



  
PERMIRA  
CREDIT

  
CAPITAL ECONOMICS

# PERMIRA CREDIT MARKET UPDATE

## Q3 2024

In partnership with Capital Economics

Please note that the views described herein represent those of Permira Credit and Capital Economics as at Q3 2024.

- Recovery is underway across major advanced European economies, with central banks around the continent gradually lowering interest rates as inflation has returned close to target. Central bank rate cuts should help to support activity over the next year.
- While we expect the euro-zone recovery as a whole to continue growing slowly, there are a number of bright spots across Europe. Permira Credit portfolio companies have generally achieved growth rates that outpace GDP growth.
- Private credit market activity picked up pace in the third quarter of 2024, as investors gained more confidence that the economic backdrop will be supportive in achieving valuations that they are looking for. While some caution remains, there are still ample opportunities for private credit to thrive.

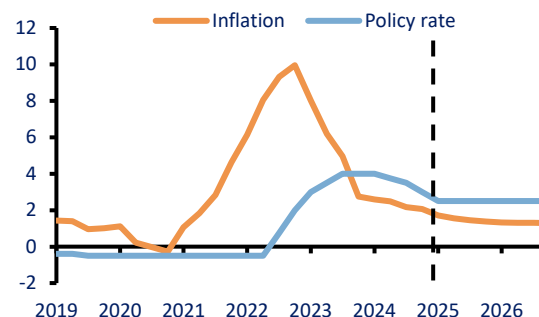
## Economic outlook

### ECB rate cuts amidst falling inflation

The euro-zone economy returned to growth in the first half of this year. Real GDP rose by 0.3% on the quarter in Q1, and by a further 0.2% in Q2. The rebound followed on from five successive quarters of stagnant growth, largely the result of the high inflation and interest rate environment. Further falls in inflation and cuts to interest rates should support the gradual recovery in the euro-zone economy this year and next.

Inflation has decreased significantly from its late-2022 peak, with the headline rate falling to 1.8% in September 2024. This is the first time that inflation has fallen below the European Central Bank (ECB)'s target of 2.0% since June 2021. (See Chart 1.)

**Chart 1: Euro-zone headline inflation (y/y%) and policy rate (end of period %)**



Sources: Capital Economics and LSEG Data and Analytics

So far, this has mainly been driven by the reversal of the energy and global supply chain shocks. Services inflation, which is more sensitive to domestic price pressures, has not fallen much since November last year and came in at 4.0% in September. This should soon ease, as the labour market continues to normalise and wage growth slows.

The monetary policy loosening cycle is set to continue. The ECB cut the deposit rate by 25 basis points at its last three meetings in June,

September and October, taking it down to 3.25%. We suspect that rate cuts from here will continue to be gradual. Although policymakers will not want to see much more loosening in the labour market, there is no need to cut rates aggressively unless downside risks materialise. And for now, we think the euro-zone is likely to avoid a recession.

We expect the ECB to cut by 25 basis points at each meeting until the deposit rate hits 2.50% in March 2025. (See Chart 1 again.)

### **Gradual euro-zone recovery underway**

The euro-zone economy will continue to expand this year, albeit at a slow pace, with looser monetary policy providing a boost in 2025.

Real household incomes are growing rapidly, but this is not translating into rapid spending growth because high interest rates and low confidence have deterred consumption and pushed the savings rate up to a record high outside the pandemic. But on this front, the worst seems to be over, particularly in Germany. And while we do not expect large falls in the savings rate in the coming quarters, we do not think they will continue to rise either. This should provide at least some support to household consumption.

In all, we expect the euro-zone economy to grow at a modest pace in the coming quarters, with GDP growth projected to average around 0.7% in 2024 and 1.0% in 2025, an improvement from the 0.5% growth seen in 2023.

### **In-depth: Growth bright spots around Europe**

While we expect the euro-zone recovery as a whole to continue growing only slowly, there are a number of countries across Europe that are set to outperform.

### **UK to lead cyclical recovery**

The UK economy is also set to outperform the euro-zone average in the years to come. While much of the UK's most recent economic growth is being supported by the fading of the drags from the previous rises in inflation and interest rates, the economy is still on solid footing. Stability with the new government should support an increase in investment, and the UK is not facing the same fiscal pressures as many of its European peers. Indeed, the Autumn budget to be announced at the end of October is widely expected to be more supportive than previous budgets.

The Bank of England will continue to cut interest rates. With inflation close to the 2.0% target and the unemployment rate close to its natural rate of about 4.0%, it makes sense for interest rates to be closer to their neutral rate. That may be around 3.00%, some way below the current 5.00%.

### **Moderate growth signals in Germany and France**

In Germany, the gradual fall in interest rates is expected to support investment, which we expect to positively contribute to growth from 2025. This is in contrast with much of the post-pandemic performance, where investment was a significant drag on the economy.

After growing by 0.2% quarter-on-quarter in Q2, the French economy was boosted by the Paris Olympics in the third quarter due to ticket sales and increased expenditure on hotels and hospitality. And while we expect the economy to continue growing at a moderate pace over the next few years, the government's recently announced fiscal policy will continue to be a headwind for the economy in the years to come.



## **Nordic recovery in sight**

After three years of stagnant growth, the outlook for Sweden's economy is looking a lot more positive. This is for three key reasons.

First, the average interest rate on household debt will fall by about 0.5 percentage points over the coming months, which will reduce households' interest expenditure meaningfully, which could lead to an increase in household consumption. Changes in interest rates in Sweden tend to have a bigger impact on consumption than elsewhere due to the combination of a large amount of household debt and the high proportion of it that is on variable or short-term rates.

Second, Sweden's government has announced a fiscal stimulus worth around 0.9% of GDP in its' recent 2025 budget. This increased government spending should further boost household consumption. And third, we expect the 2025 collective bargaining agreement, which is set to cover around 80% of all workers, to result in a wage rise of around 4% for next year.

With all these developments helping to hopefully meaningfully prop up consumption, we expect the Riksbank to cut the policy rate from 3.25% currently to a terminal rate of 2.50% early next year. That is much less easing than anticipated by investors, who currently expect the policy rate to fall to 1.5%. Indeed, we think that if the Riksbank did cut interest rates that far it would cause the economy to overheat and inflation to rise above target.

Elsewhere in the Nordics, the economic outlook in Norway has also improved. And with inflation falling towards the target and labour market conditions normalising, we think the Norges Bank will soon be ready to join the developed market loosening cycle. This should help support the consumer and residential property sectors, with economic growth remaining more resilient than most European peer countries.

## **Rising employment and incomes to lift Dutch GDP**

The Netherlands has turned a corner and its GDP growth is set to outpace the rest of the euro-zone in the coming years. The economy rebounded strongly in Q2, following several successive quarters in recession as consumer confidence and economic sentiment improved. We expect consumption growth to pick up in the coming months, as rising employment and real wages will boost aggregate household incomes. Moreover, falling interest rates should reduce household interest expenditure more than elsewhere because household debt is relatively elevated in the Netherlands.

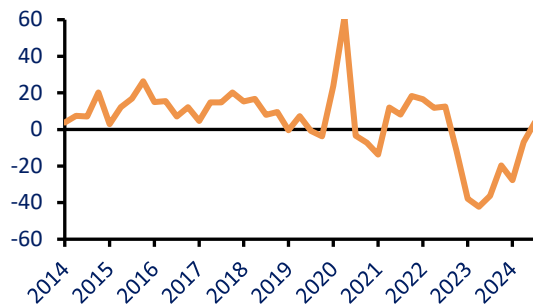
And unlike most of the euro-zone, where fiscal policy will be tightened in the coming years, the government's budget balance is slightly expansionary due to increased spending on welfare and public investment by the new four-party coalition. That said, low public debt and robust growth prospects will keep the debt position in check.

## **Implications for credit markets**

### **Early signs of improvement in credit demand**

Monetary policy loosening is already having ripple effects on the broader investment climate in the euro-zone. Recently released data from the ECB showed that loan demand – a precursor to durable economic growth – increased in the third quarter of 2024. According to the central bank's quarterly 'Bank Lending Survey', banks in the euro-zone saw credit demand from companies increase for the first time since 2022. (See Chart 2.)

**Chart 2: Net change in credit demand from companies (%)**



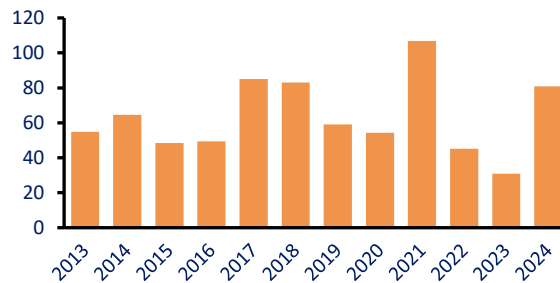
Sources: Capital Economics and the ECB

This rise was mainly driven by declining interest rates as well as a small contribution from fixed investment, after broadly two years of negative impacts from these factors. Corporate demand for credit typically precedes actual loan activity by around three quarters for firms, which provides hope that credit growth should pick-up pace soon.

Additionally, the ECB’s ‘Bank Lending Survey’ also noted that net credit standards for loans to businesses were unchanged in the third quarter, bringing an end to two years of tightening. Yet while credit standards remained unchanged in net terms, risk perceptions were still reported as having a small tightening impact. This backdrop of tight bank lending standards will further encourage the migration of credit from banks to direct lenders, particularly for the middle market.

The improvement in the macroeconomic backdrop can already be seen in the European private credit market. New loan volumes totaled €81 billion in the first three quarters of 2024, making it the busiest period for loans since the first three quarters of 2021. (See Chart 3.)

**Chart 3: European new issue leveraged loan volume, January to September (billion euro)**



Sources: Capital Economics and PitchBook | LCD

Deal volumes should continue to grow from here. With lower levels of activity in 2023, European-focused buyout funds still have vast amounts of capital waiting to be deployed. But more importantly, diminishing uncertainty around the outlook for growth across Europe will be a larger driver of activity. While further policy rate cuts should help spur sales processes, increased dealmaking has more to do with expectations for economic performance over the next few years. Investors need to be confident that the businesses they are buying and selling have the potential to grow. Investors are still waiting to see what’s going to happen – including around the outcome of the US election in November and the conflict in the Middle East – before there’s a big catalyst of activity. The more confidence there is that economies are not going to fall back into recessions, the more confidence investors will have to sell businesses and achieve valuations that they are looking for.

**Sectoral bright spots despite macro headwinds**

While M&A activity remains behind its peak levels seen in 2021, there are ample opportunities for private credit to thrive under the current macroeconomic backdrop particularly when you look deeper into subsectors and regions.

Indeed, the Nordic region has been one of the fastest growing private credit markets across

Europe as Nordic countries are home to many strong mid-market companies in resilient sectors such as technology, business services and healthcare. Over the last years banks continue to be displaced by credit funds with 100% of deals done by credit funds in the mid-market in 1H24 according to MidCapMonitor by Houlihan Lokey.

Our view is that the UK will continue remain the dominant market in Europe for private credit, as its legal framework and focus on non-cyclical services industry lend themselves well to private credit. Additionally, falling interest rates and more stability on the political front should support private investment further.

And even in countries with some macroeconomic headwinds, there appear to be considerable opportunities in non-cyclical sectors. In Germany, for example, where subdued export demand is expected to weigh on industrial sector activity, output in the professional services sector has continued to expand apace despite the adverse economic cycle. Healthcare is another sector which could fare particularly well in the coming years, as demand for healthcare grows on the back of Germany's rapidly ageing population.

Similarly, while tighter fiscal policy will weigh on economic growth in France, it is not as likely to impact the outlook for less cyclical sectors such as technology. The sector is now almost 25% larger than it was before the pandemic, and despite slowing in recent quarters, still expanded around three times faster than GDP since 2023.

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