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**JOUMANA BERCETCHE, CNBC:**

Let's get to our first guest at the show, Nicola Mai, Portfolio Manager from PIMCO and the Sovereign Credit Analyst Team. Nicola, the UK market is notorious for moving really hard whenever something happens. It moves a lot in both directions on good days and bad days. Today, we are seeing quite a sizable reaction across all UK assets. Let's just start with the interest rate market. Tear gilts are about 24 basis points lower. The market was quick to reprise a lower terminal rate out of the Bank of England. Are these moves justified?

**NICOLA MAI, PIMCO:**

Well, I think that, you know, the market is obviously very sensitive to inflation, which makes sense, because inflation in the UK has been surprising to the upside relative to other countries. Now, I think there are reasons for that. I mean, some of it is the big increases in energy prices and import prices, which are feeding into inflation and leading to a lag in the disinflation in the UK versus the US. You know, I think some of it is the later reopening from lockdowns, which means there is some impulse there and also a tight labor market. But generally speaking, I do think that the disinflation process is going to be global. And ultimately, the UK inflation- the UK disinflation will follow the US. So I think the market is recognizing that maybe the UK is perhaps not going to be on its own, but eventually is going to follow in the disinflation of other countries. And if you look at the peak rate priced now in the market, which is around 6%, I think it's a fairly, fairly high rate. And I think gilts look relatively attractive here. And I think the market is recognizing that.

**BERCETCHE:**

Yeah, yeah. And indeed, the peak rate has now moved down to 5.8% just in the last hour or so. But core CPI is still sitting at 6.9%. That is a very elevated number relative to where it should be printing or printing or sitting at. And I just wonder to what extent the inflationary dynamics in the UK are specific to the UK. You talk about a global disinflation momentum. Some people have started talking about it in the context of the US. Yesterday, we had some comments out of ECB's Klaus Knott, who's known to be one of the more hawkish members of the committee, also signaling that on the European side of things, perhaps the inflationary dynamics are beginning to change. But people say that the UK stands out for a different reason because of the labor shortage effects and because of some of the supply side impacts that can't be remedied that quickly with monetary policy.

**MAI:**

I mean, I think if you are to look at some specificities of the UK, I think the labor participation, the low labor participation driven according to surveys by a lot of people reporting to be sick, appears to be a bit of a unique feature of the UK economy, which arguably has constrained supply and ultimately boosted wage inflation. But again, I'm not sure we should attribute too much importance to that. As I said, I think in parts, what we're seeing in the UK is big increases in energy and import prices like in Europe, which are leading to a lag in the disinflation process, especially in the goods sector. You had later been opening from the pandemic, which again leads to a lag relative to the US. And I think compared to Europe, you're right that the labor market here is tighter. But again, we are seeing some incipient signs that things are changing. Vacancies appear to be slowing. We're seeing some signs that unemployment is turning a corner. So I would expect wages to moderate. And perhaps there is some extra supply side pressures on inflation. But I'm not sure the UK inflation trajectory is on a completely different path compared to the rest of the global economy.

**BERCETCHE:**

Okay, so disinflationary trends are in place. Let's talk about the growth side of things. More and more, it feels like people are turning optimistic about countries' abilities to avoid a recession. We hear about it in the US, UK sort of skirting around a recession as well. Is it your view that despite all of the monetary policy tightening we've seen, major economies will be able to ever, at the worst, case scenario on the growth side?

**MAI:**

You know, our view remains that the global economy and the US economy will go into some kind of mild recession at the turn of the year. I mean, there is no doubt that the recent data have raised the chances of a so-called “soft landing" or “immaculate disinflation”, which is where inflation kind of moves towards target without having a contraction in activity. But in our mind, there have been things that have mitigated the effects of monetary policy and bank lending, such as tightening in bank lending standards, including, for example, excess savings in the economy and the fact that loan and bond maturities have been longer compared to before. But we think ultimately the weakness is coming. We studied the lags of monetary policy to activity over time, and we found that generally speaking, the peak impact on macro of monetary tightening tends to be around 18 months after the start of the hiking cycle. And in the case of the Fed, that would mean that towards the end of the year, we're going to get to the peak impact. I also think that to really get inflation down to 2%, you probably need some loosening in the labor market. And so the central banks will keep policy tight to ensure that inflation ultimately moves towards 2%.

**BERCETCHE:**

So perhaps higher for longer than I also love the concept of “immaculate disinflation”. That's a very good term. I might have to steal it from you, Nicola. One last question for you, where do you see the opportunities right now? I think earlier on, you mentioned that you see some value in owning gilts. Which part of the curve were you looking at being involved in?

**MAI:**

Well, I think we like fixed income generally at these rate levels. And I think there are arguments to be positioned across the curve. So if you look at the short end of the curve, you obviously have high yields. The curve is very inverted. And you can get very interesting yields for very low duration risk. But at the same time, we don't expect these yields to prevail in the market for a very long time. And as such, you probably want to take some exposure in the longer end of the curve, because you want to lock these yields, which are not going to be there tomorrow or in a year's time. So I think it's a balanced approach across the curve. I would say, generally speaking, when it comes to jurisdictions, we tend to favor the jurisdictions where the tightening cycle is more advanced or there is more price in the curves. So on a relative basis, for example, we would tend to prefer US duration to European duration, as the ECB has more work to do. As I said, UK duration is starting to look attractive here. Despite the inflation uncertainty, given the very high peak rate priced in, and also jurisdictions like Australia and Canada, for example, appear to offer a decent value here, given that they are more advanced in the monetary cycle.

**BERCETCHE:**

Wonderful. Nicola, thank you so much. Thank you for joining me today on the show. Nicola Mai, the Portfolio Manager and Sovereign Credit Analyst at PIMCO.