



# MONGOLIA MONTHLY BRIEF – APRIL 2009

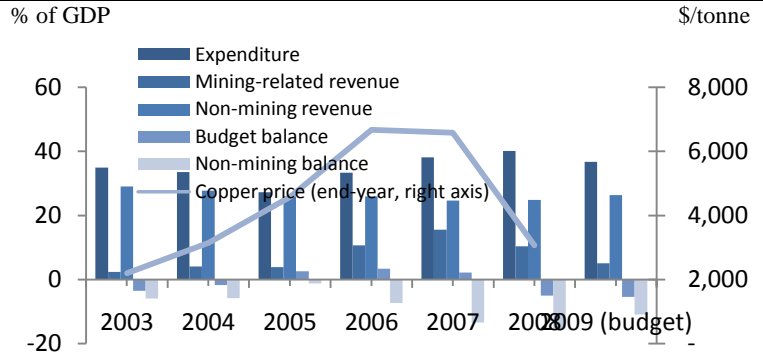


(The full report in English and Mongolian can be downloaded at <http://www.worldbank.org/mn>)

The global crisis has hit Mongolia hard, predominantly due to the slump in mineral prices which returned the prices of Mongolia’s main exports back to their 2004 levels.

In the absence of sufficient fiscal savings from previous years, the government’s fiscal position became precarious once fiscal revenues declined as a result of the sharply lower commodity prices. To keep the fiscal deficit within financeable limits, the government was faced with the difficult choice of cutting spending or raising revenues. Since the latter is difficult during an economic downturn, the government had little choice but to resort to the former.

## Components of the general budget



Notes and source: see Update

Strong import growth driven by domestic demand (as a result of social transfers and consumption) and falling commodity prices in the second half of 2008 led to a current account deficit of 12.9% of GDP in 2008, from a 4.4% of GDP surplus in 2007. As Mongolia’s export destinations are facing a prolonged slowdown, short-term exports prospects are grim, and growth is projected to slow down to 2.9% in 2009, down from 8.9% in 2008.

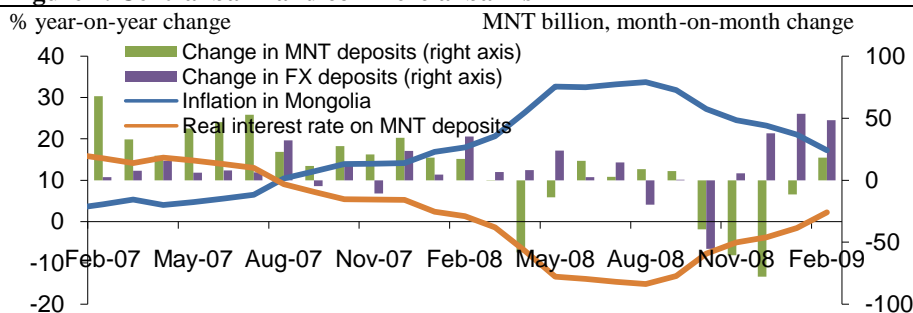
However, there are also hopeful signs. The Government and the IMF reached an agreement on an 18-month Stand-By Arrangement (SBA) with \$229 million in balance of payments support for the Bank of Mongolia. At a subsequently organized external development partners meeting, the Asian Development Bank, Japan and the World Bank pledged a total of \$160 million for budget support and expectations are that the remainder (about \$45 million) will be filled soon by other donors. This quick and substantial support for Mongolia was only possible because of the strong measures Parliament, the Bank of Mongolia and the Ministry of Finance had very recently taken to correct and improve fiscal, monetary and exchange rate policies. These strengthened the confidence of the development partners in the Government’s commitment to the stay course on this painful path of correcting and improving fiscal, monetary and exchange rate policies.

Parliament approved in March an amended budget that projects a 5.4 percent of GDP fiscal deficit (MNT 341 billion) in 2009, less than the 6 percent deficit mandated under the SBA. The amended 2009 budget takes into account the large revenue shock and projects large expenditure cuts by prioritizing public investment projects and excluding those without a feasibility study, by maintaining existing infrastructure maintenance and by freezing public servants’ wages and hiring. It also reduces projected interest payments on foreign loans, implying possible borrowing of up to \$50 million only.

The amended budget cuts the allocation for universal social transfers under the Child Money Program. The introduction of targeting is urgently needed, so that the poor can be better protected from the downturn. Fortunately, in June, Parliament is expected to discuss new amendments to the 2009 budget, which would include steps to consolidate and target the various welfare programs. At the recently held external development partners meeting, the Ministry of Finance confirmed the Government’s commitment to consolidate the existing social transfer programs and introduce objective targeting mechanisms, so that social grants will effectively reach the poorest families. It will also propose a Fiscal Responsibility Law which ensures that mining revenues are better managed in the future.

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**Figure 7. Central bank and commercial banks**



Notes and source: see Update

improves transparency. So far, the tugrug has appreciated against the US dollar since mid-March, due to an increased supply of US dollars on the market, which suggests these measures have had a positive impact. The Government's key actions for the medium term include improving the BoM's supervision capacity, enhancing risk management in the banks, and strengthening the legal environment.

Going forward, there are large uncertainties about the level of FDI inflows in the near term. These had grown strongly from a small base during the last few years, but the latest data point to a leveling off. Anecdotal evidence suggests that some mining projects are coming on stream and sentiment in Ulaanbaatar is positive. And once one (or even two) of the large mining investment agreements currently being negotiated materializes, investor sentiment will pick up significantly. The Government also recently outlined a number of policy actions which could further boost this sentiment. To reduce the perceptions of instability in the policy environment, the Government intends to formulate draft standard mining investment agreements, building on the recently gained experience in the negotiations on the Oyu Tolgoi project. It also plans to increase the number of Mongolians trained in relevant mining skills.

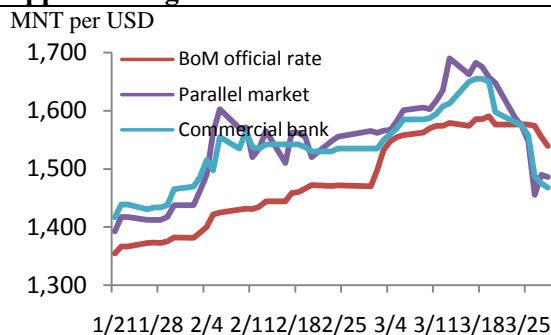
The Government and Parliament have taken the necessary and painful steps to address the economic crisis, and have started to lay out a medium-term plan to make Mongolia more resilient to future boom and bust cycles. These are positive moves, which inspire hope. But there are still many risks.

The seasonality of revenues leads to very tight financing conditions in first half of 2009. The fiscal and monetary adjustments taken will be unpopular and could be reversed under populist pressures. Expenditure cuts could fail to protect the maintenance of key infrastructure. Based on current data and projections, Mongolia is at low risk of external debt distress, but there is little headroom for additional borrowing. Finally, copper and other commodity prices could fall further, which will put even further strains on the budget, slow down the recovery and negatively impact FDI inflows.

In conclusion, the new policy stances taken, both on the budget and on monetary policies, are clearly in the right direction, but will need to be maintained over time. And the global environment continues to look grim, which, for a small, open economy like Mongolia is enough reason to remain cautious about the hopeful signs just outlined.

The Bank of Mongolia (BoM) raised its key policy rate to 14 percent from 9.75 percent on March 11. The move signals a fundamental shift in policy and will make it easier for the BoM to manage the exchange rate while preserving its FX reserves. It also started to buy and sell FX reserves via an auction, which greatly

**After a long slide, the MNT has started to appreciate against the USD...**



Notes and source: see Update