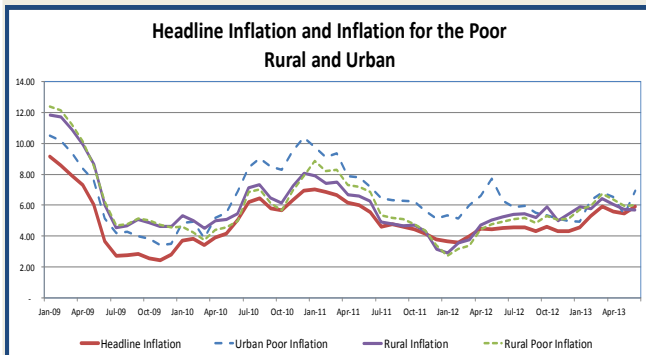


INFLATION

As expected, after two consecutive months of deflation, the urban "headline" price index increased in June by 1.03%, in large part due to the fuel subsidy reduction. The resulting increase in the cost of transportation directly contributed more than half (0.57) to the rate of inflation. The uncertainty caused by the long process of deciding on fuel price increases resulted in some increased prices even before the fuel subsidy reduction was announced (on June 22, 2013). Expected increases in transport costs and increases in world food prices were among the factors in the inflation of food prices (1.17%) and processed food prices (0.67%).

The annual inflation (June 2012 to June 2013) was 5.9%, much higher than in 2012 (4.53%) or 2011 (5.54%). With inflation for 2013 (January – June) of 3.35% the 2013 inflation target of 7.72% will be difficult to achieve, especially because of expected high inflation in some coming months: fasting month and starting school year in July, Idul Fitri/ Lebaran in August and Christmas in December.

With annual inflation of 10.7% for food, inflation for the urban poor in June was much higher than the headline inflation. Inflation in the rural areas in June was only 0.59% as food price rose only 0.9%, less affected by higher transport costs. The difference between rural poor inflation and rural inflation was small.



World food prices

According to the World Bank, the price of food on average increased about 3.2% from April to June 2013, primarily due to an increase in the price of fats and oils.

DEVELOPMENT

World economic growth continued to slow

The IMF's World Economic Outlook predicted that world output will expand by just 3.1% in 2013, down from 3.3% in April and 3.5% in January. The lower forecast is driven by weaker domestic demand and slower growth in several key emerging market economies, a protracted recession in the euro area and weaker growth in the U.S. as stronger fiscal contraction countered improving private demand.

China's economic growth fell to 7.5% in the second quarter after the slowdown in the global economy triggered a fall in manufactured exports coupled with a shrinking working population and lack of structural reform. As a result the ADB revised its projection for Asian growth from 6.6% to 6.3% for 2013 and from 6.7% to 6.4% for 2014.

Indonesia revised its growth target in 2013 from 6.8% to 6.2%

The World Bank has revised its growth forecast for 2013 for Indonesia to 5.9%, from 6.2% earlier this year. The main reasons are the slowdown in world growth, international financial volatility and renewed downward pressures on commodity prices.

The reduction of the fuel subsidy will help reduce the budget deficit, projected at 2.1% of GDP in 2013. In the longer term, this reduction contributes to more efficient and equitably government spending.

The Ministry of Finance estimates economic growth in the first half of 2013 reached 6.1%. On this basis, the Government is optimistic that this year's economic growth target of 6.3% will be achieved. Bank Indonesia estimates a maximum growth rate of 6.2% in 2013.

Trade Balance

The deficit of the trade balance for May 2013 was \$590 million compared to \$1.2 billion in April 2013. Both oil and non-oil exports were higher in May than April, while imports of oil declined and imports of non-oil increased. The trend toward a weaker rupiah that has accelerated recently, with the rupiah hitting four year lows, may be providing some support to exporters and curtailing some imports.

Cumulative exports for January-May 2013 were \$ 5 billion or about 6% below the same period in 2012. Oil and gas account for \$ 3.9 billion of the export decline, the result of aging fields, and of policies that discourage investment and of subsidies that encourage domestic consumption. On the import side, as well cumulative oil & gas imports increased for the same reasons, though only by \$ 0.4 billion. Total imports were down slightly despite the increase in oil/gas imports because of an 18% decline in imports of capital goods. This implies lower investment and growth in the future. With exports down by \$ 5 billion and imports down by less than \$ 1 billion, the trade balance showed a deficit of \$ 2.4 billion in the first 5 months of 2013. It had been a surplus of \$ 6.4 billion in all of 2011 and \$ 1.9 billion in 2012.

With the adjustment of fuel prices in June, it is expected that oil/ imports will be lower in June but imports of non-oil goods especially foods are expected to increase to stabilize domestic food prices in advance of the fasting month and Idul Fitri. Therefore the deficit in the trade balance is expected to continue.

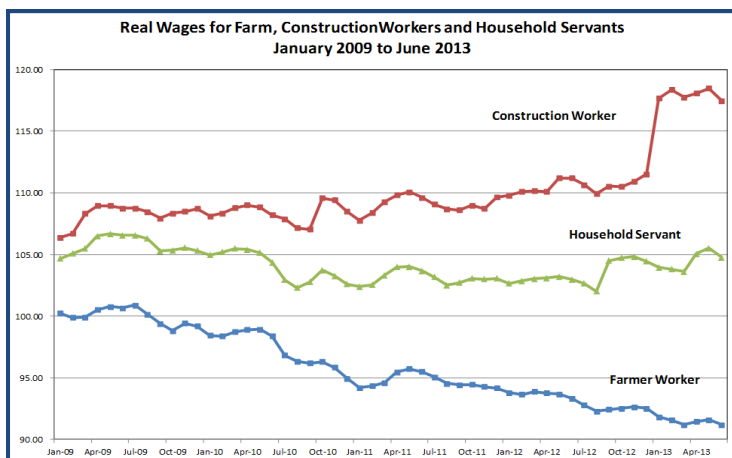
Impact on the Poor

Real wages declined because of inflation

Because of high inflation in June 2013, the real wages, the purchasing power, for both urban and rural worker declined substantially. The real wage for agricultural workers which started to increase in the last three months after having declined since 2009, dropped to the lowest level in 4 years, nearly 10% below its high point.

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The real wages for poor urban poor worker, i.e. construction workers and household servants also declined. After having risen quite steadily for the first 5 months of 2013 they saw their real wage decline by 1% in one month to June.

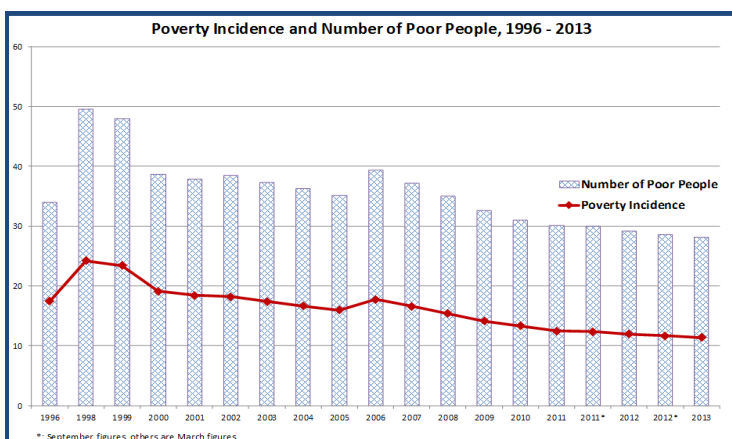


March's poverty rate is lower than September's

BPS has released its report on poverty in March 2013. The number of poor in Indonesia fell in March to 28.1 million or 11.4% of the population. This is lower than the September 2012 figure of 28.6 million or 11.65% of the population. Poverty is a more significant problem in rural areas than in urban areas with the poverty rate in rural areas at 14.3% (compared to 14.7% in September 2012) while the poverty rate in urban areas was 8.4% compared to 8.6% in September 2012.

Other measurements of poverty: P1 (poverty gap index) and P2 (poverty severity) also were improved in March 2013 compared to September 2012. The decline in the P1 index from 1.9 to 1.75 indicates that not only are fewer people poor but those who are poor are consuming an amount closer to the poverty line than in September. The decline in the P2 index from 0.61 to 0.48 suggests that the reduction in poverty has helped people well below the poverty line as well as those near the poverty line.

Macroeconomic conditions that supported a reduction in poverty during period September 2012 – March 2013 included a lower inflation rate, rising real wages and stable rice prices. The higher rate of inflation in June if continued may increase poverty incidence in September 2013.



SPECIAL REPORT

Poverty and Education Access

Over the last 30 years, Indonesia has made remarkable improvements in education with the average years of schooling increasing from 4 years in 1980 to 6.1 years in 2010 and the percentage of those with no schooling declining from 32% in 1980 to only 13% in 2010 (Barro-Lee dataset).

Today the Government is required to allocate a minimum 20% of its budget for education and offer free basic education for all children between 7-15 years old. To accomplish this, the Government has initiated a number of key policies and programs some of which are significantly pro-poor. Among these initiatives are scholarships, conditional cash transfers for the poor, and the school operational subsidies (*Bantuan Operasional Sekolah/BOS*).

At the Poverty Conference held in June by TNP2K and SEADI, one session was dedicated to discussing poverty and access to education. Two papers presented in the session reached similar conclusions that access to education and benefits from government's spending on education are not equally distributed across the population.

Overall government spending on education in 2007 was equally distributed between populations. But in contrast, overall spending on education in 2009 was regressive as it provided more benefits to middle and upper classes than lower classes. Government spending on primary education was pro-poor and progressive, while spending on secondary and tertiary schools benefit more the better off.¹ This has implication to the education progression. Most of the children who do not advance from primary to junior secondary school, and from junior secondary to senior secondary school, come from poor families, although the gap has narrowed. Children from the richest quintile are 3.9 times more likely to continue their schooling from primary to junior secondary and 4.0 times more likely to continue their schooling from junior secondary to senior secondary school than those from the poorest quintile. This is supported by the fact that most children who were not enrolled in school dropped out for financial reasons: 57 percent of out-of-school children aged 13-15 had discontinued their education because they could not afford the cost and another 6 percent because they had to work to earn a living.²

The findings of these studies provide policy guidance for ensuring that all children, regardless of their socio-economic background, have equal access to education. Fundamentally, for poor children to stay in school children must not only receive free or low cost education but families must be provided enough income to be able to afford for children not to work.

¹ Wika, Gek Shinta Jasmin, "Distribution of Government Spending on Education in Indonesia: Benefit Incidence Analysis", paper presented at Academic Conference on Poverty Alleviation in Indonesia, Jakarta, 2013

² Suharti, "Inequality in Education Progression in Indonesia: When the Poor Remains Left Behind", paper presented at Academic Conference on Poverty Alleviation in Indonesia, Jakarta, 2013