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**JONATHAN FERRO, BLOOMBERG:**

PIMCO’s Andrew Balls writing this: “We believe that US growth has likely peaked and will gradually decelerate towards the rest of developed markets, yet the factors that have contributed to US resilience could continue to support the still slowing economy for a while longer.” Andrew joins us now. Andrew, let's get straight to it, and it's great to catch up as always, sir. What is behind that divergence, that US exceptionalism, the US versus the rest of the world?

**ANDREW BALLS, PIMCO:**

I think part of it is fiscal policy in the past. Fiscal policy in the US has continued to provide a supporting role. I think part of it comes from the investment around AI, and I think that's been a positive factor as well. I think it continues to be really hard in that kind of post-COVID environment to figure out exactly where we're going to shake out here. But the other thing has been that there's been less impact from the monetary policy tightening in the US, maybe compared with more interest rate-sensitive markets, markets where mortgages are floating rate mortgages. So a combination of these factors, but it does look like you have this US exceptionalism compared with the rest of the world. And the recent data suggests that continues into this year.

**FERRO:**

Andrew, is that fiscal impulse a reason to avoid US duration?

**BALLS:**

I think overall US- the level of US interest rates now, high quality bond funds in the US look attractive. So I think no, I think that fixed income here looks attractive in the US. But in terms of tactical positioning from our point of view, non-US duration looks like a really good complement. So the UK, Europe, Australia, Canada, the places where you can have a little bit more confidence, I think, that the slowdown has already happened clearly. And this can give you a little bit more confidence, I think, in terms of the inflation path. The strength in the US remains an issue. The Fed needs to see some slowing down in terms of the activity in the US to be confident in terms of the inflation path. So overall, I think high quality US fixed income looks pretty good, but complementing this with the rest of the world. I think it makes a lot of sense just in terms of the balance of risks. Maybe there'll be more ongoing US exceptionalism.

**LISA ABRAMOWICZ, BLOOMBERG:**

This is a bit of a shift for you, right? Andrew, I mean, a couple of weeks ago you were quoted in the financial time saying you were looking outside of the US for duration more significantly because of this concern about stickier inflation and higher yields. Are you saying that given the rise that we've seen; 4.6% or around that for a 10-year is fair value and you'd be a buyer here?

**BALLS:**

I think two things. I think the first thing, go back a month, the level of yield in the US looks pretty attractive. It makes sense to have global diversification, the global duration positioning. But overall, I think the level of high quality fixed income looks pretty attractive. So there's a new one. You like US duration and you like the rest of the world as a diversifier and in terms of the balance of risks that we see there. Yes, then the second thing, as you alluded to, since we put on some of these positions, since we've been talking about this, the trade has been moving in our direction. It was interesting last week with some of the repricing in terms of policy rate expectations you weren't seeing that say for the ECB. So the trade has been moving in our direction. But I think at this point still in the global portfolios, I manage for example, overweight the rest of the world first as the US continues to make sense. But as US yields creep higher, then over time we'll need to reassess that.

**ABRAMOWICZ:**

There is a concern among a number of different investors that at some point this Federal Reserve is going to have to start thinking about rate hikes. If we start seeing inflation remaining so sticky, how are you sort of gaming that out? Does that seem like something that you have to start factoring in?

**BALLS:**

I think that's a low probability in terms of the outlook for this year. I think that the Federal Reserve is- clearly expects to be easing policy, second half of this year. Chairman Powell has been quite clear on that other Fed communications. But the market has been pricing out expectations in terms of rate cuts. We think appropriately there's a lot priced in at the start of this year, given what's been happening with the data now looks broadly fair to us. So I think it's a low probability that the next move is higher. But as you reduce expectations in terms of cutting, then those risks just mathematically have to become larger in terms of how you think about it. But I think it's an important distinction. You have had the pricing out of rate cut expectations in the US. And this has gone along with perfectly good performance in terms of equities, credit markets, and more broadly risk assets. I think it would be more of a surprise, more of a market event were you have a shift to expectations for hiking. So not our expectation. I think market pricing looks broadly fair for the US.

**ABRAMOWICZ:**

There's also a question about how much the rest of the world can diverge from the United States and from the Federal Reserve policy. Yes, the ECB indicated that they were sort of laying the groundwork, maybe for a June rate cut. How far can that go given some of the currency reactions? I'm thinking, for example, of the Yen, that's the weakest going back versus the dollar since 1990.

**BALLS:**

Right. So I think the Yen is an interesting and important point. If you start with Europe, I don't think there's a great deal to stop the European Central Bank, the Bank of England and others from easing policy. You are seeing differentiation across countries in terms of the GDP and maybe in terms of the inflation data. And these countries have gone through significant slowdowns, technical recession in Germany, technical recession in the UK. And so I think that there's not a great deal to stop them moving ahead. Again, market pricing looks pretty reasonable. And I don't think that the Euro in that context is going to be a concern for the ECB. The Japanese situation is different in the sense that clearly the authorities have expressed concerns about theYen. It tends to be about the kind of the pace of the movement, not the level only, but there have been concerns expressed there. But it's not at all obvious that this is going to lead to any faster pace on the part of the Bank of Japan. So jawboning in Japan, keep an eye on that. In the case of Europe, UK, Australia, and others, I don't really see anything significant in terms of currency markets, which will hold them back. So a different sort of cycle to the ones we've had historically. But I think it's just great differentiation across countries. And again, it makes sense for us to position for that in FX markets, as well as in rates markets.

**FERRO:**

Well, let's talk about what that means, Andrew, just briefly. Does that mean additional dollar strength?

**BALLS:**

Well, I think that in particular the European currencies, given the path for the ECB and then given valuation, I think that something like Australia, Canada, the UK, expressed this differentiation view using the interest rate markets. In the case of Europe, the baseline, that the valuation not quite as attractive, but the FX, I think, position currencies like the Euro, Swiss Franc, Swedish Corona, I think kind of a broad European beta, underweight via currencies, is a good way to position for, again, the risk of ongoing US, exceptionalism, in the baseline, I think the US should slow down second half of the year. The Fed should deliver pretty much what's priced in in terms of easing. But the balance of risks may be towards US exceptionalism. And so the FX positioning is another way to prepare for that.

**FERRO:**

Interesting, Andrew, this was brilliant. Thank you, sir. Andrew Balls there of PIMCO on the limits of central bank divergence and maybe pushing some of that through. The FX market is looking for a stronger dollar.