



PERMIRA CREDIT MARKET UPDATE Q2 2025

In partnership with Capital Economics

Uncertainty reigns but a new dawn in Europe

- Analysis of the impacts of US tariffs on the EU and UK for 2025 and 2026 indicates almost no effect on UK GDP growth and a possible modest reduction on growth in the EU.
- With tariffs posing less of a threat to the European economy, regional conditions will be the primary drivers of economic growth in the near term. These include low interest rates, low inflation and a more unified region both politically and economically.
- In light of these factors, Europe is currently experiencing a meaningful increase in investor confidence both domestically and as a location for investment. We believe that this is likely to create significant momentum and investment opportunity for credit investors in the region, with incumbent players such as Permira Credit well-positioned to capture this wave.

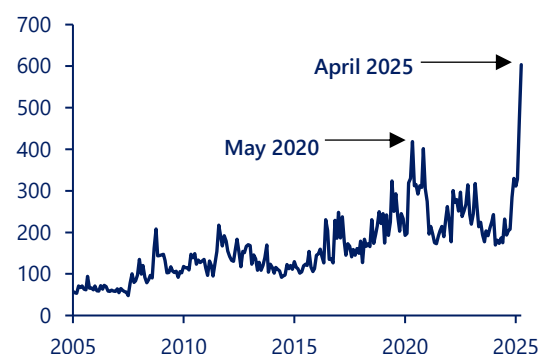
Economic outlook

Uncertainty reigns

The famous quote that “nothing is certain except uncertainty itself” is highly relevant these days. In fact, uncertainty is playing a role in market movements and business sentiment as it arises from geopolitics as well as economic policymaking. The third anniversary of the war in Ukraine passed on 24 February but the hostilities continue, and a lasting peace agreement seems well out of reach. The Middle East is heating up with escalation in the conflict between Israel and Hamas (which began in October 2023), and the US has upped the stakes with Iran regarding its nuclear program. Middle East tensions have not yet affected the global economy more broadly and oil prices remain low given the oversupplied market.

On top of these two long-simmering conflicts is the ongoing ripple effect of the second term of US President Donald Trump, which has raised the spectre of an even broader trade war following “Liberation Day” on 2 April. It is little wonder that the Global Economic Policy Uncertainty index rocketed to a new high in April 2025, significantly beating the prior high reached in May 2020, two months after Covid-19 was declared a global pandemic.

Chart 1: Global Economic Policy Uncertainty index



Sources: Capital Economics, Davis, Steven J., 2016. “An Index of Global Economic Policy Uncertainty,” *Macroeconomic Review*, October.

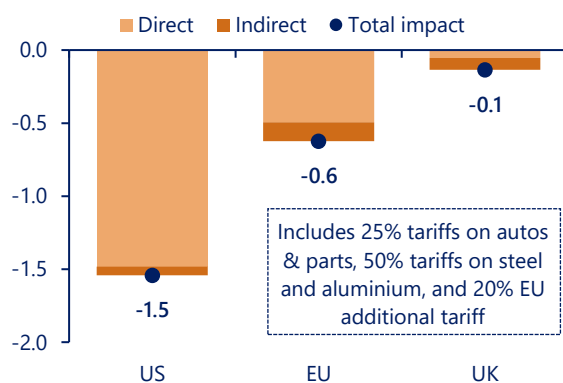
US tariff impact on EU and UK growth will be modest

High uncertainty around tariffs appears on the list of risks on sentiment surveys of investors, consumers and companies and persists due to the extension of the Liberation Day tariff pause until 1 August and President Trump’s ongoing comments related to negotiations. Our analysis indicates, however, that in the aggregate, the

UK economy is now relatively insulated from tariff impacts while tariff effects on EU GDP are likely to be less significant than initially feared.

The chart below shows how much tariffs will weigh on the level of GDP by 2027. Most of the impact is coming from the tariffs themselves (direct impacts) with spillover effects (indirect impacts) being much smaller. The US is by far the hardest hit by its own tariff policy because it is US consumers and businesses that must pay for the tariffs, reducing their ability to spend on other goods and services. By contrast, there is a negligible effect on UK GDP. For the EU, we have applied the 20% country-specific tariff on top of the 10% universal tariff and the effect on GDP over three years is still modest at -0.6%.

Chart 2: Cumulative reduction in baseline level of GDP by 2027



Source: Capital Economics Tariff Impact Model

That said, there are some countries and industries where tariffs will have a more observable impact on activity. As was the case during his first term, President Trump remains focused on bolstering US manufacturers and preserving the steel, aluminium and vehicle industries which he believes are critical to US economic health.

The universal 10% tariff imposed on Liberation Day remains in effect. It is also unlikely to be removed for the foreseeable future since it is a critical component to limiting the even larger

fiscal deficits which are expected to result from President Trump's recently passed spending agenda. There is still time for countries to negotiate exceptions and exemptions to the tariffs and the UK's trade deal may be a model for others – it includes the 10% universal tariff and vehicle quotas, with aluminium and steel yet to be addressed.

China's country-specific tariff of 145% has been negotiated down to 30% but tensions between the US and China remain high. Of course, Chinese goods flowing into Canada and Mexico will be highly scrutinised to prevent them from finding their way into the US via the (theoretical) non-tariff route. Although Canada and Mexico have been subject to some flip-flopping on what goods will see tariffs due to exemptions related to USMCA, the real concern is whether the trilateral agreement will survive until its scheduled review due in July 2026.

Before the 9 April tariff pause, the EU would have been subject to an additional 20% tariff on all exports to the US (on top of the 10% universal tariff). It still faces additional tariffs of 50% on steel, aluminium, and 25% on vehicles and parts, which affect €28bn of products exported to the US. For context, Eurostat reports that EU GDP in 2024 was €17.9 trillion, so the impact of the tariffs on the overall economy will be very small. Certainly, the steel and aluminium industries will feel some pain and countries with large manufacturing sectors, particularly Germany, are expected to bear the brunt. However, the steel and aluminium industries together account for only 1.3% of EU GDP. By contrast, services comprise a little over two-thirds of EU GDP and are not subject to what amounts to a tax on the EU manufacturing sector. In response to President Trump's actions, the EU planned to impose tariffs on a range of US imports worth €26bn, but these are on pause while negotiations are ongoing.

A new dawn for Europe's economy

With tariffs posing less of a threat to the economy, regional conditions will be the primary drivers of economic growth in the near term. The landscape is rather positive. Inflation has now returned to target levels and consumers' real incomes are recovering, boosting the chances of a spending rebound. Fading inflation has also enabled the ECB to lower interest rates by 100 basis points so far this year. We expect another 25bps cut in September which will end the easing cycle, leaving the benchmark rate at 1.75%. At this point, the euro-zone policy rate will be much lower than those of the UK (4.25%) and the US (midpoint of 4.38%). We see business sentiment improving in the form of a less negative EU Business Conditions Indicator that has been moving towards positive territory since the beginning of the year, underscoring the prospects for enhanced growth.

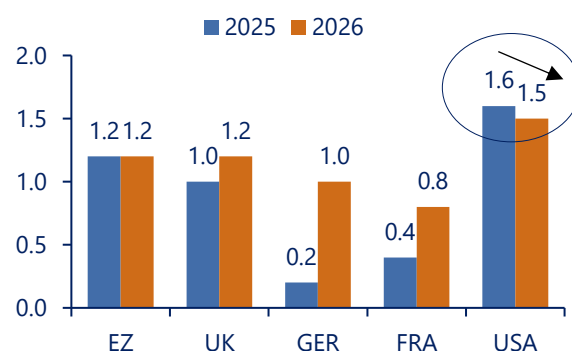
A positive side effect of President Trump's foreign policy is that it has caused Europe's economies to seek out areas of common ground, with national defence coming into focus. President Trump's prior term created unease in the NATO alliance due to his complaints that European members were not spending enough on their own defence. Former President Biden largely salvaged the relationship between the US and NATO and cemented it by offering military and financial support to Ukraine. Upon his return to the White House, however, President Trump again raised the issue of the adequacy of Europe's spending on its own defence. In addition, the ongoing uncertainty about President Trump's support for Ukraine has made many European nations question the reliability of the administration as a military ally in the event of a future conflict.

As a result, defence spending is now a higher priority across Europe, with the NATO allies having broadly committed to a target of 3.5% share of GDP towards military defence by 2035. A critical development in this priority shift is

that Germany has agreed to loosen its fiscal policy to fund that spending increase and, since Germany is in one of the best fiscal positions of the euro-zone, taking on additional debt is not a problem. While not all countries have the same fiscal headroom to follow Germany's lead, Germany's expanded fiscal outlays are likely to support growth across the region.

These positive developments add up to a more optimistic growth outlook this year across Europe and the UK, with 2026 offering opportunities for stronger expansion. Euro-zone GDP growth has been revised up to 1.2% this year (from 1.0%), with similar growth expected in 2026. The EU growth trajectory is more favourable than for the US where 2025 growth has been revised down to 1.6% (from 1.9%) and will fall slightly to 1.5% next year.

Chart 3: Forecasts for real GDP growth rates (%)



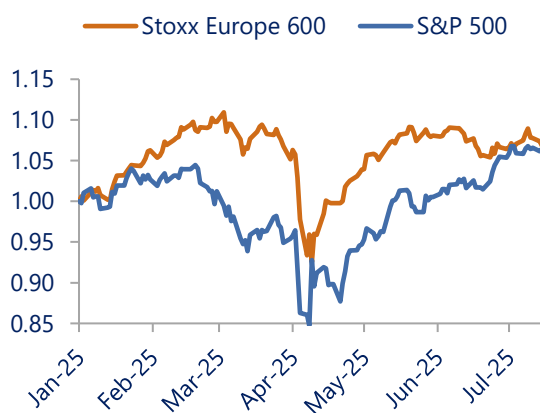
Sources: Capital Economics

Can Europe become a safe haven?

European equities have mostly outperformed US stocks since the beginning of the year (Chart 4). The initial impulse was due to several factors, namely Germany's suspension of its debt brake, an EU decision to relax fiscal rules for defence spending, and a perception that policy in Europe is now more predictable than in Washington.

Euro-zone investor confidence, as measured by Sentix, is now squarely in positive territory (Chart 5). Sentiment was improving until April's tariff announcement reversed that momentum. In June, investor sentiment turned positive for the first time since Feb-2022 and the most recent level for July has extended that positive upward trajectory.

Chart 4: Stock market performance YTD (Jan.1,2025=1.0)

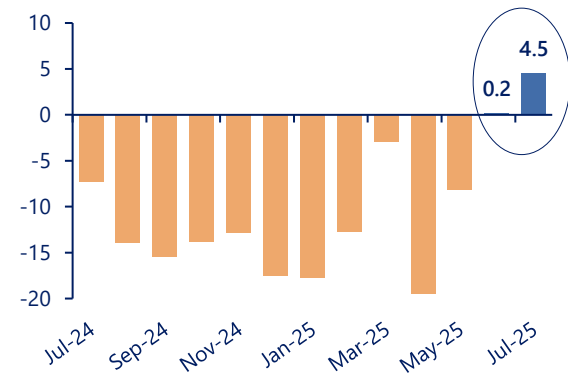


Sources: Capital Economics, LSEG Analytics.

This improved sentiment corresponds to data related to investment flows during Q1 from Morningstar, which showed that that European ETF inflows hit a record €91 billion, with equity ETFs attracting €70.2 billion. Euro-zone large-cap funds received €14.4 billion in net inflows, more than double that of US equivalents, which fell sharply from the highs of Q4 2024. In the bond market, most new investments went into very short-term euro bonds and Swiss

government bonds, as investors sought safer options in response to inflation worries and uncertainty about the US dollar.

Chart 5: Eurozone Sentix Investor Confidence (0 represents neutral)



Sources: Capital Economics, Investing.com

This rotation of assets away from the US and towards Europe, particularly in equities, reflects confidence that, from a policy standpoint, the euro-zone is more shock-resilient than a decade ago. The ECB is no longer trapped at the zero interest rate lower bound and, thanks to the experience of the GFC, it now operates a Transmission Protection Instrument to cap unwarranted increases in national bond spreads. The addition of these systemic stabilisers explains why, during April's Liberation Day turmoil, ten-year Bund yields held steady and periphery spreads widened by less than moves in Treasuries or Gilts.

In assessing the current landscape, the bottom line is that Europe's economy is expected to expand due to a combination of political and economic factors and its policymaking environment presents a stable foundation for near-term growth. This is in strong contrast to the US where, though the growth rate is likely to be higher, activity is slowing, inflation and interest rates are higher, and there is a lack of clarity on major policy initiatives.

Seizing the opportunity in a strengthening market

The European private credit market remains active despite recent volatility, continuing to be a key source of financing for leveraged buyouts and refinancings. We have clearly seen the strength of the market reflected in increased activity levels across our own funds.

- **Direct Lending:** Our direct lending funds deployed €1.9bn in European companies over the last 12 months, supported by investor confidence and resilient corporate fundamentals.
- **Strategic Opportunities:** Despite a brief hiatus in Q1 ahead of Liberation Day, our strategic opportunities fund saw a meaningful increase in the size and quality of the pipeline in the first six months of 2025, with the number of opportunities growing by 36% compared with the same period last year. This increase in pipeline transactions is likely to drive an increase in deployment in H2 2025.
- **CLO Platform:** In the liquid credit markets, we are now seeing a similar story with CLO issuance growing by approximately 20% in H1 2025 compared with H1 2024, even given the tariff volatility.

Stricter bank capital regulations, ample private equity dry powder and ongoing market instability are expected to make private credit an increasingly important financing source for companies and private equity firms. Europe's credit markets will benefit from the increased government spending outlined above – particularly with Germany's ambitious fiscal expansion encompassing infrastructure investment, increased defence spending and corporate tax relief. Germany's economic policies will influence the broader European economy, boosting EU demand and attracting increased foreign investment, all significant drivers for a positive credit environment. The region also features high-quality issuers with lower default risks and limited vulnerability to creditor conflicts, in contrast with the US market, due to stronger legal protections, the smaller number of market participants and complex security arrangements.

Europe's relative insulation from tariffs and external trade disruptions, combined with generally stable economic fundamentals and legal safeguards, enhances its investment appeal. As ever, portfolio selection will be critical, as well as adapting underwriting criteria to reflect the changing geopolitical landscape. This is likely to culminate in some dispersion in prospects, as the impact of the uncertainty will disproportionately impact companies with significant cross-border trade.

Even so, we continue to believe that in a period of global uncertainty and volatility, cautious investor sentiment makes Europe a stable and attractive destination for investment.

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