

Private Credit & Infrastructure Intelligence

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MARKET INSIGHT · PRIVATE CREDIT & INFRASTRUCTURE INTELLIGENCE #006

The rate shock arrives as soft defaults

Floating coupons protect the fund's income, not the borrower; the stress shows up as PIK and extensions

>>> The rate shock hits private credit through the back door. 88% of Fitch's default events were amendments rather than missed payments, while reported fund returns stayed calm.

The rates. The Fed raised its target range by 25bp to 3.75%–4.00% on 16 September. Futures markets priced the chance of another hike at the 27–28 October meeting at 73% on 23 September. The figure rose above 75% on 24 September and eased to 64% by the end of the week. The US 10-year Treasury closed at 5.18% on 24 September and 5.17% on 25 September. It touched 5.223% intraday, its highest since June 2007. That is up about 45bp in under four weeks. The 30-year closed at 5.49%, its highest since June 2004. SOFR, the base rate most direct loans float over, rose to 3.90% from 3.62% before the hike.

The Bank of Japan raised its policy rate to 1.25% from 1% on 18 September, the highest since 1995. The 10-year JGB reached 3.075%, its highest since August 1996, and the 30-year 4.130%. Brent crude has stayed above \$100 through September, peaking at \$130.80 on 15 September, and was quoted at about \$108 on 28 September.

The defaults. Fitch's US private credit default rate reached a record 6.3% in the 12 months to August, from 6.1% in July. Fitch published the data on 14 September. August had 14 default events, the most in the trailing year. The mix is the story. Interest deferrals and PIK substitutions were 47% of events. Distressed maturity extensions were 41%, and 45% of August's events alone. Missed payments that were not cured were only 8%. Together, soft defaults made up 88%. In the 12 months to January, deferrals and PIK were 60% and extensions 27%. On the evidence so far, lenders are increasingly pushing out maturities rather than capitalising interest.

Stress is concentrated. Borrowers with under \$25m of EBITDA (operating profit before interest, tax, depreciation and amortisation) default at 12.0%; healthcare and industrials at 9.9% each; software at 0.6%. Lincoln International finds PIK in 11.1% of loans and 11.3% of interest income in Q2. "Bad PIK" added after closing reached 6.2% of all loans, which Lincoln calls a potential "shadow default rate". Lenders foreclosed on \$22.3bn of pre-takeover debt in H1 2026, nearly matching 2025's \$24.2bn, 70% of it from 2021–2022 buyouts. KBRA's middle-market default monitor, which counts cases where sponsors or lenders stepped in to prevent a missed payment, rose to 3.5% from 3.4%. Its three-month downgrade rate jumped to 13.9% from 12.2%, and median gross leverage rose to 6.5x.

The returns. The MSCI Global Private Credit Closed-End Fund Index returned 1.7% in Q2, up from 0.9%. Opportunistic lending led at 2.4%; direct lending and real-estate debt made 1.0% each. Infrastructure returned 2.5% and venture 12.7%.

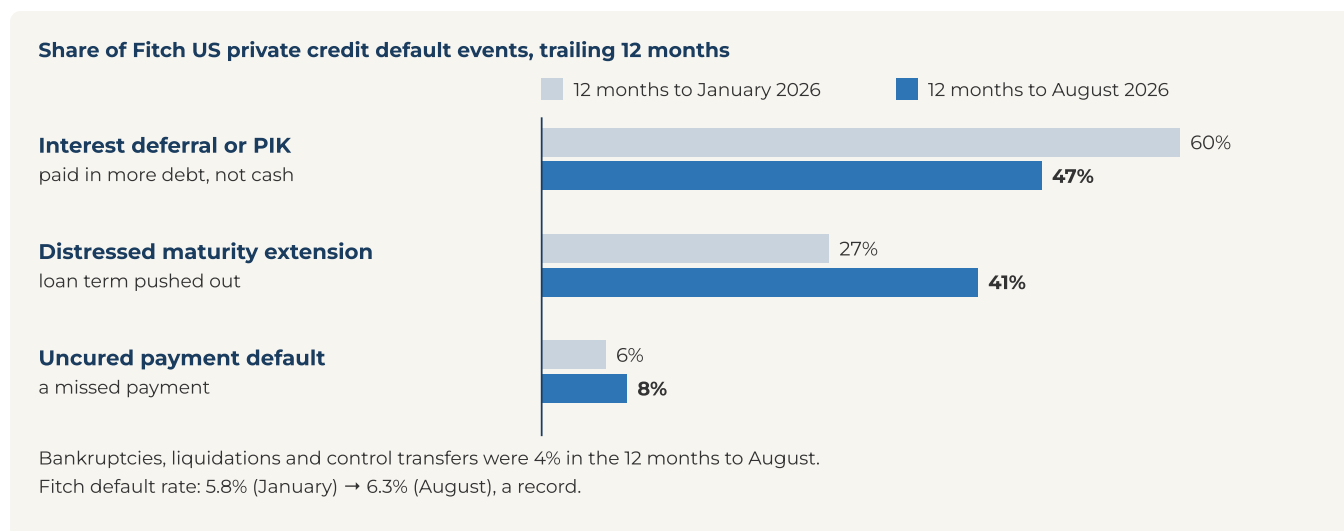


Figure 3 — Stress is arriving as amendments, not missed payments, and the mix is shifting toward extensions

Sources: note 10.

For Wealth Managers: A record default rate and a calm 1.0% direct-lending quarter can sit side by side, because a fund can carry an amended loan near par while the borrower struggles. The headline return and the headline default rate measure different things. On an illustrative median borrower (6.5x leverage, SOFR+5.00%), interest now takes about 58% of EBITDA; each 25bp hike adds about 1.6% of EBITDA to the bill, on our arithmetic. In manager reporting, watch three numbers: the share of income paid in PIK, the count of loans amended or extended in the past year, and exposure to borrowers under \$25m of EBITDA. For yen-based clients, hedging dollars into yen costs about 2.9% a year on three-month forwards, on our calculation. With the 30-year JGB near 4.13%, the home-market alternative now pays more. On our reading, that narrows the pick-up from hedged US direct lending.

For Fund Managers: Stress splits by size and vintage. Managers with large 2021–22 books and a lower-middle-market tilt face the sharpest LP questions. Opportunistic and special-situations credit led MSCI's Q2 sub-indices; its opportunity set widens if extensions turn into restructurings. Insurers rely on Fitch's privately monitored ratings for capital, and that component sits at 8.5%, above the blended 6.3%. KBRA already counts lender intervention as default. Managers who report only payment defaults will look out of step with the agencies their LPs rely on.

→ The rate shock is arriving as extensions and PIK, not missed payments; October's Fed meeting decides whether extensions keep buying time or start turning into losses.

Sources

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