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Global Markets Weekly Update

Regulators signal rate cuts coming—but not soon

Highlighted Regions

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U.S.

Equities end with narrow advance as investors adjust rate cut expectations

Stocks ended mostly higher over the holiday-shortened week, although the advance was narrow—an equally weighted version of the S&P 500 Index recorded a modest loss—and heavily focused on growth stocks. Information technology stocks outperformed, helped by a rally in semiconductor shares. Artificial intelligence (AI) chip giant NVIDIA was particularly strong, as was rival Advanced Micro Devices (AMD). Markets were closed Monday in observance of the Martin Luther King, Jr., holiday.

The fourth-quarter earnings reporting season remained in its early stages, with only 23 companies in the S&P 500 expected to release fourth-quarter earnings reports during the week. On Tuesday, shares of Dow Jones Industrial Average component Boeing fell sharply after the company reported earnings following an analyst downgrade warning of possible delivery delays in case regulators discover more safety issues surrounding the company's 737 MAX airliners. The stock recovered most of its decline later in the week, however.

Manufacturers struggle even as consumers grow more optimistic

The week's data offered some starkly different pictures of the economy's health. T. Rowe Price traders noted that sentiment appeared to take a blow Tuesday from a plunge in an index of manufacturing activity in the New York region, which reached its lowest level since early in the pandemic. A similar measure in the Mid-Atlantic region also surprised modestly on the downside when it was released Thursday, but it appeared to ease investors' concerns in the wake of the early report, according to our traders.

Conversely, Wednesday's December retail sales numbers easily exceeded expectations, suggesting that the consumption side of the economy remained in a much more solid condition. Retail sales jumped 0.6% in October, with online sales growing 1.5% and hitting a new record high. On Friday, the University of Michigan issued a preliminary report that its index of consumer sentiment jumped in January to its highest level in nearly three years and by the most since 2005; over the past two months, the index rose the most since 1991. Head researcher Joanne Hsu told Bloomberg that the increase was evidence that consumers finally believed that "inflation has truly turned the corner."

Waller sees no reason to move quickly in cutting rates

Expectations for rate cuts in 2024 fell sharply over the week, with futures markets pricing only a 13.1% chance of seven or more rate cuts in 2024 as of the close of trading on Friday versus 61.5% the week before, according to the CME FedWatch Tool. Chances of a rate cut in March fell from 81.0% to 47.4%. The decline appeared due in part to comments Tuesday by Fed Governor Christopher Waller, who told a virtual conference that "I see no reason to move as quickly or cut as rapidly as in the past" given the healthy state of the economy.

Waller's comments appeared to be one factor driving the yield on the benchmark 10-year U.S. Treasury note sharply higher for the week and to its highest intraday level since December 12. (Bond prices and yields move in opposite directions.) Tax-exempt municipal bonds traded lower against the backdrop of rising Treasury yields and heavy primary issuance. Within the primary market, our traders noted that the new issues had a mixed reception. January reinvestment cash waned, which further weakened the technical backdrop.

U.S. investment-grade corporate bonds generated negative returns throughout the week as corporate bond yields rose alongside Treasury yields, although our traders noted that spreads tightened throughout the week. More issues came to market than expected, although they were largely oversubscribed. Our traders noted that elevated cash balances and limited net new issuance continued to be broadly supportive of the high yield market, and most deals were similarly oversubscribed. A heavy primary market activity, which was largely repricing or refinancing based, was also the focus of the bank loan market.

Index	Friday's Close	Week's Change	% Change YTD
DJIA	37,863.80	270.82	0.46%
S&P 500	4,839.81	55.98	1.47%
Nasdaq Composite	15,310.97	338.21	2.00%
S&P MidCap 400	2,740.96	12.33	-1.46%
Russell 2000	1,944.39	-6.57	-4.08%

This chart is for illustrative purposes only and does not represent the performance of any specific security. ***Past performance cannot guarantee future results.***

Source of data: Reuters, obtained through Yahoo! Finance and Bloomberg. Closing data as of 4 p.m. ET. The Dow Jones Industrial Average, the Standard & Poor's 500 Stock Index of blue chip stocks, the Standard & Poor's MidCap 400 Index, and the Russell 2000 Index are unmanaged indexes representing various segments of the U.S. equity markets by market capitalization. The Nasdaq Composite is an unmanaged index representing the companies traded on the Nasdaq stock exchange and the National Market System. Frank Russell Company (Russell) is the source and owner of the Russell index data contained or reflected in these materials and all trademarks and copyrights related thereto. Russell® is a registered trademark of Russell. Russell is not responsible for the formatting or configuration of these materials or for any inaccuracy in T. Rowe Price's presentation thereof.

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Europe

In local currency terms, the pan-European STOXX Europe 600 Index ended the week 1.58% lower as comments from central bank policymakers prompted financial markets to scale back bets on an early reduction in interest rates. Major stock indexes were mainly softer. France's CAC 40 Index fell 1.25%, Germany's DAX declined 0.89%, Italy's FTSE MIB eased 0.61%, and the UK's FTSE 100 Index lost 2.14%.

European government bonds were generally weaker. Yields on Germany's two-year sovereign note climbed to more than 2.7%, while the yield on Italy's two-year note increased to 3.2%. In the UK, the yield on the two-year gilt reached 4.2% after data indicated that inflation had accelerated, dousing hopes for a reduction in interest rates.

European Central Bank (ECB) rate-setters smother early rate cut hopes

ECB President Christine Lagarde signaled it was "likely" that interest rates would be cut in summer, not spring as the market had increasingly come to expect. When asked by Bloomberg at the World Economic Forum in Davos if she agreed with Governing Council members who had indicated that they expected a rate cut midyear, Lagarde replied: "I would say it is likely too, but I have to be reserved." She said that the ECB would have crucial information on wages that would influence a policy decision by "late spring."

German economy avoids technical recession but shrinks in 2023

The German economy shrank 0.3% in the final quarter of 2023, according to a preliminary estimate, but an upward revision to the previous quarter meant that Germany avoided a second straight quarter of contraction —the technical definition of a recession. However, gross domestic product is estimated to have shrunk by 0.3% over the whole of 2023.

UK inflation rises unexpectedly; wage growth slows, retail sales drop

The annual rate of inflation defied expectations for further easing in December, ticking higher to 4.0% from 3.9% in November—the first increase in 10 months. The Office for National Statistics attributed the acceleration, in part, to higher tobacco prices. Core inflation, which excludes volatile energy and food prices, was unchanged at 5.1%.

Other data provided mixed signals for policymakers. Growth in wages, excluding bonuses, slowed to its weakest pace in nearly a year, rising 6.6% from year-ago levels in the three months through November. However, retail sales volumes were much weaker than expected in December, falling 3.2% sequentially for their biggest month-over-month drop since January 2021.

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Japan

As yen weakness prompted strong performance from exporters, Japan's stock markets rose over the week, with the Nikkei 225 Index gaining 1.1% to reach a 34-year high and the broader TOPIX Index up 0.6%. Further signs of easing inflationary pressure dampened expectations about any shift in the Bank of Japan's (BoJ's) monetary policy stance at its January 22–23 meeting. The likelihood of the BoJ exiting its negative rates policy in the near term had already been reduced due to the economic impact of the deadly earthquake that struck Japan's Noto Peninsula on New Year's Day.

As the chances of an imminent interest rate hike in Japan appeared to recede, the yen weakened to around JPY 148 against the U.S. dollar, from the prior week's high-144 range. The yen's rapid decline prompted fresh verbal intervention by Finance Minister Shunichi Suzuki, who said that the government was watching currency moves carefully and that currencies should move stably reflecting fundamentals.

In the fixed income markets, as U.S. Federal Reserve officials adopted a more hawkish tone, the yield on the 10-year Japanese government bond rose to 0.66% from 0.59% at the end of the previous week, tracking U.S. Treasury yields higher.

Easing inflation challenges view that BoJ could hike rates multiple times this year

On the economic data front, Japan's core consumer price index (CPI) rose 2.3% year on year in December, down from November's 2.5%. The in-line CPI print was the lowest since June 2022. However, the BoJ has anticipated a slowdown in consumer inflation.

This appeared to challenge the view of some investors that the BoJ could hike interest rates multiple times this year, as the central bank has repeatedly stated that it will maintain its ultra-accommodative monetary policy stance until it sees a sustainable rise in inflation driven by wage growth. Headline wage growth slowed sharply in November. Many investors have instead converged around the view that the BoJ will wait for more data before any shift in its stance—including the outcome of the "shunto" wage negotiations between large firms and unions in March.

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China

Stocks in China slumped as the latest indicators underscored the weak outlook for the economy. The Shanghai Composite Index, which is popular among domestic investors, fell 1.72%, its eighth weekly drop in the past nine, according to Bloomberg. The blue chip CSI 300 gave up 0.44%, its ninth weekly drop in the past 10 weeks. In Hong Kong, the benchmark Hang Seng Index plunged 5.76%, according to FactSet.

China's gross domestic product expanded 5.2% in the fourth quarter over a year earlier and for the full year of 2023, meeting Beijing's official annual growth target. On a quarterly basis, the economy grew 1.0%, up from the third quarter's 0.8% expansion. Quarterly readings provide a better reflection of China's underlying growth than comparisons from a year ago, when major cities were still under pandemic lockdown.

However, other data highlighted pockets of weakness in China's economy. Retail sales rose a lower-than-expected 7.4% in December from a year earlier, down from November's 10.1% increase. Fixed-asset investment grew an above-forecast 3.0% for the full year amid higher infrastructure growth, but a decline in real estate investment deepened. December industrial production rose more than expected from a year ago, while urban unemployment edged up to 5.1% from November's 5.0%. The youth jobless rate was 14.9% in December compared with a record high 21.3% in June, after which the government suspended the report, saying that it needed to do more research on its data collection methodology.

In monetary policy news, the People's Bank of China (PBOC) injected an above-forecast RMB 995 billion into the banking system via its medium-term lending facility, but left the lending rate unchanged, disappointing traders. Nevertheless, many analysts predict that the PBOC will loosen policy this year and could cut its reserve requirement ratio to boost demand.

New home prices fall at steepest pace in almost nine years

China's new home prices fell 0.4% in December, down from November's 0.3% decline, marking the sixth consecutive monthly drop and the fastest fall since February 2015, according to the statistics bureau. Following a brief recovery in early 2023, China's yearslong real estate slump has been a major headwind to its economy despite Beijing's efforts to prop up the sector.

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Other Key Markets

Hungary

On Wednesday—as reported by Bloomberg—the National Bank of Hungary's Deputy Governor Barnabas Virag, while making public comments in neighboring Austria, indicated that the central bank has "more room" to contemplate larger interest rate cuts than in December. Considering that recent inflation readings have been lower than expected and that economic growth has been sluggish, policymakers could deliberate increasing the size of their interest rate reductions when they next meet on January 30. The central bank has reduced its key rate, the base rate, by 75 basis points (0.75%) three times since the end of the third quarter of 2023.

Colombia

Late Thursday, credit rating agency S&P Global Ratings announced that it was changing the outlook on its long-term ratings for Colombia to "negative" from "stable." S&P did not change its current ratings on the sovereign debt. However, the agency cautioned that a downgrade is possible in the next two years if economic growth is less than expected, if there are larger-than-anticipated current account deficits, or if there is "unexpected fiscal slippage" that hurts the government's financial situation.

S&P specifically cited "potentially persistently weak investor confidence" as the reason for the outlook change. The agency expressed concern that weak confidence could, in turn, affect private sector investment and hinder gross domestic product growth from returning to its long-term trend rate of just over 3%.

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