

MARKET SIGHT LINES



A Credit Market Check-In: Limited Risks or Systemic Issues?

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A few weeks ago, a couple of defaults in the private credit market briefly spooked investors and raised questions about potential broader credit risks. While the situation appears contained, the event reminds us how 1) higher rates and tighter financial conditions can stress even strong credit segments and 2) the monitoring of credit markets is even more important when we see the economy slow. In this SightLines, we take a “credit check-in,” reviewing conditions across private, consumer, and corporate credit markets – and what to watch for as we anticipate a slowing economy over the next couple of quarters.

THE TAKEAWAY: POCKETS OF WEAKNESS IN CREDIT MARKETS, BUT SYSTEMIC RISKS REMAIN CONTAINED

Some weakness in the credit market is limited so far, but investors who are vigilant in monitoring credit risks going forward will be well served. In summary:

- A recent private credit stress event highlighted potential vulnerabilities in a fast-growing asset class that may well increase during a slowdown.
- Investors continue to invest more in the expanding private credit arena, but liquidity mismatches and sector concentration are areas to monitor.
- Consumer credit quality appears to be weakening modestly, with delinquencies rising from historic lows.
- Defaults on below-investment grade (“high-yield”) bonds have edged higher, while higher rates continue to lift refinancing costs.
- We expect a mild economic cooling this quarter and next, not a recession.
- Even so, investors should be [ready for a market correction](#), and increasing credit market stresses are possible.

IN-DEPTH: WE SEE POCKETS OF WEAKNESS IN CREDIT MARKETS, BUT SYSTEMIC RISKS APPEAR CONTAINED, AT LEAST FOR NOW

Some weakness in the credit market appears limited for now, but investors will be well served to be vigilant in monitoring credit risks going forward. Going deeper:

- Bankruptcies of auto parts supplier First Brands and lender Tricolor revealed potential vulnerabilities in a fast-growing private credit market:
 - These events exposed the potential for alleged fraud and insufficient due diligence.
 - Regional bank stocks sold off, with investors worried about a "credit cockroach" problem: Where there is one issue, there are likely more.
- Investments in private credit continue, but sector concentration and liquidity are in focus:
 - Private credit investments have surged to nearly \$1.7 trillion, supported by investor demand for yield and borrowers' desire for flexible financing outside of traditional banks.
 - Over 90% of assets are illiquid middle-market loans maturing in more than five years, while some capital is in semiliquid offering quarterly withdrawals – creating a potential redemption-liquidity mismatch.
- Consumer credit quality appears to be weakening modestly, with delinquencies rising from historic lows:
 - The New York Federal Reserve (Fed) reported credit card delinquencies 90+ days past due reached 12.3%, the highest since 2011.
 - Auto loan delinquencies are at 5%, while student loan delinquencies surged to 10.2% in Q2.
- Defaults on below-investment grade bonds are up modestly, even as refinancing costs are rising:
 - The high-yield default rate has climbed to roughly 3.5%, up from about 2% a year ago.
 - ~\$3.6 trillion in rated corporate debt matures through 2028, most refinanced at higher rates.
- We expect modest slowing in this quarter and next quarter, not a recession.
 - Annualized U.S. GDP consensus growth estimates stand at 1.1% for Q4 2025 and 1.5% for Q1 2026.
 - The median estimate in Bloomberg's survey of economists places the probability of a U.S. recession in the next 12 months at 30%, roughly in line with the long-term average.
- Even so, a [market correction](#) and increasing credit market stresses are possible.
 - Markets today are more susceptible to a pullback, given elevated valuations.
 - We'll be monitoring liquidity conditions, delinquency trends, and credit spreads for early signs of stress.

CONCLUSION

Recently, a couple of defaults in the private credit market briefly shook investor confidence, raising questions about the potential for a systemic problem across broader credit markets. Our review indicates that the situation appears contained for now, but we're reminded that the higher rates and tighter financial conditions orchestrated by the Fed in recent years can stress even strong credit segments. The continued monitoring of private, consumer, and corporate credit markets will be important for investors going forward.

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