# From a bumpy road to a narrow path

La Trobe Financial has increased the crediting rates of its portfolio accounts in each of the past three months, and we look forward to bringing you news of a further increase in next week's CIO Newsletter.

There are a range of tailwinds driving portfolio income, supporting the ongoing increases to our crediting rates:

- The Credit Fund has returned to being at or near fully invested.
- Our portfolios' allocations are normalising following the conservative settings we unapologetically implemented through the volatile moments of the last two years.
- Market interest rates are increasing, boosting portfolio income even further.

Since the onset of the COVID-19 pandemic, we have been talking about the 'bumpy road' to economic recovery. Following the commencement of the Ukraine conflict and the associated burst in inflation, this 'bumpy road' is now more akin to a 'narrow path'. It can however be traversed if calm heads prevail. This week, we explore the three key economic data releases the Reserve Bank of Australia (**RBA**) is watching closely. Not quite a Draghi moment of 'whatever it takes', but the RBA has committed to doing 'whatever is necessary' to ensure that inflation in Australia returns to target over time.

The RBA has a set mandate which includes stability of currency, full employment, and economic prosperity and welfare of the Australian people. Its chief instrument in this is Australia's monetary policy which includes an inflation target of 2-3%.

On that basis, the three key economic data points the RBA is closely watching are unemployment, wage growth and inflation.

**Data Point 1 – Unemployment**

Unemployment has been the standout data point of the past two years. Peaking lower than many anticipated, it has continued to fall and now sits at its lowest level in nearly 50 years. At 3.4% in July 2022, we are at a moment in time where nearly every person who wants a job, has a job. By any reckoning, we are at full employment, or indeed beyond that measure. Full employment creates incredible resilience for the Australian economy as a contributor to household wealth, small business, and indeed income tax receipts for government. Things may not be perfect, but full employment is a great place to start.

**Data Point 2 – Wage growth**

The Wage Price Index (WPI) is a measure of how quickly wages are increasing. These need to move in alignment with inflation to ensure our standard of living does not fall. The WPI was stable in the decade leading up to COVID, and has been incrementally increasing in each of the past six quarters, increasing by 0.7% in the June quarter and 2.6% over the year to 30 June 2022. So, wages are growing, just not as fast as inflation.

The trajectory for wage growth is set with employers reaching capacity right across the economy. Public and private wages are moving upwards in unison, with wage growth present in each sector of the economy. Inflation, is moving faster but the die is cast that will see wages growth do its bit to catch up.

**Data Point 3 – Inflation**

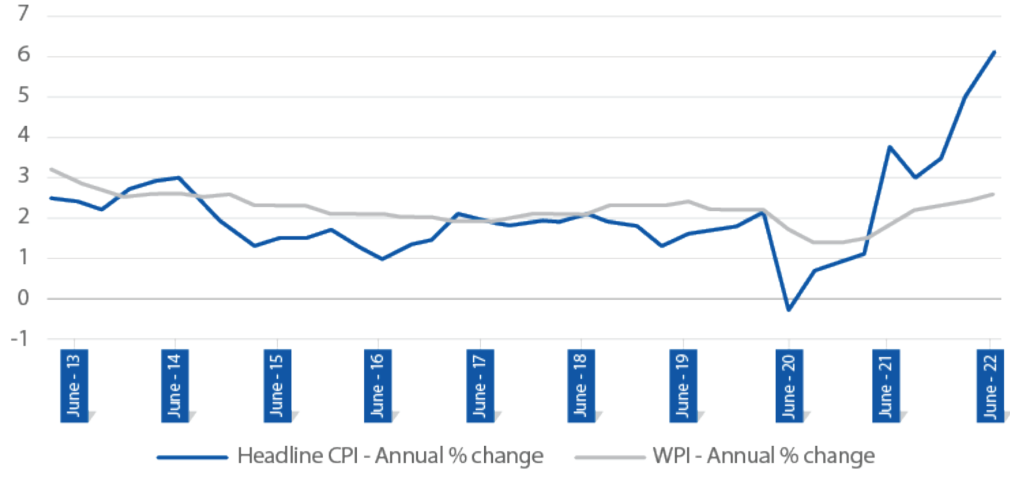
Finally to inflation, which is the runaway figure around the world at the moment. In the US, inflation fell from 9.1% in May to 8.5% in June following a zero-percent core inflation observation. While the swiftness of rate hikes, prospects of recessionary conditions through 2023 and falling oil prices will help soften inflation numbers, it is far too early to call 'peak' in such a dynamic international environment.

In the UK, inflation numbers continue to increase month-on-month, staying above 9% for three consecutive months, and reaching double digits in July at 10.1%. UK numbers are also being driven by the costs of energy including gas and oil, with motor fuels the key driver up 15.2% in the year to June 2022.

Oil prices have begun falling from the peak of US$123.48 per barrel on 8 March 2022 to $US92.428 per barrel on 17 August 2022. Sustained observations below US$100 per barrel will help curtail inflation however we note that after a relatively benign period in the 1980s and 1990s, oil prices have rarely stood still since.

The trend of increased inflation globally has not escaped Australia. While lower than many of its global peers, the annual headline inflation rate of 6.1% in June is the highest observation this century. Over the past ten years wages have broadly kept pace with inflation, and indeed exceeded inflation through the early stages of the pandemic. Since the post-pandemic economic rebound inflation has exceeded wages growth – not something the RBA wants to see as it considered the economic prosperity and welfare of the Australian people.

## Inflation vs Wage Growth




Source: Australian Bureau of Statisitcs

The RBA, as the chief regulator of monetary policy has a narrow path to tread. Move too fast and derail fragile economic growth. Move too slowly and risk runaway inflation. Australia's economy is diversified, resilient and well placed to navigate significant policy grind that regulators and governments will need to undertake, and we will watch these datapoints (and more) very closely over the coming months.

In an environment of heightened volatility and inflation, investors may wish to consider an allocation to products which are inflation-responsive and perform across the economic cycle. Our existing portfolio investment rates provide a range of opportunities for investors across different return and duration profiles.

| CLASSIC NOTICE ACCOUNT | 90 DAY NOTICE ACCOUNT | 6 MONTH NOTICE ACCOUNT | 12 MONTH TERM ACCOUNT | 2 YEAR ACCOUNT | 4 YEAR ACCOUNT | SELECT INVESTMENT ACCOUNT |
|---|---|---|---|---|---|---|
| 2.50%*# p.a. | 2.80%*# p.a. | 3.10%*# p.a. | 4.70%* p.a. | 4.80%* p.a. | 6.00%* p.a. | from 5.50%* p.a. |
| current **variable** rate after fees, reviewed monthly | current **variable** rate after fees, reviewed monthly | current **variable** rate after fees, reviewed monthly | current **variable** rate after fees, reviewed monthly | current **variable** rate after fees, reviewed monthly | current **variable** rate after fees, reviewed monthly | Peer-to-Peer |

*The rates of return on your investment are current at 1 August 2022. The rates of return are reviewed and determined monthly and may increase or decrease each month. The rate of return applicable for any given month is paid at the start of the following month. The rates of return are not guaranteed and are determined by the future revenue of the Credit Fund and may be lower than expected.

An investment in the Credit Fund is not a bank deposit, and investors risk losing some or all of their principal investments. Past performance is not a reliable indicator of future performance. Withdrawal rights are subject to liquidity and may be delayed or suspended. Visit our website for further information.

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