Poverty and the Economy

August 2013

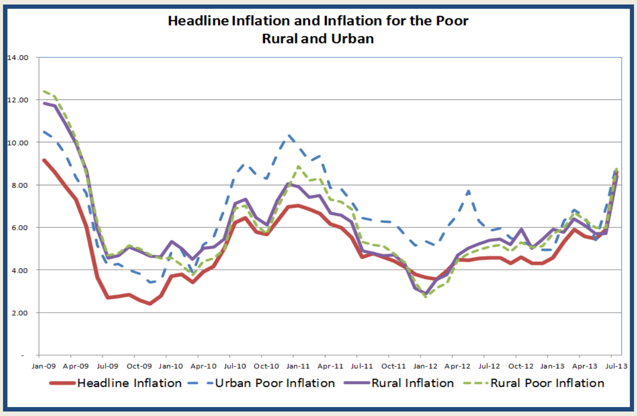
INFLATION

As expected, the inflation rate for the month of July was 3.29%, more than three times June inflation of 1.1%. The major contributors to inflation this month were a 9.6% increase of transportation costs as a result of the fuel subsidy reduction and 5.5% and 1.5% of increase in price of food and processed food tied to the increase in fuel prices as well as the usual Lebaran food price increase.

Year-on-year inflation in July was 8.61% and year-to-date inflation was 6.75%. As a result the Government's inflation target of 7.72% for 2013 will be difficult if not impossible to achieve, despite the traditional decline in food prices after Lebaran.

In recognition of the negative impact on the poor of the reduction in fuel subsidies, the Government has issued a Social Protection Card (*Kartu Pelindungan Sosial*) to 15.5 million poor households, roughly the poorest 25% of the population. This card is used to gives access to such social protection programs as Rice for the Poor (*Raskin*), Assistance to Poor Students (*Bantuan Siswa Miskin*) and Temporary Direct Cash Transfer (*Bantuan Langsung Sementara Masyrakat – BLSM*). As of end of August, the realization of *BLSM* disbursement is around 93% which indicates that the unified database that is used as a basis for card issuance is good.

As shown in the following graph, the difference between urban/rural and poor/non-poor inflation rates has almost disappeared. This may seem odd, but it is due to the fact that food inflation affects the poor quite heavily, while increases in direct transportation costs have more of an impact on the non-poor. With both high food price inflation (13.03%) and high annual transportation cost inflation (13.93%), both the poor and non-poor were hard hit this month. However, because the high rate of food price inflation hurts the poor the Government's program to compensate the poor for the fuel subsidy reduction is appropriate.



World food prices

World food prices in July were down 2.5% compared to May with a 5% decline in grains prices and 1.7% decline in other foods while price of fats and oil remain unchanged. For Indonesian consumers the approximately 3-5% depreciation of the rupiah over the same period totally offset the decline in dollar prices. For the month of July, Indonesian food prices were driven more by local market factors related to Ramadan than global price movements.

DEVELOPMENT

World Economic Growth Gaining Momentum

The global economy is gaining momentum. According to the Economist world GDP rose at 1.1% annually in the second quarter. European countries' GDP grew by 0.3% after the German and France economies rose by 0.7% and 0.5% respectively. Prospects for Europe are still poor in the near term as there are still substantial obstacles to overcome in a number of countries. Particularly troubling are the high unemployment rates in the hardest hit economies.

Growth in the US was faster than previously expected in the 2nd quarter with the actual figure reaching 1.7% compared to 1.1% in the first quarter.

While economic conditions across the large advanced economies are looking more promising, the growth performance of the large emerging market economies has been disappointing. Chinese growth slipped from double-digit levels in 2010 to 7.5% y-o-y in June 2013. India has also slowed markedly with growth halving from around 10% in the first half of 2010 to around 5% y-o-y in early 2013. The emerging market slowdown extends beyond China and India, stretching from the export-oriented economies of East Asia to even large and more protectionist Latin American economies like Brazil where growth of only around 2% is expected this year. This weakness reflects subdued world trade and the exhaustion of previous credit-led growth in places like Brazil and South Korea. This suggests that while global demand may be rising, it will not be growing rapidly enough to give a significant boost to the Indonesian economy. This is certainly being reflected in Indonesia's export figures.

Indonesia's growth is lower than predicted

According to Bank Indonesia, economic growth in the second quarter of 2013 at 5.81% was slightly lower than had been forecast (5.9%) recently. The economic slowdown is mainly due to the contraction in non-building investment. The quantity of exports has continued to increase, so in real terms exports appear to contribute to growth. But the prices of the commodities Indonesia exports have fallen to such an extent that exports earnings have fallen.

Looking ahead, Indonesia's economic growth in 2013 will likely be at the lower end of the predicted range of 5.8 to 6.2% or lower. This is due to the impact of China's slowing economic growth and the reversal of large capital inflows. However, preparations for the 2014 elections are expected to improve economic growth in the fourth quarter of 2013.

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Trade Balance

The trade deficit in June 2013 was $847 million compared to $590 million in May. The deficit in the oil sector is larger than non-oil sector because the impact of fuel subsidy reduction has not been captured in the June trade data. Moreover these data do not reflect the impact of the recent weakening of the Rupiah. Both the reduction in the fuel subsidy and the depreciation of the Rupiah should reduce the trade deficit in the future.

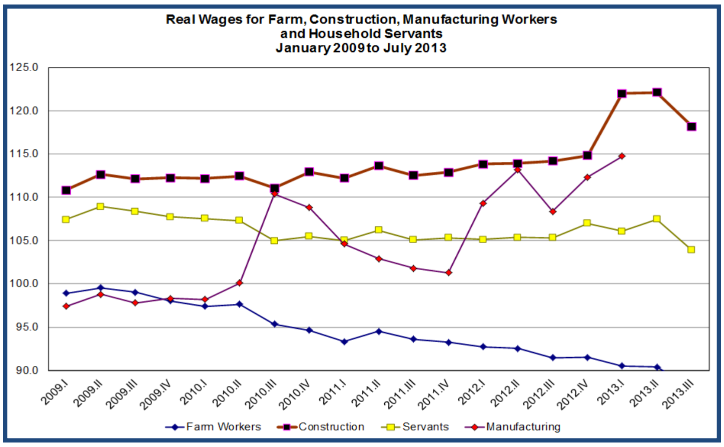
For the first 6 months of 2013 exports were down by $ 6 billion compared to the same period in 2012. About $ 4 billion of this decline was due to oil/ gas; of which about a third was due to lower quantities exported. The fall in world commodity prices accounted for almost $ 5 million of the decline in export earnings. Indonesia actually increased the quantity of the non-oil/ gas commodities it exported but it was hit be declining prices: by 16% in the first 4 months of 2013 compared to 2012. Imports in 2013 were also down, but only by $ 2 million.

The future trade balance should be substantially improved by higher fuel prices, which will reduce both consumption and smuggling of Indonesian oil abroad. The depreciation of the Rupiah will stimulate exports and deter imports. But higher wages, especially in Jakarta, due to a big increase in the minimum wage, will discourage exports. Continued declines in commodity prices as a result of slow global growth are another negative factor. Whether the trade balance improves or deteriorates will largely depend on the policies the country adopts to provide incentives to exporters, those competing with imports and investors in general.

Impact on the Poor

Real Wages

With higher inflation in July 2013, real wages for both urban and rural workers fell. Wages for agricultural workers and household servants generally reached their lowest level for the last four years. Wages for construction workers also declined in the last 2 months, but that only partially offset a large increase in real wages earlier this year. The real wages of production workers in manufacturing also declined in 2013 despite a large increase in the minimum wage in Jakarta and smaller increases elsewhere. The negative effects of inflation, the deterioration in world growth and the slow-down in Indonesian growth seem to have offset the decreed increase in the minimum wage.



SPECIAL REPORT

Variation in Provincial Poverty Rates in Indonesia

There are significant disparities in provincial poverty rates, with provinces such as East Nusa Tenggara, Papua and Maluku persistently having the highest poverty rates and Jakarta having the lowest poverty rates. While decentralization has focused more on district level issues, provincial disparities in poverty are significant for policy and deserve greater study. SEADI commissioned a study[1] by Dr. Riyana Miranti (NATSEM - University of Canberra) to analyze the factors that drive variations in poverty at the provincial level in Indonesia.

Using data for 2006-2011 for 33 provinces, the paper focuses on short-term changes in poverty but findings are relevant for policy purposes and the same framework could be used to study trends over a longer period if comparable data can be developed.

The main findings in the study are: First, higher income and therefore income growth is an important factor in poverty reduction. In general the province with the higher per capita GDP had a lower incidence of poverty and provinces with a higher rate of growth showed a greater reduction in poverty incidence. Every 10% increase in per capita income reduced poverty incidence by 2.8%

Second, the type of income growth in a region matters. Growth in income from non-food crops and service sectors are more poverty reducing than growth in income from natural resources, and especially from minerals. Natural-resource-rich provinces tend to have a high incidence of poverty despite a high average per capita Regional Gross Domestic Product, because their income is unequally distributed among population. This is especially true of mineral-rich provinces.

Third, poverty incidence is not only a function of growth in income but also of levels of education. Consequently investment in human capital reduces poverty incidence. But the benefits of education come only with a lag. Every 10% increase in the number of year of schooling reduces poverty incidence by 30%, but 10 year later.

Fourth, poverty persists. Provinces with a high incidence of poverty tend to have poor living conditions with less access to electricity and clean drinking water. Their high incidence of poverty continues over time.

Fifth, for some of the variables causality seems to run both ways. That is especially true for access to electricity and drinking water. Low access five years ago is correlated with high current poverty incidence; but conversely high poverty incidence five years ago is correlated with poor access to these services currently. But for most variables causality is from the variable to poverty.

Lastly, while migration might be expected to reduce poverty, no significant relationship could be found between either in-migration or out-migration and poverty.

1 Miranti, Riyana, 2013 Factors explaining variation in Provincial Poverty Rate in Indonesia (2006 – 2011).

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