MACQUARIE FUNDS GROUP
Economic Commentary
January 2009

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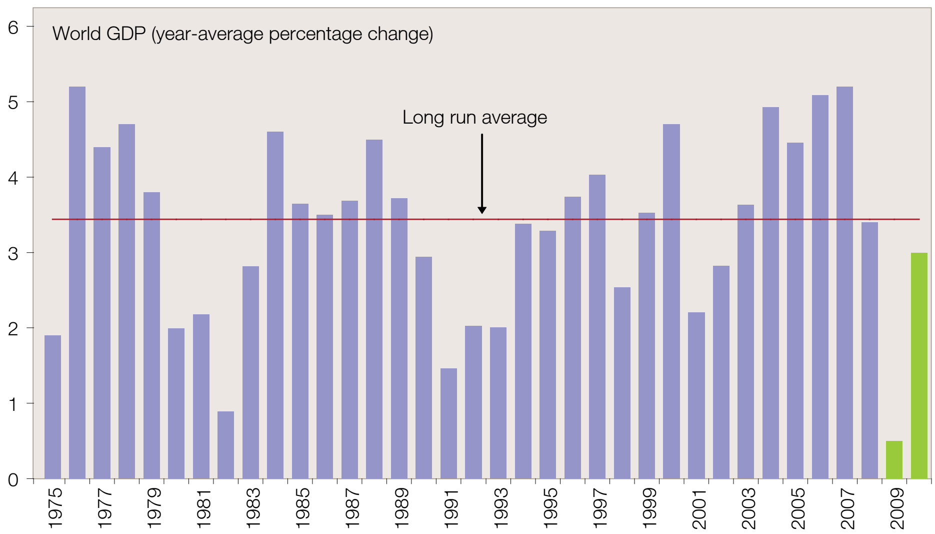
Market highlights for the month were:

- Data confirmed an intensification in the contraction in activity in the G7 economies at the end of 2008;
- Global bond yields rose significantly on concerns over increased supply of bonds to fund fiscal rescue packages. Downgrades to sovereign debt ratings in some European economies weighed on bonds in the region;
- Australian bonds outperformed their global counterparts as the market priced in further aggressive easing by the RBA;
- Equities weakened further on concerns over the economic backdrop and uncertainty over the make-up of a potential US Government rescue of financial institutions;
- The US$ strengthened on a continued flight to quality and narrowing interest rate differentials. The A$ weakened on global growth concerns.

The economic data released in January confirmed that the contraction in the major industrial economies intensified at the end of 2008. The US economy contracted by an annualised -3.8% in the December quarter, its worst result since 1982 as nominal GDP recorded its first quarterly decline since 1960. The UK economy recorded an even larger decline in the quarter, while preliminary estimates point to a large contraction in Germany. Meanwhile, a nearly -10% decline in industrial production in December points to a sharp contraction in the Japanese economy. The weakness in activity has not been confined to the G7 economies, with activity in many economies in Asia weakening markedly due to a sharp slowing in global trade. While survey indicators of business conditions strengthened slightly in most countries in January, in all cases the level of conditions remains consistent with continued weakness in activity. Against this back drop, the IMF revised their forecasts to now expect the weakest period of global growth since WWII.

Global growth expected to be very weak



Source: IMF

The weakness in activity has seen a marked deterioration in labour markets, with unemployment increasing significantly in all of the G7 economies. This continued in the US into the early part of 2009, with a further large decline in employment recorded in January and the unemployment rate rising to 7.6%, its highest rate since 1992.

Global central banks continued to ease rates aggressively in January, with the ECB and Bank of England (BoE) cutting rates by a further -50bps and the RBNZ dropping rates by -150bps. Further rate cuts are expected over coming months, and the BoE subsequently cut rates again in February by -50bps, taking the cash rate down to 1.00%. Governments also took further steps to help support financial markets and the economy. In the US, a large stimulus package is planned, while speculation has increased over the potential establishment of a 'Bad Bank' to remove distressed assets from the banking sector.

In Australia, concern over the domestic economy continued to rise given the bleak global landscape. Business credit fell in December, while anecdotes point to a marked scaling back in business investment plans. Consistent with this, non-residential construction approvals fell substantially during the final months of 2008. Weakness in business conditions has seen a further deterioration in partial indicators of the labour market, with most now pointing to a decline in employment over coming months. Finally residential dwelling approvals continued to fall sharply, suggestive of a large drag on growth from housing activity in early 2009. By contrast, housing finance approvals have recently shown improvement, driven by a surge in 1st home buyer activity in response to falling interest rates and an increase in Government assistance to 1st home buyers. In addition, retail spending strengthened in the latter part of 2008, on the back of the reduction in interest rates, falling petrol prices and Government handouts which propelled a 3.8% rise in retail spending in the month of December.

With the global outlook deteriorating, the Commonwealth Government announced a $42 billion (almost 4% of GDP) fiscal stimulus package in early February to help support the domestic economy. The package comprises significant cash handouts to workers and families and a substantial infrastructure programme for schools. Despite this package, the Government forecasts growth of just ¾% for the coming financial year. In addition, the Reserve Bank cut rates by a further 100bps in early February, taking the cash rate down to 3.25%. We expect the RBA to cut rates further over coming months.

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