T. Rowe Price

Global markets monthly update

In The Loop
December 2023

Key Insights

- Stocks in the U.S. and Europe rose on hopes that calming inflation and slowing growth would lead to rate cuts in 2024.
- Conversely, shares in Japan moved lower on the fears that the central bank may soon tighten its ultra-loose monetary policy.
- Chinese shares also lost ground, weighed down by slowing economic growth concerns over new regulations on the country's massive online gaming sector.

Highlighted regions

- U.S.
- Europe
- Japan
- China
- Other Key Markets

U.S.

Stocks recorded a second consecutive month of strong gains, helped by calming inflation fears and falling long-term interest rates. Value and small-cap stocks, which had underperformed through much of the year, led the gains, but the narrowly focused Dow Jones Industrial Average and the large-cap, technology-heavy Nasdaq 100 Index stood out for marking record highs. The S&P 500 Index moved within about 0.5% of its all-time intraday high, led by gains in the small real estate and industrials sectors; energy was the only segment to record a small overall loss.

The yield on the benchmark 10-year U.S. Treasury note decreased 49 basis points (0.49 percentage point), providing a general tailwind to fixed income markets. Corporate and securitized bonds, especially mortgage-backed securities, outperformed.

Inflation fears continue to recede

The primary factor driving sentiment appeared to be a more benign inflation environment in the eyes of both investors and policymakers. Early in the month, core (less food and energy) consumer price inflation came in roughly in line with expectations, but producer price inflation surprised modestly on the downside. Later in December, the Commerce Department reported that the core personal consumption expenditures (PCE) price index, the Fed's preferred inflation gauge, rose only 0.1% in November, while October's increase was revised lower to the same level. The headline PCE index fell 0.1% in November, marking its first decline in 21 months, thanks to a sharp decline in goods prices.

Stocks had some of their best gains of the month in the wake of the Federal Reserve's final policy meeting of the year. Officials left rates unchanged, as expected, but the quarterly "dot plot" summarizing individual policymakers' rate expectations indicated that the median projection was for 75 basis points of rate cuts coming in 2024, up from the 50 basis points of easing in their previous projection.

More dovish comments from Fed officials seemed to further boost sentiment. In particular, San Francisco Fed President Mary Daly told an interviewer that short-term interest rates "will be quite restrictive even if we [cut the federal funds rate] three times next year" and stated that "we have to be forward-looking and make sure that we don't give people price stability but take away jobs."

Economy proves resilient, although job openings fall sharply

The month's economic data arguably suggested that the Fed wasn't yet slowing the economy too rapidly, however. The closely watched November nonfarm payrolls report surprised modestly on the upside, with employers adding 199,000 jobs versus consensus expectations of around 180,000. The Labor Department's count of October job openings fell much more than expected, however, to 8.73 million, the lowest level since March 2021. New home construction surged unexpectedly in

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November, and sales of existing homes also beat consensus expectations.

The manufacturing sector appeared to remain the expansion's weak spot, although the data offered some conflicting signals. October factory orders fell more than expected, and S&P Global's gauge of national manufacturing activity surprised on the downside and moved further into contraction territory. Most regional manufacturing indexes also disappointed. Durable goods orders jumped 5.4% in November, however—well above expectations and the biggest increase since July 2020. Orders for non-defense capital goods excluding aircraft, considered a proxy for business investment, rose 0.8%, the biggest increase since 2004, according to Reuters.

Europe

In local currency terms, the pan-European STOXX Europe 600 Index climbed 3.77% amid growing optimism that key central banks could lower interest rates early in 2024. Major indexes in Germany, Italy, France, and the UK also rose sharply.

European government bond yields touched their lowest levels in a year as investors brought forward their bets on rate cuts. The yield on the 10-year German government bond ended the month around 2.0% after breaking below that level briefly for the first time since January. The equivalent Italian bond yield declined to about 3.7%. In the UK, the 10-year gilt yield dropped to around 3.5%.

Interest rates stay high, ECB lowers outlook for inflation and growth

The European Central Bank (ECB) kept its benchmark rate unchanged at a record high of 4.0%, while the Bank of England (BoE) kept rates at a 15-year high of 5.25%. The ECB also reduced its inflation forecast, saying that the annual increase in consumer prices would slow to just below the 2% target by 2026. It also lowered its projection for economic growth to 0.6% in 2023 and 0.8% in 2024. Slowing inflation and flatlining economic growth fueled bets on lower borrowing costs in the first half of 2024, as did strong hints from the U.S. Federal Reserve that it could soon start to lower borrowing costs.

Key policymakers push back on rate cuts

A handful of leading ECB policymakers, including ECB President Christine Lagarde, reiterated that it was too early to cut rates. Executive Board member Isabel Schnabel, before the policy meeting, described the slowdown in inflation as "remarkable" and apparently signaled a shift to a more dovish stance, saying in an interview with Reuters that "the most recent inflation number has made a further rate increase rather unlikely."

At the BoE, policymakers kept the option of raising borrowing costs on the table if evidence of more persistent inflation were to emerge. Governor Andrew Bailey continued to say it was too early to cut rates, while Deputy Governor Ben Broadbent said more evidence of a weakness in the labor market would be required before policymakers contemplated lowering borrowing costs.

Inflation slows faster and growth falters

Annual consumer price growth in the eurozone slowed more than expected in November to 2.4% from 2.9% in October. In the UK, the headline inflation rate fell to 3.9% in November, compared with 4.6% in the first month of the fourth quarter.

Both economies struggled to grow in December. Purchasing managers' surveys suggested that business activity in the eurozone remained in contractionary territory for a seventh consecutive month, pointing to a heightened risk of recession at the end of the year. In the UK, the Office for National Statistics (ONS) indicated that the economy performed worse than previously thought in recent quarters. It lowered its estimate of growth in gross domestic product (GDP) for the April-to-June period to 0% from 0.2%, while the final estimate for the third quarter indicated that the economy shrank 0.1%. The ONS also said the economy weakened further in October, contracting 0.3% sequentially.

Japan

Japanese equities generated a negative return in December, with the MSCI Japan Index down 0.5% in local currency terms. Comments by Bank of Japan (BoJ) officials early in the month stoked speculation that the central bank may abandon its policy of negative interest rates earlier than anticipated, weighing on riskier assets. However, the BoJ retained its ultra-accommodative monetary policy stance, including forward guidance, at its December meeting. It refrained from making comments about possible policy tweaks in 2024, appearing to push back against market expectations of a near-term interest rate hike.

Against this backdrop, the yield on the 10-year Japanese government bond (JGB) fell to 0.61% from 0.68% at the end of November. The yen strengthened to about JPY 141.0 against the U.S Dollar, from about JPY 148.2 the prior month. The Japanese currency gained in anticipation of reduced interest rate differentials with the U.S., where the Federal Reserve gave the clearest sign yet that it will pivot away from monetary policy tightening, as it held interest rates steady and projected three rate cuts in 2024.

BoJ appears to push back against rate hike expectations

In a widely expected move, at its December meeting, the BoJ maintained its key short-term interest rate target at -0.1% and made no changes to its yield curve control policy, which regards the upper bound of 1.0% for 10-year JGB yields as a reference in its market operations.

Comments by BoJ officials in early December had been taken by some investors as suggesting that the central bank could be preparing for an earlier-than-expected shift in its ultra-accommodative monetary policy—and that the removal of its negative interest rate policy could come soon after any potential lifting of yield curve control.

However, comments by BoJ Governor Kazuo Ueda appeared to push back against expectations of a near-term interest rate hike, with no mention of potential policy tweaks next year. Ueda reiterated the view that, while the chance of trend inflation accelerating toward the BoJ's 2% target is gradually heightening, the central bank will still need to scrutinize whether a positive wage-inflation cycle falls into place. He added that determining an exit strategy now would be difficult, with the condition of sustained inflation not yet met.

Economic data paint mixed picture

Japan's core consumer price index rose 2.5% year on year in November, down from the previous month's 2.9% and the softest such inflation print since July 2022. Japan's GDP, meanwhile, contracted by a bigger-than-estimated 2.9% quarter on quarter, annualized, in the three months ended September, compared with an initial reading showing the economy had shrunk 2.1%.

December Purchasing Managers' Index data showed that Japan's private sector experienced a mild expansion in business activity over the month, as a stronger rise in services activity offset a quicker contraction in manufacturing. Separately, the BoJ's quarterly "tankan" survey suggested growing optimism among Japan's large manufacturers. This could bode well for companies' ability to hike wages, adding to the positive price-wage spiral that the BoJ is waiting to see become entrenched as a condition for normalizing monetary policy further.

China

Chinese stocks declined after the government announced new restrictions on the gaming sector and stoked fears about a potential clampdown. The MSCI China Index fell 2.41% while the China A Onshore Index gave up 1.25%, both in U.S. dollar terms.

Persistent deflationary pressures also weighed on sentiment. China's consumer price index fell 0.5% in November from the prior-year period, accelerating from October's 0.2% contraction and marking the steepest drop since November 2020. Meanwhile, the producer price index dropped a bigger-than-expected 3% from a year ago, marking the 14th monthly decline.

At the end of December, Chinese regulators approved more than 100 new online games, signaling a softer stance toward the industry after a draft of new rules designed to curb spending on video games led to a stock sell-off earlier in the month. The regulations wiped out nearly USD 80 billion in market value from some of China's largest gaming companies amid concerns that Beijing would reassert tighter control over the tech sector following a two-year crackdown that started in 2021. However, stocks of leading technology names clawed back some of their losses by month-end.

Other readings painted a mixed picture of China's economy. Industrial production grew a better-than-expected 6.6% in November from a year earlier, while retail sales surged 10.1% but missed expectations. Fixed asset investment rose a weaker-than-forecast 2.9% in the first 11 months of the year as declines in infrastructure growth and real estate investment deepened. The urban unemployment rate remained steady from October at 5%.

In monetary policy news, the People's Bank of China on December 15 injected a net RMB 800 billion into the banking system via its medium-term lending facility, a record amount of cash that reflected a more forceful response to the weak recovery. The medium-term lending facility rate was left unchanged, as expected.

Moody's cut its outlook for China's government bonds to "negative" from "stable," saying that the country's indebted local governments and state firms posed downside risks to the economy. The ratings downgrade was a prominent setback for China's financial markets amid a yearslong property market downturn and flagging consumer and business confidence. In response, Beijing issued a flurry of pro-growth measures for 2024 to shore up demand, although many analysts fear they will prove insufficient to revive the economy.

Other Key Markets

Central bank sees inflation expectations improving in Turkiye (Turkey)

Turkish stocks, as measured by MSCI, returned -6.35% in December versus 3.95% for the MSCI Emerging Markets Index.

On December 21, the central bank held its regularly scheduled meeting and raised its key policy rate, the one-week repo auction rate, from 40.0% to 42.5%. While real (inflation-adjusted) interest rates are still well below 0%, policymakers decided to reduce "the pace of monetary tightening"—as they projected they would in their November post-meeting statement—because they determined that "monetary tightness is significantly close to the level required to establish the disinflation course."

In the central bank's December post-meeting statement, policymakers noted that the "existing level of domestic demand, stickiness in services inflation, and geopolitical risks" were sustaining price pressures. However, they also observed that "recent indicators suggest that domestic demand continues to moderate as monetary tightening is reflected in financial conditions." In addition, central bank officials ascertained

that “inflation expectations and pricing behavior” have “started to show signs of improvement,” as various factors—including an “accelerated increase in domestic and foreign demand for Turkish lira-denominated assets”—are contributing “significantly to exchange rate stability and the effectiveness of monetary policy.”

As for future rate increases, policymakers anticipated that they will “complete the tightening cycle as soon as possible,” which could mean that there may be only one more interest rate increase. However, they expected to maintain a tight monetary policy “as long as needed to ensure sustained price stability” and will aim to bring inflation down to the central bank’s 5% target in the medium term.

Brazilian equities outperform broad emerging markets

Brazilian stocks, as measured by MSCI, returned 7.29% in December versus 3.95% for the MSCI Emerging Markets Index. On December 13, Brazil’s central bank reduced its key interest rate, the Selic rate, by 50 basis points, from 12.25% to 11.75%. This decision was widely expected.

According to the post-meeting statement, policymakers characterized the global environment as remaining “volatile,” but they also noted that it is “less adverse than in the previous meeting, with a reduction in longer-term interest rates in the United States and some incipient signs of lower core inflation.”

Domestically, they viewed economic activity as being “consistent with the scenario of deceleration expected” by policymakers. They asserted that headline consumer inflation “remains in a path of disinflation” while noting that “various measures of underlying inflation are closer” to the central bank’s inflation target. Regarding possible future rate cuts, the statement indicated that, if the economy and inflation evolve as they expect, policymakers “unanimously anticipate further reductions of the same magnitude in the next meetings, and judge that this pace is appropriate to keep the necessary contractionary monetary policy for the disinflationary process.”

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Major index returns

Total returns unless noted

As of 12/31/23 Figures shown in U.S. dollars	December	Year-to-Date
U.S. Equity Indexes		
S&P 500	4.54%	26.29%
Dow Jones Industrial Average	4.93	16.18
Nasdaq Composite (Principal Return)	5.52	43.42
Russell Midcap	7.73	17.23
Russell 2000	12.22	16.93
Global/International Equity Indexes		
MSCI Europe	5.01	20.66
MSCI Japan	4.39	20.77
MSCI China	-2.41	-11.04
MSCI Emerging Markets	3.95	10.27
MSCI All Country World	4.84	22.81
Bond Indexes		
Bloomberg U.S. Aggregate Bond	3.83	5.53
Bloomberg Global Aggregate Ex-USD Bond	4.46	5.72
Credit Suisse High Yield	3.51	13.55
J.P. Morgan Emerging Markets Bond Global	4.81	10.45

Past performance is not a reliable indicator of future performance.
Note: Returns are for the periods ended December 31, 2023. The returns include dividends and interest income based on data supplied by third-party provider RIMES and compiled by T. Rowe Price, except for the Nasdaq Composite Index, whose return is principal only.
Sources: Standard & Poor's, LSE Group, Bloomberg Index Services Limited, MSCI, Credit Suisse, Dow Jones, and J.P. Morgan (see Additional Disclosure).

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ID0006626 (01/2024)
202401-3318992