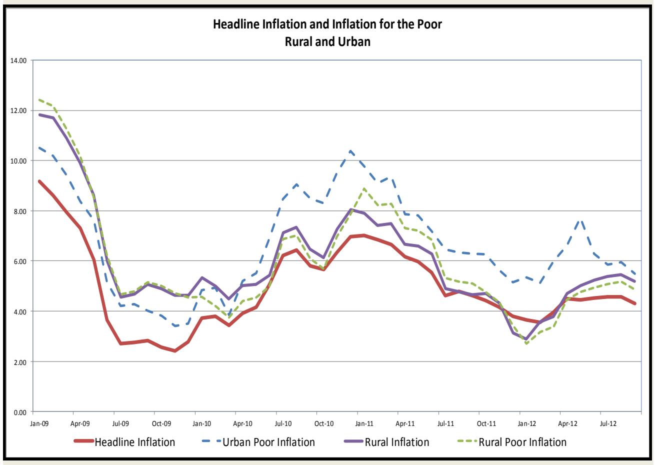
Poverty and the Economy October 2012

INFLATION



Inflation Continues to be Low by Historical Standards

Inflation in September 2012 was 0.01%, the lowest month-to-month inflation for the past five years. Year-to-date inflation was 3.5%; year-on-year inflation was 4.3%. Inflation in food prices was also low at 4.6% for the year to date and year-on-year food inflation was 6.6%. The CPI for both the rural and urban poor remains modestly higher than headline CPI. All measures of inflation are low by historical standards. There was some evidence of increasing inflation during July to September when food prices rose at an annualized 9.8%.

Increasing World Food Prices Are a Potential Threat to the Poor

Because of drought in major growing areas and prohibitions on grain exports by some countries, world food prices have risen 10% since the first quarter of the year and grain prices are up by 16%. Fortunately rice prices were not affected until September when they increased by 11% over June. World prices of grains and food more generally, are expected to remain high, adversely affecting prices in Indonesia. Because of the danger that higher world food prices would increase Indonesian food price inflation, it would be prudent to consider policies to counter the potential effect on the poor.

DEVELOPMENT

Slower Growth in the World Economy Affects Indonesia

In June the World Bank forecast that growth of world economy would slow to 2.5% in 2012, from 4.1% in 2010 and 2.7% in 2011. Since then the World Bank has reduced its forecast of growth in East Asia from 7.6% to 7.2%, primarily because it has reduced the forecast of Chinese growth by a further 0.5%. Growth has also slowed in Russia, India, Brazil and Vietnam. Europe has slipped into recession. The net result may be even slower growth in the world economy in 2012 than forecast in June. The principal impact to date on Indonesia has been a decline in the prices of most commodity exports.

A Major Factor in Slowing Growth: Declining Export Earnings

The world commodity boom was a major factor in Indonesia's growth from 2005 to 2011. Export earnings increased at a rate of 12% a year. This growth was dominated by commodities. Nearly three-quarters of the increase in commodity exports from 2005 to 2011 was due to increased prices, making Indonesia vulnerable to a downturn in world commodity prices. With slower growth in the world economy, the commodity boom ended in 2012 and most commodity price fell: palm oil & copper by 12%, coal, nickel, tin by 26-28%, rubber by 39%. As a result export earnings in the first 8 months of 2012 were 6% lower than the same period of 2011. Instead of increasing by US$ 46 billion, as they did from 2010 to 2011, export earnings are set to decline by $12 billion. This decline in export earnings will significantly contribute to slower growth in 2012. From January to August 2012 imports increased by 10.3% over the same period in 2011. Some of that increase in imports was in machinery imports as a result of increased investment, especially foreign private investment, and should lead to more rapid growth in the future.

THE IMPACT ON THE POOR

Slower Growth Due To The End of the Commodity Boom May Have Little Effect on the Poor

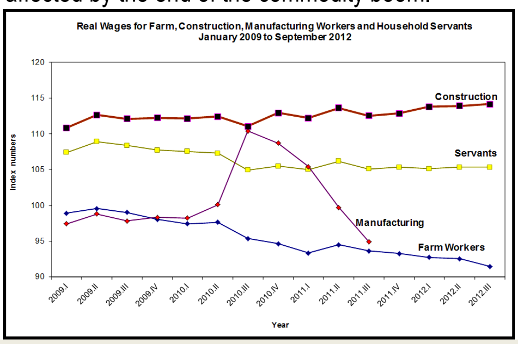
The decline in the percent of the population below the poverty line from 16% in 2005 to 11.9% in 2012 suggests that some of the poor benefitted from the rapid growth fueled by the commodity boom. But the poor benefited less than the non-poor from commodity-driven growth. The per capita consumption of the poorest 40% increased at only 1.2% a year from 2005 to 2010 that of the average household increased by 3.4%. (preliminary data).

In most countries, not just Indonesia, commodity booms benefit primarily the non-poor because many commodities (coal, copper, oil/gas) employ primarily skilled workers who are not poor. Furthermore, when the increase in earnings is primarily the result of higher prices, the initial beneficiaries are wealthy, or at least non-poor, owners of mines, plantations, and timber concessions. Since the poor benefited less from the boom, they should be hurt less by its end.

Real Wages in Agriculture Continue to Fall

Real wages of unskilled and semi-skilled workers provide an indication of changes in the welfare of the poor. Real wages, which are wages adjusted for inflation, measure the purchasing power of working families. Since data on real wages are available 6 months or more before other indicators of poverty they provide an early indication of changes in the welfare of the poor.

The most reliable wage data are for agricultural laborers. They are a large group since many families with small plots supplement their income with agricultural labor, as do some informal sector workers. From 1997 to 2005 real agricultural wages increased by 23%. In contrast during the peak of the commodity boom from 2009 to 2011 real agricultural wages declined by 6% and they have declined by a further 2% since then. The real wages of urban construction workers and servants have essentially stagnated since in 2009. So far their real wages have not been affected by the end of the commodity boom.



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POLICY IMPLICATIONS

1. To avoid the strong negative impact on the poor of world food price inflation and the depreciation of the Rupiah, the government should consider lifting import restrictions that keep rice prices artificially high and consider developing social safety net programs to increase purchasing power for poor families if food prices rise.
2. Create more “good jobs” with regular income and some benefits and raise the income/ real wage of the poor by creating more demand for their labor. As a first step, expand labor-intensive public works through an expanded PNPM program and accelerated building and rehabilitating roads, irrigation works and some other infrastructure in line with MPE3I.

SPECIAL REPORT
FOOD EXPENDITURES AND INFLATION MEASUREMENT

A more rapid increase in prices, especially of food, usually has a large negative impact on the poor. It erodes their purchasing power and therefore reduces their economic well-being. For this reason, increasing food prices on world markets raise concerns over the well -being of the poor in Indonesia

In Indonesia, as in most other developing countries, policymakers typically use the official consumer price index (CPI) to track changes in urban and rural inflation. However, it is important to realize that this official consumer price index –or “headline inflation”– in Indonesia, as in other countries, is based on the consumption basket of the urban lower middle class. Since the consumption basket of the urban middle class is usually quite different from that of the urban and rural poor, the official consumer price index may do a poor job of measuring the impact of general price increases on the urban and rural poor.

A study commissioned by SEADI documents that the expenditure patterns for the poor are quite different from those of the general population. They spend a much higher proportion of their income on food than the population as a whole and food prices are highly volatile.

Over the last 7 years the average annual rate of urban headline inflation is different from the CPI for the poor: 5.85 and 7.65 percent for the urban and 8.3 percent for the rural poor. The largest differences were in 2006 and 2010 when food prices spiked (29 percent and 26.9 percent respectively). These sharp food price increases had a large negative impact on the poor.

Jonathan McIntosh, 2004

Table 1: Inflation, December 2006 – 2011 (yoy)

Year	Urban headline inflation	Inflation for Urban Poor (lowest 40%)	Rural inflation	Inflation for Rural Poor (lowest 40%)
2006	6.60	9.18	14.47	14.91
2007	5.42	6.88	8.77	9.35
2008	11.06	12.97	12.80	13.25
2009	2.78	3.52	4.63	4.55
2010	6.96	10.38	8.06	7.87
2011	3.79	5.14	3.14	3.43
2012*	4.31	5.49	5.19	4.87
Average	**5.85**	**7.65**	**8.15**	**8.32**

Note: 2012 figure is up to September 2012

These estimates suggest two key policy findings. First, there is little difference between the reported rural inflation rate and our calculated inflation rate for the rural poor. Thus the standard rural inflation measure is sufficient for tracking inflation for the rural poor. Second, the calculated inflation index for the urban poor is different from headline CPI and thus is useful in analysis. Thus we will use the calculated inflation rate for the urban poor and BPS’ reported rural inflation figure rather than the headline CPI figure when analyzing the impact of inflation on the poor in Indonesia.

(REUTERS/Enny Nuraheni)

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