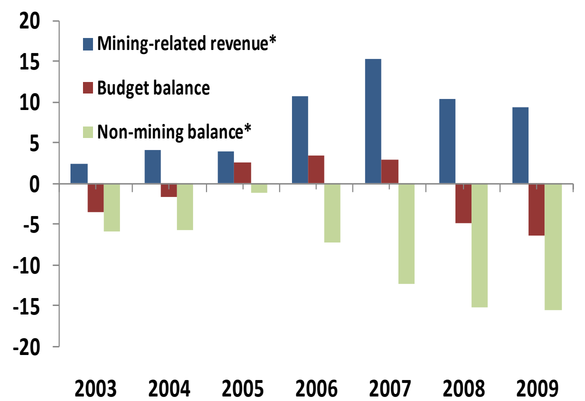
# MONGOLIA MONTHLY BRIEF – JANUARY 2010

(The full report can be downloaded at http://www.worldbank.org.mn)

This month's Mongolia Economic Update provides a review of the main economic, fiscal and financial developments over 2009, the policy response and future challenges. Collapsing mineral prices and a steep drop in external demand due to the global downturn hit Mongolia's economy extremely hard. This external shock exposed underlying weaknesses in the economic and policy environment, as demonstrated by the sudden and sharp deterioration in fiscal and external balances and in the quality of banks' balance sheets. However, the strong policy response of the authorities, helped by improved external conditions, led to a rapid stabilization in the economic situation from mid-year. Nonetheless, real GDP in 2009 fell by 1.6 percent on a preliminary basis after growth of 8.9 percent in 2008. And the social impact of the crisis was seen in sharp real wage declines, particularly in the informal sector. Recent livestock losses due to the dzud have put further pressure on the livelihoods of the rural poor.

Entering the crisis, the country's fiscal position was highly reliant on mineral revenues with saving inadequate during the preceding boom which saw increases in unsustainable or inefficient expenditures. The banking sector was also hard hit, because loans had outpaced deposits during the boom years and it was highly exposed to sectors such as construction which suffered badly during the downturn. After a crisis of depositor confidence in late 2008, triggered by the collapse of the fourth largest bank, the health of bank balance sheets and credit quality deteriorated markedly. In turn, this contributed to a tightening of credit conditions, which presented a drag on the economic recovery. In the mining sector, significant progress in mining sector reform and development was made during 2009 with the signing of the Oyu Tolgoi (OT) Investment Agreement. In the process leading up to the signing of this agreement, a number of policy issues were clarified and some of the key disincentives to mining investment were removed.

**Mongolia's non-mining fiscal deficit grew during the boom years (% of GDP)**




Notes and source: see Update.

Starting in the second quarter of 2009, the government undertook strong actions on fiscal, monetary, exchange rate, and financial policies. They were made possible by strong political leadership and an effective bi-partisan consensus. They were also supported by a rapid response by the development partners in the form of international and bilateral donor budget and balance of payments support, and technical assistance.

Looking forward, Mongolia's medium-term growth outlook is favorable, driven by the large mining investment in OT. However, the upcoming mining boom does carry with it the attendant "Dutch disease" risks and a return to the profligate populism of the past. Other risks to the outlook relate to resolving the ongoing solvency problems in the banking sector and to near-term fiscal pressures before the sharp increases in mineral revenues associated with the OT project in later years. Accordingly, it remains crucial to continue the policy reforms started in 2009. These include the adoption of the planned fiscal stability law to move away from the boom and bust cycle of mineral prices; improvements to the budget process and to the planning and management of public investment; and putting in place a framework to support future infrastructure investment. And implementation of a targeted poverty benefit should ensure that in the future the poor are protected from mining boom-and-busts in a fiscally sustainable manner. Similarly, addressing the banking sector problems in a decisive and transparent manner is urgently needed to prepare the sector for the upturn in economic activity, investment and capital inflows in the years ahead. Finally, continued reforms in the mining sector will enhance incentives for new exploration and environmentally and socially sustainable development in a sector that is a key driver of medium to long term growth.