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**LUCY MEAKIN, BLOOMBERG:**

Now, I want to get back to our market's conversation. We're joined by Nicola Mai, Portfolio Manager and Sovereign Credit Analyst at PIMCO. Great to have you with us, Nicola. I noted that the bond bulls at JP Morgan are doubling down on their bet that the US recessions in the post, even though it's a call that's already been painful when it comes to returns. What's your outlook for Treasuries?

**NICOLA MAI, PIMCO:**

Well, I think that we're around 4.30 now on the 10-year treasury, which is actually close to the upper end of the range that we've been expecting Treasuries to trade at. I think we're close to the final innings of the hiking cycle and coupled with our view that neutral rates, equilibrium rates remain pretty low because of long-standing considerations like demographics, inequality, a global saving glut. I think we're close to the top when it comes to treasury yields and I think duration at these levels is looking pretty attractive here.

**STEPHEN CARROLL, BLOOMBERG:**

Are you excited about this week's Jackson Hole symposium? Will you be glued to Jerome Powell's speech for any hints of where the Fed goes from here?

**MAI:**

I think Powell is probably not going to disclose too much. The topic is secular- it’s secular sort of structural shifts in the global economy, and I think at this point the Fed just wants to maintain a data dependence message. I think they're done or very close to being done and I think the data will inform the decision. I don't see a case for him pre-committing to anything at this point.

**MEAKIN:**

The last time I checked, Andrew Bailey isn't going to Jackson Hole even though some other speakers from the Bank of England are. I wonder whether you think that we'll start to see a bit of divergence between the BOE and the ECB from the Fed over the next year.

**MAI:**

Well, I think some divergence is in the pipeline in the near term. If you look at the ECB, they started hiking after the Fed. The Bank of England actually started earlier but one more slowly for some time. Importantly, I think the disinflation process in Europe is lagging partly because of a big increase in energy prices which fed into core prices and takes time to go down, partly because they had double lockdowns and a later reopening of the economy post-pandemic and partly because the wage process is more laggy. I think in the near term, the ECB will probably hike once more. In September, the Bank of England maybe had a couple more hikes to go. There should be some near-term divergence but I think, generally speaking, we should be close to the end of the hiking cycle across economies in the fall.

**CARROLL:**

I'm keen to get your take on UK debt, the rating agencies due to update their assessments over the next four months. How worried are you about Britain's debt pile and how much would a potential downgrade potentially matter when it comes to the investment outlook for the UK?

**MAI:**

Well, I think the fiscal situation is not deteriorating and I think the fact that there's going to be some losses on the part of the Bank of England that need to be paid by the Treasury because of legislation. I think all of that is worsening the fiscal dynamics, but I think, generally speaking, I think there are also some tailwinds. The higher inflation is obviously helping and I think over time the UK can have its fiscal trajectory back on track. Now, I think at the margin, the fiscal considerations could support the yields in the long end of the curve, so I think that the term premium could be somewhat higher on the back of that, especially if there is a downgrade, but again, I don't see a loss of control type outcome for the UK.

**MEAKIN:**

So then what is your sense on risk assets? Where do you see opportunities?

**MAI:**

We're pretty cautious here. I mean, you mentioned many people still have a recessionary top- type outlook. We're sticking to that call as well. We think there's been quite a lot of monetary restriction. We think it's going to be a mild recession, but we see the unemployment rate rising here by about a point or so in the US. So I think every time the unemployment rate has risen by more than half a point in the past, that was called a recession by the NBER. I think the markets are very bullish here. I mean, if you look at the equity markets, but also credit markets, you know, spreads are tight, equity valuations are very elevated. I think you want to take a risk, but you want to take it in a really defensive way. So we focus on securitized assets like agency mortgages in the US to give you pretty juicy yields with very low risk. We focus on the senior part of the capital structure when it comes to corporate bonds and financials. We tend to be cautious on equities here, given this macro outlook.

**CARROLL:**

What about gilts and all of this? Given the peak rate calls, it looks like we've got a couple of hikes to go.

**MAI:**

I think actually gilts are starting to look pretty attractive here, because as much as inflation is no doubt higher than elsewhere, I think ultimately the inflation will be brought under control. I think the Bank of England peak rate at 6% that is priced in the market is pretty elevated. I think with a neutral rate that remains low, I think what's priced is pretty chunky. As a result, I think gilts are looking relatively attractive here.

**MEAKIN:**

All right, Nicola Mai Portfolio Manager and Sovereign Credit Analyst at PIMCO, great to have you with us on the program.