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**MANUS CRANNY, BLOOMBERG:**

Nicola Mai is Portfolio Manager Sovereign Credit Analyst over at PIMCO. Good to have you with me, timely, isn't it? 32 basis points in the space of August gone on to the slightly longer end. How nervous will Jerome Powell be with the volatility, one could say, and the explosion higher in yields? How unnerving is that for Chair Powell this week? Good morning.

**NICOLA MAI, PIMCO:**

Good morning. Well, I'm not sure I would call it unnerving for Chair Powell. Let's remember that the Fed is determined to bring inflation down and the tightening in financial conditions that we've seen, is something that the Fed has been aiming for. And actually, given that a lot of the mortgages in the US are long mortgages, you know, some rise in longer yields actually makes the monetary tightening somewhat more effective. And I think the Fed will- is data dependent from here? It's done or nearly done, but it's going to watch the data closely.

**CRANNY:**

I mean, you talk about the mortgage rates in the United States of America, but it's had limited impact so far. The long variable lag has been limited in its arrival. We caught up with Grantham at the end of last week and he said, well, the Fed are always wrong. They never really call it right. Is there something much harder and more oppressive to come in the US economy in your view?

**MAI:**

Yeah, I mean, I think the economy has held up remarkably well, given how much tightening there has been in terms of policy rates. I think there are different reasons for that. I mean, one of them is there's still excess savings in the economy, which is the counterpart of the big fiscal stimulus during the pandemic. Some of it is the extension of the loan maturities for both households and corporates. And I think it could also be that the fiscal policy in truth is more stimulative than it appears. As we've seen, for example, from the rise in the US deficit. But I also think that simply, you know, there are lags, long and variable lags when it comes to monetary policy. And if you look at previous cycles, actually the peak impact of policy rates, of tightening cycles, tend to be six to eight quarters after the start of the cycle. And let's remember the Fed started to hike in March 2022 at the start of 2022. And so I think as we get towards the end of this year, I think, especially with longer yields now rising, we should see an additional impact on the economy.

**CRANNY:**

I mean, there's a number of narratives out there from the people that we've spoken to, Ed Yardeni warns that the bottom vigilantes have been woken from their slumber. And I suppose this takes me to the next question: Stephen Major thinks it's a good opportunity to step in at 4.2, 4.3%. But if bond vigilantes are only reawakening, what is the risk in a deficit rising, supply-orientated, backed up to the bond market, of materially higher, nominal, and real rates?

**MAI:**

Yeah, so we subscribe to the view that the equilibrium interest rate in the US remains pretty low. For reasons which have not changed since before the pandemic, among them demographics, they are changing, but they're changing over a very long period of time. Another one is inequality, which remains wide. And generally speaking, we think there is a saving glut globally that ultimately keeps medium-term rates low. And as a result, I think the market is already pricing at a fairly high rate. So if you look at the 10-year real rate in the US–

**CRANNY:**

So is this transitory? Do you think 4.2, 4.3% is transitory? And we will roll down quickly?

**MAI:**

I think we're close to the upper end of the treasury range that we've been expecting. And so I think bonds look pretty attractive here. Now the word “transitory" is a word that has been used, probably overused. What I would say is, until we get a bit more clarity about the inflation outlook, we could stay at fairly high yield levels, but yes, I think in equilibrium, treasury yields will settle at a lower level from here.

**CRANNY:**

OK, does that compound your underweight dollar narrative? I mean, last week, it's amazing isn't it? How analysts, “oh, it's risk-on, risk-off drives the dollar. Oh, no, it's rates that drive the dollar. Oh, well, maybe it's back to risk”. It depends which week you ask an analyst. But I'm looking at your narrative, and it is underweight, the dollar. Why? And what is the alpha for that?

**MAI:**

So there are a couple of reasons. I mean, first of all, broadly speaking, if you look at most value H metrics, the dollar looks expensive against most currencies. Secondly, I think the US disinflation cycle and the interest rate cycle is more advanced than in other places. So the Fed started hiking well before the ECB, for example. Inflation has started to slow in the US more quickly than it has in Europe and in several other places. So I think when it comes to the rate cycle, I think the Fed is ahead. The pause came earlier, whereas, for example, in the case of the ECB and the Bank of England, I think they have a bit more tightening to do. And as a result, I think the rate differential is likely to support the dollar underweight position. In addition, I would say that the dollar tends to do well when there is big risk of events like a deep recession because of the hedge value of the dollar. And we do see a very weak growth slash recessionary environment over the next year. But we don't see a deep recession. So that's, I think, the combination of all these factors make us underweight the dollar against currencies that we find relatively cheap.

**CRANNY:**

How anxious are you about China's on the global- If I look at global risk, every week I had an analyst on, telling me, “China's re-opening, buy commodities! China's re-opening, buy risk! China's re-opening, the velocities on the up.” Here we are. The distance between reality and fantasy is really quite- or reality and hope is quite a broad gap. Here we are. Our hopes are being dashed for global risk. How important is the slow-dying, the FX intervention in China? How concerning is that for global risk?

**MAI:**

Yeah, well, I think China is certainly underperforming relative to most expectations. And I think a lot of it has to do with the weakness of the property sector. And the policymakers support being fairly piecemeal. Now, I don't think the policymakers will allow a financial crisis to unfold in China, but it appears to me that the support measures that are being delivered, including some modest rate cuts and some fiscal easing are fairly modest. Now, what is the risk? I think that the margin in China will be a source of weakness for the global economy, and it will help to contribute to the disinflation that we should see ahead, which is actually positive news in a way for Western central banks, which are trying to aim for the disinflation. Now, I don't think it will be something that causes a global crash, partly because I think the Chinese financial sector, which is obviously going through some wobbles, is not very intertwined with the rest of the global economy. And from a trade perspective, I would say at the margin, the Chinese economy is less connected to the rest of the globe. And especially when it comes to the service sector, that's very much a domestic issue. So China, imparting some weakness, some disinflation, but not really causing a global crash.

**CRANNY:**

Maybe we're just a little bit more emotionally engaged with China than we are financially exposed. Nicola Mai, thank you so much. Portfolio Manager, Sovereign Credit Analyst at PIMCO, on Bloomberg this Monday morning.