



Peripheral ABS playing catch-up

Structured finance issuance in the European core has held up well over the summer, with spreads continuing to grind tighter. Although peripheral ABS spreads remain wide of the core, the periphery appears to be catching up.

"Spreads throughout Europe – in both the core and periphery – have been going in the same direction for a while now, albeit at different speeds. All spreads are compressing, it is just that peripheral spreads remain a lot wider than core spreads," says one market participant.

Dutch RMBS has reached pre-crisis levels, with auto ABS not far from that marker. Less consistent issuance away from the core makes it difficult to identify broad trends in the periphery, although country-based tiering appears to be compressing.

"With products such as UK or Dutch RMBS, there is sufficient primary market activity to direct the market; there are big prints that define where the market is going. However, in the periphery, primary market issuance is more limited and therefore the patterns are harder to discern," says Colin Behar, senior investment analyst at Prytania Investment Advisors.

He continues: "There have been some interesting auto ABS deals in the periphery, as well as a few RMBS in Italy and Spain, that have provided interesting colour. However, many of these deals, particularly recent auto ABS from Spain and Portugal, are opening the market and therefore they are issued with considerable spread pickup for investors at inception."

Beyond spread tightening in the core's wake, the main shift in peripheral ABS appears to be a shift from a healthy balance between fundamentals, technicals and correlation to sovereign spreads, to pricing driven almost entirely by supply dynamics.

"The technical consideration for the periphery has always been supply, but that is very limited at the moment. Supply now mainly comes from the secondary market, where previously bad banks and legacy holders provided plenty of paper but now there are fewer sellers," notes the other market participant.

They continue: "The improvement in spreads has made people less willing to sell, and BWIC volumes have halved over the last 12 months. Some paper, of course, has just never come to market – there are programmes, such as BBVA, that you never see trade – and other paper which used to trade is now trading less often."

This market participant believes that the previous balance between technicals, fundamentals and sovereign spreads has become completely imbalanced, with the imbalance of demand and supply now "simply outweighing any other consideration".

Fundamentals still have their place, however. Behar notes that Spanish ABS provides a good example of investors increasingly assessing a sector simply on its merits.

"Spanish autos are now trading tighter and more in line with the actual risk, whereas when that market opened the paper was particularly wide because there was an added stigma that came with being a Spanish deal. That stigma may not have been warranted, of course," says Behar.

The third part of the balancing act described by the other market participant, alongside fundamentals and technicals, is correlation to sovereign spreads. Behar notes that, while peripheral paper may not deserve the stigma that has been attached to it, some correlation between structured finance and sovereign bond prices is unavoidable.

"Should Italy default, then Italian long-dated RMBS performance would also be impacted, which is why there should be some correlation. However, as the market saw with Greece, structured finance by its very nature should also insulate bonds from the worst fallout from government default. For bonds backed by shorter-dated collateral, even if the government was to default, you would likely get your money back in relatively short order," notes Behar.

The other market participant says that in certain circumstances the correlation to sovereign spreads has all but broken down. "When the Italian sovereign worsened relative to the Spanish sovereign recently, we saw no commensurate widening of Italian ABS spreads relative to Spanish ABS," they say.

The participant continues: "The relationship is not always automatic. With weak sovereign correlation, investors are looking at benign fundamentals and are seeing pricing driven almost exclusively by supply."

Another historic driver of pricing has been ECB-eligibility. Two recently issued Portuguese ABS – Ulisses Finance 1 and Aqua Finance No.4 (see SCI's [deal database](#)) – appear to underline this point, with the senior spreads of the former pricing at plus 85bp and the seniors of the latter pricing at plus 105bp.

"ECB-eligibility certainly played a part in the difference, but it was not the only factor. There were also structural and placement process factors that added to the spread," says Behar. "Aqua is also a mixed pool, so the comparison is complicated by that, as well."

The other market participant points to Banca IMI as an example of paper changing from ECB-eligible to ineligible without any noticeable effect on pricing. "ECB-eligibility used to be a big factor in tiering, but now it seems like it might be irrelevant," they say.

That suggests that an ECB taper would have at most a limited impact on the market, just as there has been little reaction to Brexit. Behar also believes that tapering is unlikely to have a marked impact.

"The ECB's ABS purchase volumes have not been massive, but they have been relevant. When the ECB cuts back its purchases, I would expect the tighter end to widen by around 10bp," says Behar.

He continues: "Demand is very high, though. That will stop paper from widening too much. The relative value to alternative asset classes in fixed income will remain attractive."

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This article was published in [Structured Credit Investor](#) on 4 August 2017.