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## Would a private credit collapse bring down the economy?

Non-bank lending to companies has expanded rapidly into a multi-trillion-dollar asset class. This has led to increasing regulatory scrutiny amid worries that the sector could pose a systemic threat to the financial system. However, a Global Financial Crisis-style collapse is unlikely.

### Key Takeaways

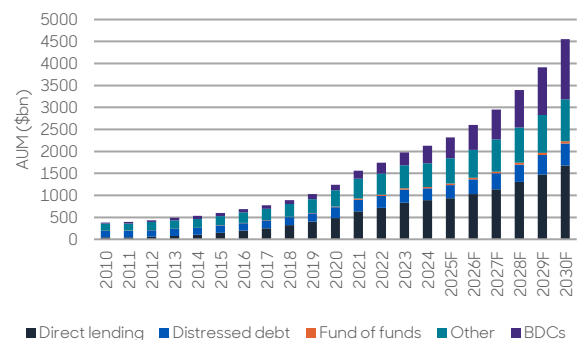
- Private credit – non-bank, privately negotiated lending by specialist funds – is a rapidly growing asset class. As with past episodes of financial innovation, this has raised concerns about asset quality and potential systemic risks to the economy.
- Asset price shocks become systemic when they spread across balance sheets, get amplified by leverage and liquidity mismatches, and break something the real economy depends on.
- Private credit may have some of these features. There are (often opaque) interlinkages between private credit funds, banks, and other key financial institutions. Private credit borrowers may be especially exposed to potential AI disruption. And a rising share of funds are of a semi-liquid nature, increasing run risk.
- However, most private credit funds use little or no leverage, rely on long-term capital, avoid deposit funding, and are somewhat removed from core financial infrastructure such as bank payment rails. Indeed, unlike during the housing bubble, aggregate US whole-economy credit data haven't shown a rapid increase due to private credit.
- So, while any rise in private credit defaults and losses could be a headwind to the economy, it is not likely to cause a systemic crisis.

### What is private credit?

Private credit is non-bank, privately negotiated lending by specialist funds, such as closed-end vehicles and "Business Development Companies" (BDCs), rather than traditional banks. It is mainly directed at middle-market corporates. For lenders, the loans offer potentially higher yields but limited secondary market liquidity.

This market has expanded rapidly in recent years, amid the post-Global Financial Crisis (GFC) environment of low interest rates but subdued risk-taking among traditional lenders. There is an estimated \$2–3 trillion in outstanding private credit globally, and this is expected to continue rising (see Figure 1). The US accounts for 70% of debt, with Europe and the UK accounting for most of the rest.

Figure 1: Private credit has been expanding rapidly



Source: Preqin, April 2026



The asset class is now comparable in size to the global leveraged loan market, although still around half the size of the high-yield bond market. Direct lending – typically floating-rate, senior secured loans – is the core approach, but private credit also includes mezzanine, asset-based, structured and opportunistic lending.

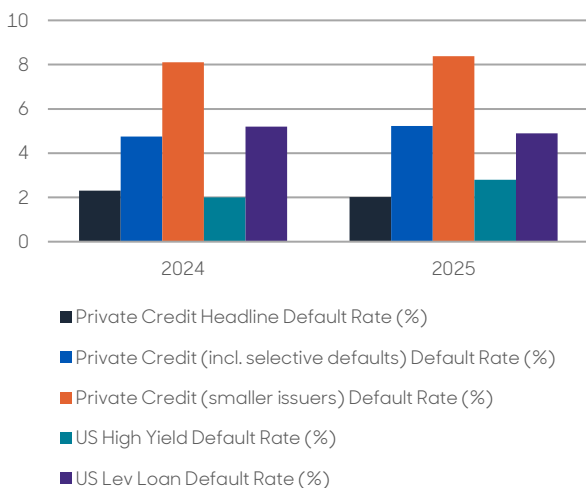
**Why are some people worried about the sector?**

Direct lending defaults increased during the pandemic, although this was not unexpected amid the shuttering of large swathes of the global economy. If anything, the low interest rate environment and widespread amend-and-extend loan restructuring kept headline defaults reassuringly contained.

However, more concerning stress in direct lending began increasing with the post-pandemic 2022–2023 rate-hiking cycle. Rapid interest rate increases have strained some borrowers, raising defaults and increasing regulatory attention.

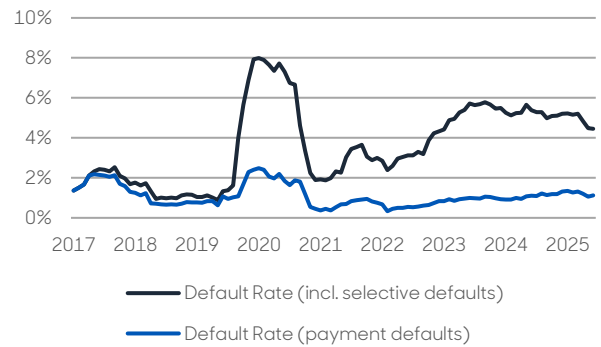
While headline default rates are still very low, this can mask stresses in the sector. The close relationship and tighter covenants between lenders and borrowers make headline payment defaults relatively rare compared to public debt markets of equivalent credit rating (see Figure 2). Instead, amend-and-extend restructurings, payments-in-kind, debt-for-equity swaps, and sponsor capital injections often substitute for default (see Figure 3).

**Figure 2: Smaller issuers typically have more covenants and as a result have higher default rates on average**



Source: Fitch, Proskauer, Moody's, April 2026

**Figure 3: Default diverge when looking at reported rates vs. selective defaults**

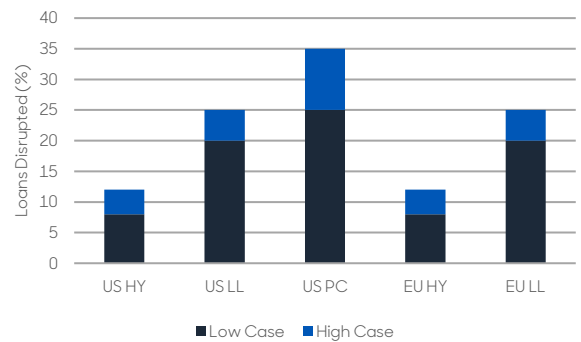


Source: S&P Global, April 2026

High-profile defaults by First Brands and Tricolor (albeit primarily bank-syndicated and not private credit issuers) have led to a worry about a deterioration in underwriting standards.

And the sort of middle market companies borrowing in the direct lending market may be more exposed to AI disruption risk (see Figure 4).

**Figure 4: Private credit borrowers may be more exposed to AI disruption**



Source: UBS, April 2026

When defaults do occur, loss severity can be higher, because direct lending borrowers often have fewer tangible assets than public market borrowers.

Finally, while the private credit investor base has historically been institutional and long-term, recent broadening to wholesale and retail investors has become a growing focus for regulators. Some direct lending fund gateings have triggered concerns about return of, rather than return on, investor capital.



### A conceptual framework for understanding when shocks to asset prices become a broader risk to financial stability

Financial crises arise not from large shocks per se, but from the way those are transmitted and amplified through the broader financial system.

High leverage is a key amplification channel, as small losses can lead to equity wipe-outs, margin calls, and forced sales. These dynamics can be especially powerful in runnable entities, where funding can be quickly withdrawn.

Meanwhile, complicated balance sheet linkages, which can be obscured by opaque deals structures, can transmit shocks from one part of the system outwards. This could be through counterparty risk or collateral chains breaking.

If the shock spreads such that it impairs something core to the system like payment rails, large scale credit intermediation, or confidence in deposit safety, then it represents a systemic crisis.

In other words, a shock becomes systemic when it spreads across balance sheets, gets amplified by leverage and liquidity mismatches, and ultimately breaks something the real economy depends on.

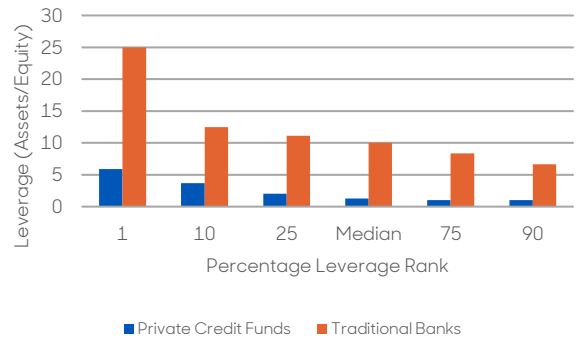
So, the things to watch when monitoring for potential systemic risks are linkages to bank financing, liquidity mismatches (e.g. open-ended funds holding illiquid assets), rising leverage, and correlated exposures.

#### Is private credit a systemic risk to the financial system?

Most private credit funds use little or no debt, rely on long-term locked capital and avoid deposit funding, which means the sector does not have many of these potentially problematic features. So, the risk of Global Financial Crisis (GFC) style collapse is not especially elevated.

For example, the absence of large, bank-style leverage within funds makes a rapid failure spiral less probable.

**Figure 5: Comparing leverage of private credit funds vs. banks shows that highly levered funds by industry standards are low leverage by bank standards**



Source: Minack Advisors, April 2026

Private credit funds historically have a much smaller maturity mismatch than banks. Loan maturities typically are above five years and funds run for 10-12 years. These durations are much higher than bank deposits.

There have been growing numbers of funds that have offered redemption windows, which creates potential maturity mismatches. But the ability of funds to gate withdrawals means that run dynamics can be managed more smoothly.

Currently, the counterparties that are exposed to private credit are overwhelmingly large institutional investors. This means that, in any downturn, pension funds, insurers and sovereign wealth funds are likely to bear the initial loss on loans.

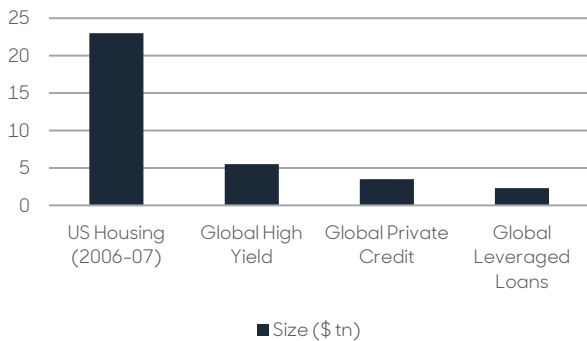
Banks may also see losses, as they are large debt providers to private credit funds. But total exposure to private credit remains small relative to other US financial asset classes.

This is a different transmission effect to the GFC, which saw damaging effects on banks, and then fed through to the broader economy.

Pre-GFC housing debt was far higher, more systemically intertwined and highly leveraged across households and banks (see Figure 6).



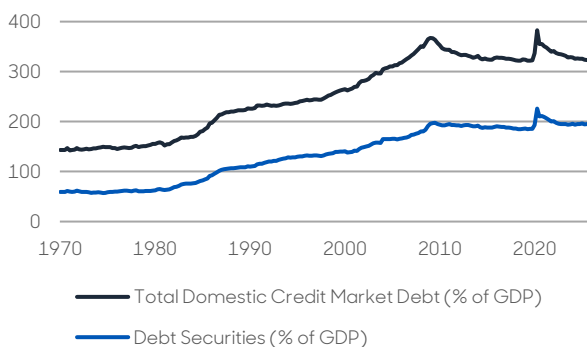
**Figure 6: Pre-GFC U.S. housing debt was significantly larger than global speculative-grade markets today**



Source: S&P, April 2026

Private credit’s relatively conservative use of leverage means that it doesn’t show up as a deterioration in aggregate US whole-economy credit data. The ratio of total US credit market debt-to-GDP has been broadly flat for the past decade (see Figure 7), unlike the sharp increases during the leveraged buyout boom of the 1980s and the housing bubble of the 2000s. Certainly, public debt has surged from 66% of GDP in 2008 to 116% today. But households, non-financial firms and financial institutions have significantly reduced leverage.

**Figure 7: US credit market debt-to-GDP has been stable post-GFC**



Source: Capital Economics, April 2026

**Reasons to be worried**

However, several vulnerabilities have the potential to see any stress in private credit transmit across the broader economy and financial system. These include valuation and liquidity pressures, opacity, limited disclosures, and the links between private equity, private credit and insurers.

**Concentration risk and interconnectedness**

Banks and private equity-owned life insurers are increasingly exposed to private credit, which now represents more than 25% of US life insurer investments

and nearly 20% for UK insurers, creating several channels for stress transmission. The estimated private credit exposure in banks and non-banking financial institutions (NBFI) is around \$1.1tn. Therefore, any potential impairment in private credit exposure could be significant.

However, the size of US banking and NBFI assets is roughly \$130tn. Thus, private credit exposure in isolation does not seem large enough to bring down the financial system even if defaults are significantly higher than expected.

**Opacity and valuation risk**

Private credit assets are typically illiquid and infrequently marked-to-market vs. public market equivalents. Thus, true risk can be difficult for regulators and markets to observe, especially during periods of stress.

Regulatory arbitrage is a key concern in this area. Some firms use private ratings from smaller ratings agencies to secure investment-grade status, which reduces the capital they must hold compared with high-yield loans. Others rely on offshore or lightly regulated jurisdictions for reinsurance, allowing leverage or affiliated-asset exposure that would not be permitted for banks.

**Liquidity mismatches and contagion risk**

In a downturn, liquidity constraints also become significant as a classic ‘run’ dynamic takes place and forced sales propagate losses.

The bulk of private credit AUM sits within illiquid structures, which theoretically provide a stronger buffer against runs.

But Blue Owl, Blackstone and Blackrock have all had examples of the issues with pairing newer semi-liquid fund structures with illiquid assets.

The semi-liquid private credit fund market is perhaps 25% of overall direct lending. Assuming redemptions continue for some time at a quarterly rate of 5% (the typical redemption cap for funds), this implies at least \$20bn in liquidity needs. Continued redemption requests could translate to selling pressure and a tightening in public market credit conditions.

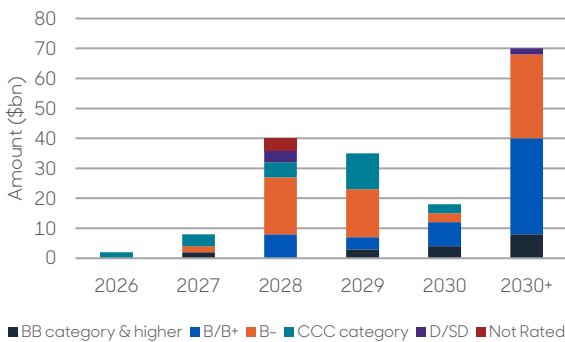


**So where does this all leave us?**

Private credit will face at least three big tests in coming quarters and years.

First, the software sector faces a \$40bn maturity wall in 2028, dominated by lower rated credits (see Figure 8). This could create significant refinancing risks amid AI disruption worries and higher-for-longer interest rates. Funds that were launched between 2019 and 2022 at lofty valuations are likely to be the most exposed.

**Figure 8: 2028 software maturity wall approaching**

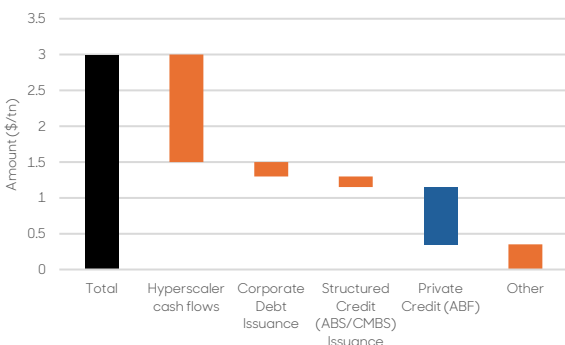


Source: Pitchbook, Morningstar LSTA US Leveraged Loan Index, Apollo, April 2026

Second, an estimated \$3tn of capex will be spent on global data centres through 2028. Private credit could fund up to \$800bn of this (see Figure 9).

Concerns regarding data centre obsolescence should be monitored. If frequent step changes like Deepseek’s breakout moment occur, then the amount of capacity being built may not be needed.

**Figure 9: \$1.5tn of data centre buildout to come from private and public credit markets**



Source: Morgan Stanley, April 2026

Third, regulatory scrutiny will keep stepping up. The Bank of England (BoE) and Banque of France are among institutions launching private credit-focused stress tests. Institutions such as the US Office of Financial Research (OFR), the Bank for International Settlements (BIS) and the IMF have focused on recommendations to close data gaps and improve oversight and cross-border regulatory cooperation.

From an investor perspective, manager selection will continue to be a key risk-adjusted performance differentiator. Understanding general partner lending processes, sectoral exposures, benefits and limitations of proposed fund structures and liquidity constraints that come with it are just some of the key aspects that investors must continue to focus on.

Investors may find useful playbooks by studying the 1980s leveraged buyout boom and the early 2000s high-yield telecom boom. Both show that periods of aggressive leverage and optimistic cash-flow assumptions can be resolved through slow restructurings, covenant renegotiations, and investor-level losses, rather than systemic collapse.

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