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**JON ERLICHMAN, BLOOMBERG:**

Let's get some more perspective on all of this. Vinayek Seshasayee is Portfolio Manager for Canada at PIMCO. Vinayek, it's great to have you back with us. I guess I'll start with the economy. I know we're in North America looking at different trends in Canada and the US. But overall, how would you characterize what you're seeing right now?

**VINAYAK SESHASAYEE, PIIMCO:**

Thanks for having me, Jon. I think what we're seeing right now, as you said, is a trend where the inflation picture is softening. Now, it's not quite back to the 2% target, both in Canada and the US, but it is a significant way away from what we saw last year. And in terms of the underlying pace of inflation, we're seeing it run at about three, three and a half percent both in the US and Canada when we look at three-month-moving averages. So the inflation picture is softening. The growth picture, on the other hand, is a different story between the US and Canada. We are seeing the US continue to grow quite strongly, whereas in Canada, we do believe we're seeing some more material softening in growth.

**ERLICHMAN:**

Do you think that has, as a majority, has to do with the fact that we have different mortgage markets?

**SESHASAYEE:**

Absolutely, I think that is one of the key factors. The pass through of higher interest rates in Canada is just much more powerful as a tool than in the US, where the 30-year fixed-rate product dominates. And even now, I mean, we're only at about 40 percent of Canadian mortgages having reset to higher rates. So we are likely to see the impact of the BOC 's rate-hiking cycle continue to pass through into the economy in a more powerful way than the Fed's hiking cycle.

**ERLICHMAN:**

So how do you think the interest rate story then plays out from here? We just played for our audience that commentary from the head of the Atlanta Fed. Let's start with Canada. I mean, do you think the Bank of Canada will feel committed to higher interest rates, possibly raising rates even more if inflation trends are improving, but not quite putting prices at their target levels?

**SESHASAYEE:**

The short answer is they will. The Bank of Canada is just as committed to the 2 percent target as the Fed is. So if we don't see any inflation beyond the 3 percent pace that we're at right now, then yes, the BOC will feel compelled to come back off the sidelines. But at the same time, I think the BOC is likely to also have made the judgment that they have now raised policy rates to a level that is quite restrictive. And so they do have the flexibility to be a little bit patient here and watch as the economy evolves over the next few months. So we don't think they'll feel compelled to hike at every single meeting. They might choose to be more data dependent.

**ERLICHMAN:**

Well, and certainly we, as we've gone through earnings season and here in Canada, we're watching what the Canadian banks have said. Clearly, they are setting more money aside for a worst-case scenario. And we'll have to see where the economy lands through that. You analyze what's happening with the economy and then you put strategy to work, particularly in the fixed-income world. What would be your key message to people who are investing in the bond market right now?

**SESHASAYEE:**

Well, I think the overarching message that we would take away is that when you look at the level of yields that we are getting in Canada right now, they are the most attractive they've been in the last 15 or 20 years. So after a very long time, it's actually possible for one to build a portfolio that yields over 5% in very high-quality debt. So I think the overarching message is that it is actually a good time to invest in fixed-income and the expected return of the asset class has improved quite materially than what we've seen the last decade. And we might, you know, debate about whether there's a couple more hikes left or whether the Bank of Canada is done with the hiking cycle. But I think the bigger picture for a longer time frame is that we are definitely close to the end of the hiking cycle and we're getting compensated much more. So, you know, bonds look attractive.

**ERLICHMAN:**

And I guess to sort of feed off of that, if we avoid calling it a worst-case scenario, which probably is what most of society would like to see, in theory, that could mean that some of these yields that are available to investors today might not necessarily be available to them tomorrow. Is that a fair way to put it?

**SESHASAYEE:**

I think that's certainly one possibility. If we do see inflation come back down to target, if we do see the economy slow significantly, the current interest rate of 5% would certainly be too restrictive and we could, you know, theoretically see the Bank of Canada begin to cut rates at some point, in which case, yeah, you certainly won't have these yields to invest in at that point in time. So, we do think it's a good opportunity.

**ERLICHMAN:**

What would be the thing you're watching most outside of what central bankers themselves are saying? We seem to be looking at everything. As you mentioned in Canada, we're looking at how households are faring with higher mortgage rates. We're looking at the business environment. We were talking earlier today about office portfolios and the exposure to this higher rate environment. What is the thing you're most closely watching right now?

**SESHASAYEE:**

So, what we're actually watching very closely in Canada is the state of the labor market. You know, this has probably not been talked about enough. And, but, you know, we've seen a small uptick in the unemployment rate in Canada over the past three or four months from 5% to 5.5%. This morning's SEPH data showed that the number of vacancies has dropped to about 750,000 economy wide from levels of over 1 million about a year ago. So, we are seeing a cooling in the labor market. And, you know, we do think that if we see, you know, some more, you know, modest cooling, something that takes the unemployment rate to 6% or higher, I think that is cause for concern. And that could be a sign to the Bank of Canada that they've probably, you know, done enough. So, we're watching the labor market very closely.

**ERLICHMAN:**

Okay. Well, we'll watch it as well. And we have the US jobs report tomorrow. And then a week later, we get the Canadian numbers. So, I know that'll keep you busy as we roll into September. Vinayak, thanks for your time. Appreciate it.

**SESHASAYEE:**

Absolutely. Thank you.

**ERLICHMAN:**

Vinayak Seshasayee, Portfolio Manager for Canada at PIMCO joining us.