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Global Structured Finance Outlook 2018: Volume Could Reach $1 Trillion If Steady Economic Conditions Persist

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Global Structured Finance Outlook 2018: Volume Could Reach $1 Trillion If Steady Economic Conditions Persist

As we begin 2018, global macroeconomic factors appear aligned to allow global structured finance issuance to continue playing a larger role in financing the world economy. With that in mind, S&P Global Ratings forecasts approximately $1 trillion of global structured finance issuance in 2018. This continues the strong growth experienced in 2017, when global issuance increased by 39% from 2016 to $930 billion-U.S. equivalent. The growth has been sustained by expectations of a 3% year-over-year (y/y) increase in U.S. GDP, combined with expectations of GDP growth of 2% or more in Canada and most of Europe, as well as continued growth in the Asia-Pacific (APAC) region.

Some potential risks that could derail the continued recovery of structured finance in 2018 include the North American Free Trade Agreement (NAFTA) renegotiation, limited Brexit progress, rising interest rates, and any market volatility that affects liquidity. As we start the new year, however, we primarily see growing consumer and business confidence, which should support another year of positive economic activity. As this positive economic activity leads to loan growth, we will continue diligently analyzing security pools, with a watchful eye for any late-cycle aggressive underwriting that could create credit risk.

Table 1 summarizes our issuance projections relative to those of the past three years.

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Table 1

Issuance Summary

All figures in U.S.$ equivalent unless otherwise stated

	2015	2016	2017 (full year)	2016 vs. 2017 % change	2018 forecast
U.S. ABS	183	191	229	20	225-250
Auto loan/lease/rental cars	89	85	89	5	95
Cards	25	35	47	34	40-50
Student loan	14	13	15	15	15-20
Equipment/fleet/floorplan	25	24	32	33	30-35
Other ABS (esoteric, personal loans, mobile phone)	31	35	46	31	45-50
U.S. CMBS	101	76	93	22	85
SASB	32	21	35	67	30
U.S. CLO	98	72	118	64	110
U.S. RMBS-related	54	34	70	106	80-100
TOTAL U.S.	**436**	**372**	**510**	**37**	**500-545**
Canada (bil. C$)	**15**	**18**	**20**	**11**	**20-22**
Europe (bil. €)	**77**	**81**	**82**	**3**	**80-90**
China	97	116	220	90	240
Japan	38	53	48	(9)	48-52
Australia	24	17	36	112	40
Latin America	**11**	**12**	**15**	**25**	**19-25**
APPROXIMATE GLOBAL TOTAL (bil. $)(i)	**701**	**667**	**930**	**39**	**947-1,014**

(i)Approximate global total reflects an adjustment for some cross-border deals that were counted in both the U.S. and Canadian totals.
ABS--Asset-backed securities. CMBS--Commercial mortgage-backed securities. SASB/LL--Single-asset single-borrower/large loan.
CLO--Collateralized loan obligation. RMBS--Residential mortgage-backed securities. NPL--Nonperforming loan.

Ideal Conditions In 2017 Should Continue Into The New Year, With Caveats

In 2017, growth in both developed and developing markets, in combination with relatively low interest rates, drove global loan production, which in turn fed issuance growth (see table 1). We foresee this trend continuing in 2018.

U.S. issuance increased 37% in 2017. With auto issuance up only 5% and commercial mortgage-backed securities (CMBS) up 22%, several sectors played outsized roles in 2017, and we expect these sectors to continue leading growth into 2018:

- Collateralized loan obligation (CLO) markets successfully implemented risk retention funding, creating over 60% of issuance growth in 2017. While we expect some growth in 2018, this segment's accelerating issuance pace should reach a saturation point in 2018.
- Residential mortgage originators also started to figure out the risk retention puzzle and increased their issuance by over $30 billion (by 106% relative to 2017). Private-label residential mortgage-backed securities (RMBS) have been under-utilized, and so could show high growth in 2018.
- As consumer lending has increased, the consumer sector in general started to utilize more securitized funding. U.S.

asset-backed securities (ABS) saw a 20% annual increase in 2017.
- The CMBS market has worked through a maturity wall, and recent tighter pricing should help keep 2018 issuance steady.
- Tighter spreads and the search for yield seems to be a global trend that has many investors comparing global ABS returns and frequently reaching into the higher-yielding U.S. structured finance market for nontraditional ABS products such as aircraft, container, and whole business deals.

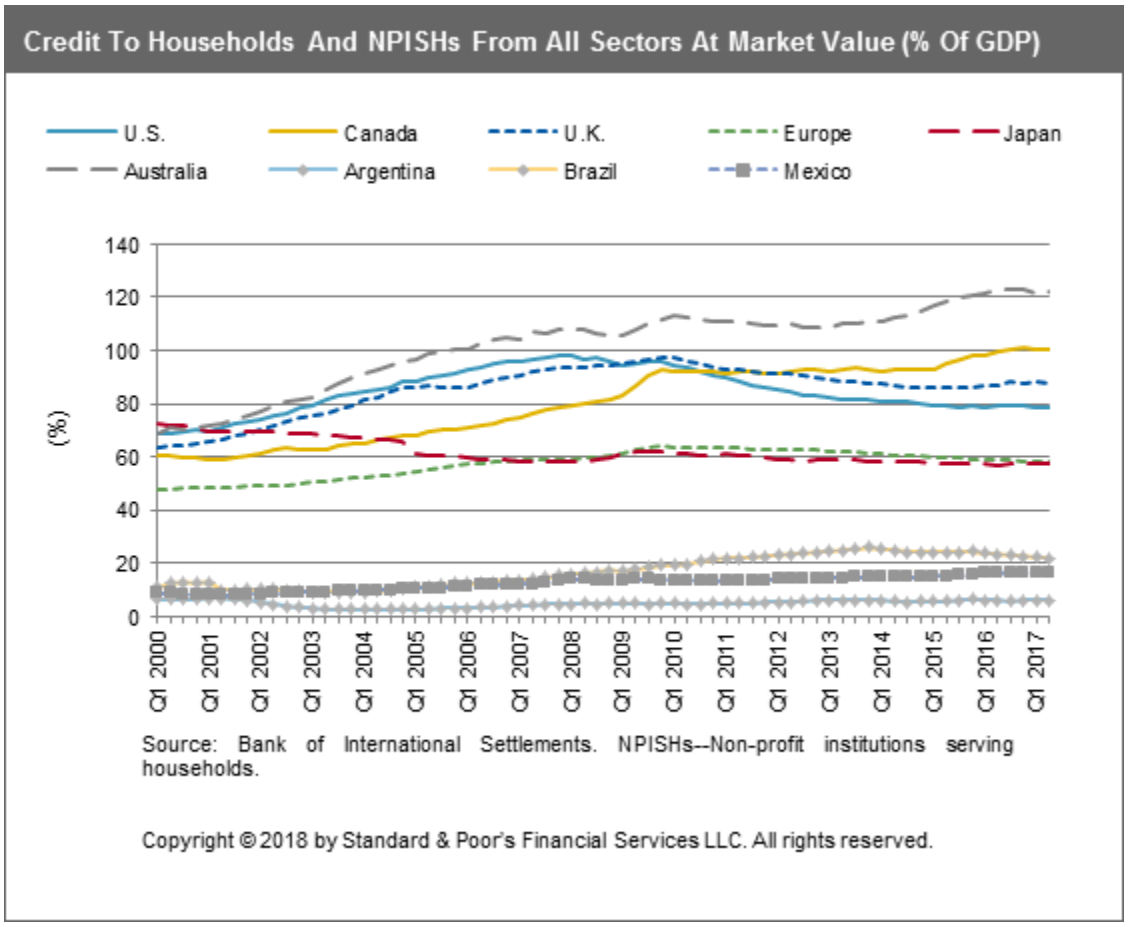
Given the higher U.S. yield environment and these continuing trends, we expect U.S. structured finance issuance to remain above $500 billion, and to continue growing in 2018.

As investors have looked for global structured finance yields, we have seen increased cross-border investment interest in asset-backed commercial paper (ABCP), autos, credit cards, and residential mortgages supported by flows out of European and APAC markets to Australia, America, China, and some European regions. Some 2017 trends transitioning to 2018 include:

- International investors buying Australian ABS, which is generally purchased locally and swapped; and Canadian U.S. dollar-denominated ABS, where several issuers brought their collateral pools to the U.S. for the tighter spreads that can be achieved when bonds are offered in U.S. dollars. The result of these cross-border investment flows and bond placements can be seen in the growing issuance numbers in Australia, Canada, and China, as we go from 2017 into 2018 (see table 1).
- The recent Japanese economic recovery has led to loan growth restarting, which we expect to stabilize or increase issuance in 2018.
- While table 1 shows limited European structured finance growth, we expect activity could pick up as the market figures out its new "simple, transparent, and standardised" (STS) designation in 2018. The final implementation of STS should provide certainty that helps increase European issuance. It may even help non-STS-designated issuance as investors realize non-STS-eligible structured finance issuance also has strong credit characteristics and spreads that attract investors beyond banks.

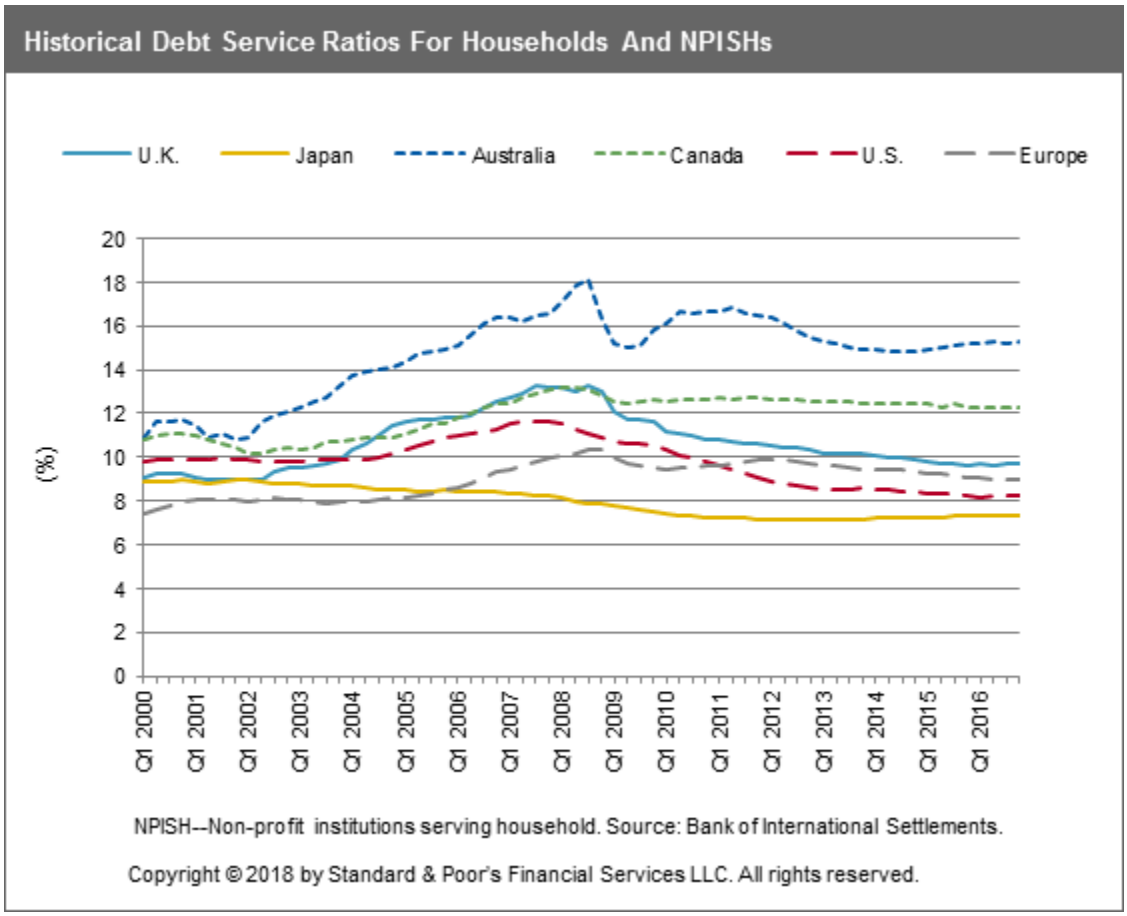
These positive factors all contributed to our 2018 global structured finance forecast--in the range of $1 trillion U.S. equivalent--but there are some risk factors that could affect structured finance issuance and credit performance. Specifically, S&P Global Ratings' Credit Conditions Committee will consider risks from possible growing protectionism in 2018 should a trade war break out with China, or if NAFTA is dismantled. In the event that one of these risks materializes, our economists project an overall negative effect on the U.S. economy and, subsequently, related global economies, ranging from 0.5% to 1% downward adjustments. While none of these risks are expected to create absolute negative GDP growth in the related markets, they could affect consumer and business confidence and slow down overall loan and bond issuance. These global economic risks exist for all credit products, but our economics group currently expects there is only a small chance of recession in 2018. Yet, the economic recovery has been fairly extended, and market participants have focused on indicators such as consumer debt relative to the economy, which we show for several global markets in chart 1.

Chart 1



A couple of these economies appear to be near peak levels; however, when we evaluated consumer capacity by looking at household debt service, we came away feeling that the consumer still has further capacity to spend and take on leverage. Chart 2 shows the household debt ratios for many of the developed and developing markets, and, in most cases, levels are still well below pre-2007 levels. As we expect several rate increases in the next 36 months, we performed a sensitivity analysis focusing on only the U.S. ratio. We found that if debt continued to grow at the recent pace, and if rates rose 100 basis points (bps) over this year, the ratio could reach pre-2007 levels by the end of 2018 (see "Is Consumer Loan Growth Creating A Systemic Risk?" published Oct. 26, 2017). The results suggest that we will have to monitor consumers' overall leverage as they could eventually become overextended.

Chart 2



Because we expect that 2018 will feature both collateral and issuance growth, we will be carefully monitoring the various structured finance sectors, which we discuss in detail in the various regional and product outlooks below.

U.S. SECTOR ANALYSIS

U.S. Auto Loan ABS: Lower Used Vehicle Values Will Continue To Impact Performance, But Ratings Are Likely To Remain Stable

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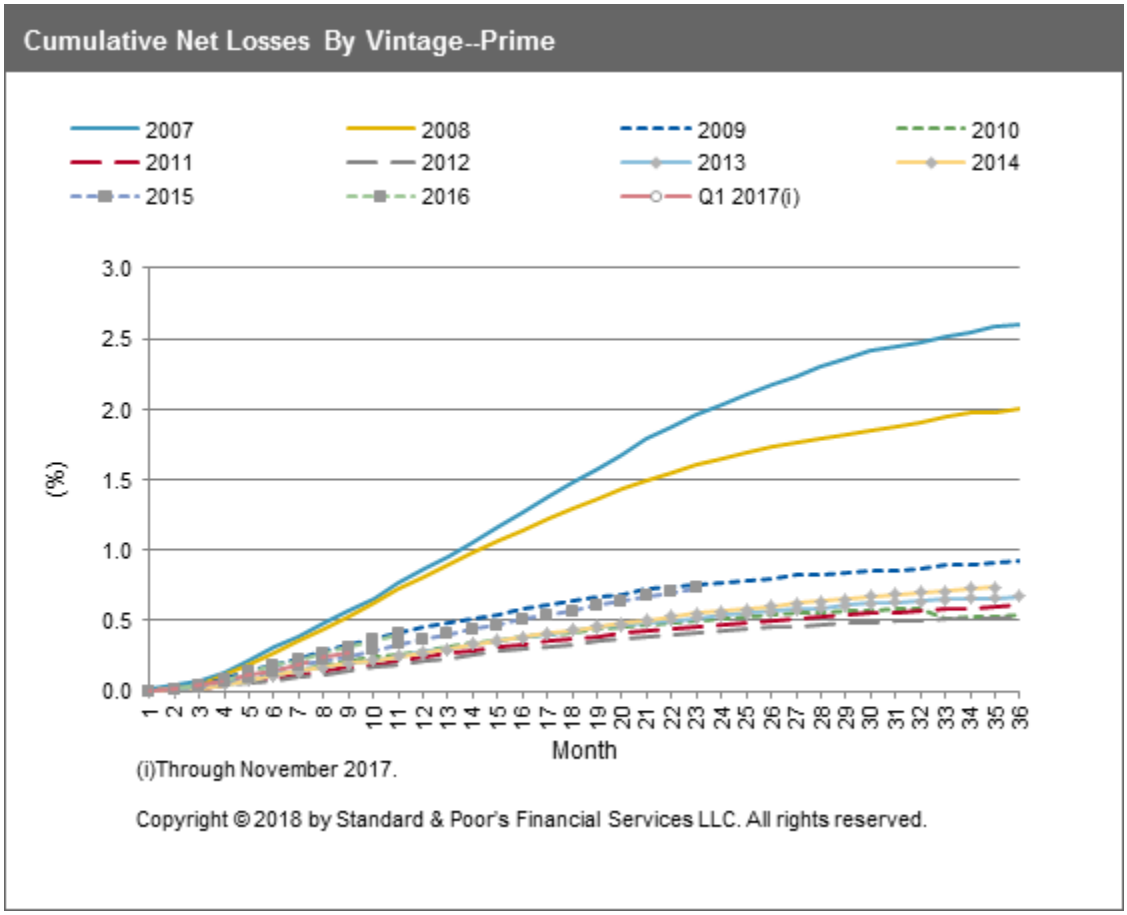
Favorable investor demand and low issuance costs supported auto loan ABS growth in 2017 and offset the effects of slightly lower auto sales of approximately 17 million units, down from 17.4 million in 2016. GM Financial, which came to market with three transactions under its new prime issuance platform (GM Financial Consumer Automobile Receivables Trust), contributed to issuance growth, as did Santander Consumer USA and Ford Credit. In 2018, we think light vehicle sales could weaken again slightly to 16.9 million units. As a result, our forecast for auto loan ABS this year is for only modest growth (perhaps 5%), to $76.0 billion, with the increase coming from independent finance

companies that are benefitting from certain banks having recently curtailed their auto lending activities. Also, several of the captive finance entities are working with independent finance companies to buy their dealers' below-prime auto loans in flow-through programs. This trend is gaining momentum, and we're likely to see more of these loans enter the ABS market. We may also see a few new issuers, including credit unions. According to the Credit Union Journal (June 20, 2017), federal credit unions have now been cleared by the National Credit Union Administration to securitize loans.

In our view, collateral performance will continue to feel the effects of lower recovery rates. We anticipate that the value of used vehicles will continue to fall by about 5% in 2018 as the supply of used vehicles increases due to record off-lease vehicle volume. Prior years' higher LTVs and the continuing trend of longer loan terms have further exacerbated recovery rates. Several lenders have tightened their lending standards, particularly their LTVs and in some cases their FICOs, and we believe that these actions are starting to offset the effects of lower recovery rates,, particularly in the prime segment. So while prime 2015 and 2016 cumulative net losses (CNLs) continue to trend up year over year, so far, with nine months of performance, the 2017 Q1 vintage is reporting slightly lower CNL than 2016 (see chart 3 below).

Chart 3



However, for the aggregate subprime index, despite several lenders lowering their LTVs and increasing their weighted average FICOs, we're still seeing rising collateral losses in the 2017 Q1 vintage. The high level of repossessions in

these pools and lower auction recovery rates are negatively impacting many of these pools. But we should note a select few subprime issuers are reporting lower losses on their more recent vintages, and we would expect that to continue this year given the significant amount of underwriting tightening, especially on the LTV front, that has occurred within these companies.

Overall, many prime and subprime issuers seemed to tighten underwriting standards in 2017, and we expect some of these efforts will compensate for lower auction values and help stabilize performance in 2018. This, coupled with the typical deleveraging that occurs in auto loan ABS, will support a strong rating upgrade-to-downgrade ratio in 2018, which was 322 upgrades to zero downgrades in 2017.

U.S. Auto Lease ABS: Flat New Vehicle Sales Translates To Flat Issuance

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We expect auto lease ABS volume in 2018 to range between $15-$17 billion, which reflects last year's level of approximately $15.5 billion and a possible 10% increase. Given our forecast for flat or a slight decline in auto sales this year, we expect auto lease ABS volume to be generally flat. An increase in ABS volume could materialize if the auto lease securitizers issue one additional transaction beyond the regular two-three deals per year (the average auto lease ABS deal size is $1.0 billion), if Santander Consumer USA increases issuance under its Santander Retail Auto Lease Trust shelf (which it debuted in 2017), or if certain captive finance entities who have been absent from the ABS market in 2016-2017 re-enter the market in 2018.

Lease penetration rates decreased slightly in 2017 to around 28%-29%, after year-over-year growth since 2009, when it hit peak levels in 2016 at over 30%. We believe this generally reflects captive finance entities' focus on limiting leasing volumes in response to rising off-lease vehicle inventory levels and declining residual values. We anticipate that lease volume penetration or lease share of retail sales will remain steady in 2018. While this may bode well for leasing, it can potentially put pressure on auto loan terms as consumers continue to seek favorable monthly payments.

We anticipate that competition among the automakers will increase as new car sales trend flat or decline. Incentive spending may increase from current levels as automakers seek to maintain or increase market share away from peers. Incentive spending on used vehicles may also increase if more focus is placed on used car sales. We anticipate that used car values will continue to fall by about 5% in 2018 as the supply of off-lease vehicles increases.

Given strong economic growth and stable employment, we expect our ratings on auto lease ABS to remain stable in 2018. We also expect that continued increased supply of off-lease vehicles will continue to put pressure on used car prices in 2018 but the rate of decline may be softer than in 2017. The mix of vehicles coming off-lease in 2018 and later will consist of a greater percentage of SUVs than in 2015-2017. The demand for SUVs may help to mitigate and soften the pressure on overall used vehicle prices. Auto lease ABS transactions in 2016 and 2017 also included a greater mix of SUVs and trucks than in prior years. We believe credit enhancement levels in the auto lease ABS we rate adequately address the expected declines in residual values. The non-amortizing credit enhancement structures and deleveraging, in our view, will help to offset the downward pressure on residuals. Our ratings approach assume that, at the 'AAA' stress level, 100% of non-defaulting leases are returned and incur a residual loss of 26%. Our 'BBB'

stress levels were established based on observed residual loss performance during the 2008-2009 recession. In addition, our ratings approach adds additional stresses to account for various concentration risks, including maturity distribution, vehicle model, and vehicle segment, that results in greater credit enhancement levels.

U.S. Credit Cards And Personal Loan ABS: Look For A Steady Flow Of 2018 Issuance

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Regulations may affect credit card issuance

For U.S. credit card ABS in 2018, we expect $40-$50 billion in new issuance volume, somewhat weaker performance, and stable ratings.

Volume: Of that issuance figure, about $4-$5 billion is likely to be private-label deals tied to retailers and about $5 billion will be cross-border from Canadian issuers. Contributing factors to the elevated volume continue to be ongoing low cost of funds, diversification of funding sources, loan growth, investor demand, and the refinancing of about $42 billion of maturities, which are frontloaded in the first four months of the year. As rates rise and deposits become more expensive, we believe that banks may have more incentive to use securitization as an alternative funding source, as these instruments could become generally more economical at the 'AAA' rating level. However, we believe that regulations will continue to constrain funding and lending decisions, which may have an impact on issuance volume.

Performance: Despite a favorable economic backdrop of marginal wage growth and consumer spending supported by real GDP growth and a low unemployment rate in 2018, we anticipate somewhat weaker credit card performance as new loans season and weaker-credit-quality accounts are originated at higher volumes. We continue to look to a combination of factors that we think drive credit card performance, including the unemployment rate, household debt service levels and overall household debt, bankruptcy filings, volume and credit quality of revolving credit, and alternative credit and payment options. For securitized trusts, we also monitor FICO scores, account seasoning, credit lines and balances, and the portion of pools from obligors who pay the minimum required payment compared with those who pay their full balance each month. As the cycle has become extended, we continue to expect a gradual increase in bank card loss rates over the next two years, starting from historical lows of 2% and normalizing at about 3%-4% in securitized trusts and 4%-5% for the industry as a whole.

We anticipate a wider gap in card losses between managed and securitized pools as long as the volume of newly originated, non-prime accounts remain limited in trusts. For now, securitized pools include mostly highly seasoned, prime accounts exhibiting FICO scores above 720 for 60% of trust receivables. Subprime accounts make up only 15% of securitized pools compared with at least 1/3 pre-recession.

Lower cost deposits and high payment rates, among other factors, led to the steady decline in trust receivables tracked in our U.S. Bankcard Credit Card Quality Index (U.S. bank CCQI), which fell more than $108 billion since the start of 2012, or 29%. Assuming issuance volumes continue to grow in 2018, it is likely that there will be an increase in account additions to trusts, which could result in a shift in pool compositions. Receivable additions and removals are typically subject to rating agency conditions.

We anticipate a larger performance deterioration in retail cards compared with bank cards in the next 12-24 months. Current retail card losses average about 4.5%, which is still in line with the historical gap of 2% between bank and

retail cards. Nevertheless, most of these cards are tied to department stores or discount chains. The utility of these cards could become less valuable due to online competition and upon store closures, which could lead to higher strategic defaults on these products. Overall, retail card losses could reach 6% by 2019.

Stable ratings: We anticipate our ratings to remain stable despite the likely weaker performance mentioned above. For bank and retail cards, our average base-case loss assumptions of 5.5% and 8%, respectively, and our annualized peak loss stresses for 'AAA' ratings of 33% and 37%, respectively, are well above actual performance, and we expect that even our lower-rated bond classes should be well protected from any expected 2018 potentially weaker performance.

Personal loans to see further marketplace lender growth

Volume: Branch-based and online marketplace lenders issued a total of about $7.2 billion securitized transactions in 2017, of which about 74% was from marketplace lenders and 26% from traditional brick and mortar issuers. Based on loan growth, investor demand, and funding needs, we expect the sector to grow about 10% from branch-based originators and about 30% from marketplace lenders in 2018. We would not be surprised if traditional bank lenders began funding a portion of their unsecured personal loan business with securitization. Several banks have been active in the space, including Barclays, Discover, American Express, PNC, and Synchrony, among others. We also anticipate an increase in partnerships between these types of lenders and community and commercial banks, merchants, and payment platform providers, which will likely boost operational efficiencies from gains in scale and digital technology, lower marketing expenses, and consumer leveraging. Ultimately, we expect these developments, along with economic growth, will help elevate the stream of personal loans and related structured products as more of these lenders reach for securitization as a partial funding vehicle.

Performance: Branch-based performance remained steady in 2017, with credit loss rates ranging from 6%-8%. This is consistent with the historical performance of the unsecured personal loan sector over the past 25 years, even though most of the lenders from the 1990s pulled out of the industry or consolidated with other companies and the landscape today includes new participants. Nevertheless, the obligor base—with FICO scores in the low to mid-600s—and the fixed-rate amortizing loan products are fundamentally the same, which explains why loss rates for the sector have not changed significantly from the past. Going forward, we anticipate loss rates to remain in the 6%-8% range over the next two years, partly due to favorable economic conditions supporting consumers' ability to pay and partly due to technological advances in risk mitigation tools, successful competitor acquisitions and integrations, the centralization of operational functions, and the development of more efficient payment options, including the Automated Clearing House (ACH).

For marketplace lenders, we observe that newer vintages generally exhibit higher losses and anticipate that, on average, current losses of 7%-8% could increase to 8%-10% next year, as loans season. This sector includes a diverse range of loans, and we would differentiate our projections based on the credit quality of each segment and terms of loans within the pools. Accordingly, our cumulative loss rate projections range from 2%-3% for 36 months loans and 5%-6% for 60 months loans in the prime segment and 12%-15% for 36 months loans and 20%-25% for 60 months loans in the non-prime segment. Generally, the sector benefits from a longer track record and now includes performance through reputational and funding challenges in 2016. Most platforms demonstrated the ability to reprice the loans, utilize balance sheets and diversify funding sources, engage in backup servicing arrangements, strengthen the alignment of interest throughout the life of the loans, retain some portions of risk after loan origination, and receive a part of their revenues from the loans held on books besides transaction and servicing fees.

U.S. Student Loan ABS: Refinance Companies To Push Issuance Higher

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Navient's acquisition of Earnest Inc. and the continued growth of the other student loan refinance companies should push 2018 private student loan ABS issuance $1-$2 billion higher than the $7.4 billion in 2017. Although the refinance companies are increasing loan origination volume, it has not been at the expense of loan credit quality, which remains very strong. Transactions in this segment across issuers have experienced very low losses and relatively high voluntary prepayments, reflecting the broader positive impact of the current economic environment and increasing financing options. Overall, we believe this segment will continue to benefit from the stable economic forecasts and a growing investor appetite.

The government's proposed elimination of the Grad PLUS loan and proposed loan limits to parent borrowers provides an opportunity for additional private student loan volume. If approved, these proposed changes could result in certain borrowers not being able to use government-funded student loans to bridge the total school financing gap between the cost of attending the school and the available funds of the student/parents. If that legislation change occurs, we would expect many private lenders will evaluate taking on further graduate loans, but with an eye to which degrees are the better credit risks.

The more mature segment of private student loans that focuses on in-school undergraduates with co-signers has gone through a transformation since the financial crisis. The typical ABS loan pool is 90% co-signed with an average FICO score 730-740. Annual loan origination levels today are much lower than pre-crisis. Private student loan originations for the industry for 2017 are estimated to be approximately $9 billion, compared to $21 billion in 2007. The smaller origination levels are producing much-improved credit quality when the obligor characteristics are compared to pre-crisis loan pools. These assets have performed well in post-2009 transactions, and we believe this trend will continue if lenders maintain similar lending disciplines.

For a number of years, Navient and Nelnet have accounted for a large amount of the issuance backed by loans from the Federal Family Education Loan Program (FFELP); this is expected to continue in 2018. For the last couple of years, the annual FFELP issuance has been around $8 billion, and we believe that 2018 will be similar as investors continue to have interest in the asset and Navient and Nelnet see favorable economics to execute FFELP transactions. Given the U.S. government's guarantee on the underlying student loans, we believe that the credit quality of FFELP student loan ABS will remain stable. New issuances in the FFELP space have mitigated "slow-pay" concerns due to income-based repayment plans typically moving legal maturity dates out 50 years from closing. The impact of income-based repayment plans on older transactions differs depending on the issuer and servicer. We will continue to monitor the payment rates and publish our FFELP Maturity Tracker to provide insight into FFELP transactions with legal final maturities in the next five years. We expect continued stable FFELP performance in 2018, as 75% of the legal maturities for FFELP transactions rated by S&P Global Ratings do not come until after 2027.

U.S. Mobile Handset ABS: New Asset Continues To Solidify Its Status With Steady Issuance Volume

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As we move into 2018, wireless device payment plan agreement (DPPA) securitization appears to be fairly well-established as a legitimate and feasible means of financing. Although, to date, only Verizon has issued publically-rated term bonds (in the form of five transactions totaling $6.6 billion since June 2016), investor acceptance of DPPA bonds has been strong, with spreads on Verizon's transactions coming in under expectations. This leads us to believe that many of the questions associated with this relatively new asset type have been answered and that a blueprint is in place for additional issuers to securitize. We believe that contributing to the market's acceptance is the consistency across issuers, which track credit losses by DPPA obligor tenure with a wireless carrier, and other relatively similar provisions of the DPPA asset including its short term, absence of an interest rate, and upgrade provisions.

If a new entrant emerges in 2018, an area that may likely distinguish potential issuers entry to the market, and any subsequent bond ratings, is the operational risk linkage we believe exists between a DPPA obligor and the wireless carrier and the wireless network upon which a DPPA obligor's phone operates. On Dec. 6, 2017, we published our criteria "Global Framework For Assessing Operational Risks Specific To Wireless Device Payment Plan Agreements" to address the risk present in connection with DPPA obligor cash flow from a prolonged disruption from the bankruptcy of a cellular network provider. The application of these criteria establish a maximum potential securitization bond rating in part by using existing corporate analysis concepts such as the business risk profile assessment, but with a more focused analysis on the continued functioning of a DPPA obligor's cell phone through such a period of disruption.

Factoring in such potential rating limitations as a result of these operational risk criteria, we believe that Verizon will maintain its existing annual volume of DPPA securitization in 2018 ($4.0 billion), and possibly increase it. Should another major carrier decide to issue, the amount of DPPA bonds issued could accordingly increase.

U.S. Commercial ABS: Continued Higher Volume And Stable Credit Quality

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Our commercial ABS outlook for 2018 is for sustained higher issuance volume. For 2017, including equipment, fleet lease, and floorplan, issuance totaled over $30 billion, up from about $25 billion the prior year, and we expect similar volume in 2018. Higher fleet lease issuance should continue as we expect Element Financial to continue to include legacy GE Capital fleet assets that were previously not financed through ABS in their fleet lease issuance. For equipment ABS, the wave of new issuers that characterized the 2011-2015 period has abated, but these entrants result in a larger existing base that, going forward, will continue to issue on an annual or semi-annual basis. Floorplan volume may be dampened in 2018 given our outlook for lower auto sales over the next two years; however, the issuance in this segment tends to be more opportunistic than sales volume driven.

Commercial ABS encompasses a wide range of industry types, so credit drivers are diverse. While we acknowledge the diversity within the segment, we expect credit quality to remain generally strong and stable, with some uncertainty around policy outcomes that could impact segments differently.

- Agricultural equipment. We expect agricultural commodity prices to remain stable and eventually rise slightly in 2018, contributing positively to farmers' income and therefore payment patterns. Trade policies, however, will play a role and could have varying impacts that remain to be seen. The projected agricultural commodity price recovery is predicated to some extent on international demand, so U.S. farmers may not share equally in the improvements if they are excluded from trade agreements. However, we believe the strong balance sheets of farmers as well as production cut backs by the primary equipment manufacturers, which resulted in relatively stable equipment values (recovery rates for ABS), will continue to buffer the delinquency and loss performance of ABS of agricultural equipment loans against the effects of commodity price volatility.
- Trucks. Truck loan performance is impacted by conditions in the trucking industry closely tied to overall economic activity, which drives demand for freight services. We project continued improvement in 2018 for new and used commercial truck values, as economic growth will drive increased demand and supply will be somewhat tighter owing to some extent to a new federal electronic logging device mandate that went into effect in mid-December 2017. While there has been some talk of auto sales evolving to autonomous auto fleet operations, we do not see this occurring in 2018 and are not anticipating additional issuance from this potential new product at this time.
- Construction equipment. Demand for construction equipment and associated performance of equipment loans showed marked improvement over the last five years, following the sharp deterioration in delinquencies and losses that occurred in the 2009-2010 period. For 2018, we expect limited impacts from the new tax code. Reductions to mortgage interest deductibility and higher standard deductions (that reduce itemization) may impact homeownership and therefore housing starts, which we've seen to be a driver of construction equipment loan performance.
- Small-ticket equipment. Our 2018 outlook is for continued strong and stable performance of small-ticket equipment loans, with slight increases in delinquencies above the record low levels that have persisted over the last five years. Cuts in corporate tax rates, especially for small businesses, should lead to materially increased profitability among the commercial obligors on equipment loans.
- Floorplan. The performance of non-diversified floorplan trusts is tied to the primary manufacturers that provide significant support to their dealers (the obligors on floorplan loans). We predict a modest decline in auto sales in 2018, but floorplan ABS will continue to benefit from manufacturer support through a combination of production cutbacks and incentives to align inventory levels with demand.

U.S. Non-Traditional ABS: Most Of The Outsized 2017 Growth To Be Sustained In 2018

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2017 was a strong growth year for nontraditional products, and we expect that demand-driven growth to continue into 2018. Given industrial activity, there should be a similar number of transactions issued in the aircraft and rail sectors in 2018. While container issuance is likely to be active next year, we do not anticipate the pace to be as frenetic as last year. Timeshare issuance in 2018 will likely equal or modestly exceed 2017 levels, as developers will continue their efforts to broaden their owner base with sales to new customers and look to capital markets for financing to continue growing their business. We expect timeshare collateral performance to show modest improvement signs as developers

make progress in stemming the impact of legal holds to timeshare obligations. Finally, while 2017 was a stand-out year for corporate securitization issuance, we do not expect that level of issuance is sustainable in 2018. Given these adjustments, we see the total dollar issuance of non-traditional ABS to be flat or perhaps down slightly in 2018.

U.S. CMBS: 2015-2017 Maturity Wave Over, And Recent Tighter Pricing Should Help Keep 2018 Issuance Steady

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We're forecasting total issuance volume of $85 billion for 2018, as we expect the low rates and tight spreads that drove 2017 issuance to somewhat remain in place this year. So while interest rates may increase, they should still remain well below historical levels, and barring any unforeseen external shocks, pricing and spread levels should continue to exhibit low volatility. One missing ingredient for strong CMBS issuance this year will be the relative scarcity of maturing CMBS loan collateral. With the wave of maturing CMBS loans from the 2005-2007 vintages largely in the rearview mirror, the amount of maturing CMBS loan collateral in 2018 drops to only $40 billion. However, CMBS represents less than 20% of total outstanding commercial real estate lending, and loan growth has been substantial during the past few years. Thus, if CMBS originators can capture a higher proportion of maturing loans from other sources, it should support current issuance levels. Another potential tailwind this year relates to the multifamily sector and the government-sponsored entities (GSEs). There are some early indications that the GSEs will be required to curb their lending activity to some extent, which could result in more multifamily loans making their way into non-agency diversified conduit transactions.

While we expect credit to remain generally stable this year, less refinancing activity may curb the number of upgrades in 2018. In addition, some signs point to the current cycle being in its later stage, with asset price appreciation and rental growth rates decelerating and vacancy rates ticking up slightly. The story gets more nuanced when examining individual property types and also specific markets (investors interested in a full analysis of property subtype performance should review "Go With The (Net Cash) Flow: Correlation Between Margins and Unemployment In U.S. CMBS and Its Impact on Property Subtype Performance," published Nov. 30, 2017.

In general, going into 2018, we remain focused on the constantly shifting retail landscape, the new supply pipelines in the multifamily and lodging sectors, continued weakness in many suburban office markets, and the proliferation of single-tenant properties and full-term interest-only loans making their way into CMBS collateral pools.

U.S. CLO: Elevated Activity To Continue

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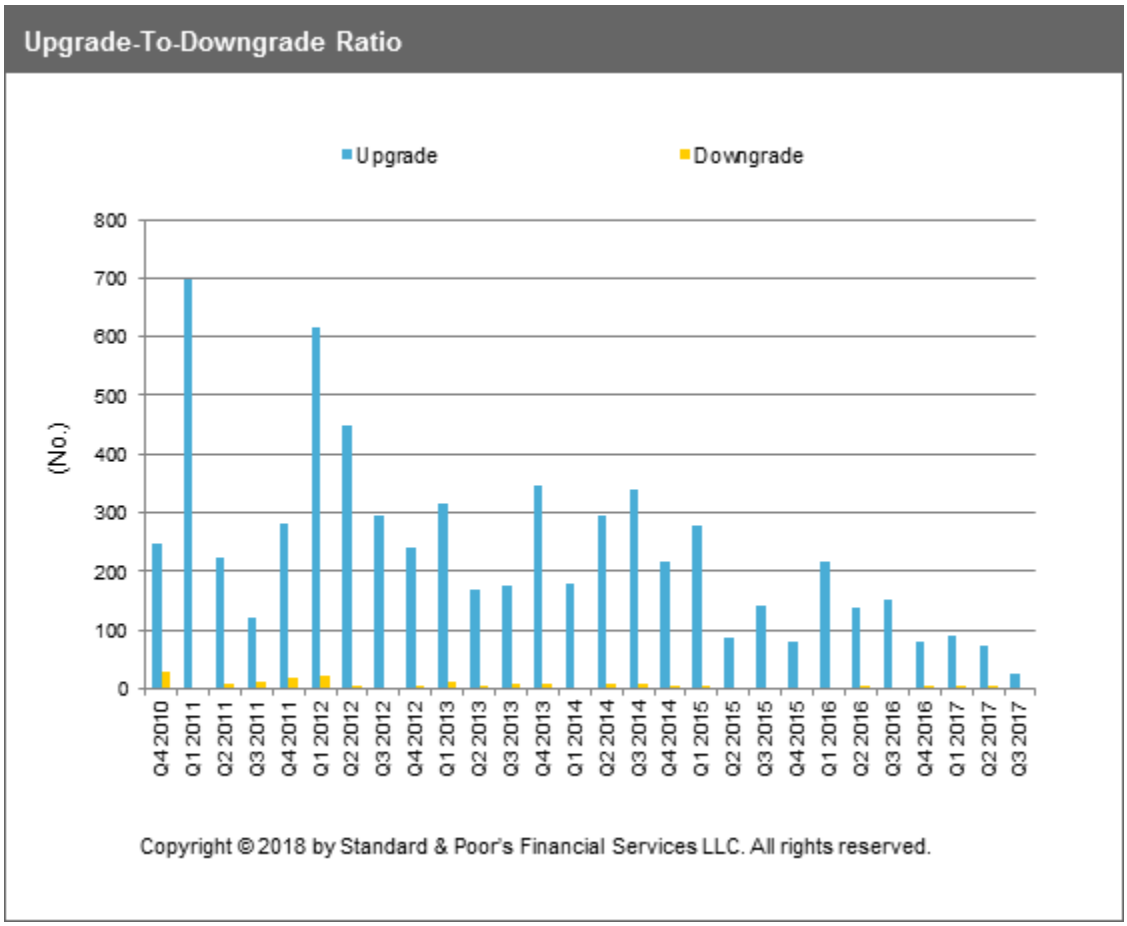
Following a very active 2017, we expect further economic growth will create $110 billion in new issue volume during 2018. In terms of resets and refinancings, we'll likely see the volume shift to mostly resets from mostly refinancings. In fact, we could see some reset volume "cannibalize" new issue volume, as managers may choose to reset certain

transactions rather than issue new ones "from scratch." It follows that we expect total 2018 reset and refi volume will likely come in at comparable numbers to new issue volume, and could even surpass it.

Upgrades continued to outpace downgrades by a wide margin in 2017, but we are seeing signs that this gap won't be quite as prominent going forward, as the volume of CLO resets reduces one of the primary drivers of upgrades: CLO transactions exiting their reinvestment periods and amortizing their senior notes. We upgraded just 25 classes in the third quarter of 2017, compared with 75 in the second quarter. Subordinate classes are also showing a bit more downgrade risk, and we recently downgraded a CLO 1.0 class to 'D (sf)' for the first time in several years. Underscoring this trend, we recently noted a quarter-over-quarter increase in our expected portfolio default rates this year and increases in the percentage of assets rated 'CCC'. Also, in recent conversations with investors, we have discussed new provisions that indicate a shift in power from senior noteholders to equity. That said, investment-grade classes continue to perform well.

Chart 4



U.S. RMBS: Issuance To Spike Further In 2018

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The non-agency residential mortgage-backed securities (RMBS) market took a big step forward in 2017 with $70 billion in new issue volume, which was more than double the 2016 figure (see chart 5). The market grew not only in traditional sectors but also in areas such as single-family rental (SFR) and credit risk transfer (CRT) transactions. Perhaps the most notable feature of the RMBS market was the increase in non-qualified mortgage (non-QM) issuance and issuers observed throughout the year. We expect 2018 issuance to be between $80 billion and $100 billion, and we expect RMBS performance to remain stable (see table 1).

Along with the broader economy, residential collateral is continuing a lengthy period of strong and stable performance. In our pre-2009 surveillance portfolio, the majority of rating actions in 2017 were either upgrades or affirmations (79%), with 422 ratings withdrawn due to discontinuances (see table 2). Within the post-2008 portfolio, we have observed strong or steady performance in most of the transactions. The seasoned deals' collateral somewhat mimics the performance of the pre-2009 transactions, but the stronger structures have proved durable with no negative ratings migration to date.

Chart 5

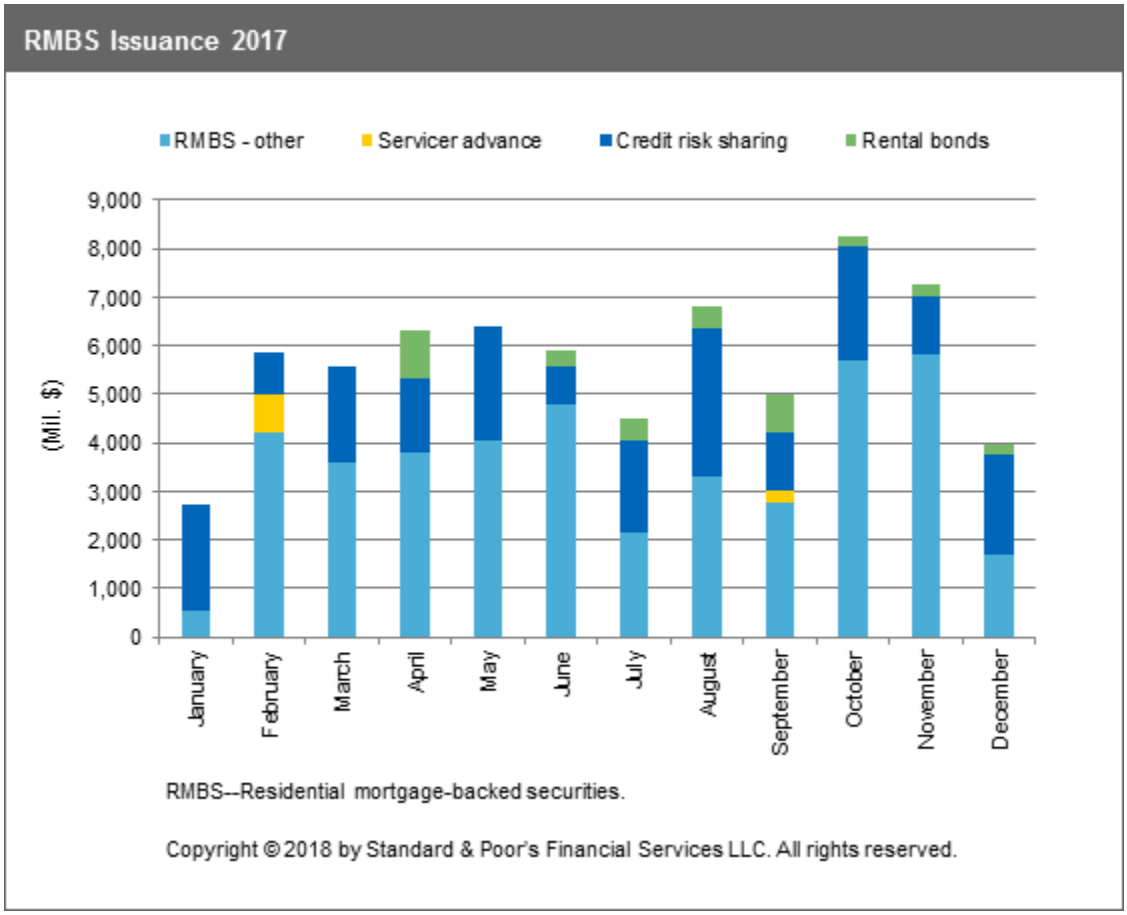

Table 2

RMBS 2017 Rating Actions

Rating category	Tranches (%)	Transactions (no.)
Upgrade	16	377
Downgrade	21	681
Affirmed	62	841

RMBS--Residential-mortgage backed securities.

We continue to pay close attention to the regulatory environment, which is trending more favorably for the mortgage industry. We are also examining the potential implications of the new tax plan, which may affect affordability and home prices by limiting the mortgage interest and property tax deductions available to borrowers.

The impact of tax reform will vary with home value and may have little impact on the typical property contained in RMBS. Among higher-valued properties (over $1 million), however, our initial analysis suggests that the lost tax deductions may affect homeowners' free cash flow by as much as 0.5%-1.0% of the property value on an annual basis, depending upon local tax rates. Consequently, we expect that overall long-term home price appreciation for these properties could be dampened by 15 percentage points or more. However, an immediate impact on prices could be difficult to discern in light of the recent upward price trend in combination with the variety of other factors that influence home values.

While the lost tax deductions may impact value, they could also incentivize borrowers to prepay their mortgages and may eventually reduce the aggregate default rate for pools of higher value loans. As the new rules are implemented, S&P Global Ratings will monitor any resulting borrower behavior.

U.S. ABCP: As Headwinds Diminish, ABCP Looks Poised To Grow

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We believe that the U.S. asset-backed commercial paper (ABCP) market will grow moderately in 2018 to between $240 billion and $250 billion in non-seasonally adjusted ABCP outstanding from $238.7 billion, as of year-end 2017. Despite challenges such as new regulations and a flat yield curve, anticipated Federal Reserve rate hikes and robust economic growth could put wind in ABCP's sails.

In the second half of 2017, U.S. ABCP outstanding declined approximately 4.5% from $241 billion to a low of around $230 billion. The increased risk and yield appetite among investors, combined with lower long-term borrowing costs for issuers, have made the long-term market more attractive than short-term ABCP over the past six months.

Looking forward, S&P Global Ratings expects the Federal Reserve to raise interest rates three times in 2018 ("S&P Global Now Expects The Federal Reserve To Raise Rates In December," published Nov. 2, 2017), which could potentially lead to wider spreads between long- and short-term rates and, in turn, entice corporate borrowers to return to the ABCP market. Widening spreads and other favorable current market conditions, such as low unemployment, strong economic growth, and growth in consumer debt, bode well for an expanding ABCP market. Additionally, in the

wake of the SEC money market reforms, the investor base formerly dominated by prime money market funds has begun to be filled with non-2a-7 private liquidity funds, government funds, and corporate treasury investors. However, we expect the growth in ABCP issuance to be gradual because it takes time for the yield curve to steepen and spreads to widen.

While traditional asset types dominated portfolios in 2017, there is also a growing sentiment from conduit sponsors that investors are more receptive to the inclusion of less traditional asset classes such as market place lending, wireless device payment plan receivables, container leases, and esoteric assets such as aircraft, solar securitizations, and whole business deals, all of which could lead to increased ABCP issuance in 2018.

ABCP sponsors are also poised to expand their portfolios in 2018, even in the face of new proposed regulations introduced by the Basel Committee on Banking Supervision (Basel) regarding the treatment of qualified short-term "simple, transparent, and comparable" (STC) securities proposed to govern U.S. ABCP this year and the accompanying treatment of STS securities proposed to govern European Union (EU) ABCP beginning in 2019. By adhering to STC or STS criteria, sponsors would receive more favorable capital treatment, but doing so would require most to significantly adjust their conduits' prevailing business models to realize the treatment because the proposal imposes several difficult to fulfill requirements.

While failure to comply with either STC or STS comes with a cost, these could pale in comparison to the cost of setting up segregated compliant and non-compliant conduits. Sponsors seem especially keen to accept the higher capital cost rather than reconstitute their conduits as they cite continued investor interest in STC non-compliant conduits. Moreover, this stance allows sponsors to continue developing relationships with their corporate clients through their conduit facilities in the hopes of expanding their financing options in the future. STC and STS standards would also give a bank ABCP investor a capital treatment benefit but, because banks represent only a small percentage of the investor base, a limited number of banks as investors would benefit from capital relief. Thus, as STC or STS is implemented, we expect most conduit sponsors will choose not to become compliant, which would lead to the loss of ABCP bank investors, but allows the securitization segment to move on with another regulatory uncertainty settled.

Ultimately, ABCP conduits are positioned to overcome the recent headwinds related to a sustained low interest rate environment and new regulations; some sponsors have even signaled their intention to increase their commitments amid greater investor demand. Favorable conditions indicate that new ABCP-financed origination will exceed the wind-down of existing ABCP transactions.

INTERNATIONAL GROWTH TO DRIVE 2018 ISSUANCE

Canada: Macroeconomic Effects Will Continue Influencing Issuance Levels

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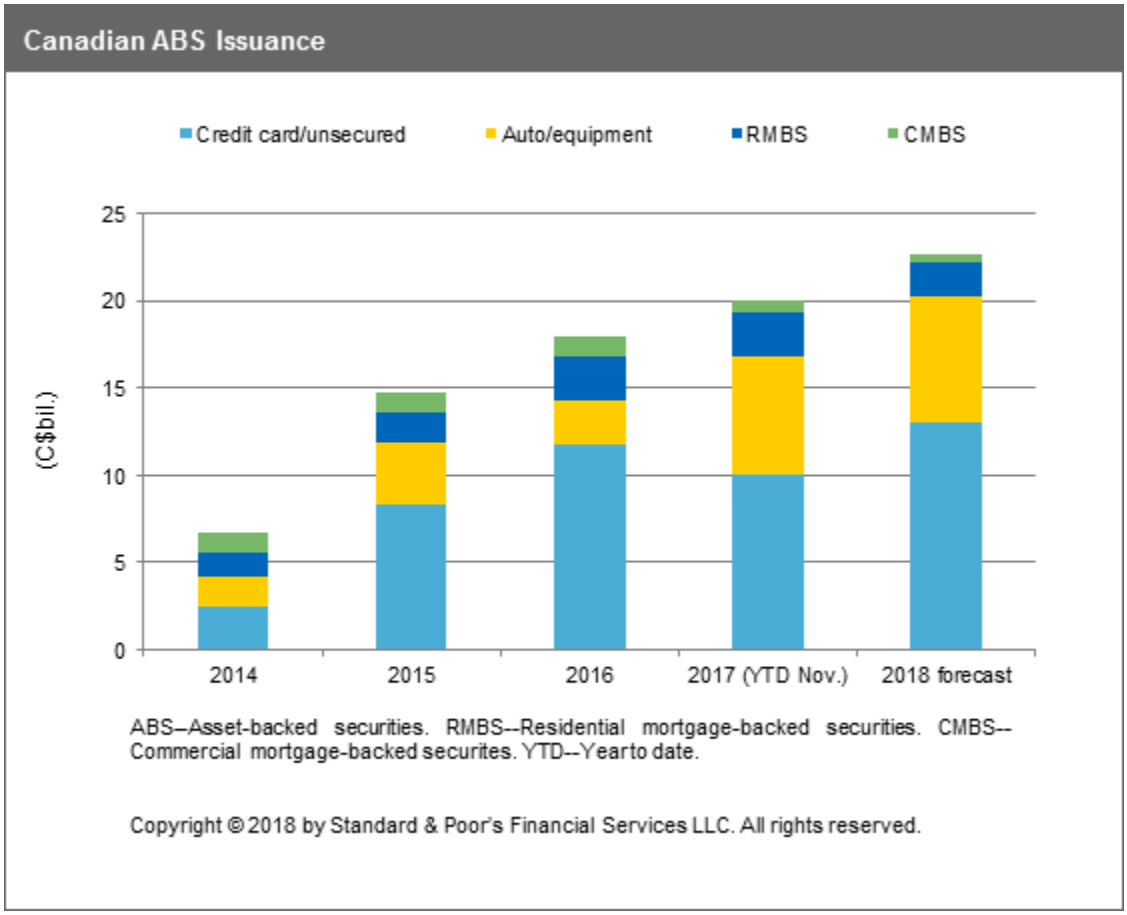
The Canadian economy continued to benefit from commodity price increases and saw strong economic and employment growth in 2017.

We believe the sector will continue on its upward trajectory, and Canadian ABS issuers will be both strategic--with regular established-program issuance--and opportunistic-- with diversification and cost-effective opportunities from cross-border issuance. We believe that the residential mortgage rules recently announced by the federal government could serve to stimulate smaller lenders to explore RMBS issuance, the volume of which will depend on the funding economics. On-balance, we anticipate issuance volumes for 2018 to range from C$20 billion to C$22 billion, about a 10% increase from 2017 issuance volumes of C$20 billion (as of November), which was up 12% from the previous full year.

Chart 6



For Canadian banks, the U.S. credit card term ABS market represents a broad, deep investor base that could result in continued cross-border transactions in 2018, especially if the funding levels are cost-effective compared with Canadian domestic levels. We expect C$13 billion in credit card ABS in 2018, up 30% from 2017, led by refinancing of maturing ABS (C$11 billion) and marginal growth in new issuance (C$2 billion).

In the auto space, unlike captives, the Bank of Montreal and Bank of Nova Scotia auto loan programs target all manufactures and for both new and used vehicles. Other larger Canadian banks have similar auto programs, and if they expand their wholesale funding platform to include auto term ABS, then there could be an increase in auto term ABS volumes. For auto term ABS space, we estimate issuance will be about C$6.3 billion, up 6% from 2017.

Cross-border transactions could continue to be attractive, and increased loan and lease issuance from established captives will help increase overall issuance in 2018.

New federal mortgage rules to stress test borrowers' ability to withstand higher mortgage rates should result in slower growth of mortgage loan credit going forward. The new stress test should cause more mortgage finance companies to utilize the private-label Canadian RMBS market for funding uninsured residential mortgages, but for the banks with larger balance sheets and more funding options, they are less likely to utilize the RMBS market for mortgage funding. So while we expect private-label RMBS issuance activity to develop further in 2018, our current issuance estimate is only C$2 billion, down 19% from 2017.

Our outlook for Canadian CMBS issuance is discouraging as the length of time to market and the competitive lending environment leave securitized commercial mortgages somewhat disadvantaged to traditional portfolio lending option. Thus, for 2018, we expect issuance will be about C$500 million, down 35% from 2017.

Generally, performance of Canadian ABS, RMBS, and CMBS will continue to be influenced by the economy, regulatory requirements and rules, and funding economics. Overvalued real estate markets--particularly in Toronto and Vancouver--large consumer debt burdens, and the uncertainty of NAFTA's renegotiation cast a shadow over an otherwise improving Canadian economic outlook. For example, the household debt-to-income ratio was 171.1% in third-quarter 2017, but mortgage borrowing is decreasing, and debt service ratio, which measures debt principal and interest payments as a proportion of income, was relatively flat at 13.9%. Yet, unemployment is expected to drop in 2018, and there is increasing demand for cross-border consumer ABS paper from Canada.

In the auto finance sector loan terms have also been lengthening to 96 months without an offsetting increase in down payments. Anecdotal evidence indicates that consumers are refinancing in 60 months (for the 72- to 96-month terms) and taking on a bigger loan to cover the negative equity. This could add to consumer indebtedness but also affect residual values, the resale market, and recovery rates.

Looking back at chart 6, Canada's elevated consumer indebtedness and macroeconomic stress could negatively affect collateral performance, but these factors are tempered by the high-quality collateral behind ABS and originators and servicers with strong track records. Moreover, highly rated originators and high-quality trust-level credit card receivables could limit the impact of weaker consumer metrics on ABS receivables performances. S&P Global Ratings' credit ratings on the Canadian receivables originators in the Canadian Credit Card Quality Index, for example, range from 'AA-' to 'BBB'.

Overall, we believe our ratings on Canadian ABS structured finance bonds ABS will remain stable in 2018.

Europe: Despite Some Positives, No Inflection Point For Issuance In 2018

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Investor-placed European securitization issuance was up for the fourth consecutive year in 2017, at over €80 billion. As a base case, we expect that greater regulatory visibility and the early signs of monetary policy normalization could help keep volumes around €80 billion-€90 billion in 2018 despite fewer, smaller transactions backed by legacy collateral. European covered bond issuance will partly depend on how issuers approach the eventual run-off of cheap central bank funding. While some may begin to re-engage more actively with the covered bond investor base, fewer redemptions and the phase-in of new regulations on bank resolution could mean many originators will focus on other types of funding issuance in 2018.

The regulatory uncertainty that has long cast a shadow over the European securitization market finally began to lift in 2017, potentially supporting issuance. The EU's new Securitization Regulation (i.e., the STS initiative) has now passed through the legislative process, along with associated changes to rules for determining banks' regulatory capital charges on securitization exposures. That said, these developments are unlikely to significantly boost volumes in 2018. Numerous details of the new rules have yet to be finalized in a raft of technical standards, before coming into effect in January 2019. Some uncertainty therefore remains. In addition, the eventual treatment of U.K.-originated transactions post-Brexit remains unclear. While the new rules may therefore do little to materially reinvigorate investor demand in the short term, they could pave the way for related changes in other regulations (e.g., Solvency II) that may eventually increase investor demand and assist with the securitization of longer-term assets.

In recent years, monetary policy has also significantly affected supply and demand dynamics in the European structured finance market through central banks' asset purchases and provision of low-cost bank funding. Helped by buying under the European Central Bank's (ECB's) quantitative easing program, structured finance spreads tightened substantially in 2017, and yields on some bonds remain negative. In October, the ECB announced that it will reduce the rate of net purchases starting in 2018, signaling the early stages of policy normalization. However, much of the reduction could come from scaled-back buying of public sector debt, with ongoing securitization and covered bond purchases still supporting prices in those sectors and curtailing development of the structured finance investor base.

For several years, ECB and Bank of England schemes offering cheap term funding have reduced banks' incentives to tap debt markets and depressed European structured finance volumes. However, the ECB recently confirmed that its future refinancing operations will go back to offering a maximum maturity of three months, rather than the multiyear term funding that was previously available under its so-called targeted longer-term refinancing operations. Similarly, the Bank of England announced that new drawdowns under its two funding schemes will cease from February 2018.

In the medium term, this removes some of the longstanding barriers to bank-originated structured finance supply, with issuers more likely to once again utilize debt markets as their official sector term funding gradually runs off. However, other considerations could postpone banks' return to these secured funding channels. Covered bond issuance in particular could face downward pressure in 2018 that outweighs the potential positives from a shifting central bank stance. Benchmark covered bond issuance in 2017 struggled to keep pace with the previous year but was supported by the volume of redemptions. We expect covered bond redemptions to be significantly lower in 2018--a negative for

gross supply. Also, many covered bond issuers are only in the early stages of addressing new regulatory requirements for their liability structures under the EU Bank Recovery and Resolution Directive. As a result, their funding plans could favor other types of debt issuance in the short term. The European Commission's project to better harmonize the region's covered bond markets could also add some uncertainty, with a proposed directive due for publication in March 2018.

Securitization issuance from nonbank originators has partly filled the gap left by banks, but some of this activity was likely opportunistic and may not continue. For the past two years, sales of legacy asset portfolios boosted issuance volumes as the purchasers structured unusually large securitization transactions for funding. At the same time, the potential for securitization issuance backed by nonperforming loans (NPLs) has remained largely untapped. These factors introduce some uncertainty to the 2018 issuance forecast. Our €80 billion-€90 billion investor-placed issuance forecast assumes more modest volumes of legacy portfolio securitizations, with some more NPL activity, and traditional bank-originated issuance making a comeback, most likely in the U.K. A downside risk to the forecast is that any decline in volumes related to portfolio divestments is not synchronized with the return of bank originators or NPL securitization.

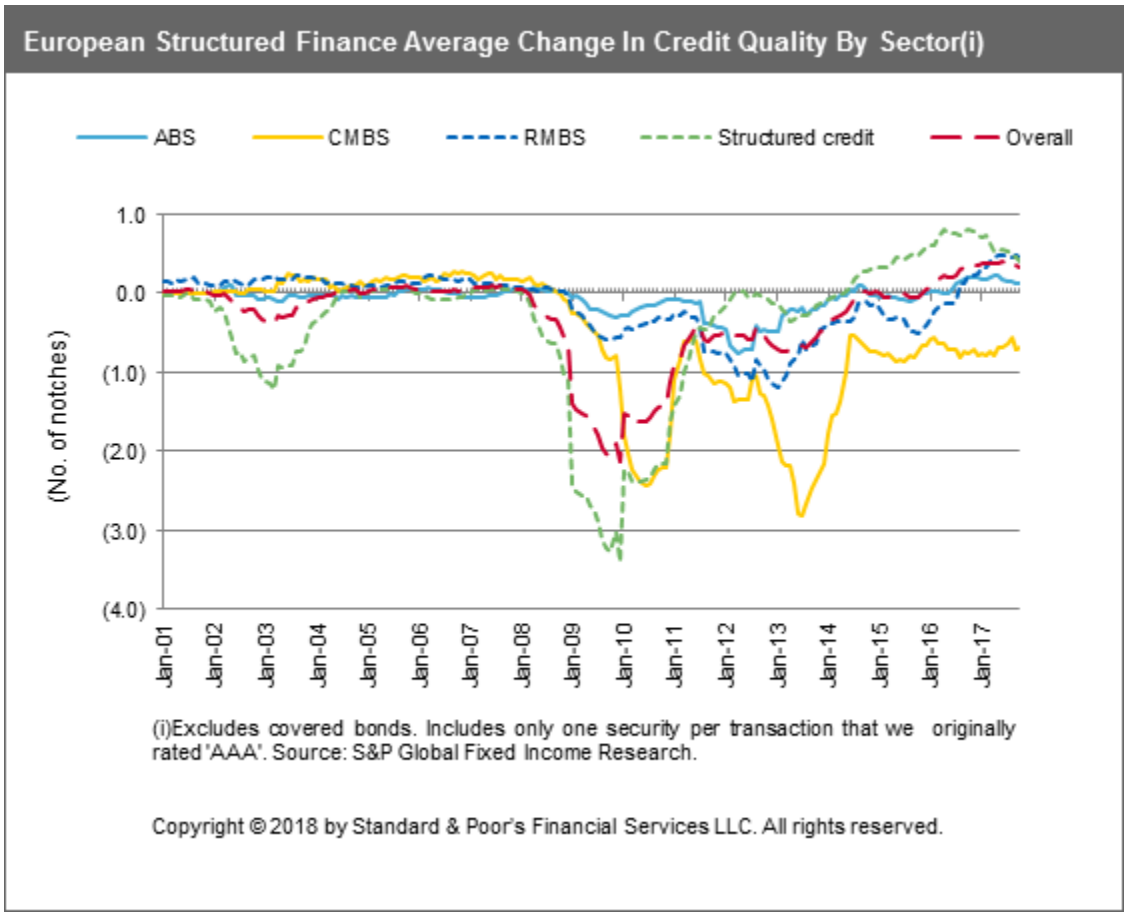
Our issuance figures in this report do not include the volume of CLO refinancings and resets, which accounted for more than €20 billion activity in 2017. We expect CLO liability spreads to remain tight in 2018, which will likely incentivize collateral managers to continue refinancing or resetting transactions that were structured in a higher-spread environment to protect equity investors' returns.

Performance set to remain positive

Given recent improvements in the economic outlook, we expect aggregate European structured finance credit performance to be positive in 2018. That said, the default rate will likely remain somewhat elevated from the pre-2008 timeframe but below 5% and therefore below its long-term average.

For most asset classes, the 12-month trailing average change in credit quality has been positive for at least a year, indicating aggregate upward ratings movements (see chart 7). Looking ahead, upgrades could continue to outweigh downgrades with the net ratings bias for European structured finance securities currently positive at greater than 1%. (We define the net ratings bias for structured finance as the proportion of ratings on CreditWatch positive minus the proportion on CreditWatch negative.) This follows recent CreditWatch positive placements in the RMBS sector, linked to our sovereign upgrade of Portugal and our upgrade of Barclays Bank, which acts as a counterparty in several transactions. We also note that our Spanish sovereign rating currently has a positive outlook, which may be a credit positive for securitization ratings that are constrained by Spanish country risk considerations. The increasingly upbeat macroeconomic backdrop in the eurozone should support collateral performance, though ratings in legacy CMBS transactions will likely continue to trend lower because of ongoing refinancing challenges on the underlying loans. In the U.K., slowing economic growth, rising consumer indebtedness, and the potential for Brexit-related disruption present downside risks.

Chart 7



The ratings mix of outstanding European structured finance securities--and therefore the aggregate credit quality--is not just affected by ratings migration but also by new ratings entering the pool and old ratings leaving due to redemption or default. On this basis too, the aggregate credit quality of outstanding European structured finance securities has generally been improving since mid-2015. Through 2017, the proportion (by rating count) of outstanding ratings in the 'CCC' category or lower continued to fall, to 6.1% at the end of September from 7.6% a year earlier. In addition, the proportion of 'AAA' ratings has been slowly rising and reached a six-year high of 17.8% in mid-2017, up from 15.7% a year earlier. That said, 0.9% of ratings remain in the 'CC' category, meaning that the related securities are currently vulnerable to nonpayment and we expect a default to be a virtual certainty, even though it has not yet occurred. This implies that the default rate could remain elevated relative to the pre-crisis period through 2018, as some older-vintage transactions continue to underperform, despite the wider positive rating trend.

Asia Pacific: Securitization Products Continue Their Development

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Pacific region: RMBS takes center stage

Structured finance new issuance experienced a resurgence in the Pacific during 2017, driven mainly by renewed interest in Australian RMBS, more than doubling its 2016 level to around US$36 billion in 2017. Offshore interest in Australian RMBS helped propel these levels with a global search for yield heightening the attractiveness of Aussie RMBS to several offshore investors given its stable collateral performance.

We expect new issuance to continue to grow in 2018 as these offshore players show no signs of abating. We also expect collateral performance to remain relatively stable with small movements in delinquencies driven mainly by movements in interest rates.

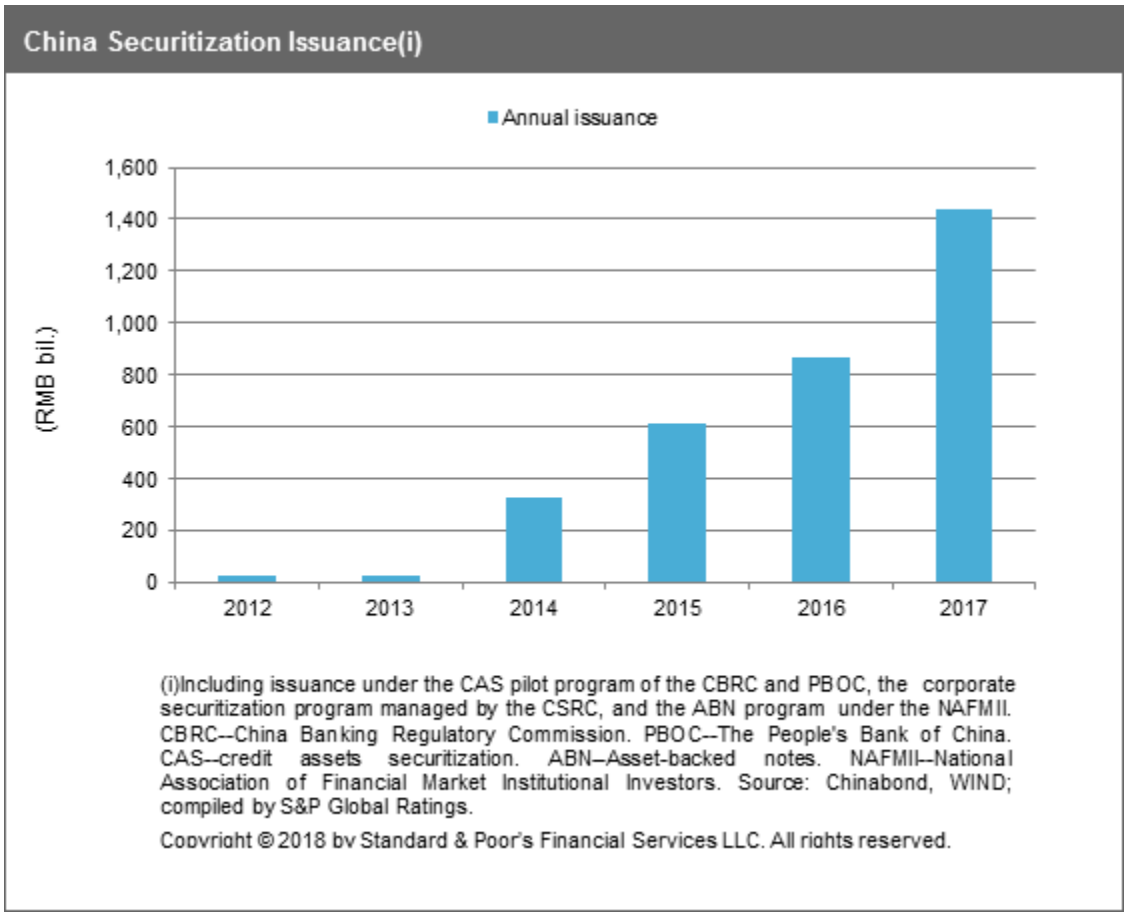
Collateral performance across asset classes in the Pacific continues to be strong with most transactions experiencing low delinquencies and loss levels. Continued employment growth and low interest rates are keeping mortgage delinquencies and those for broader consumer loans relatively stable. Underpinning the stable performance observed across Australian RMBS transactions is the high seasoning of many loan portfolios. This has contributed to modest loan-to-value ratios, which has enhanced refinancing prospects. On the flip side, economic headwinds, including high household indebtedness and sluggish wage growth, heighten borrowers' sensitivity to rising interest rates and any deterioration in economic conditions. This risk is more pronounced for loans originated in recent years in a strong property price growth, low interest rate environment. Regulatory scrutiny of lending standards has increased since 2015 in light of these risks.

China: stable economy should counteract rising household debt

We expect a mild 10% increase of securitization issuance in China this year, with around US$240 billion-equivalent new notes. The moderate growth expectation reflects the already high 2017 issuance and government efforts to curtail and regulate consumer loan origination channels. Nonetheless, we expect that auto and other consumer ABS, as well as RMBS, will continue to lead growth. Despite the fast-growing household debt in China, we do not expect the household sector to face stress because of the benign economic environment, stable employment, and income growth. The stable performance of China retail securitizations therefore should persist in 2018.

China securitization issuance reached over Chinese renminbi (RMB) 1.4 billion (US$220 billion) in 2017, exceeding our expectation. The growth was mainly driven by strong issuance of consumer receivables ABS, auto loan ABS, trade receivables securitization, and RMBS, despite higher borrowing costs starting in late 2016. The increasing demand for consumer financing fueled business growth of many nonbank financial institutions, which then used securitization to acquire funding. That said, banks remain important securitization issuers in China, particularly in sectors such as corporate loans and residential mortgages.

Chart 8



Asset performance has been stable in China securitization transactions. So far, no defaults have been reported in 2017. Retail consumer securitizations demonstrated particularly strong performance. For example, payment delinquency and asset losses remained low for auto loan ABS, with the cumulated asset default rate in most transactions below 1%. Cumulated mortgage default rates in most RMBS transactions also remain below 0.5%. We believe the lower household indebtedness, rising household income, shorter loan terms, and full-amortization nature of most loans support debt serviceability for retail consumer loans and mortgages. Robust economic growth and stable employment conditions also underscore asset performance as 2018 begins.

Japan: 2018 should match the previous year

In 2018, we expect issuance of Japanese structured finance transactions to be on par with that in 2017, between $48 billion-$52 billion. We believe ABS and RMBS will remain the major asset classes. Performance of underlying loans is, in our opinion, generally susceptible to various factors including changes in economic factors such as the unemployment rate or interest rates on loans. However, we expect no material change in such factors in 2018. Accordingly, we believe loans backing ABS and RMBS transactions we rate to continue to perform steadily in 2018.

During 2017, these loans continued to perform strongly amid favorable employment conditions and a continued low interest rate environment in Japan. We see potential risk from a possible interest rate hike because most borrowers of

mortgage and consumer loans are accustomed to the low rate environment and have never experienced a material rise in interest rates. But we believe this risk is limited because a majority of these loans have fixed rates. Transactions backed by floating-rate loans generally benefit from increased credit enhancement, given that most of the underlying loans are relatively well-seasoned.

Latin America: Stronger GDP Growth Across The Region Could Favor Securitization, But Multiple Elections Bring Uncertainty

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We continue to expect real GDP growth in most major Latin American economies to be stronger in 2018 than in 2017. We believe that credit conditions could foster asset diversification across the region (such as RMBS in Argentina, covered bonds in Brazil, and more traditional securitizations across the region) and promote participation of new originators, such as financial technology (fintech) companies.

However, we remain cautious because of the fragile recovery in domestic demand and the relevant downside risks, which in some cases have increased in recent months. The future of NAFTA has become more uncertain in recent months, which could result in increased volatility in Mexico. General elections will take place in Colombia (May 2018), Mexico (July 2018), and Brazil (October 2018), which could bring additional volatility to these markets, as we believe elections could cause investors to delay their plans, as well as curb debt issuances, and, to some extent, GDP growth.

A potentially faster-than-expected increase in long-term interest rates, political uncertainty in the U.S., and a disorderly correction in asset prices in developed markets could also affect the region.

Fintech companies aim to bring credit alternatives closer to people who are not the key target of banks or to small and medium enterprises (SMEs) that find it difficult to access financing to cover their working capital needs, among others. We've seen digitalization advancing strongly across the region's origination practices, which responds to technological advances and cost reductions linked to physical documentation. The Brazilian market had the first fintech securitization in 2017 rated by S&P Global Ratings. Also, fintech regulation is currently being discussed in Argentina and Mexico. Therefore, we expect to see increased participation in 2018. Key risks shown in this type of originator primarily relate to the short track record of asset performance, and change in competitive dynamics that could affect underwriting policies to attract more customers.

We also expect that, given the current portfolio's composition, ratings in the region will likely remain stable thanks to good collateral performance, with some exceptions that depend on counterparty or sovereign ratings.

Brazil: counterparty exposure could bring ratings changes

Economic recovery could further boost the number of issuances for Brazil in 2018, especially for some new originators that could benefit from a lower inflation and interest rate environment. For reference, 2017 had a total issuance amount of Brazilian real (BRL)21 billion (as of November) compared with BRL19 billion a year ago.

These improved conditions will likely reshape the portfolio's composition; therefore, we could see greater exposures to traditional assets such as mortgages, consumer, corporate, and SMEs loans. However, we expect corporate repackages will maintain their momentum from 2017. Also, we may see the first covered bond (or Letra Imobiliaria Garantida) issued by a bank, following the approval of its legal framework in 2017, but it could still take a while.

Keeping in mind the current composition of the Brazilian portfolio, which now has greater exposure to counterparties rather than to long-term assets, we expect ratings to change if ratings on sovereigns, corporates, or banks--which currently have negative outlooks--change.

Argentina: new participants and a potential new market could come into play

With a new capital markets law currently being discussed, Argentina may see new participants in the capital markets in 2018, which could bring asset diversification. However, consumer and personal loans and credit card receivables continue to be the key asset types for structured finance in Argentina. Also, we think that, as more mortgage loans are originated, an RMBS market could open up. However, this asset class could bring new risks to investors, such as a short track record and the testing of an asset with longer terms in a high inflation environment. Moreover, given the government's support to infrastructure projects through a public private partnership, we could see replications of some infrastructure-related deals like those seen in Peru and Panama.

So far, we don't expect negative trends in ratings to occur given macroeconomic stability.

Mexico: political issues could add volatility to new issuance

Presidential elections and NAFTA renegotiations will remain the key volatility sources for 2018, which could affect new issuance, especially in the first half of the year. Some originators could attempt to secure financing conditions before the elections in July, but others may prefer to wait.

Equipment leasing companies are expected to be the most frequent issuers in 2018 (as in 2017), but operational risks will remain one of the key risks for this asset class, especially when analyzing new originators. On the RMBS front and following the trend in 2017, we expect to see few issuances from government entities this year, as liquidity remains strong. We also continue to expect that the asset class spectrum could broaden, as some new originators could tap the capital markets in an attempt to secure better financing conditions.

From a ratings perspective, we continue to expect stable collateral and ratings performance across the main asset classes, though we will continue to closely monitor the impact of September's earthquakes on several portfolios.

Colombia: SF market is opening to asset diversification

We could see greater asset diversification this year, but RMBS continues to be the primary product. Also of note, we have seen increased participation from the strongest commercial banks in the market as originators. This is an effort to diversify funding sources and a response to the central bank's downward monetary policy. In our view, mortgage portfolios will continue performing well under a stable inflationary environment (around 4%). In 2018, presidential

elections will be held, which may decrease the regular pace of new issuance due to the uncertainty that this type of political change brings.

Cross-border: infrastructure remains hot

We will likely see more one-off transactions with infrastructure-related debenture repackages as the key driver in cross-border deals, as infrastructure projects develop further in the region. In general, issuances involving frontier markets such as Panama and the Caribbean occurred in 2017, and we believe 2018 will still see participation from these jurisdictions, as well as from others with less experience in the structured finance market, such as Paraguay, Ecuador, Chile, and Peru.

As the securitization market has further developed in Latin America, we now see more sophisticated and diversified asset types, more experienced market participants, and also growth opportunities for lagging jurisdictions that we believe could strongly benefit from this alternative source of funding.

Economic Growth Will Improve Performance And Issuance In 2018

As we enter 2018, macroeconomic fundamentals seem ideal. While there are a few extraneous risks that could affect this outlook, none of them appear likely to materialize. In addition, several lending programs appear to be self-regulating their underwriting. This growth, and what seems to be a globally cautious approach to loan underwriting, leaves structured finance products on a stable footing and unlikely to experience downward credit performance in 2018. In chart 9, we show the average trailing 12-month-change in credit quality (ACCQ), which is measured in rating notches. The overall reading was +0.16 rating notches as of October 2017, and all four major sectors have remained above the zero threshold for each month of 2017.

Chart 9

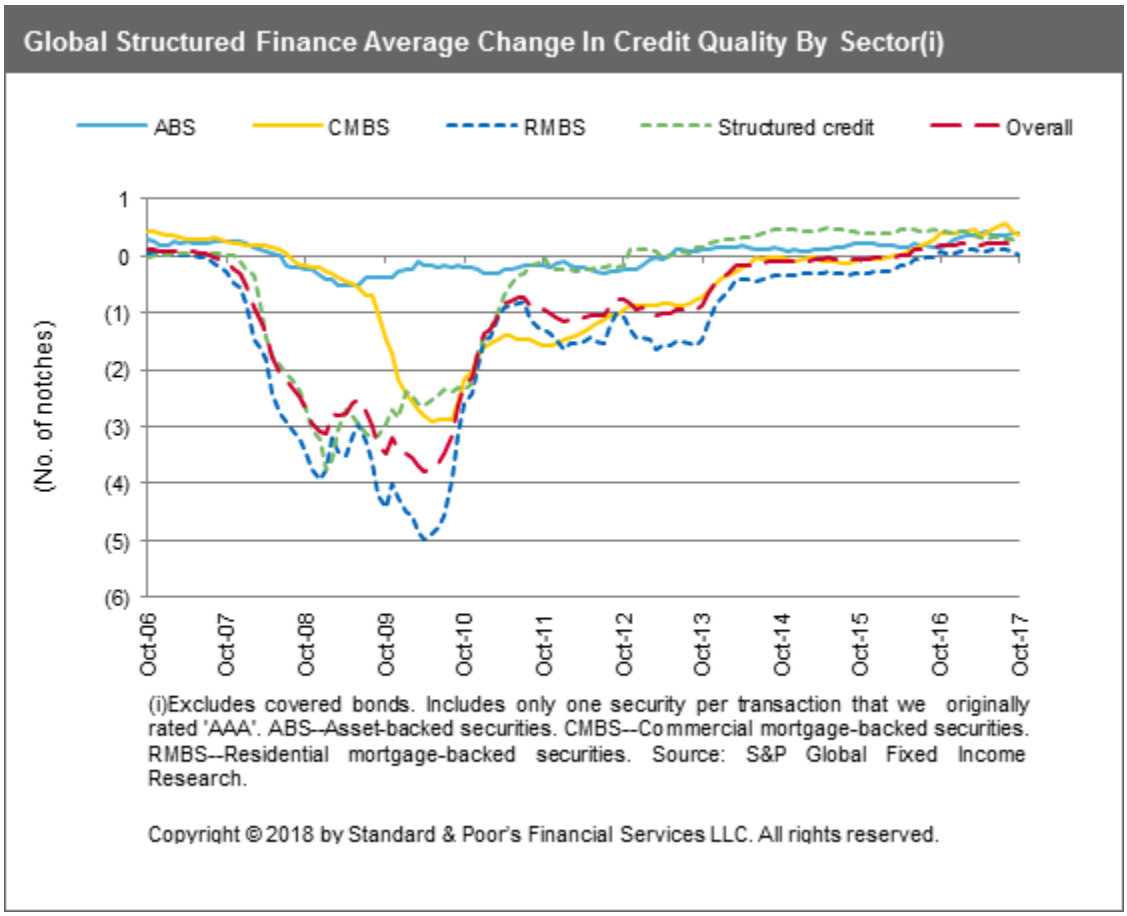

Chart 9 shows that the overall performance turned positive in April of last year, after being in negative territory since the spring of 2007. Looking forward, we expect the positive upward trend to continue. While we are aware of many potential negative credit risks, and we will continue to monitor our ratings portfolio performance, we expect that most of our 2018 rating actions will be positive.

Only a rating committee may determine a rating action and this report does not constitute a rating action.