

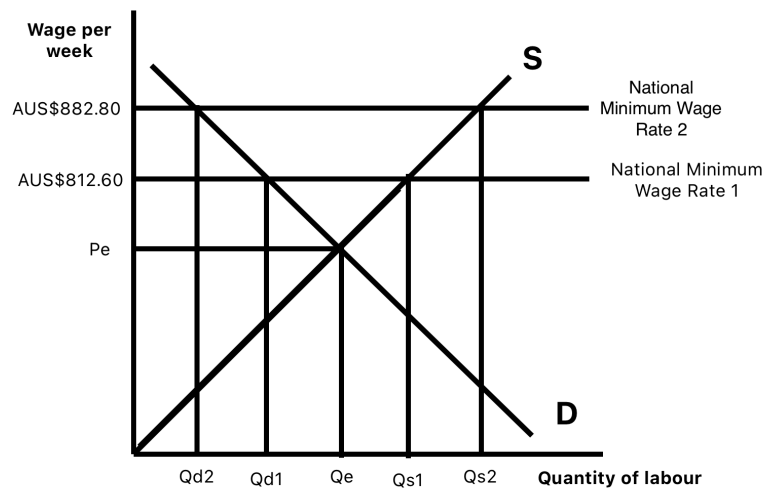
Growing risk of June interest rate rise after minimum wage lift

Commentary of article:

<https://www.smh.com.au/politics/federal/a-fifth-of-australia-s-workforce-to-get-5-75-per-cent-pay-increase-20230602-p5ddd2.html>

The above article describes the trade-off between wage price and inflation. For instance, the Fair Work Commission is deciding to increase the minimum wage by 8.6% to ensure the **economic well-being** of 180,000 people so they are able to keep up with the cost of living crisis. However, the Reserve Bank Of Australia (RBA) is concerned about the effect on inflation which is a sustained increase in the general price level which was 7% in the March quarter.

Figure 1 represents the effect of the increased minimum wage rate on all stakeholders. The minimum price is AUS\$882.80 set above the original minimum wage of AUS\$812.60. This increase would result in a larger quantity of labour available in the market; at MWR2 the  $Q_s$  is greater than  $Q_D$ . The price floor leads to a smaller quantity demanded by the employers at AUS\$882.80 at  $Q_d$  which results in disequilibrium due to the surplus of labour in the market.

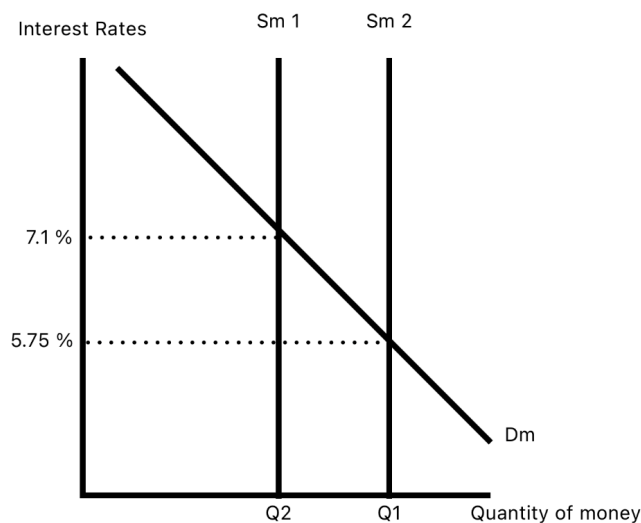


**Figure 1: Effect of minimum wage rate on the labour market**

With the 8.6% wage rate increase for 180,000 employees, the labourers may be ensured greater **economic well-being** as they could beat the cost of living crisis, higher electricity prices, high interest rates, and higher mortgage repayments in Australia. This would also allow the living standards to increase as the disposable income of employees will increase and the employees will have greater purchasing power. Considering the minimum wage is an award rate for 180,000 employees it will also incentivise greater demand and productivity in the economy.

However, firms will incur a higher cost of production, for instance, small firms will incur an increase of AU\$12.6 Billion in costs which may make it harder for firms to efficiently produce and lead to a loss in revenue, thus threatening the **economic well-being** of the firms. The surplus due to the minimum wage increase can lead to an increase in Australia's unemployment rate. Thus, risking the **economic well-being** of unemployed labour in Australia. The increased disposable incomes can all lead to increased consumer expenditure,

a component of Aggregate demand (AD):  $(C+I+G+X-M)$ . As a result, the AD in the economy will increase which would lead to a risk of demand pull inflation. Furthermore, as the cost of production rises, there may also be a risk of cost push inflation. To prevent the demand pull inflation, the RBA increases interest rates from 5.75% to 7.1% as seen in the following diagram:



*Figure 2: Increase in Interest rates by RBA*

The RBA is concerned with the high risk of inflation. Considering the inflation in the March quarter was 7%, the RBA would utilise contractionary monetary policy and decrease the money supply in the economy consecutively. This is represented by Figure 2 where an increase in the interest rates from 5.75 % to 7.1 % leads to a fall in the money supply from Q1 to Q2 consequently making borrowing expensive and therefore, reduces the borrowing by consumers and firms. This policy would decrease the consumer spending in the economy along with the investment spending. They are both components of AD  $(C+I+G+X-M)$  which may lead to a reduction of AD, therefore, preventing higher inflation. However, implementing contractionary monetary policy might lead to an increase in the unemployment

rate and lead to unemployment in Australia. This will threaten the economic well-being of employees as they will find it harder to manage the high cost of living.

Due to the higher interest rates the cost of borrowing for firms will increase along with that the consumer demand for many products will also fall due to the rise in prices which will result in low revenue and consequently lower profit margins. This will jeopardise firms' **economic well-being** and firms and producers will therefore be worse-off. Furthermore, since the cost of borrowing increases, the cost of production will still increase and therefore the cost-push inflation will not be mitigated and the economy may still suffer from high inflation rates.

Additionally, the government is also likely to be worse-off as they will be required to provide unemployment benefits and transfer payments to the newly unemployed population. This is likely to bring a constraint in their government budget and will subsequently increase the aggregate demand as government expenditure is a component of AD.

In conclusion, the contractionary monetary policy used to combat the high inflation caused by increased minimum wages may compromise the economic well-being of major stakeholders in society being worse-off such as the firms/producers, employees/labour, consumers, and the government. Therefore, the government and RBA is recommended to seek a policy that prioritises the economic well-being of stakeholders in the economy while adhering to their government objectives.