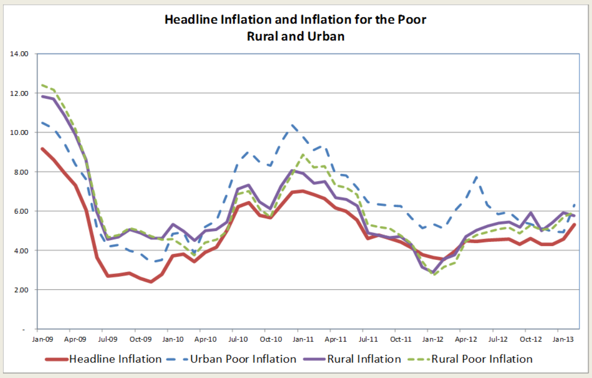
Poverty and the Economy March 2013



INFLATION

Inflation in February

Inflation accelerated somewhat in 2013 with the "headline" inflation rate in February 2013 at 0.75%, and year-on-year inflation of 5.3%. This was higher than February 2012 (3.6%) but not unusually high by historical standards: from 2007 to 2011 inflation ranged from 2.8% to 11.1% annually. The largest contributor to February inflation was food prices which contributed more than half of the month's inflation (0.495% of 0.75%). Food price inflation did not result from increases in the price of staple foods, such as rice, but from a sharp increase in the prices of such foods as garlic, red onions and chilies. Their high domestic price was not caused by high world prices. While there is some concern over market manipulation, most observers believe that the proximate cause of these price increases was government restrictions on imports.

As rising food prices have a greater impact on the poor, inflation for the urban poor (6.3% year-on-year) and for the rural poor (5.8% OR 6%) was higher than the headline inflation (5.3%). This illustrates the negative impact that government policies can have if not properly designed and implemented.

In the rural areas, the inflation in February 2013 was 0.66% with the highest inflation was also in food prices (1.33%) Similar to the urban poor, the inflation for the rural poor was also higher than the rural inflation (0.72%). The year-on-year inflation for the rural in February 2013 was 5.77% while the year-on-year inflation for the rural poor was slightly higher of 5.95%.

World food prices

World food prices in February 2013 were unchanged from January but were 2.5% below the average for 2012. The prices of cereals, oil/fats and meats in February 2013 were unchanged compared to January 2013, and compared to 2012. The pressure on Indonesian food prices from higher international prices is not currently a factor in inflation, as it was earlier, as the world food situation has eased.

DEVELOPMENT

The World economy has improved modestly but forecast growth remains low

The World Bank's January 2013 forecast for world GDP growth is more pessimistic than earlier forecasts: it projects an expansion of the world economy in 2013 of only 2.4 percent, down from its forecast six months ago of 3.0%. Growth in the global gross domestic product (GDP) in 2012 was also revised downward to 2.3%.
World economic growth in the last quarter of 2012 remained weak with growth in the US and Japan flat. The recovery in the housing market in the US helped to improve the economy but there is still uncertainty because of the ongoing fiscal consolidation through sequester. In the Euro area, economic conditions remain challenging as the recent problems in Cyprus indicate. The growth of China's economy has accelerated to 2 percent, quarter on quarter, because of the rapid credit growth and Japan's policy has changed from an emphasis on austerity to an emphasis in growth. Indonesia cannot count on more rapid world growth and higher prices for its commodity exports to give a boost to its own growth.

Indonesia continues to grow steadily

The World Bank just released its latest Indonesia Economic Quarterly Report. It concludes that Indonesia's economy continued to grow at a steady pace in the final quarter of 2012, which resulted in full-year GDP growth of 6.2%. This was only a modest reduction from the 6.5 percent growth recorded in 2011—a resilient performance considering the weak global environment and unsettled financial market conditions which prevailed for much of the year. The growth projection for 2013 is 6.2 percent, slightly below the Bank's December 2012 projection. The main contributor to growth is still private consumption which will be boosted by pre-election spending starting in the midyear. Investment is expected to grow, but at a slower pace than in 2012, as uncertainty about government policies and the decline in commodity prices in 2012 affect investment decisions.

Growth of over 6% should lead to continued modest reduction in poverty rates. But this rate of growth will not yield the kinds of improvements in the well-being of the poor that the Government has targeted.

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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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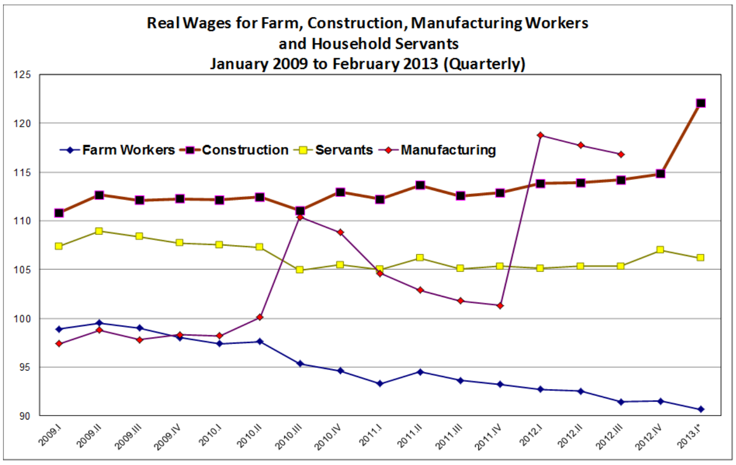

Non-oil trade balance improved in January 2013 but total trade does not generate needed surpluses

Non-oil exports in January 2013 were up slightly over the previous month, while non-oil imports were down slightly, mainly because of lower capital goods imports. Consumer goods were also down, in part due to government policies to limit imports. As a result the non-oil trade balance was positive in January 2013 by about $1.2 billion. However, the oil trade balance recorded its highest deficit of $1.4 billion as a result of continued fuel subsidy policy. The trade balance therefore remained slightly negative, as it has been for all of 2012. Since Indonesia has large deficits in services and income accounts, it ended 2012 with an $ 8 billion deficit on current account. The data for January 2013 are for a continued deficit, funded by drawing down reserves, and by primarily short-term capital inflows. Until Indonesian export earnings can be increased, the growth rate of the country will be limited by the ability to attract foreign capital to fund the current account deficit.

Impact to the Poor

Real Wages Rise in the formal sector but fall in agriculture

A substantial increase in the minimum wage for 2013 and in construction activity benefitted construction workers whose real wages increased by 7% from early 2012 to January/February 2013. Over the same period the real wages for agricultural workers declined by 2%. The same trend persists over a longer period of time: from the first quarter of 2009 to the first 2 months of 2013 the real wages of construction workers increased 10%, while the real wages for farm workers fell by 8% and for household servants stagnated (they declined by -1%).

While the massive increase in minimum wages may seem like a victory for the poor, it is more likely that these benefits are accruing to a small portion of the labor force. The ultimate impact of these increases will likely be to slow the growth of formal sector employment and thus limit the positive impact of the increase in the minimum wage to a small group of workers, while the majority of poor and unskilled workers in the informal sectors actually experience a decline in their purchasing power – their nominal wages increase less than the rate of inflation.

SPECIAL REPORT

Poverty and the Services Sector

The Services sector has an important role in poverty alleviation. Better services such as higher quality education and better health services will impact directly on labor productivity and poverty alleviation on the supply side. In addition, the sector also provides employment. Currently, half of Indonesia's population is urban, and most of the urban poor are in services, especially trade, transport and social-private services. As described by Manning and Aswicah-yono (2012) in their ILO report, more than half of all Indonesian employment is now in services, even excluding construction, and two thirds of the growth of employment has been in services in the 2000s.

Services employ both female and male workers; the trade sector is the only sector where females achieved reasonable parity with males. Community and social services came second (financial services are a male domain).

The distribution of jobs changes a lot for workers with a tertiary education. Almost half all tertiary-educated workers in services were in education (teachers, etc.). Together with government services this accounts for nearly two-thirds of graduate employment. While retail-wholesale trade accounted for over 40% of all jobs, it absorbed just 7% of graduates. Less educated workers are concentrated in such specific sectors as construction and road transport and are also heavily concentrated in the informal sector.

International migration is one of the important areas of service sector job creation. In Indonesia, there are around 4.3 million migrant workers, equivalent to about 4% of the work force. Malaysia and Saudi Arabia account for around 75% of the total, with domestic service absorbing around 60-70% in all locations except Malaysia. Most of the migrant workers are unskilled (around 90%). Total foreign exchange earnings from remittances are around $6-7 billion–large, though still only around 3-5% of total foreign exchange earnings. The remittances are larger, on average, from East Asian countries. Studies show that most of the remittances are used for education and health by these poor families.

With mostly unskilled worker, Indonesia still needs to develop a more comprehensive system of protection for migrant workers (like the Philippines), especially for workers engaged in the informal sector. One proposed solution in the study is for government to develop training programs so that migrants can get jobs in the formal sectors. That would help maintain high levels of out-migration and could contribute more effectively to the reduction of poverty.

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