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Macro Roundup Article

Headline: The Calm Before the Storm

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Tweet: .@GregObenshain argues direct lending, at $574B in June '23, 46% as large as the $1.25T high-yield market, is in "the calm before the storm," that will be followed by a "default spiral."

Summary: In our view, neither private credit nor direct lending have rewritten the rules of credit risk. We'd argue that what passes for innovation in finance is often just repackaging risk in more convenient and higher-fee wrappers. To cite just one example of risky lending that grew rapidly, faced a reckoning and then developed into a more stable, mature market, look no further than high yield. The junk bond boom of the 1980s was built on the idea that the historical performance of high-yield bonds more than compensated for their higher risk. At its core, this idea has proved to be correct, but it was taken to extremes. After the boom in the 1980s, the Moody's below–investment grade default rate hit 6% starting in 1989 and spiked to 10.4% and 9.1% in 1990 and 1991. But what developed afterwards was a mature market that is now tame compared with its history. We suspect that private credit will follow a similar path.

Related Articles: Private Credit: Characteristics and Risks and Where Are All the Defaults? and Corporate Debt, Boom-Bust Cycles, and Financial Crises

Primary Topic: Financial Markets

Topics: Financial Markets, GDP, Op-Ed/Blog Post

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