Mongolia: Recent Economic Developments and Outlook

Technical Meeting
January 28, 2008
Economic Situation

There has been a lot of good news…

- Economic growth has remained very strong.
- The budget recorded its third consecutive surplus.
- International reserves have risen to a record level.
- Public debt ratios have fallen sharply.
GDP has grown by 7-10 percent per annum since 2003.

Per capita GDP doubled from $717 in 2004 to $1,486 in 2007.

Sources: Mongolian authorities; and IMF staff estimates.
The budget recorded its third consecutive surplus in 2007.

**Fiscal Balance**
(In percent of GDP)

Sources: Mongolian authorities; and IMF staff estimates.
Mining sector has been major contributor to growth in budget revenue…

Mineral Revenue

*In billions of Togrogs*  

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<th>Year</th>
<th>Royalty (LHS)</th>
<th>Corporate income tax (LHS)</th>
<th>Windfall profit tax (LHS)</th>
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<th>Total mineral revenue (RHS)</th>
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*Sources: Mongolian authorities; and IMF staff estimates and projections.*
...thanks in part to the sharp run-up in copper and gold prices.

Copper and Gold Prices

Source: IMF, Commodity Price System.
As a result, public debt ratios have declined sharply and are now below the debt-burden thresholds.

Debt Indicators

Sources: Mongolian authorities; and IMF staff estimates.
The current account surplus disappeared in 2007 but FDI and overall balance remained strong.

**External Balances**
(In percent of GDP)

Sources: Mongolian authorities; and IMF staff estimates.
And international reserves rose to record levels.

**Gross Official Reserves**

- **In millions of U.S. dollars (LHS)**
- **In mo. of next year's imports of goods and services (RHS)**
- **In mo. of next year's imports of goods and services minus FDI (RHS)**

Sources: Mongolian authorities; and IMF staff estimates.
However, the exchange rate has remained stable against the U.S. dollar and has depreciated against the Chinese yuan and Russian ruble.

**Exchange Rates**

(January 2002=100, end of period, increase denotes appreciation)

Interest rate spreads have narrowed.
Financial soundness indicators look good, but there are still weaknesses in the financial sector.

Financial Soundness Indicators
(In percent)

- Capital Adequacy Ratio
- Non performing loans
- Return on Assets

Source: Mongolian Authorities
But not all the news is good…

- Inflation is up sharply.
- Government spending is increasing at a breakneck pace.
- The investment agreement for a very large new copper and gold mine was withdrawn from Parliament and may need to be renegotiated.
Inflation picked up from 6 percent at end-2006 to 15 percent at end-2007…

**CPI Inflation**
(Year-on-year percent change)

Source: Mongolian authorities.
...driven by rising food prices. But nonfood items also contributed substantially to high inflation.
Government wage bill, transfers, and capital expenditure have increased rapidly.

**Fiscal Expenditure, Wage Bill, and Transfers**
(Year-on-year percent change)

Sources: Mongolian Authorities and Staff Estimates
Broad money and private sector credit have accelerated.

Money and Credit Growth
(Year-on-year percent change)

Source: Mongolian authorities.
What are the main policy issues?
What are the main policy issues?

- In short term: Inflation, inflation, and inflation. Both fiscal and monetary policies need to be tightened.

- Over the medium term, there is a need to:
  - Develop a clear fiscal strategy, taking account of mining sector prospects.
  - Put in place a transparent and stable fiscal and investment regime for the mining sector.
  - Make further progress in strengthening the financial sector.
Bank of Mongolia needs to …

- Slow the pace of NIR accumulation.
- Use exchange rate policy more flexibly.
- Raise the interest rate on CBBs to increase outstanding stock.
- Reverse some of last year’s cut in reserve requirements.
The 2008 budget is too expansionary.

- The budget calls for a deficit of 2½ percent of GDP, but revenue estimates seem optimistic.

- Possible measures that need to be taken:
  - Slowing growth in wage bill
  - Curtailing low priority capital expenditure
  - Rationalizing transfer payments
  - Restoring some SS contribution cuts
Medium-term fiscal outlook is favorable but also very uncertain.

- Declines in copper prices could be large over the medium term.

- Increased production from new mines could be even larger, but timing is uncertain.

- Large sovereign debt issue in the near term is not needed. Attempting to spend it would contribute to overheating and worsen inflation problem.
IMF will maintain its very close TA engagement.

- Fiscal—Upcoming mission on fiscal framework, budget preparation, and organizational setup of the government.
- Legal—Ongoing assistance with AML/CFT.
- Money and banking—Upcoming missions on strengthening foreign exchange market, banking supervision, and monetary operations.
- Statistics—Ongoing assistance with real sector and government finance statistics.
Thank You