some end-of-month direct debits on the next business day, in December. We expect to see some seasonal increases in arrears in coming months, reflecting the holiday season in Australia.

**Ratings Outlook**

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

# Unsecured Consumer ABS Performance Is Holding Steady

## Credit card balances remain steady despite lower household savings




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.
- Total credit card balances fell during the pandemic as people saved and delayed spending. The balances have stabilized because borrowers have curtailed discretionary spending.
- Prudence in consumer spending decisions has helped to keep arrears stable for credit card and personal unsecured lending portfolios, despite cost-of-living pressures.
- This prudence has been a consistent theme globally, with credit card ABS performance in larger markets demonstrating resilience despite higher interest rates and inflationary pressures for households.

# New Issuance

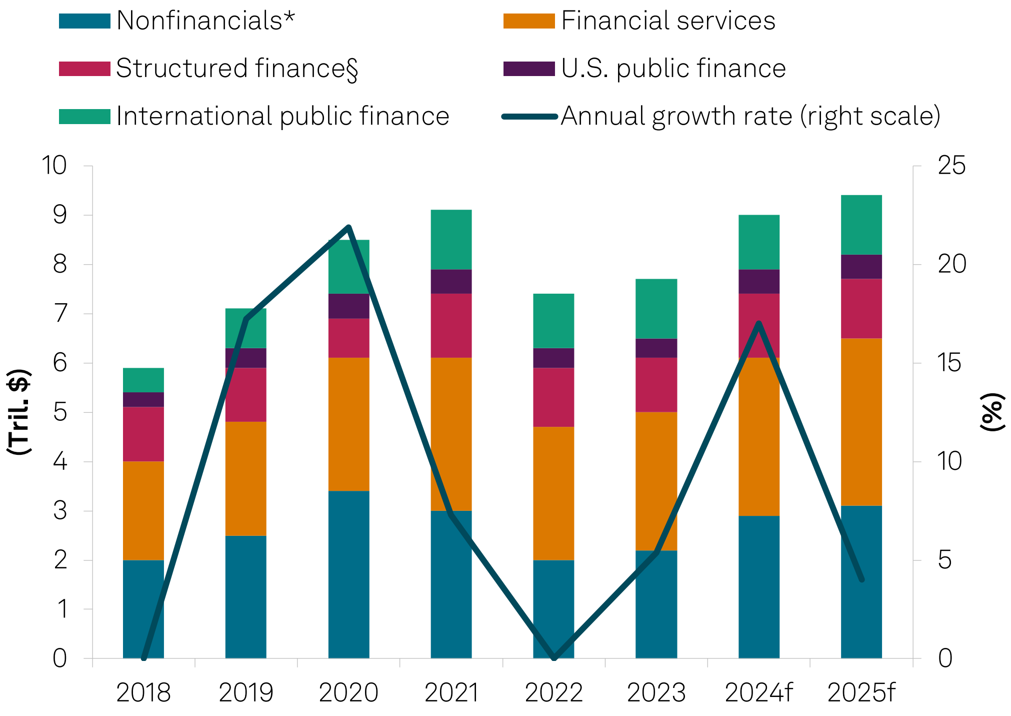
## Issuance momentum set to continue

# 2025 New Issuance Outlook

- We expect total new issuance in Australia for structured finance, to be similar to 2024 levels, a record year with new issuance levels reaching over A$70 billion, a post-financial crisis peak.
- 2024 was also a blockbuster year for structured finance issuance globally, with over US$1 trillion issued.
- Issuance in Australian in 2024 was buoyed by sustained global and domestic interest, reflecting the sector's longstanding "relative value" credentials. This appeal transcended all asset classes.
- S&P Global Mobility predicts that light-vehicle sales in Australia will fall about 3% in 2025 as economic uncertainty weighs on demand. This is unlikely to hinder auto and equipment ABS issuance in 2025 because the fast paydown of these structures creates a frequent cycle of new issuance to replenish maturing notes.
- Other ABS is also likely to gain more traction, particularly with rate cuts on the horizon, as investor interest widens beyond traditional RMBS and auto ABS.
- Forecast rate cuts are likely to stimulate home loan lending, increasing competition for mortgages, and refinancing activity.
- Higher unemployment could present a headwind, slowing economic activity, but this will be offset by lower rates.
- Sustained issuance will be underpinned by the predominance of nonbank originators in this market and their reliance on securitization.
- New issuance trends in other markets, particularly the U.K., and global interest rate trends, will influence global demand and pricing, given Australia's relative value appeal to offshore investors.

# Lower Rates To Aid Global Issuance

## Historical global issuance and forecast




*Includes infrastructure. §Excludes transactions that were fully retained by the originator, domestically rated Chinese issuance, and resets and refinancings of collateralized loan obligations. f--Full-year forecast.
Sources: Dealogic, Refinitiv, S&P Global Ratings Credit Research & Insights.

- We expect global bond issuance to rise 4% in 2025 off the back of a blockbuster 2024.
- Markets appear to have reached relative consensus regarding interest rate cuts in 2025, which will boost issuance, all things being equal.
- But yield declines may prove modest and lower policy rates still depend on growth slowing in certain regions, which would slightly offset potential increases to issuance.
- Potential upside drivers to global new issuance include stronger-than-expected economic growth; more issuance from China, given recent moves by the central banks; and, on the fiscal side, a boost in economic growth and increasing AI investment.
- We expect another year of strong of US structured finance issuance, led by ABS and CLOs.
- European securitization issuance also looks set to remain high, given a broadening base of originators and sponsors, a better outlook for most areas of underlying lending, and rising market engagement from bank originators.
- While rate cuts will benefit consumers, their pace and magnitude as well as how long they take to materialize remain uncertain and will vary by region.
- These trends will affect ABS and RMBS issuance levels, the dominant asset classes in structured finance.

See: "Global Financing Conditions: Blockbuster Growth in 2024 With Tailwinds Heading Into 2025," published Oct. 23, 2024.

# Ratings Movements

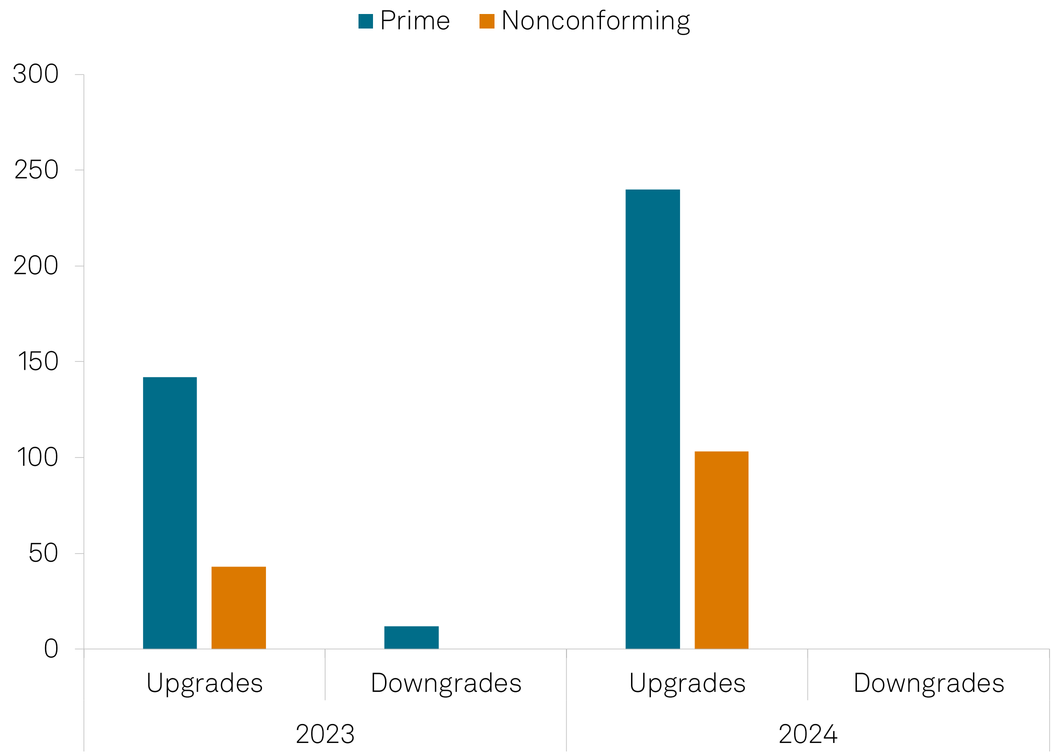
Upgrades in 2024 again exceeded downgrades

# 2025 Ratings Outlook: Stable With A Positive Rating Bias

- Despite a rapid rise in interest rates, we lowered no ratings due to collateral deterioration. We expect this to continue in 2025, given the structural supports in transactions and ongoing credit support build up.
- Forecast rises in unemployment will lead to rising arrears, but this will be offset by rate cuts. We expect the effect on collateral to be modest and is unlikely to cause any ratings deterioration.
- We expect a positive ratings bias due to the ongoing deleveraging of structures. The rate of deleveraging will be influenced by prepayment speeds. Higher prepayment speeds are likely if refinancing activity rises after rate cuts, due to increased competition.
- Raised ratings in 2024 were primarily due to the implementation of our new "Global RMBS Criteria," a buildup in credit support, and stable collateral performance.
- There are no recorded rating defaults for Australian RMBS ratings. We lowered our ratings on a small number of mezzanine tranches of nonconforming note classes during the financial crisis due to collateral deterioration.
- Historically, the primary reason for lowering our ratings on Australian RMBS is the lowering of key counterparty ratings, particularly on lenders' mortgage insurers. This counterparty risk has declined because 100% lenders' mortgage insurance coverage is now less common in prime RMBS transactions, .
- We have lowered our ratings on a small number of legacy prime RMBS transactions in recent years due to increased borrower concentration risk because of their small size.
- 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.

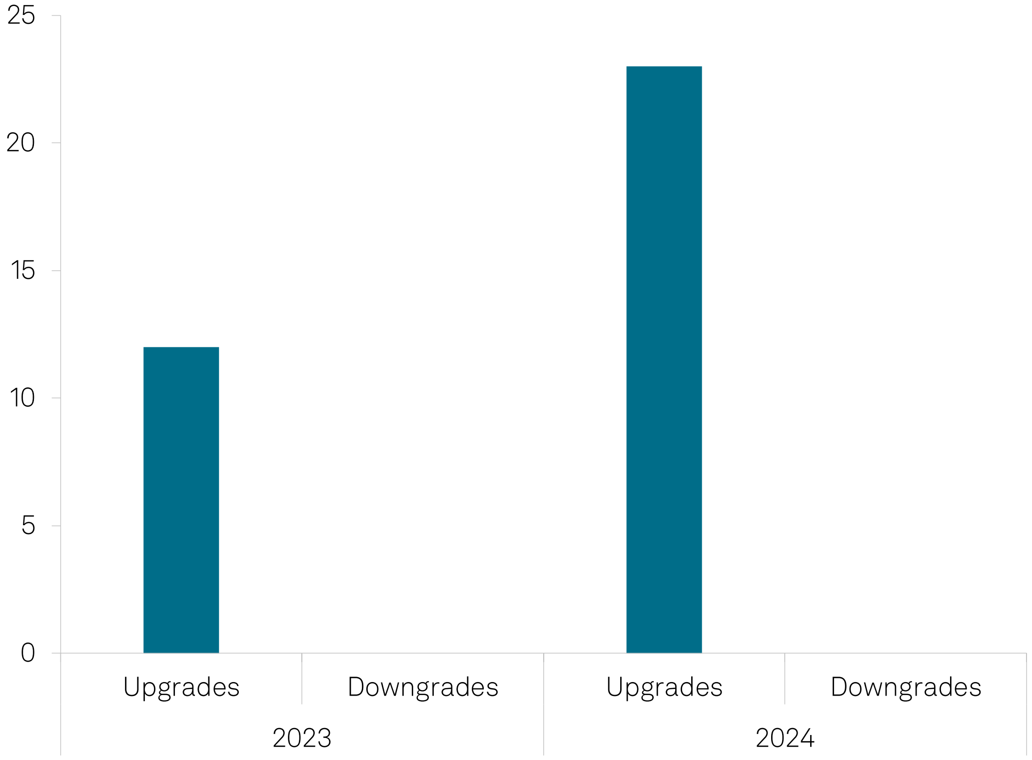
# Rating Bias Remains Positive With Support From Continued Deleveraging

## RMBS: Number of upgrades vs. downgrades (Australia)




Source: S&P Global Ratings.

## ABS: Number of upgrades vs. downgrades (Australia)

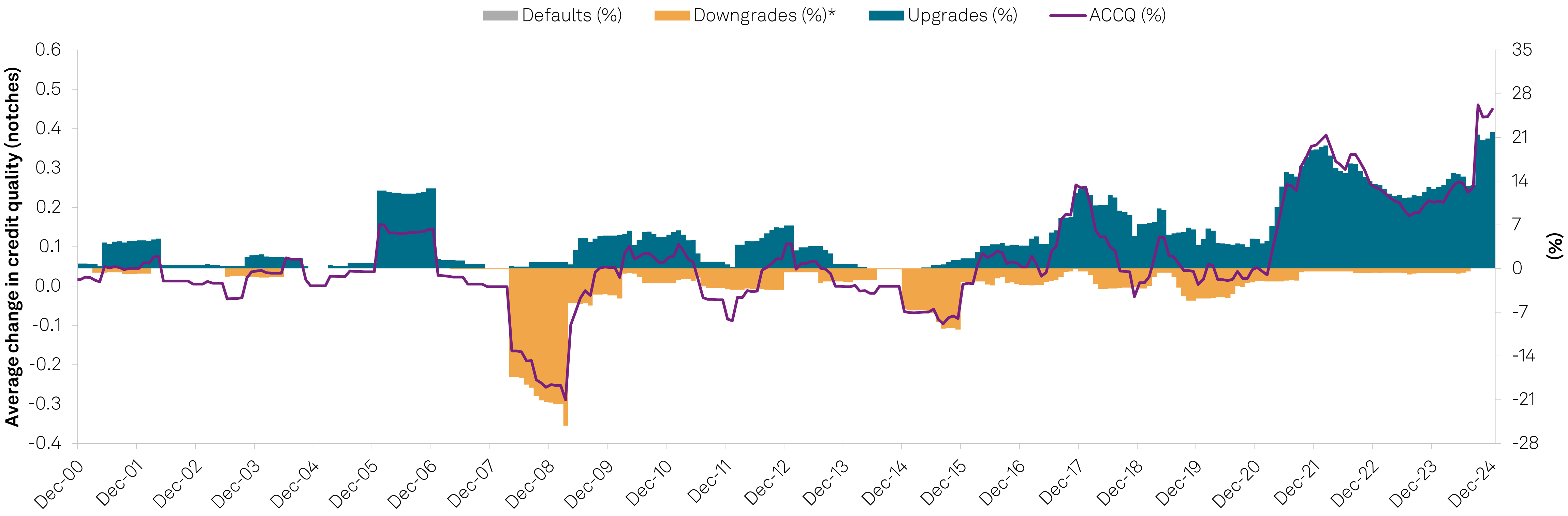



Source: S&P Global Ratings.


25

# RMBS Ratings Demonstrate Positive Rating Bias

## Average change in credit quality - Trailing 12-months ACCQ RMBS




ACCQ--Average change in credit quality – Australia and New Zealand Structured Finance Ratings. Source: S&P Global Ratings.

S&P Global
Ratings

# New Zealand

Lower rates to help ease debt serviceability and boost housing demand

# Declining Net Migration Slows Labor Force Growth

- The New Zealand economy is slowing as the downstream effects of higher interest rates drag on domestic demand. Unemployment is expected to rise further, wage growth is slowing, and net migration is falling, partly in response to subdued labor market conditions.
- Inflation, currently at 2.2%, is well within the target band of 1% - 3%, enabling monetary policy easing. This has flow-on effects on mortgage rates, which have fallen more than 1%.
- We expect house prices will grow in the mid-single digits over the next two years. Ongoing supply shortages, high net migration, easing interest rates, and a slight loosening of macroprudential lending restrictions should continue to support the recovery.
- We expect the restoration of interest deductibility for investors in April 2025 to bolster investor participation, adding to housing demand. These factors will help property price growth in 2025.
- Rising unemployment will place further pressure on arrears, which have been rising since 2022 due to higher interest rates.
- The significant buildup in equity across the New Zealand RMBS sector, given the seasoning of portfolios, means that higher arrears are unlikely to translate into losses.
- An improving economy in the wake of lower interest rates will help consumer demand for mortgages and other forms of consumer lending. This may help drive ABS issuance, but RMBS issuance will remain hindered by the dominance of major banks and their cheaper funding costs, and the recent exit of some nonbank lenders in the mortgage space.

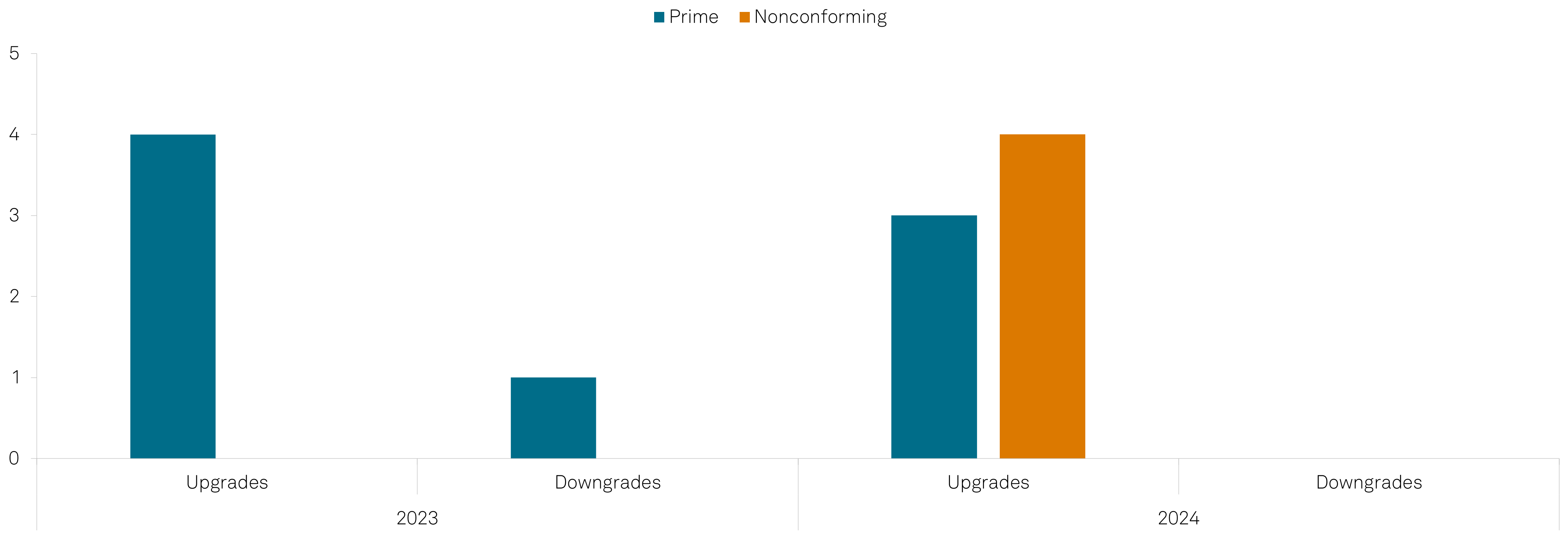
# S&P Global Ratings Economic Outlook

| | 2025f | 2026f | Outlook | Effect on credit quality |
|---|---|---|---|---|
| **Real GDP forecast (% year over year)** | 2.2 | 2.4 | Higher interest rates are dragging on consumer demand. We expect growth to pick up in 2025, with gradually lower inflation and interest rates. | **Neutral.** New Zealand's earlier commencement of its tightening cycle has slowed the economy, with flow-on effects on household demand and property markets. |
| **Unemployment rate (year average; %)** | 5.3 | 4.9 | The labor market has weakened, with a contraction in employment. More accommodative monetary policy should help to boost growth. | **Negative.** Rising unemployment will lead to higher arrears, albeit off a low base. |
| **CPI (%)** | 1.9 | 2.2 | Inflation is within its target range. | **Positive**. Lower inflation will enable monetary policy to remain accommodative and lower cost-of-living pressures. |
| **Policy rate, end of year (%)** | 3.25 | 3.00 | The Reserve Bank of New Zealand lowered the cash rate to 4.25% in November. | **Positive.** The lowering in the cash rate is flowing through to lower mortgage rates, which will ease debt serviceability pressures. This will be offset by rising unemployment. |

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

# Rating Bias Remains Positive; Support From Continued Deleveraging

## RMBS: Number of upgrades vs. downgrades (New Zealand)




Source: S&P Global Ratings.

# Structured Finance Analytical Contacts


### Erin Kitson

**Primary Analyst | Sector Specialist Research**

erin.kitson@spglobal.com

### Kate Thomson

**Analytical Manager**

kate.thomson@spglobal.com

### Narelle Coneybeare

**Sector Lead**

narelle.coneybeare@spglobal.com

### Elizabeth Steenson

**Lead Analyst**

elizabeth.steenson@spglobal.com

### Alisha Treacy

**Lead Analyst**

alisha.treacy@spglobal.com

### Timothy Bartl

**Lead Analyst**

timothy.bartl@spglobal.com

### Paul Prajogo

**Lead Analyst**

paul.prajogo@spglobal.com

**spglobal.com/ratings**

S&P Global
Ratings