Box 1
Potential Effects of the Increase in the Minimum Wage on Inflation

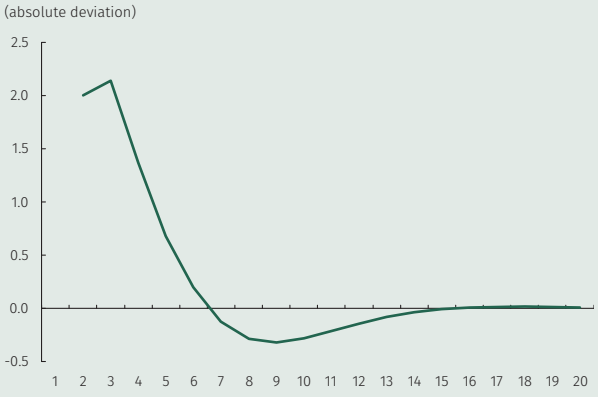
This box analyzes how a significant increase in the minimum wage may affect inflation. The exercise considers a scenario in which such an increase exceeds past inflation and labor productivity growth by 17.2 percentage points (pp), a magnitude consistent with the adjustment considered for 2026. The objective is to quantify the inflationary contribution attributable to this specific shock, recognizing its unusually significant increase. Accordingly, what follows should not be interpreted as a comprehensive projection of observed inflation, which depends on multiple factors and concurrent shocks, but rather as a measurement of the marginal impact of the minimum wage increase on inflation.

This exercise uses a small open-economy macroeconomic model that allows analysis of how changes in the minimum wage affect prices, originally presented in Chapter 3.2 of *Ensayos sobre Política Económica* (Issue No. 103). The model incorporates household heterogeneity (high- and low-productivity households) and labor market segmentation (formal and informal employment), as well as a central bank that sets the monetary policy interest rate to reduce fluctuations in inflation and output. Within this model, the minimum wage is determined as a function of past inflation and labor productivity, plus an unexpected component that captures deviations from this rule, which may reflect bargaining agreements between workers and employers or Government decisions. This element is crucial for the inflation analysis, as it allows the minimum wage increase to be interpreted as an exogenous shock or unexpected change that alters the cost structure and, through this channel, modifies the price path generated by the model.

The main mechanism through which a minimum wage shock is transmitted to prices operates primarily through the cost channel[1]. When the minimum wage increases in the model, it becomes more costly for many firms to pay their low-skilled formal workers, since these workers earn the minimum wage. As the minimum wage rises, labor costs increase in the directly indexed segment; that is, firms face higher expenses as marginal production costs increase, and part of this rise is typically passed through to consumer prices. Additionally, in the short term, other wages are also affected as they use the minimum wage as a reference point. In that regard, a partial adjustment of high-skilled wages is incorporated in proportion to the increase in the minimum wage (the so-called “lighthouse effect”), which temporarily amplifies the cost pressures faced by the productive sector and, consequently, the inflationary pressures associated with the shock. In summary, the real increase in the minimum wage acts as an increase in marginal costs and, through this channel, becomes a source of inflationary pressure in the model.

1 The model also includes a demand channel in which the minimum wage increases the disposable income of a fraction of the population and, consequently, aggregate demand rises in the short term, reinforcing cost-driven inflationary pressures; however, this channel has a comparatively smaller quantitative impact.

Graph B1.1
Response of Quarterly Inflation (annualized) to a Permanent Increase in the Real Minimum Wage



Note: Quarterly inflation is expressed in annualized terms and as an absolute deviation from the initial equilibrium.
Source: *Banco de la República* (Monetary Policy Report, January 2026).

The main result of the exercise is that a 1,700-basis-point (bp) increase in the minimum wage translates into an increase in inflation of approximately 200 bp in annual terms. This increase occurs even under a monetary authority that responds to inflationary pressures in line with its inflation-stabilization objective, thereby allowing inflation to be gradually steered back toward its long-term target (Graph B1.1).