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**DANI BURGER, BLOOMBERG:**

So yesterday we got a couple bits of data. All of it did turn into a session, where you have the front end of the curve in the US, move about five basis points higher. It's been a big dovish run in November and some of it started to come back. This was the real piece of data that you started to see a change. It is University of Michigan, we have the final reading on it and short term inflation expectations are at a seven month high in the longer run, prices, expectations are at a 2011 high. So that curbed some of the cut and some of the dovish enthusiasm. Let's bring in now, Nicola Mai, Sovereign Credit Analyst at PIMCO. Nicola, if you look at something like that and it has a reaction, I know on thinner volume heading into Thanksgiving of a sell off and treasuries, has the dovish run has the rally throughout this bond market just gone too far?

**NICOLA MAI, PIMCO:**

I don't think it's gone too far. I mean, if you look at the US Treasury notes, you know, yielding 4.4%. You know, implied in that, there is a real rate in the above 2% between 2 and 2 25%. I think that's a pretty healthy real rate that investors can earn on a US Treasury note. Especially if you take the view like us at PIMCO, that the neutral rates, that the equilibrium rates in the economy have not changed substantially over the past few years. And, you know, we think equilibrium rates in the US remain pretty low in the 0 to 1 percent area. Now in the near term, there is a decent amount of rate cuts priced in already for central banks like for the Fed, almost 100 basis points for next year. Similar for the ECB. So I don't think- I wouldn't bet necessarily on more cuts than what's priced in the market. But if I look at the curve as a whole, I think there's still value in duration.

**BURGER:**

Well, you say that the market's not pricing in enough recession expectations. So does 100 basis points of cuts reflect a recession in that case?

**MAI:**

No, I think the market is pricing what you could call an “immaculate disinflation” scenario, where growth remains pretty solid and inflation falls nevertheless to target. We would take a different view. I mean, we think that what has been supporting growth is a fiscal sugar rush, which looks set to fade. And we also think the impact of monetary tightening will accumulate and will be felt in 2024. So, I think if you look at risk assets, be it equity markets or credit spreads, I think they are signaling a pretty benign economic outlook and we would probably be more cautious than that.

**BURGER:**

Okay. So that makes sense. And you would be more cautious on some of that riskier outlook, but can you kind of define what type of downturn you're exactly looking for? Because we've kind of lost the meaning of soft landing, hard landing, no landing. Honestly, Nicola, none of it makes any sense anymore. What exactly are you expecting for 2024?

**MAI:**

So, for 2024, I mean, we expect a sort of mild recession type environment between stagnation and mild recession. So a US Economy that has been growing at a very healthy pace, you know, shifting down towards 0 percent or slightly negative growth as we go into 2024. Now, that's not a deep recession, but it is still a recessionary type environment. I mean, remember that whenever the unemployment rate rose on a sustained basis by more than half a percentage point in the past, the so called “Sahm Rule” would, you know, suggest that at that point normally a recession has been called by the NBER so that, you know, we think the unemployment rate will rise from here and that will be a recessionary type environment. Now there are risks of a deeper downturn. The reason why- yeah, go ahead

**BURGER:**

Sorry. Yeah, sorry. Go ahead, Nicola. What, what are the risks then? The down, deeper downturn?

**MAI:**

I mean, there's a risk of a deeper downturn of course, because often we don't know when there's a sharp tightening cycle like the one we've seen; something breaks in the financial system, and there are some areas of weakness among which commercial real estate, some areas of the private markets that we're watching closely. Now, the deep downturn is not our central expectation because A), Corporate and household balance sheets start from a fairly healthy position. You know, B), financial Stability policymakers have been very active. So whenever there was the risk of a breakage generally speaking, we had a you know, we had an intervention by policymakers. So it's not our expectation but we need to be–

**BURGER:**

It all squares with your view on perhaps high yield spreads have come in too much and in this most recent rally, high yield and IG have come in even more. Now Morgan Stanley estimates that the default rate on junk bonds is likely to peak at about 5% in the second quarter. Where do you see this default cycle going? Does something like 5% for junk bonds sound about right to you?

**MAI:**

I mean, I don't have a precise level in mind. What appears to me, the case is that credit spreads, especially in the higher risk parts of the market, like high yield, they seem quite compressed relative to what we should expect economically. But the point I would make also is that it's not just about the realized defaults being a lot higher than what's priced in, because often the market actually, prices in more defaults than what actually happens, but it is the, the mark to market losses that you're subject to when credit spreads widen. So even if defaults ultimately don't end up being much higher than what the market is anticipating, I think, you know, from a mark to market perspective, the widening in credit spreads is something you want to protect yourself against in a weak economic environment.

**BURGER:**

Yeah, especially considering where we are now. Nicola, thank you so much for joining us. That is PIMCO 's Nicola Mai.