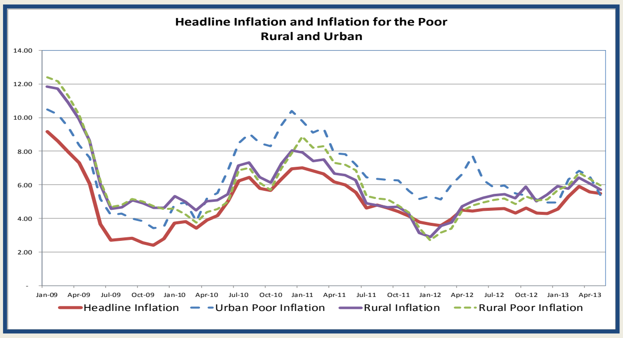
Poverty and the Economy June 2013

INFLATION

Inflation in May

In May consumer prices fell for the second month in a row, with the headline CPI declining by -0.03% compared to April. Inflation had been unusually high in the first four months of 2013 only slightly compensated by the April-May decline. Therefore the year-on-year inflation for May was a high 5.5%, slightly lower than the 5.6% in April. The government revised its inflation target for 2013 from 4.9% to 7.2% the new inflation target is reasonable, particularly given the increase in fuel prices that was implemented in mid-June. The decline in the May CPI, as in April 2013, was caused by declines in food and clothing, this month by -0.83% and -1.22% respectively. Prices of onions, garlic and vegetables declined significantly as a correction to unusually high prices in previous months.

As the deflation was caused mainly by food price reductions, the impact was greater on the poor: year-on-year inflation for the urban poor was 5.4% compared to 5.5% for the headline CPI. The impact was even greater for the rural consumers, with a much larger share of their income spent on food: -0.03 and -0.06 for the rural poor. The differences between poverty indices and indices for the non-poor have become quite small, but they remain large between urban and rural CPI.



World food prices

The world food price in May 2013 was relatively stable with no changes from last month.

DEVELOPMENT

No notable changes to the international outlook

The global economy appears to be transitioning toward a period of more stable, but slower growth. The latest World Bank's Global Economic Prospect issued in June 2013 predicted that the global economy will grow at 2.2%, a touch slower than 2012. The strengthening of quarterly growth will show up in whole-year global GDP growth of 3.0 percent for 2014 and 3.3 percent in 2015.

Financial conditions in high-income countries have improved and risks are down, but growth remains subdued, especially in Europe. The recovery is on more solid ground in the United States, where a fairly robust private sector recovery is being held back, but not extinguished, by fiscal tightening. Meanwhile, in Japan, a dramatic relaxation of macroeconomic policy has sparked an uptick in activity, at least over the short term. Overall, growth in high-income countries is projected to accelerate slowly, with GDP expanding a modest 1.2 percent this year, but firming to 2.0 and 2.3 percent in 2014 and 2015, respectively.

Growth is firming in developing countries, but conditions vary widely across economies. Less volatile external conditions, a recovery of capital flows to levels that support growth, the relaxation of capacity constraints in some middle-income countries, and stronger growth in high-income countries are expected to yield a gradual acceleration of developing-country growth to 5.1 percent this year, and to 5.6 and 5.7 percent in 2014 and 2015, respectively. However uncertainty remains with respect to China, the world's second largest economy, which could affect world prospects.

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

The Indonesian government revised its economic growth target from 6.8% to 6.2%. The downward correction was caused by the pressure of a slower world economic growth and the impact of state budget cuts. The negative impact of the budget cuts is predicted to be stronger than the positive effects of the acceleration and expansion of social protection and related programs.

April Adds to the 2013 Deficit in the Trade Balance, Primarily because of Rising Oil Imports and Declining Oil and Gas Exports

In April 2013, the trade balance registered a deficit of $1.6 billion because of the large increase of both oil and non-oil imports and decrease in oil exports compared to March 2013. The most striking change in comparing January-April 2013 with the same period in 2012 is the decline in oil/gas exports and the increase in oil imports. Of the decline of $ 4.2 billion in exports, $ 2.7 billion was due to oil/gas. For the same period oil imports were up by 0.6 billion, while total imports have actually declined by a small 0.7 billion. Indonesia's low price for petroleum products due to the subsidy was a major factor in the deterioration in the oil/gas trade balance and therefore in the trade balance as a whole.

For the non-oil sectors, the most dramatic change for January–April 2013 was the decline of $ 2.3 billion in the import of capital goods, reflecting the slowing down of investment spending which will tend to slow GDP growth in the future. There was a large increase in the import of raw materials and intermediate products, some of which reflects a welcome increase in Indonesia's participation in the global production network.

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Tim Nasional Percepatan Penanggulangan Kemiskinan Republik Indonesia
Jl. Kebon Sirih No. 35, Jakarta, 10110, Indonesia
Office: +62 21 3912812 Fax: +62 21 3912513 http://www.tnp2k.go.id

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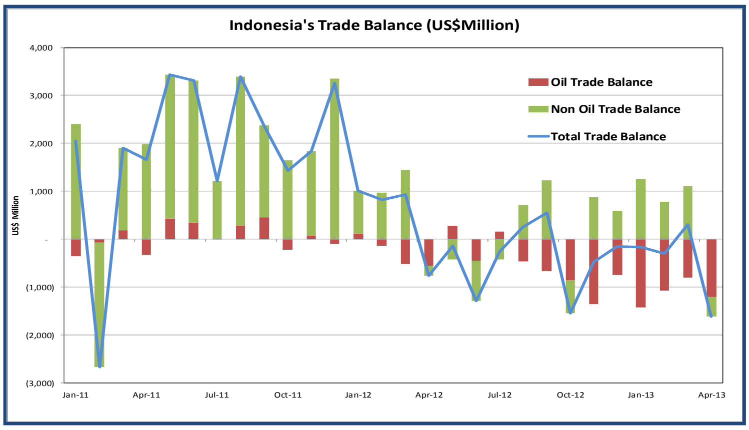
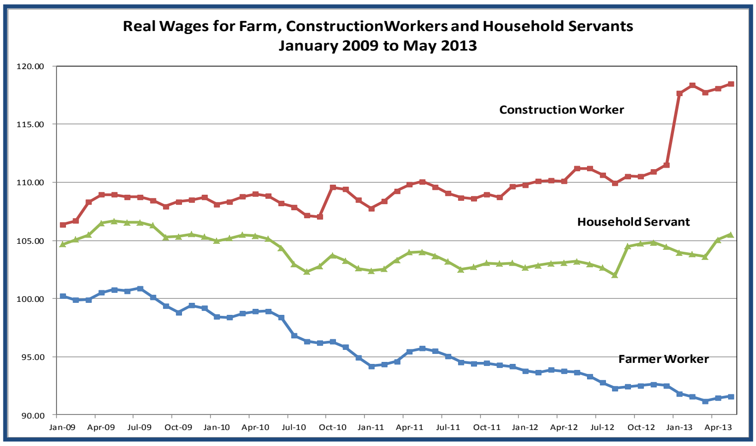
On the export side, during January – April 2013, the export value of some agriculture and mining products was higher than in 2012, as increased production more than made up for decreased prices (including palm oil and coal according to detailed data for the first 2 months of 2013). The biggest decline, in addition to oil/gas, was in the export of a large number of manufactured products as Indonesia became unable to compete in the world market in some products.



Impact on the Poor

With the deflation in both urban and rural prices, the real wages for urban and rural worker in May 2013 were higher than in March-April 2013. The real wages for urban informal sector workers, represented by construction workers and household servants, have increased steadily since 2009 because of the impact of higher minimum wages. In April and May their real wages increased more rapidly because of deflation. The real wages for farm workers, representing the poor in rural areas, also increased since March 2013 but only marginally.



SPECIAL REPORT

Poverty and Macroeconomy

Dr. Jonathan Haughton (Suffolk University) opened the 2013 TNP2K - SEADI Poverty Alleviation Conference with an observation that after rapid macroeconomic growth starting in the 1980s that lifted millions out of poverty, Indonesia now faces more complicated poverty alleviation challenges.

The poverty headcount ratio in Indonesia is decreasing at a decreasing rate and inequality is increasing at a predictable rate, so poverty reduction in the next decade will occur more modestly than in the past.

Indonesia is unique because in most countries, Dr. Haughton said, the core of the country is rich, and the peripheries are poor. "In Indonesia, there is a large amount of poverty in Java itself, and this is unusual. It might actually make it easier to deal with poverty." Despite the slowdown in poverty reduction, Dr. Haughton noted that both poverty and growth in Indonesia are widely distributed, and poverty is coming down everywhere because growth is occurring broadly.

He highlighted several areas of concern and opportunity for Indonesia's future growth and poverty alleviation efforts:

- Rise of the Informal Sector: Indonesia actually saw an increase in the share of the labor force employed in "own-account and family work," with the share per 1000 people going from 177 in 1990 to 191 in 2008. Dr. Haughton explained that, "you could interpret this as 'vibrant entrepreneurship at work,' but I think that's wrong. I think we [Indonesia] are not being good at creating wage jobs, which are the foundation of the middle class, and a way out of poverty."
- Fuel Subsidies: Indonesia has by far the largest subsidies of any net-fuel-importer, with energy subsidies that comprise 3.7% of GDP. This is spending that largely benefits the middle class and that could go toward pro-poor programming. Yet, spending on fuel comprises a relatively high proportion of spending by the poor, even as most of the benefits of the subsidy go to the rich. An IMF study found that the top 25% of income earners worldwide received 42.8% of total fuel subsidies, while the bottom 25% only get about 7% of subsidy benefits.
- Minimum wage: This lowers labor demand in the formal sector, and lowers wages in the informal sector, which absorbs displaced formal sector workers. Dr. Haughton showed how the poor that were already working in the informal sector actually see their incomes fall as a result of minimum wage laws. He also explained that the recent rise in the minimum wage is a signal of the power of labor in Indonesia, which worries investors about possible "future labor militancy."
- Import Restrictions: These raise the cost of food, and the poor are not producing restricted goods in large enough quantities to boost income or smooth consumption.
- Infrastructure: The government now spends about 3% of GDP on infrastructure. In comparison, China, Vietnam, and Thailand are spending 7% or more of GDP on infrastructure investments. At the margin, incremental investments will help the poor.

Dr. Haughton closed with the recommendation that practitioners combine academic rigor with a policy focus. "Governments may come and go," he said, "but good civil servants outlast every government."

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