Mongolia

Mongolia continues its rapid growth but inflationary pressures have emerged. **R**eal GDP growth rate was 8.6 percent in 2006 and is projected to be around 8.5 percent this year. As of August 2007 gross industrial output increased by 13.6 percent in real terms compared to the corresponding period last year, led by manufacturing (33.7 percent), grain mill and fodder products, dairy products, and basic metals. While most of the foreign direct investment (FDI) coming into Mongolia continues to go to mining, its output grew by only 3.9 percent this year (mainly from coal extraction). Mining is also the main source of government revenues. The revenues from the mining windfall tax accounted for 18.5 percent of total central government budget revenue in August 2007. Inflation (CPI) picked up from a low 4.2 percent in January 2007 to 11.3 percent in August, due to rapid monetary growth, public sector wage increases and increases in the price of some main imports (e.g. petrol). As of August 2007, broad money increased by 45 percent and credit to the private sector by 53 percent.

High international prices for copper and gold have sustained Mongolia's export earnings in 2007. Total exports increased by 27 percent and total imports by 40 percent in August 2007 compared to the same time a year ago. Mineral products exports rose by 36.7 percent during this period with copper concentrate contributing to 44.3 percent and gold exports to 16 percent of total export volume, respectively. Meanwhile the togrog depreciated somewhat vis-à-vis the U.S. dollar and reached an exchange rate of Tg 1,187.3/USD at end-August 2007.

The government's fiscal surplus has continued, mainly due to revenues from trade and income taxes. As of end-August 2007, the government budget recorded a surplus of 172 billion togrog. Government revenues reported an increase of 50 percent compared to the same time last year, while government expenditure had increased by 54 percent during this period (y-o-y). The main factors contributing to this surplus were the prevailing high levels of copper and gold prices which led to an increase in foreign trade and income taxes, and dividend earnings from the Erdenet Copper plant that were transferred to the Government, its owner (Tg 59 billion). Meanwhile, government revenues from the other main taxes, such as Personal Income taxes (PIT), navigation, royalty and land fees were below budget targets. VAT refunds are on the rise as well.

Fiscal policy, as outlined in the amended 2007 budget, is going to be significantly expansionary. Government expenditure is budgeted to increase by 80 percent due to another public sector wage increase, and renewed spending on social welfare programs and public investment programs. This raises concerns about the efficiency, sustainability and quality of these expenditures, partly since any analyses of the trade-offs involved in the government's spending plans are not readily available to the public to facilitate debate. Questions also have been raised by businesses about the nature of implementation of the Windfall Tax for gold and the instability it has caused in the investment climate in the mining sector. Many have called for a review of the mining tax legislation. Meanwhile, Parliament has started discussions on draft investment and shareholder agreements for the two large mining deposits Oyu Tolgoi and Tavan Tolgoi. A joint Parliamentary and Government Working Group has been set up to re-visit these agreements.

Mongolia is at moderate risk of debt distress over the medium term. The debt burden looks sustainable assuming no major negative terms of trade shock and only concessional borrowing. The total public debt was equivalent to 42.3 percent of GDP as of end-2006, and 31 percent in Net Present Value terms (NPV).

Governance reforms are underway. Asset and Income Declarations of high level government officials had been collected by the Anti-Corruption agency and made publicly available according to the Anti-Corruption Law that was adopted by Parliament last Fall. In the financial sector, Parliament recently approved a Law that partly covers the half of the losses of the victims of the failed Savings and Credit Cooperatives (SCC).