CREDIT CONDITIONS

Q2 2025

INTRO

Welcome to this edition of *Credit Conditions*, a quarterly publication that analyzes recent debt market trends.

IN DEPTH

KEY DEBT MARKET TRENDS

Tariffs and Rates: On Pause

- So-called "Liberation Day" tariffs shook markets and sparked recession fears on April 2, with rates ranging from a universal 10% to a country-specific reciprocal tariff as high as 49% for Cambodia. While the 10% universal tariffs took effect on April 5, the country-specific reciprocal tariffs were paused on April 9 for 90 days before taking effect, other than for China, which instead saw its reciprocal rate increased sequentially to 145%. However, the reciprocal rate for China was reduced to 30% on May 12, reflecting a reversion to the universal 10% rate plus a 20% fentanyl-related tariff imposed prior to Liberation Day. While tariffs may be paused and their impacts on economic data are yet to be seen, the uncertainty has led economists to cut 2025 US GDP growth forecasts, on average, by 0.8% (to 1.4%).
- At its May meeting, the Federal Reserve held rates steady at 4.5%, citing stable employment, sticky inflation, and rising economic uncertainty. Concerns remain, however, that tariff policy could result in stagflation (*i.e.,* higher inflation and lower economic growth), which could put the Federal Reserve's dual mandate of stable prices and full employment in tension and make future policy decisions more challenging. Currently, markets still expect that the Federal Reserve will implement two rate cuts of 0.25% by the end of this year but with the first rate cut pushed back from June to July or September, depending on how the economy performs. However, the Federal Reserve will need further data before it moves in any direction.

M&A: Shifting Gears

- M&A volume stumbled out of the gate in Q1. According to Bloomberg data, M&A activity for the first two months of the year was down 21% year over year, dropping to $434.2 billion in the aggregate and with the lowest deal count during that period since 2020. April saw a further slowdown in new deal signings as market participants grappled with how to price assets in light of the market uncertainty. According to Dealogic data, global and US M&A activity in April reached its lowest monthly level since May 2009. Similarly, global private equity-backed deals were down 24% year over year for the period from April 1 to April 22, according to PitchBook data.
- While the market gyrations sidelined some sellers, others accelerated exits to outrun potential volatility later this year. Some strategic and private equity buyers similarly leaned into volatility, using tools like seller notes and earnouts to bridge valuation gaps caused by the uncertainty. Acquisitions of divestitures from troubled parent companies at discounted prices also saw a recent uptick, while sponsors continued to bid aggressively in resilient sectors, including domestic supply chain manufacturers, tech and healthcare platforms, and regulated infrastructure such as telecom and utilities.
- Expectations for the remainder of the year are in flux, but structural factors still point to deal activity ramping up. Private equity still sits on $1.2 trillion of dry powder, with 25% of it aging past four years and entering use-it-or-lose-it territory. Private equity also remains under pressure to sell aging companies – including about 3,800 businesses that have been held for five to 12 years, according to PitchBook data – in order to return cash to their investors. However, if there is a significant economic slowdown, private equity exits may be hampered, and instead we may see even longer portfolio hold times, with sponsors using dividend recapitalizations to provide partial liquidity events or continuation vehicles to extend holding periods to allow time for the volatility to pass.

BSL Market: Freeze and Thaw

- The broadly syndicated loan (BSL) market started 2025 by setting records with $212 billion of new issues, the highest ever for January, and $35 billion of new money issuances, the second-highest monthly volume in three years. However, as tariff concerns increased, lenders began pulling BSL deals from the US market in February and from the European markets in March. In early April, BSL issuance halted completely for 14 straight days, marking the longest freeze since the COVID-19 pandemic, and resulting in several hung deals. However, by early May, the BSL market had thawed, with deals returning in both the United States and Europe and with banks resuming arranging and underwriting deals as market conditions began to normalize. Elevated deal risk remains though, and sponsors are expected to increasingly use dual-track processes to ensure they have a private credit backstop in case BSL conditions worsen.

Private Credit: Marching On

- The start of 2025 continued the trend of the BSL market luring borrowers away from the private credit market, with borrowers obtaining average interest rate reductions of 2.63%, as well as looser covenants. But the tide shifted back to the private credit market in late March and early April, as private credit lenders continued funding while the BSL market grew choppy. In addition to winning market share by offering certainty of closing, traditional selling points like covenant-lite and the availability of paid-in-kind (PIK) interest, as well as a smaller lender group in the case of a workout scenario, may also be more attractive to borrowers in a more volatile macro environment. But private credit's advantages come at a cost, with mid-April seeing pricing widen by 0.25% to 0.50% and leverage tighten by 0.25x to 0.50x for some middle-market borrowers. By the end of April though, pricing for top-tier private credit borrowers had reverted back to earlier levels due to tight competition among lenders for the strongest borrowers, so price discovery may continue for some time.

- Despite policy shifts, private credit continued to expand. Prior trends continued in 2025, with private credit deepening institutional ties through a wave of new partnerships with banks and insurers, including (1) General Atlantic and UBS, (2) Apollo and Standard Charter, (3) Monroe Capital and Sumitomo Mitsui Banking, (4) Sixth Street and Northwestern Mutual, (5) Fortress and Mubadala, (6) BMO and Canal Road Group, (7) Oak Hill Advisors and Aspida, and (8) Bain Capital and Lincoln Financial. Private credit managers have also pushed into retail this year, with the launch of retail private credit ETFs by KKR and Capital Group, as well as Apollo and State Street, with expectations that more will soon follow, further blurring the lines between public and private capital. The new deal and funding sources will likely give private credit a runway to further growth into additional areas such as investment-grade and asset-based financing.

Distress to Be Seen

- Despite the choppiness in the finance markets, 12-month default rates in the BSL market at the end of April dropped across the board as compared to 2024, with payment defaults by dollar amount dropping to 0.73% (down from 0.91% in December 2024 and below the 10-year average of 1.53%) and payment defaults by issuers falling to 1.23% (down from 1.45% in December 2024 and below the 10-year average of 1.67% by issuer count). Similarly, Fitch's private credit default rate ended Q1 2025 at 4.5% (down slightly from 4.6% in Q4 2024). Looking ahead, many business leaders expect that tariffs will put pressure on profit margins and may cause further distress. Fitch reflected the same in its April forecast for the BSL market, increasing its 2025 default rate forecast by 2% to 5.5% to 6%, noting that highly impacted sectors exposed to international supply chains – such as automotive, retailers, and hardware technology companies – may struggle to find new supply chains and avoid operational disruptions.

- Traditional default rates, however, only tell a portion of the story. In the BSL market, liability management exercises (LMEs) overtook traditional defaults as the dominant restructuring tool starting in January 2024 and now account for 72% of all defaults in the BSL market. However, the dual-track default rate by issuer count (which includes traditional payment defaults and LMEs) fell to 4.38% in April (down from 4.7% in December 2024). Distress may also not show up in official data since private credit lenders often take a more hands-on approach with borrowers and negotiate targeted relief, such PIK interest and temporary financial covenant relief, to address one-off macroeconomic pressures before defaults arise. Some have criticized these tools as “amend-and-pretend” if the distress is not one-off or the relief is unlikely to bridge to a turnaround. At least for now, however, it remains to be seen whether the expected distress will arrive and, if it does, the extent of the downturn.

KEY DEBT MARKET DATA

- Private Credit Pricing & Leverage Data (May 21, 2025)
- BSL Leverage Trends April 2025 (May 6, 2025)
- BSL vs PC Spread & Covenant Trends Q1 2025 (April 25, 2025)
- BSL Documentation Trends April 2025 (May 1, 2025)
- BSL Aggressive Terms Trends Q1 2025 (April 30, 2025)

CONTRIBUTORS & CONTACTS

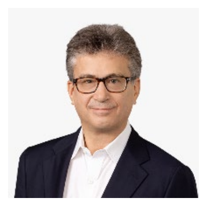
STEPHANIE S. McCANN
PARTNER
smccann@mwe.com
+1 (312) 984 3671

MICHAEL L. BOYKINS
PARTNER
mboykins@mwe.com
+ 1 (312) 984 7599

GARY B. ROSENBAUM
PARTNER
grosenbaum@mwe.com
+ 1 (310) 284 6133

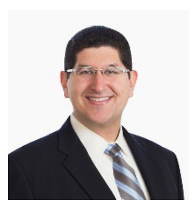
AYMEN MAHMOUD
PARTNER
amahmoud@mwe.com
+ 44 20 7570 1428

DARSHAK DHOLAKIA
PARTNER
ddholakia@mwe.com
+1 202 756 8217



CHRISTOPHER KANDEL
PARTNER
ckandel@mwe.com
+44 20 7575 0304

JOSHUA SAMIS
PARTNER
jsamis@mwe.com
+1 312 984 7549



GEORGE M. HOUHANISIN
PARTNER
ghouhanisin@mwe.com
+ 1 (312) 984 3367