



<i>Population</i>	2.6 million
<i>Population growth</i>	0.9 percent
<i>Surface area</i>	1,566,500 sq. km.
<i>Capital</i>	Ulaanbaatar

Source: World Development Indicators.

Mongolia's economy continues to recover with most sectors rebounding strongly from the sharp drop in output in late 2008 and early 2009. Preliminary estimates suggest that real GDP grew 6.1 percent in 2010, following a contraction of 1.3 percent in 2009. The agriculture sector is still feeling the impact of last winter's 'dzud' which wiped out one-fifth of the livestock.

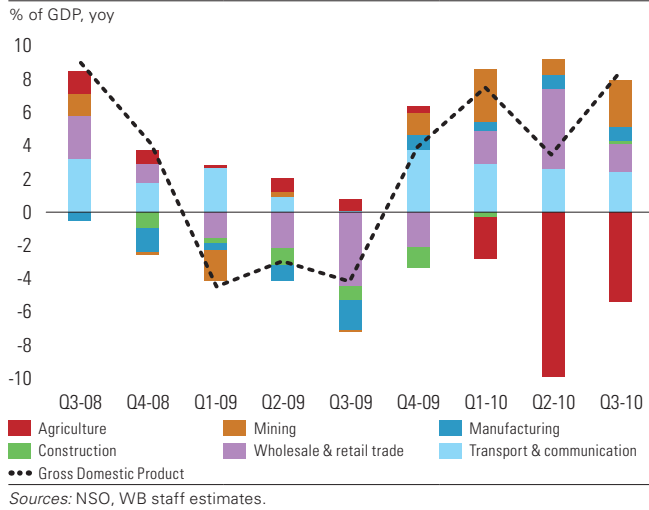
A perfect storm is gathering with inflation, created by a combination of external and internal pressures. The headline 12-month inflation rate in Ulaanbaatar rose to 14 percent year-on-year (yoy) from 1.9 percent at the end of 2009. Global monetary policies and food supplies, and rising food inflation in China and Russia, from which Mongolia imports several food products such as vegetables and grain, suggest that continued inflationary pressures can be expected from the external environment. Domestically, Mongolia's booming economy is running into capacity constraints, while the adverse impact of the dzud continues to be felt through high meat prices. Finally, the 2011 budget approved a large increase in public spending, including substantial cash handouts to the population. Hence, we expect continued strong upward pressure on prices during 2011.

Mongolia's public finances recorded a balanced budget for 2010, supported by the economic rebound and buoyant commodity prices. However, the recently approved 2011 Budget envisages a steep increase in government spending, together with a sharp rise in the deficit to an unprecedented 9.9 percent of GDP. It sets the record of the largest budget in the history of Mongolia amounting to more than half of GDP. The fiscal stimulus should compound already existing inflationary pressures and is inconsistent with the budget guidelines set out in the Medium Term Budget Framework approved last summer, which sets out a ceiling on the deficit of 5 percent. It also goes against the spirit of the new Fiscal Stability Law and will make it difficult to make the transition to a cyclically-adjusted fiscal deficit of no more than 2 percent of GDP starting 2013.

The exchange rate against the U.S. dollar has been appreciating back to the pre-crisis level and by the end of year had appreciated by nearly 14 percent in real terms against the U.S. dollar compared to December 2009. Projections for 2011 point to a continued real exchange rate appreciation, given the current macroeconomic policy stance. Without policy action, this will have negative implication the non-mineral export and import-competing sectors. Foreign exchange reserves reached a new peak of over \$2 billion at the end of 2010 (about 30 percent of GDP). The trade deficit has begun to widen due to rising fuel, transport equipment and machinery imports related to the construction of the Oyu Tolgoi mine and associated infrastructure projects. As a result, the current account deficit widened to around 9.8 percent of GDP in the third quarter of 2010, after narrowing to 7.4 percent in the previous quarter on a four-quarter rolling sum basis.

In the banking sector, non-performing loans and loans in arrears still stand high at 16 percent of total outstanding loans in December. Rising inflation is rapidly bringing real interest rates down and average real MNT deposit rates are already negative. However, MNT deposits continue to rise fuelled by currency appreciation expectations and supported by the deposit guarantee law. There is a significant increase in private overseas

The economic recovery is becoming more broad-based...

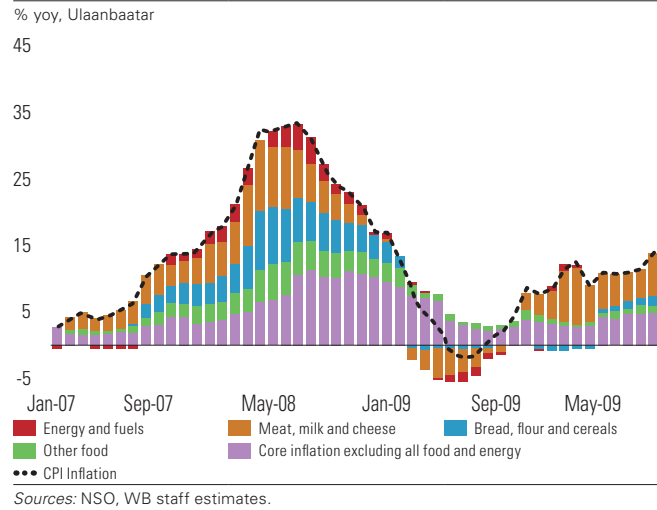


borrowing. This development merits close monitoring by the central bank: they are likely to be unhedged, and could leave borrowers vulnerable to unexpected reversals in capital inflows. It is vital that the banking restructuring reforms, driven by the need to improve bank balance sheets, move forward in order to strictly and consistently enforce the existing regulatory policies.

The latest informal labor markets survey conducted in December 2010 revealed a reduction in number of casual workers by about 40 percent compared to September due to the seasonal closure of construction labor markets, and reduced outdoor sales activities due to cold weather. Workers' real informal market wages on average decreased by about 30 percent from September to December 2010. Reduced job opportunities during the winter months, combined with rising inflation, explain the decline in real wages of the most vulnerable in society.

Mongolia has made significant progress in improving budget transparency, but there is still considerable room for improvement vis-à-vis public investment management. Parliament is expected to debate critical public finance issues in its spring session that would improve the public investment planning and budgeting system. On the agenda are the draft Integrated Budget Law (IBL) and the Law on Development Policy and

...but inflation continues to rise reflecting both demand side and supply side pressures



Planning, as well as a revised law on public procurement, as well as the implementation of public-private partnerships (PPPs). Mongolia also plans to establish a Development Bank during 2011. The Bank will use a portion of the proceeds from the Fiscal Stability Fund to finance its long term infrastructure needs.

Mongolia Key Economic Indicators

	2007	2008	2009	2010e	2011f	2012f
	Year	Year	Year	Year	Year	Year
Output, Employment and Prices						
Real GDP (% change y-y)	10.2	8.9	-1.3	6.1	10.3	7.6
Industrial production index	110.4	113.4	109.7	..	..	..
(% change y-y)	10.4	2.7	-3.3	..	..	..
Unemployment (%)	2.8	2.8	3.3	3.3	3.2	3.2
Consumer price index (% change y-y)	14.1	23.2	1.9	14.3	20.0	12.0
Public Sector						
Government revenues (% GDP)	35.3	37.6	35.5	37.3	52.1	38.9
Government expenditures (% GDP)	37.9	33.1	30.3	37.3	42.2	35.0
Government balance (% GDP)	2.7	-4.5	-5.2	0.0	-9.9	-3.9
Non-mineral government balance (% GDP)	-13.4	-15.5	-12.9	-12.2	-7.5	..
Domestic public sector debt (% GDP)	0.5	0.0	6.3	22.7	30.4	..
Total public sector debt (% GDP)	36.5	31.0	49.4	43.0	..	..
Foreign Trade, BOP and External Debt						
Trade balance (millions US\$)	-52	-613	-195	-378	..	..
Exports of goods (millions US\$)	1,949	2,535	1,876	2,899	3,825	4,083
(% change y-y)	26.1	30.0	-26.0	54.5	31.9	6.7
Key export (% change y-y) 1/	27.7	3.0	-39.9	53.6	..	..
Imports of goods (millions US\$)	2,003	3,147	2,070	3,165	4,874	5,190
(% change y-y)	32.2	57.1	-34.2	52.9	54.0	6.5
Current account balance (millions US\$)	265	-722	-409	-589	-1,301	-1,437
(% GDP)	6.3	-12.9	-9.0	-9.6	-15.1	-13.6
Foreign direct investment (millions US\$)	360	836	496	1,400	1,130	548
External debt (millions US\$)	1,529	1,601	1,977	2,176.0	2,252	..
(% GDP)	36.1	31.0	43.3	30.8	..	..
Short-term debt (millions US\$) 2/	0	0	0	0	0	..
Debt service ratio (% exports of g&s) 3/	2.0	2.0	3.7	..	..	..
Foreign exchange reserves, gross (millions US\$)	1,001	658	1,328	2,091	..	..
(month of imports of g&s)	3.8	3.0	4.3	7.6	..	..
Financial Markets						
Domestic credit (% change y-y)	78.4	52.5	-7.6	47.1	..	..
Short-term interest rate (% p.a.) 4/	8.4	9.8	..	..	..	..
Exchange rate (Tugrik/US\$, eop)	1,170	1,268	1,443	1,259	..	..
Real effective exchange rate (2000=100)	104.8	124.4	100.6	..	..	..
(% change y-y)	-5.5	-18.2	15.6	-13.7	..	..
Stock market index (Dec. 2000=100) 5/	2,048	1,182	1,229	1,872	..	..
Memo: Nominal GDP (millions US\$)	4,235	5,607	4,574	6,125	8,630	..

Sources: Bank of Mongolia, National Statistical Office, Ministry of Finance, IMF and World Bank staff estimates.

e = estimate

f = forecast

1/ Copper concentrate

2/ Short-term public and publicly-guaranteed (PPG) debt

3/ On PPG debt

4/ Yield on 14-day bills until 2006 and on 7-day bills for 2007 onward

5/ Top-20 index