Private Debt in Asia

June 2024

Introduction

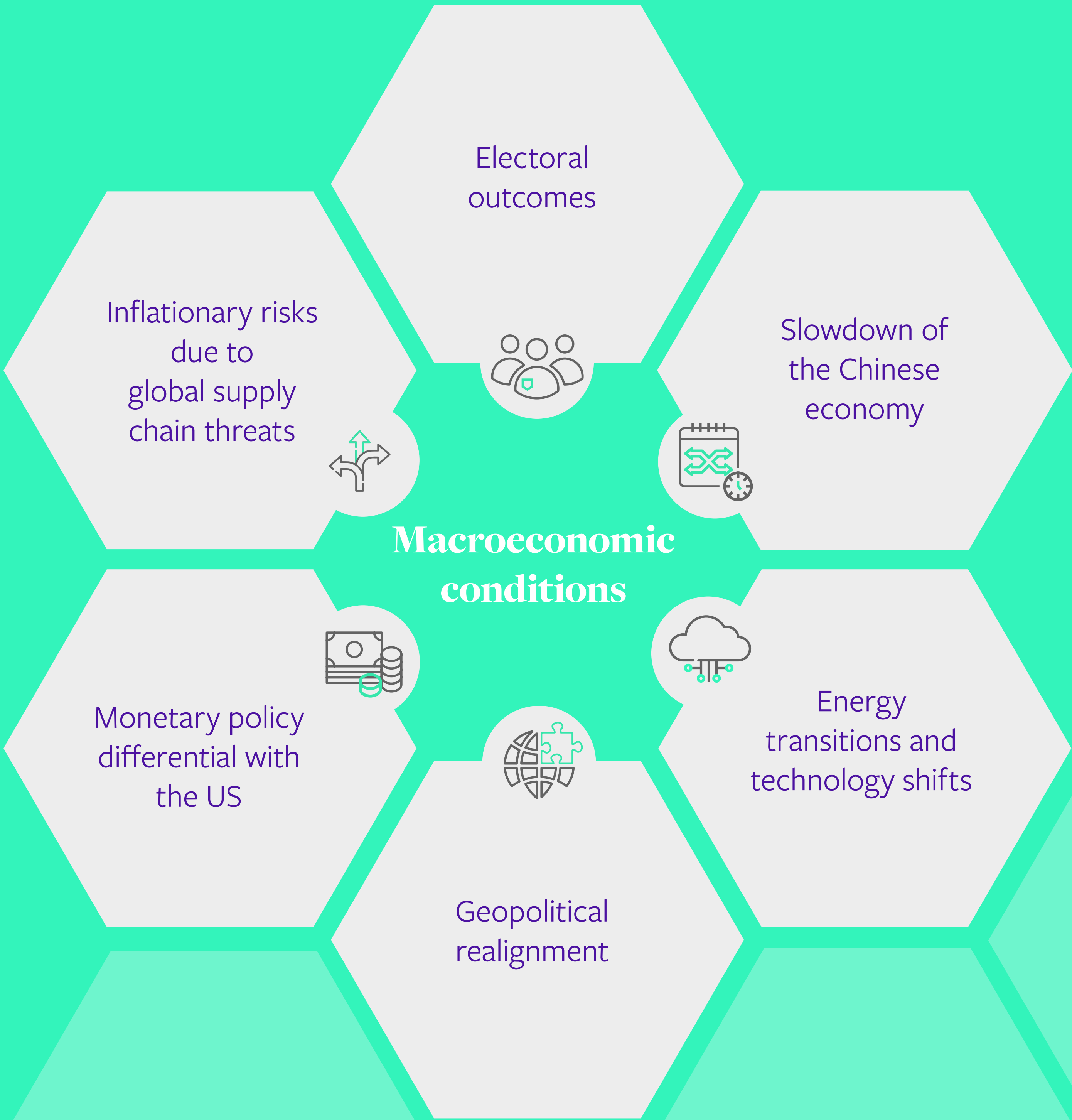
Over the preceding year, marked by unprecedented developments, we witnessed notable macroeconomic shifts, including record-high inflation rates and an aggressive monetary policy tightening campaign across advanced economies.

Such headwinds have precipitated a global downturn, injecting a considerable degree of uncertainty into markets. Private markets, in turn, have borne significant pressure in light of such headwinds in 2023, albeit with some notable exceptions across strategies and regions.

In 2024, a more optimistic landscape emerges, fuelled by expectations of major central banks implementing rate cuts and inflation stabilising at levels close to target. This optimism sets the stage for a potential resurgence in private market activity. Nevertheless, a broader sense of uncertainty is still expected to linger, driven in part by geopolitical tensions, the prospect of a significant shift in the global political order amid the numerous elections slated for 2024, and persistent macroeconomic challenges.

Against this intricate backdrop, we delve into the examination of how these conditions will influence the outlook for private markets in 2024. Our comprehensive series of reports will scrutinise the prospects for three specific asset classes—private debt, private equity, and real estate—across diverse geographical regions, in light of developments in each region. Accordingly, we provide insights into how investors across various segments can navigate current market dynamics, leveraging opportunities strategically to their advantage.

Macroeconomic overview



Inflation in the region aligns with the wider disinflationary trend witnessed globally though consumer price growth remains elevated by historical standards. Nonetheless, most Asian markets, excluding Japan, are anticipated to reach their central bank inflation targets this year.[1]

Central banks in the region have closely monitored the Federal Reserve's (the Fed) interest rate decisions and will likely match the Fed's imminent cuts with their own loosening of monetary policy.

The growth trajectory in the region is largely steered by large emerging markets like India, which are expected to perform strongly relative to other economies. On the other hand, the ongoing property sector downturn in China continues to present itself as a substantial downside risk, dampening growth in the mainland, and capable of generating broader economic and financial stress in the region. This, in turn could lead to a disproportionately larger asset quality deterioration more broadly. Nevertheless, the region's diverse economies, each with robust individual growth prospects, still provides optimism for 2024.

The political outlook in the region is dominated by elections, with eight countries holding presidential or legislative elections. Moreover, the region remains susceptible to geopolitical tensions, which can pose supply-side risks and exert upward pressure on inflation. Nonetheless, Asia continues to demonstrate resilience in its pursuit of becoming the fastest-growing region globally, underlining its importance in the global economic landscape.

Overview of private credit market

The aftermath of the global financial crisis (GFC) heightened regulations on the banking sector, propelling the expansion of the private credit market.

This market, operating beyond strict banking regulations, emerged as a vital alternative credit source, particularly for risky firms shunned by traditional banks.

The sector's growth is notably underscored by its rapid assets under management (AUM) growth to $1.7 trillion as of mid-2023, from $231 billion in 2008.[2] This surge, despite a general slowdown in fundraising activities across private market asset classes, illustrates the sector's solid foundation and readiness to navigate economic complexities. Indeed, while overall fundraising across private market asset classes saw a 22% decline in 2023, private debt saw a much more modest 13% decrease.[3] Notably, the accumulation of over $500 billion in dry powder globally signifies a potent war chest, ready to be deployed, enabling private debt funds to seize opportunities even in times of high inflation and interest rates.[4]

Navigating fundraising and exit strategies in Asia amidst prevailing macroeconomic conditions

The credit landscape in Asia remains predominantly dominated by traditional banking institutions, with bank credit comprising approximately 80% of the credit market.[5] However, the private credit market has been steadily gaining traction, experiencing significant growth over the past two decades.

Notably, the prevailing opinion among investors indicates that the current condition of the private credit sector in the Asia-Pacific (APAC) region closely resembles the early phases of market development in Europe, wherein banks served as the principal capital providers for private equity buyouts. Should the evolution of the European market serve as a template for Asia, it suggests a robust growth path for private debt as an asset class within the region.

In the first half of 2022, Asia outpaced Europe in private debt fundraising for the first time, indicative of the growing confidence in the region compared to Europe.[6] Leading players in the private credit market, such as Blackstone, KKR, Bain and Apollo Management have expanded their presence in Asia, with Blackstone planning a tenfold increase in private credit assets and KKR raising $1.1 billion for its inaugural credit fund.

The significant factors contributing to this increase are primarily the economic performances of India and China, the two principal economies in the region, which have experienced considerable expansion in their total private debt assets under management (AUM). Specifically, in India, the total private debt AUM experienced a remarkable growth of 51% from 2020 to June 2022, attaining a value of $13.4 billion. Concurrently, in China, there was a 31% growth in this metric during the same timeframe, culminating in a total of US$51 billion.[7]

Yet, in 2023, total fundraising amounted to $5.0 billion in the region, the lowest full year number since 2016, though this decline was in line with the overall downward trend in fundraising globally.[8] Asian private credit funds also saw a decrease in their average size, going from US$344 million in 2021 to US$294 million in 2023. Despite this reduction, the 2023 figure aligns with the average size seen in 2019 and remains high by historical standards, suggesting promising prospects for Asian markets.[9]

Importantly, the private credit market in Asia originated with distressed debt, as private lenders offered a viable means of refinancing distressed high-yield bonds during the Asian financial crisis. Consequently, unlike in Europe and the United States, where direct lending forms a substantial segment of the private credit market, Asia has distinguished itself through its expertise in facilitating loans for special situations. Over the past decade, about 50% of the private credit capital mobilised within the region has been directed towards special situations or distressed investments.[10]

Amid rising borrowing expenses and the prospect of an uptick in defaults in 2024, private credit stands as a robust pillar for lending. This is particularly significant as traditional banking institutions withdraw from transactions involving higher-risk loans. Moreover, private debt funds also stand to reap significant benefits from the region's higher yield opportunities.

In addition, the fundraising landscape is currently witnessing a strategic shift towards a wider 'derisking' from China, particularly due to stress in the real estate sector that has undermined investor confidence in the mainland. This shift presents a pivotal opportunity for GPs of private debt funds to enhance their market presence by offering bespoke financing solutions to enterprises that were previously reliant on financing from sponsors now grappling with the mainland's economic challenges. Currency volatility poses a downside risk for private credit funds however, necessitating the development of strategies to hedge against such risks.

Additionally, spillovers China's economic downturn, amongst other regional market stresses, provide these GPs with leverage to negotiate more favourable terms, leading to higher risk-adjusted returns. The potential for GPs to capitalise on these conditions is underscored by the accumulation of dry powder in the Asian private credit market.[11]

Looking more long-term, a crucial factor influencing the growth of the private credit market in the region is its robust economic expansion, fuelled by the emergence of a growing consumer class.

As the Asian market continues to flourish, there will likely be a rising need for alternative financing solutions, driven by the expansion of middle-market companies, infrastructural development projects and a rapidly expanding consumer base. This is expected to drive the growth of private credit as an asset class.

Private credit is poised to play a crucial role in meeting the evolving needs of Asia's dynamic economies. With the traditional banking sector's dominance expected to give way to more specialised and flexible financing solutions, the outlook for private credit funds is promising. As these funds continue to harness growth opportunities and adapt to the region's unique economic challenges, they are expected to contribute significantly to the diversification and sophistication of Asia's financial markets.

References

1 IMF WEO (October 2023)

2 Federal Reserve (2024), Private Credit: Characteristics and Risks

3 McKinsey & Company. (2024) Private Markets: A slower era

4 S&P Global Ratings. (2023) Global Credit Outlook 2024

5 KKR (2023). Private Credit in Asia Pacific: A Region on the Rise

6 Private Debt Investor (2022). Could 2022 be Asia's breakthrough year for private credit?

7 Ibid

8 Preqin

9 Preqin

10 KKR (2023). Private Credit in Asia Pacific: A Region on the Rise

11 Monetary Authority of Singapore (2023). Figures sourced from Prequin pro

Opportunities for new funds/ emerging trends in Asia

Increase in funding requirements for start-ups and SMEs	High	Medium	Low
There is compelling opportunity for private credit to transition from special and distressed lending to direct lending in Asia. This comes from the increase presence of SMEs and startups in the region seeking sources of financing. Startups, in particular, are increasingly utilising venture debt, further fuelling the demand for private credit.	✓		

Strong growth prospects in emerging economies, especially India	High	Medium	Low
Private credit funds have shown interest in financing infrastructure projects across the region, such as Apollo Management's investment in Mumbai International Airport. As the region continues to remain on an upward growth trajectory which will create more infrastructure opportunities, private credit funds are well-positioned to capitalise on these developments.	✓		

Maturing buyout market focusing on traditional leveraged buyouts	High	Medium	Low
The region's buyout market has seen expansion over the years with a heavy focus on traditional leveraged buyouts. These buyouts are traditionally financed by private credit, thereby creating another avenue of increased demand for this asset class in Asia.		✓	

Regulation to facilitate private credit market	High	Medium	Low
Regulation in Asia is also largely in alignment with facilitating the growth of this asset class. Notably, in India recent changes by the SEBI have allowed alternative investment funds to engage in credit default swap (CDS) transactions providing businesses with a mechanism to hedge risks associated with the bond market.		✓	

China real economy slowdown	High	Medium	Low
Market stress in China could offer opportunities for private credit funds to act as viable substitutes for borrowers who are leveraged with sponsors affected by the slowdown in the mainland. However, the slowdown in China could have wider spillovers in the region. While this opens up further opportunities for funds, it also has the potential to reduce activity.		✓	

IQEQ

Key contact

Neil Synnott
CHIEF COMMERCIAL OFFICER, ASIA

E Neil.Synnott@iqeq.com

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