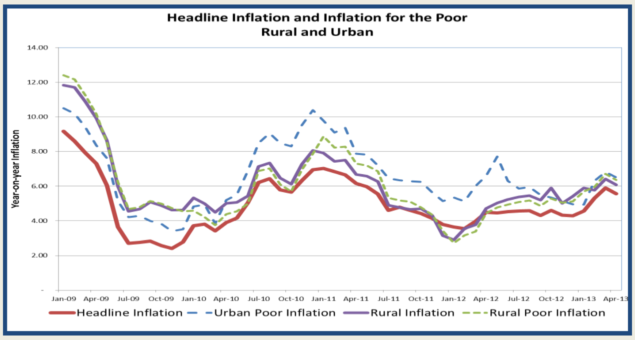
Poverty and the Economy May 2013

INFLATION

Inflation

The Headline CPI for April 2013 compared to March showed deflation of -0.1%. It partially corrected for the unusually high inflation of 0.6% in March 2013. However, the more meaningful year-on-year inflation for April was a fairly high, 5.6% higher than 2012 (4.5%) but lower than 2011 (6.2%). The government inflation target of 4.9% in 2013 will be difficult to achieve because year-to-date inflation in the four months of 2013 already reached 2.3%. The decline in the CPI in April was largely due to deflation in food (-0.8%) and clothing (-1.1%) prices. The prices of garlic and chilies dropped in April, after they had shot up the month before, while the price of onion and fruits (especially imported fruits) continued to rise.



Since food expenditures are a larger share of the consumption of the poor than of the general population, deflation in the CPI for the poor was greater than Headline inflation. In urban areas the deflation for the poor was -0.2% compared to -0.1% for the population, while in the rural area it was -0.04% for the poor and only -0.02% for the population.

World food prices

World food prices in March 2013 were lower than February 2013 by 1.1% while beverages eased by 0.6%. The lower food price in the world market should benefit the poor in Indonesia if import policies are not too restrictive.

DEVELOPMENT

No notable changes to the international outlook

There have been no notable changes to the international outlook in recent weeks. The IMF, which tends to be more optimistic than the World Bank, in April lowered its forecast for world GDP growth from 3.5% to 3.3%. The current international consensus is that the global economy has escaped various potential catastrophes –the break-up of the Euro block; renewed recession in the US; a hard landing for China- and is likely to record growth above 3% in 2013.

Indonesia growth in the first quarter of 2013 was 6.0%, lower than in 2012

Data on Indonesian GDP just released by BPS showed that growth during the first quarter of 2013 of 6% was lower than in the same period of 2012 (6.3%). The modest slowdown was not surprising due to the difficult international situation. The World Bank forecasts 2013 growth at 6.2% and the IMF at 6.3%, virtually the same as the 6.2% in 2012.

The poor performance of the oil sector continued to be a significant drag on the Indonesian economy. With low domestic prices and poor incentives for investment by foreign firms, oil exploration has been limited. As production at old fields declined, new development was inadequate and the quantity of oil and its products exported at constant prices declined steadily from $ 20 billion in 1978 to $ 6.5 billion in 2011 and $ 5 billion in 2012. Increased production of natural gas did not make up for that decline. In 2012 its value was less than $ 7 billion at constant prices.

The main source of growth in 2013 was strong private consumption which grew faster in Q 1-2013 than in Q1-2012 (5.2% compared to 4.9%). Weak contributions from investment and government spending mean that if consumer confidence weakens it will have an immediate impact on aggregate demand.

GDP Growth: Demand and Supply

	Q1 12 On Q1 11	Q1 13 On Q1 12
Demand side		
Household consump.	4.9	5.2
Govt consumption	5.9	0.4
Gross fixed investment	9.9	5.9
Inventories & discrep.	4.0	--
Exports	7.8	3.9
- Imports	8.2	(0.4)
Total	**6.3**	**6.0**

	Q1 12 On Q1 11	Q1 13 On Q1 12
Supply side		
Agriculture, etc	3.9	3.7
Mining	2.9	(0.4)
Manufacturing	5.7	5.8
Electricity, gas, etc	6.1	6.5
Construction	7.3	7.2
Trade, hotels, etc	8.5	6.5
Transport, communic.	10.3	10.0
Finance, real estate	6.3	8.3
Other services	5.5	6.5
Total		
Incl oil and gas	**6.3**	**6.0**
Excl oil and gas	**6.7**	**6.7**

From the supply side the weakening of the mining sector is quite noticeable. Changes in agriculture (decline) and in manufacturing (rise) were modest. The increase in growth of services was striking, but it is unclear to what extent this is statistical artifact: more people shining shoes or picking up waste paper because they can find no better source of income.

Positive trade balance in March 2013

For the first time since October 2012, the trade balance was positive in March 2013, but not because of the strength of exports but the relative weakness of import growth. This was due first to the impact of policy measures to restrain horticultural imports; and second, a slowing of investment spending reflected in lower capital goods imports. The latter will have a negative impact on future growth.

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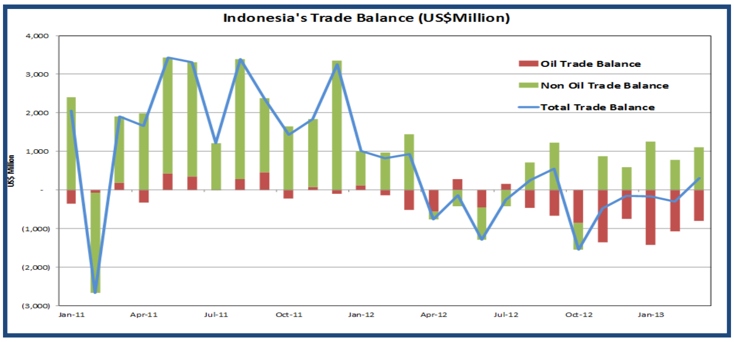


Impact on the Poor

Unemployment rate in February 2013 was lower

The labor force in February 2013 at 121 million was higher than in August 2012, at 118 million, and February 2012 at 120 million. The open unemployment rate in February 2013 of 5.9% was lower than in August 2012 (6.1%) and February 2012 (6.3%). At the same time the number employed increased from 112 million in February 2012 to 114 million in February 2013. Almost all sectors absorbed more labor except for the agriculture sector (decline from around 41 million to 40 million).

More important: employment in the formal sector increased by 3.5 million from 2012 to 2013 and the employment of unskilled labor declined by 2.3 million. The movement from the informal sector to the formal sector means an increase in labor income and in stability of employment which benefits the poor.

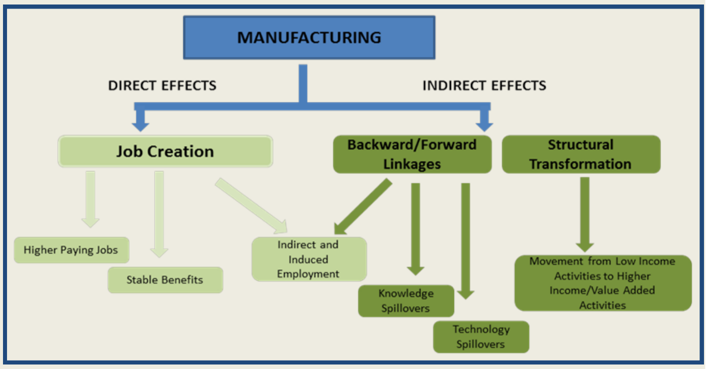
SPECIAL REPORT

Poverty and the Manufacturing Sector

A literature review makes clear the important role of manufacturing sector in poverty eradication, especially in low income countries. While the share of the manufacturing sector in GDP is about 25%, its share in employment is only 14%. But it has a major role in creating the better-paying, regular formal sector jobs with some fringe benefits that lift many former agricultural laborers out of poverty. Of the 26 million formal sector jobs added between 1980 and 2011 nearly 7 million or 25% were added directly in manufacturing. Millions more were due to the indirect effects of the growth in manufacturing: in construction to build factories and workers' housing; in trade to handle the goods produced; in services to supply consulting, advertising and repairs directly and to provide haircuts, repairs and education to its workers with additional income. A rough estimate would be that about half of all formal sector jobs were due to the growth of manufacturing.

In low income countries, including Indonesia from the late 1960s to the mid-1990s, the crucial role in poverty alleviation was played by the labor-intensive export industries, which absorbed large numbers of poor agricultural workers in higher paying and better jobs. Furthermore, the skill-barriers for workers in these industries were lower, allowing uneducated and unskilled worker to participate. For every $ 1 billion worth of exports these industries needed an estimated 250,000 workers. So as these industries increased exports by over $ 9 billion from 1985-1996, they hired an estimated 2 million additional workers directly.

Since the manufacturing sector has one of the largest multipliers, the indirect and induced effects of the sector is high. Indirectly, manufacturing can provide strong backward/forward linkages to both other manufacturing sectors and services sectors. Since most services sector jobs are accessible for the poor, uneducated and unskilled labor, these indirect effects are important to alleviate poverty.



As Indonesia has become a middle income country, Suryahadi, et al. (2012)[1] showed that the industrial sector has become irrelevant in reducing poverty, although it is the second largest contributor to GDP. Unfortunately the manufacturing sector does not absorb as much labor as the agricultural and services sectors. The low and declining capacity of the manufacturing sector to absorb labor in part reflects the use of technology that is more capital and skill intensive. Another study by Anshory, et al. (2013)[2] argued that the intensification of capital use and an acceleration of real wage growth can be the main culprits of "jobless growth" in the Indonesian manufacturing sector for the period of 1999-2008, a period of recovery from the Asian Crisis. Increased capital utilization helped the economy to recover and reduce poverty but when constrained by the increasing real wage, the recovery and the rate of poverty reduction was slower. The situation is in favor of the non-poor because the poor find jobs in the informal sector which does not benefit from the increase in the minimum wage.

Government policies play a significant role in the contribution of manufacturing to poverty reduction. With the increase of GDP per capita, wages inevitably rise and low-cost labor intensive manufacturing will tend to move to lower income countries. But how quickly a country loses its competitiveness in relatively low-wage, labor intensive industries depends in part on policies with respect to labor costs. If labor costs rise more rapidly, pushed up by higher minimum wages, an appreciating currency and costly labor regulation then the movement out of labor-intensive industries can be rapid and their contribution to poverty reduction can quickly become small. This is happening in Indonesia.

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1 Suryahadi, Asep, Gracia Hadiwidjaja and Sudarno Sumarto, 2012, "Economic Growth and Poverty Reduction in Indonesia Before and After the Asian Financial Crisis", SMERU Working Paper, June 2012

2 Ansory, Arief Yusuf, Ahmad Komarulzaman, Muhammad Purnagunawan and Budy Resosudarmo, 2013, "Growth, Poverty and Labor Market Rigidity in Indonesia , A General Equilibrium Investigation", Working Paper, Center for Economics and Development Studies, Department of Economics, Padjadjaran University, January 2013.

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