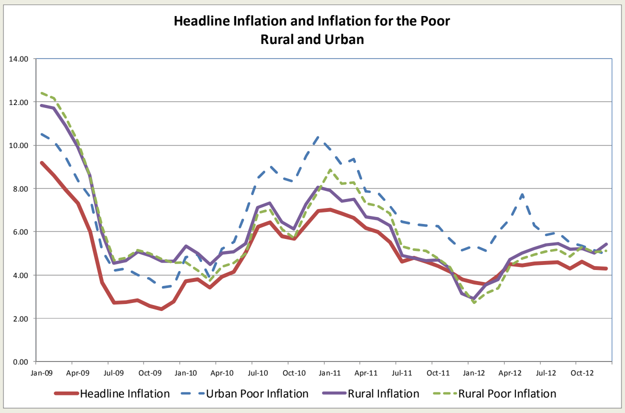
Poverty and the Economy January 2013



INFLATION

Inflation in December

Inflation for the 2012 calendar year was 4.3%. This was slightly higher than 2011 figure of 3.8% but just at the average for 2009-2012. Inflation has moderated since the mid-2000's when it was closer to 10%.

Monthly inflation in December was a somewhat high 0.54%. This was mostly driven by a food price increase of 1.6% that month. Food inflation was 5.7% for 2012. This was the largest contributor to 2012 inflation.

In rural areas, inflation in December was 0.43%, higher than the rate in November of 0.22%. Total rural inflation for the year was 5.3%, significantly above that in the urban areas because of the greater share of food in rural consumption. .

The high inflation of food and processed food in 2012 has meant that the effective CPI for the poor rose more rapidly than the reported inflation rate since more of the poor's income is spent on food and processed food. That being said, the overall rate has moderated over the past four years, helping the poor and non-poor alike.

World food prices

World food prices in December were 1.2% lower than November, and the average of October-December was 6.4% lower than July-September. However the annual average of 2012 food prices was still 0.7% above those in 2011. Higher world food prices translated into higher domestic prices because some of the food consumed by the poor such as soybeans, rice and wheat were imported. World Bank predicted that food prices in 2013 will be 8% lower than 2012. The predicted lower food prices would have a positive impact on the poor in Indonesia because it will slow or reverse domestic food inflation.

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DEVELOPMENT

World Growth remains slow

A just published paper by the World Bank estimates world GDP growth at 2.3% in 2012 and forecasts a similarly lackluster 2.4% for 2013. These estimates are in line with the consensus forecasts for 2012 and 2013. The East Asia region, of which Indonesia is part, also grew more slowly in 2012 than the year before (7.5% rather than 8.3%) and is forecast to reach 7.9%, still less than in 2011.

The World Bank discusses risks that could reduce world growth to as little as 1 - 1.3%, including a decline in China's investment rate, continuing troubles in Europe, and fiscal contraction in the United States. All of these could adversely affect world commodity prices and thus Indonesia. Another risk is supply shocks in the food supply especially given the low maize stocks. If the world food prices rise markedly then the health and nutrition of the poor will be affected significantly.

The Indonesian economy

The World Bank revised its projection for Indonesia's growth. The latest projection of growth for 2012 is 6.1% (higher than previously projected of 6%) while the projection for 2013 is lower (6.3% instead of 6.5%). The less optimistic projection is due to some risks faced by developing countries such as China's slower investment rate. Although it is unlikely that China's investment rate will drop significantly, the impact on Indonesia's economy would be somewhat lower than the impact on Vietnam and Thailand.

The conclusion is clear: 2012 was a period of slow growth and 2013 is forecast to be only slightly better. The World Bank's advice to countries like Indonesia therefore has a strong basis: in a risky and uncertain environment it is urgent to raise productivity and rebuild fiscal, monetary and foreign exchange buffer stocks.

Imports continue to rise, exports are down. The value of exports is substantially at the mercy of world commodity prices, especially of energy.

As noted in previous Monthly Reports, imports continue to increase in line with growth in the GDP. Some of the demand from the main drivers of growth --investment and consumption-- inevitably spilled over into demand for imported goods. During the first 11 months of 2012, imports were up 9% over the same period of 2011, almost 50% higher than the rate of growth in GDP.

During the same 11 months, exports declined by 6%. Therefore what had been a $26 billion surplus turned into an estimated $ 4 billion deficit. In December prices of some export commodities, like coal, increased, while others declined, notably palm oil. Average prices have changed little. Export earnings for all of 2012 are therefore likely to be slightly below what they were in 2011.

From 2010 to 2011 export earnings contributed significantly to growth of GDP, while last year they held back growth. Over the two years *from 2010 to 2012 the change in the gross contribution of exports to GDP is nearly US$ 60 billion* –from an increase of $ 46 billion to a decrease of $ 13 billion (Table 1). What made a difference were commodity or raw material exports, which account for 85% of the increase and 99% of the decline in the value of total exports. 6 commodities account for 75% of the growth and 91% of the decline in the value of all commodities. Of the cumulative change in the value exported between 2010 and 2012,

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84% was due to a change in world prices and only 16% due to a change in quantity. Indonesia's ability to finance its imports of goods is therefore significantly at the mercy of highly changeable world commodity prices.

Table 1: Changes in the Value of Exports from 2010 to 2012 due to Changed Quantities Exported and Changed World Prices (all in billions of US$)

	Change in value of exports			Change due to changed quantity			Change due to changed prices		
	2010 to 2011	2011 to 2012	Cumulative 2010-2012	2010 to 2011	2011 to 2012	Cumulative 2010-2012	2010 to 2011	2011 to 2012	Cumulative 2010-2012
Oil/Gas	13.4	-3.3	-16.8	0.8	-2.3	-3.1	12.6	-1.0	-13.7
Rubber	4.5	-4.4	-8.8	0.3	-0.2	-0.5	4.2	-4.1	-8.3
Palm oil & other Oils	4.6	0.4	-4.1	0.0	1.4	1.4	4.6	-1.0	-5.5
Copper	-1.7	-4.7	-6.4	-1.8	-1.0	-2.9	0.1	-3.6	-3.5
Coal	8.7	-0.1	-8.8	1.9	1.0	2.9	6.8	-1.1	-11.7
Textiles & garments	2.1	-0.8	-2.9	-0.7	-0.1	-0.1	2.8	-0.7	-2.8
All commodities	39.0	-13.2	-52.2	8.4	-0.5	-8.9	30.6	-12.7	-43.3
All manufactures	6.8	-0.1	-6.9	-1.1	-0.4	-1.5	7.9	0.3	-5.4
All exports	45.8	-13.3	-59.1	8.4	-0.9	-9.3	37.4	-12.4	-49.7

Data for 2012 are extrapolated from 10 months actuals and are subject to change.

Impact on the Poor

Growth of the economy has historically benefited the poor and growth in Indonesia is currently constrained by the stagnation of exports, the principal source of funding for imports. Imports needed to support 6% growth in the economy could grow only because of a greater inflow of foreign capital. This source of funding is volatile and could disappear with little warning. In short, the stagnation of exports is limiting the rate of growth that Indonesia can achieve and a lower rate of growth means a slower improvement in the well-being of the poor.

In virtually every large country with millions of poor the most powerful instrument for reducing poverty is the movement of relatively unskilled workers from low productivity, low income, and irregular work with no benefits, especially as agricultural laborers, to higher productivity, higher income, regular full time work with some benefits, particularly in manufacturing. But at an early stage of development the domestic demand for the goods produced by these workers is satisfied. More manufacturing jobs for the poor can be created only if most of the products are exported. The stagnation of export of kitchenware, textiles, garments, tools, and other labor-intensive goods, not only in the last two years, but in the last decade, has made poverty reduction particularly difficult in Indonesia.

SPECIAL REPORT

Poverty, Growth and Income Distribution

Indonesia has been remarkably successful in reducing the share of the population that is poor.

The indicator of poverty that is used most widely is the poverty incidence, the percent of the population that is below the poverty line. That percentage declined dramatically from 60% in 1976 to 17.5% in 1996, as Indonesia was cited as one of the greatest success stories in reducing poverty. However, as a result of the Asian Financial Crisis (AFC) the poverty rate jumped dramatically in 1998 to 24%. This reflected the reality that the poor suffered particularly from the AFC because of the sharp increase in all staple food prices, particularly the rice price. The index for food prices more than doubled in one year –from 1997 to 1998. Since the rural poor spent over 70% of their income on food, the increase in food prices hit them hard. But after the 1998 shock the poverty incidence has continued to improve virtually every year, with the exception of 2006 when poverty incidence increased slightly. But the decline slowed down considerably. Poverty incidence for Indonesia had declined from 62% to 17.5%, or by more than 70%, in the 20 years to 1997. In the 15 years to 2012 it declined from 17.5% to 11.7%, or by only 33%. One reason for the slowdown was that as the number of poor declines it becomes increasingly difficult to achieve further gains. Those who remain poor have a high proportion of families with no one capable of working to earn a regular income. These are families whose members are too young, too old or too sick to work. They are therefore unable to climb out of poverty as wages or employment increase. The number of poor has also declined, but more slowly. Poverty is increasingly an urban, as well as rural, problem.

The important problem is how to help the "near-poor", the poorest 40% that are below $ 2 a day.

The Indonesian poverty rate is set to enable the poor to buy a basket of foods and other necessities, but is considered low by the standards established by the World Bank. There are a large number of families clustered around the Poverty Line so even a small change in its level results in a large change in the number of poor and in poverty incidence. These roughly 100 million people moreover can be helped to climb out of poverty by broad policies that also increase growth: better education for all, increased demand for labor from the formal sector, better access to health services and other measures to increase the rate of growth. To accelerate poverty reduction macro-economic policies should focus on this group while the problems of the poor, as defined by the Poverty Line, would become increasingly the responsibility of the Ministry of Social Welfare. Calculating two poverty lines, one defined as at present, the other encompassing the near-poor and defined as the equivalent of $ 2 would be a useful step toward directing more attention to this important group.

More rapid growth of the economy is good for the poor but the relationship is not consistent or stable. The more labor intensive the growth, the better for the poor.

In general, during periods of more rapid growth, there was also a more rapid decline in the proportion of poor people in the country. However, the relationship or correlation is far from perfect. For instance, from 1999 to 2005 the growth rate of GDP was only 3.6%, yet the decline in poverty incidence, at 7.8%. On the other hand, from 2005 to 2012 the GDP growth rate increased by over 60% to 5.8% but the change in poverty slowed to 4.5%. Part of the explanation lies in the labor intensity of growth in the formal or commercial sector.

The most dramatic improvement in poverty incidence occurred during the very early period of the "New Order". Growth during this period was unusually labor intensive particularly in construction. The rehabilitation of irrigation, roads and buildings was done by labor intensive methods. Finally, the early stages of industrial development which took place at the same time were relatively labor intensive industries, most notably, the textile industry.

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