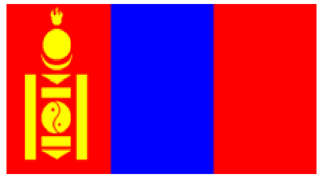

MONGOLIA MONTHLY ECONOMIC UPDATE

WORLD BANK

July 2009

The World Bank's *Mongolia Monthly Economic Update* provides an update on recent economic and social developments and policies in Mongolia. It also presents findings of ongoing World Bank work in Mongolia. The *Mongolia Monthly* is produced by a team from the World Bank's Poverty Reduction and Economic Management (PREM) Sector Unit in the East Asia and Pacific Region Vice-Presidency, with key inputs from other members of the Mongolia country team. Questions and feedback can be addressed to Altantsetseg Shiilegmaa (ashiilegmaa@worldbank.org). Copies can be downloaded from http://www.worldbank.org.mn.

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1. Introduction[1]

The economic slowdown continues to adversely affect the financial and the real sectors. The negative impact is felt across all major sectors in the real economy. And while some financial indicators were stable, risks exist in the banking sector going forward.

In June, copper prices have held up at fairly well at around $5000/tonne and gold has also been consistent. And Parliament approved an amended budget that allocates additional funds for the Child Money Program for the remaining two quarters of 2008 and for high priority, on-going investment projects.

The overall budget situation still looks grim. Total fiscal revenues for the first half of 2009 are much lower than in 2008, while total expenditure, including net lending by the government to private sector entities, increased somewhat in nominal terms (but is still negative in real terms). The main driver was a planned increase in lending by the government to the private sector. Excluding such lending, the 12-month rolling fiscal deficit shows a slight improvement to 6.5 percent of GDP in June from 6.8 percent in May.

On a 12-month rolling basis, the trade deficit is narrowing, because imports are falling faster than exports, pointing to a continued slowing down of the economy. The exchange rate has depreciated slightly, while the Bank of Mongolia’s net international reserves increased further.

The economic slowdown continues to adversely affect the financial and real sectors. A positive sign is that both MNT and FX deposits increased from May to June. And loans with principal in arrears decreased, while non-performing loans were stable from May to June, although remaining at a high level. However, banks are still reluctant to lend to individuals and the private sector, instead purchasing central bank bills. Risks remain present in the banking sector.

The unemployment situation also disappoints. The negative impact is felt across all major sectors. The informal sector has been particularly hard hit, with real declines in incomes of up to 60 percent.

On June 23, the World Bank approved budget support of $40 million as part of a joint effort by Mongolia’s major development partners to help the country manage the downturn.

[1] The analysis is based on the most recent data (June 2009) from the Bank of Mongolia (monthly bulletin and monthly consolidated banking system balance sheet), the National Statistical Office and the Ministry of Finance.

2. Fiscal balance

Revenue has fallen 29.2 percent in real terms in the first half of 2009 compared to 2008

The fiscal situation continues to look grim. If we compare the first half of 2009 with the first half of 2008, revenues have fallen by nearly a third in real terms (29.2 percent in real terms[2] and 20.0 percent in nominal terms) (Table 1). Tax revenues were down by more than a third in real terms. The largest drivers were corporate income tax, down by 50.8 percent in real terms, and the Windfall Profits Tax (WPT)[3] down by 86.0 percent in real terms. However, tax revenues from wages and salaries, social security contributions and dividends were higher.

Table 1. Changes in total revenue and grants

	Share in first half of 2009 (%)	Change in first half of 2009 relative to 2008 (%)	
		Nominal	Real(1)
Total revenue and grants	100.0	-20.0	-29.2
Tax revenue, including	78.2	-28.8	-36.9
Corporate income tax	9.0	-44.4	-50.8
On wages and salaries	6.3	17.1	3.6
WPT	3.8	-84.2	-86.0
Social security contributions	14.3	19.4	5.7
Vat	17.4	-8.3	-18.8
Excise taxes	9.6	-4.2	-15.2
Import duties	6.0	-26.1	-34.6
Royalty	4.2	-42.4	-49.0
Nontax revenues, including	21.6	45.8	29.1
Dividends	10.9	262.1	220.6

Note: From the general budget, which includes state/central and local budget, Mongolian Development Fund and Social Security Fund
(1) Revenue in first half of year deflated by average CPI in corresponding period.
Source: Ministry of Finance, World Bank

The disappointing tax revenues were somewhat offset by a large jump in dividends by 262.1 percent in nominal terms from MNT 24.8 billion in the first half of 2008 to MNT 89.8 billion in the first half of 2009.

If we compare revenues in June 2009 to the previous month, revenues from royalty more than doubled and WPT revenues rose 40 percent, due to increased mining exploration in the summer months. Except for a small improvement in personal income tax and social security contributions, there were no other significant changes.

Total expenditure has fallen 7.2 percent in real terms in the first half of 2009 compared to 2008

Total expenditure and net lending dropped by 7.2 percent in real terms, although it increased by 4.8 percent in nominal terms in the first half of 2009 compared to the first half of 2008 (Table 2).

[2] In order to calculate the change in real term, the revenue and expenditure items have been deflated by the consumer price index (CPI). Better deflators would have been revenue and expenditure deflators, but these are not available on a monthly basis.
[3] A 68 percent tax applies to revenues from prices exceeding base prices of $2600/tonne for copper and $850/ounce for gold, which will be deposited in the Mongolian Development Fund (MDF) to finance savings, social programs and infrastructure investments in equal amounts..

Table 2. Changes in total expenditure and net lending

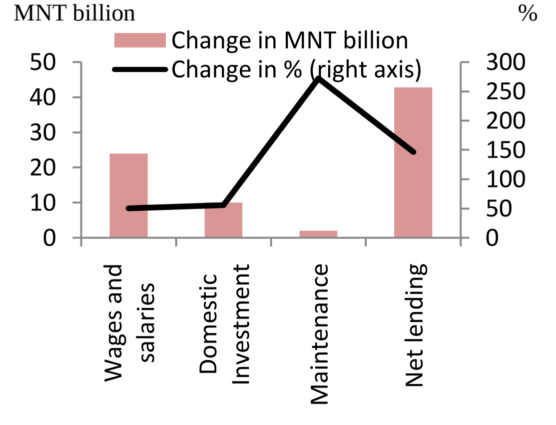
	Share in first half of 2009 (%)	Change in first half of 2009 relative to 2008 (%) Nominal	Real(1)
Total expenditure and net lending	100.0	4.8	-7.2
Current expenditure, including	79.1	2.6	-9.1
Wages and salaries	27.8	11.6	-1.2
Purchases of goods and services	16.4	-13.1	-23.0
Subsidies to energy	0.8	35.9	20.4
Subsidies to public transportation	0.5	17.5	4.0
Social security fund	17.0	2.1	-9.6
Social assistance fund	10.3	2.0	-9.7
Capital expenditure, including	10.1	-26.8	-35.2
Domestic investment	7.9	-34.4	-41.9
Maintenance	0.3	-68.8	-72.4
Net lending	10.8	136.3	109.2
Total expenditure	89.2	-1.8	-13.1

Note: General budget includes state/central and local budget, Mongolian Development Fund and social security fund.
(1) Expenditure in first half of year deflated by average CPI in corresponding period.
Source: Ministry of Finance, World Bank

The largest change was in planned net lending by the government to the private sector, which increased by 136.3 percent in nominal terms. Excluding net lending, total expenditure (current and capital expenditure), in the first half of 2009, fell by 1.8 percent in nominal terms and 13.1 percent in real terms compared to the first half of 2008.

Although expenditure on maintenance decreased by 72.4 percent in real terms compared to the first half of 2008, the June 2009 expenditure on infrastructure maintenance is nearly four times (272 percent) higher than in May 2009 (Figure 1). Compared to the previous month, net lending increased by MNT 42.8 billion, and domestic investment increased by MNT 10.0 billion, in June 2009. Wages and salaries increased by MNT 23.9 billion due to annual leave and bonus disbursements, which has caused similar spikes in expenditure in June in the last two years.

Figure 1. Largest changes in total expenditure and net lending from May to June, 2009



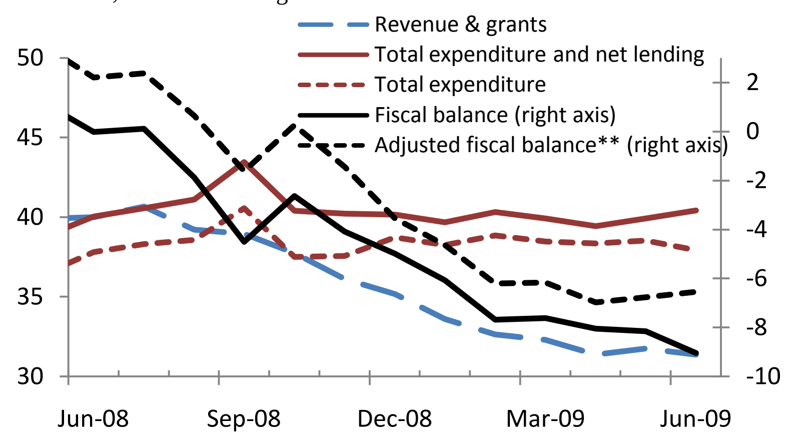
Source: Ministry of Finance, World Bank

The fiscal deficit continues to widen

In order to gauge the fiscal deficit over past 12 months, and filter out seasonal effects on the budget, we sum the monthly revenue, expenditure and fiscal deficits from July 2008 to June 2009 to arrive at the 12-month rolling revenue, expenditure and fiscal deficit respectively, for June 2009.

Figure 2. The fiscal deficit continues to widen, but the adjusted deficit (excluding net lending) improves slightly

% of GDP*, 12-month rolling sum



* GDP interpolated using actual 2008 GDP (MNT 6,130 billion) and projected 2009 GDP (MNT 6,294 billion). ** Adjusted fiscal balance excludes net lending from expenditure, leaving current and capital expenditure only.
Source: Ministry of Finance, World Bank

On a 12-month rolling basis, revenue has been relatively stable for last few months, after having fallen continuously between July 2008 and March 2009. Revenue now stands at 31.4 percent of GDP. Total expenditure and net lending increased to 40.4 percent of GDP. The 12-month rolling fiscal deficit increased to MNT 562 billion or 9.0 percent of GDP in June, from MNT 505 billion or 8.1 percent of GDP in May.

However, if we exclude net lending (since it is short term, and needs to be repaid this fiscal year), we can better focus on the underlying trends in total (current and capital) expenditure only.[4] Total expenditure was 37.9 percent of GDP in June, down from 38.5 percent in May. This leads to an *adjusted* fiscal deficit of MNT 406.7 billion or 6.5 percent of GDP at the end of June, which is slightly narrower than the adjusted fiscal deficit in May, which was 6.8 percent of GDP (Figure 2).

Meanwhile, the World Bank approved budget support of $40 million in June to help the country manage the downturn (Box 1).

Parliament amended the 2009 budget

In June, Parliament amended the 2009 annual budget for the second time[5] in order to avoid reducing the existing level of relevant welfare expenses and finance the additional costs of on-going, priority projects caused by unexpected increases in the price of certain inputs. The government upgraded its copper price estimate to $3995/tonne from $3400/tonne, and gold price estimate to $900/ounce from $850/ounce.[6] Consequently, the government amended the Mongolia Development Fund (MDF) revenue by an

[4] The lending is to gold producers who are expected repay the government within this year, so the lending and repayment of this bond will net out over 2009.
[5] The first amendment was made in March 2009.
[6] Figure 1 in World Bank (2009), *Mongolia June Monthly Economic Update*, shows the recovery of the copper prices since the end of December 2008 until mid-June 2009. On July 20, the copper price reached $5400/tonne.

additional MNT 81.6 billion. This includes MNT 62.9 billion from the copper windfall tax, and MNT 16.1 billion from the gold windfall tax and production.[7]

Box 1. World Bank budget support approved

On June 25, the World Bank's Board approved $40 million in budget support for Mongolia. It was ratified by Parliament on July 2. The support came as part of a concerted effort by Mongolia's development partners, including the IMF, the Asian Development Bank (ADB), Japan[a] and Australia, to help the country manage the downturn, which was triggered by the collapse of the copper prices last year. The World Bank's budget support to Mongolia is in the form of a Development Policy Credit (DPC) to Mongolia of $40 million on IDA terms.[b]

The DPC is the first of two credits, designed to support reforms in key policy areas: (i) fiscal policy and management, (ii) social protection, (iii) the banking sector, and (iv) the mining sector.

Fiscal policy and management is an important area for reform, given the budget's strong dependence on mining revenues. In the past few years, Mongolia experienced a classic "boom and bust" cycle, caused by the volatility in the prices of minerals. The DPC, and its successor (DPC 2), planned for next year, will support the government to turn the crisis into an opportunity by putting in place a better policy framework.

For instance, during the boom, Mongolia did save some of the windfall, "boom" revenues, but public sector wages and salaries also "boomed", along with untargeted social transfers. It also rapidly increased spending on investment projects, sometimes without proper screening and planning.

The DPCs support improvement in capital budget planning, including the protection of maintenance of basic infrastructure. To support these reforms, the Bank will provide technical assistance to develop robust criteria for project prioritization and selection, and the financing of project maintenance over the lifespan of the infrastructure.

The second area is social protection. Together with the ADB, the Bank supports social welfare reforms by helping to create a system which will allow the Ministry of Social Welfare to better target its social assistance so that the poor are protected during the economic downturn.

The third area is the financial sector, which was had been overheating during the boom years. When the global crisis hit, a major bank failure occurred in late 2008. The aim is to improve confidence in the financial sector and strengthen banking supervision.

The final area is the mining sector, given the sector's importance in driving the recovery. Using current negotiations of major mining projects, the government is working with Parliament to clarify and improve its mining policy framework. This includes insisting on responsible mining practices, consistent with international standards (viz. the Equator Principles), and becoming validated under the Extractive Industries Transparency Initiative (EITI) program.

The full DPC document is available at the World Bank's Documents and Reports website: http://go.worldbank.org/ROT5TQLVC0.

[a] The IMF is disbursing about $230 million according to an 18-month Stand-By Arrangement (see World Bank (2009), *April Monthly Economic Update*). The ADB and Japan have also approved their loans of $60 million and $30 million (with $20 m more planned for 2010) respectively.
[b] It is a concessional loan, which will need to be paid back in 40 years, with no payments due for the first 10 years. The interest rate is zero percent. There is a service charge of 0.75 percent per year.

[7] A MNT 10 billion increase thanks to higher projected gold prices, and a MNT 6.1 billion increase from higher gold production.

Expenditure was increased by MNT 104.6 billion. MNT 47.4 billion was allocated for the Child Money Program (CMP) for the remaining two quarters of 2009 from the Mongolian Development Fund (while the monthly CMP payments from the central budget were remained unchanged). Domestic investment funded by MDF was increased by MNT 57.2 billion in order to complete funding for the existing projects.[8] This led to an improvement in the share of domestic investment to GDP from 5.8 to 6.7 percent.

The fiscal gap of the amended budget is MNT 23.0 billion or 5.8 percent of 2009 GDP, from 5.4 percent under the March amendment (Table 3).

Table 3. Highlights of the June budget amendment versus March

MNT bn, unless otherwise indicated

	March 2009	June 2009	Difference
Total revenue and grants	1,973	2,055	81.6
% of GDP	31.3	32.6	
Total expenditure and net lending	2,314	2,419	104.6
% of GDP	36.8	38.4	
Fiscal balance	-341	-364	-23.0
% of GDP	-5.4	-5.8	
Specific items:			
MDF(1) revenue, of which	51.3	133.0	81.7
WPT, copper	24.7	87.6	62.9
WPT, gold	26.0	42.1	16.1
Interest payment	0.6	3.3	2.7
Child Money Program			
from central budget	37.7	37.7	0.0
from MDF	57.2	104.6	47.4
Domestic investment	366.0	423.2	57.2
% of GDP	5.8	6.7	

(1) Mongolian Development Fund.
Source: Ministry of Finance, World Bank

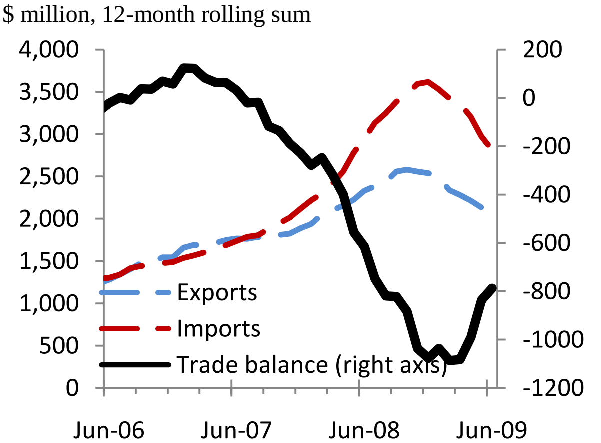
3. Trade balance

The 12-month rolling trade deficit is narrowing further, as imports are falling faster than exports

The 12-month rolling trade deficit is narrowing to $788 million in June, from $836 million in May, because imports continue to fall faster than exports, (Figure 3) pointing to a continued slowdown of the economy.

Figure 3. The trade deficit has narrowed further

$ million, 12-month rolling sum



Note: sum over previous twelve months to adjust for seasonal effects.
Source: National Statistical Office, World Bank

[8] This increase was mandated under parliament resolution #27, dated March 13, 2009, "to review status of PIPs funded by state budget and MDF, estimate additional costs caused by price increase and resolve additional funding by May 1, 2009".

Improvements in copper and coal, but a decline in gold exports

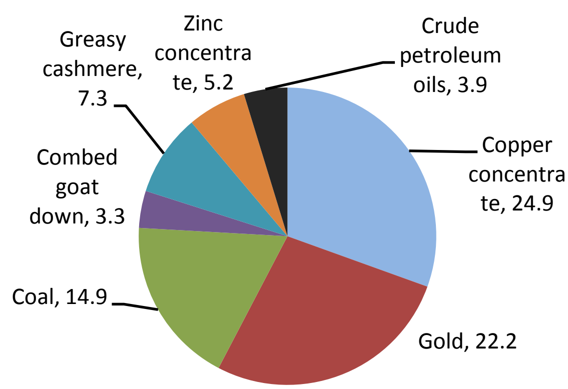
Exports of copper in the first half of 2009 were 57.4 percent lower than in the first half of 2008, a small improvement compared to May. The lower exports were entirely due to a lower copper price compared to 2008, whereas the volume of exports was relatively stable. Gold exports were 47.1 percent lower in the first half of 2009 compared to the same period in 2008 and compared to the previous month; no gold exports were officially registered by the customs in June[9]. Coal exports were 59.2 percent higher in the first half of 2009 compared to 2008, mainly to a higher export volume. Greasy cashmere exports jumped, and were 11.1 percent higher in the first half of 2009 than in 2008, mainly due to higher export volume. The positive cashmere volume trend continues as we anticipated due to the lifting of quality restrictions as well as opening of more authorized ports with China (Table 4 and Figure 4).

Table 4. Changes in exports by commodity

	Change in first 5 months of 2009 compared to 2008 (%)	Change in first half of 2009 compared to 2008 (%)
Copper concentrate	-58.7	-57.4
Gold[(1)]	-29.9	-47.1
Coal	61.6	59.2
Combed goat down[(2)]	-25.4	-30.8
Raw/Greasy cashmere[(3)]	-43.2	11.1
Zinc concentrate	-68.7	-60.4
Crude petroleum oils	-58.7	-57.4
Total good exports	-29.9	-47.1

(1) Unwrought or in semi-manufactured forms. (2) and (3) are intermediate cashmere products.
Source: National Statistical Office, World Bank

Figure 4. Shares of exports by commodity
% of first half of 2009 exports



(1) Unwrought or in semi-manufactured forms. (2) and (3) are intermediate cashmere products.
Source: National Statistical Office, World Bank

[9] Most of the gold exports are destined for the European Union and Canada.

Exports to China improved, but exports to other major countries fell

Exports to China in the first half of 2009 were 35.9 percent lower than in the first half of 2008, which is an improvement compared to May. Exports to China improved, whereas exports to the EU, Canada (in both cases mostly due to the fact that no gold exports were recorded in June) and Russia fell, and exports to the US were unchanged. These countries account for the vast majority of exports –98 percent of exports in the first half of 2009 (Table 5 and Figure 5).

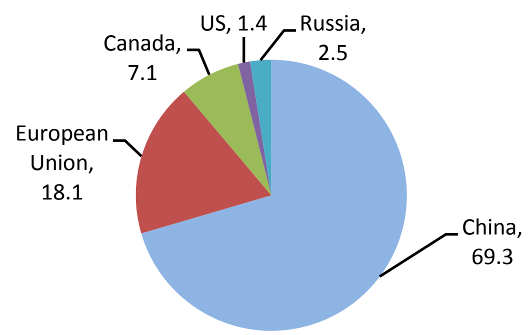
Table 5. Changes in exports by destination

	Change in first 5 months of 2009 compared to 2008 (%)	Change in first half of 2009 compared to 2008 (%)
China	-43.0	-35.9
European Union	15.9	-25.9
Canada	-23.9	-36.4
US	-89.4	-89.4
Russia	-34.3	-40.0
Total good exports	-40.6	-40.2

Source: National Statistical Office, World Bank

Figure 5. Shares of exports by destination

% of first half of 2009 exports



Source: National Statistical Office, World Bank

Imports

Imports in the first half of 2009 were 39.3 percent lower than in the same period in 2008, which was similar to May. Imports of mineral products and base metals have seen the largest drops in imports, followed by machinery and equipment, food and transport equipment (Table 6 and Figure 6).

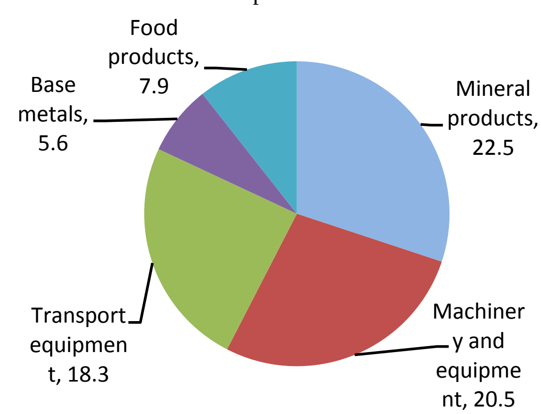
Table 6. Changes in imports by commodity

	Change in first 5 months of 2009 compared to 2008 (%)	Change in first half of 2009 compared to 2008 (%)
Mineral products	- 51.5	- 53.1
Machinery and equipment	- 28.5	- 31.2
Transport equipment	- 26.0	- 25.3
Base metals	- 66.4	- 61.2
Food products	- 33.0	- 28.4
Total goods imports	-39.6	-39.3

Source: National Statistical Office, World Bank

Figure 6. Shares of imports by commodity

% of first half of 2009 imports

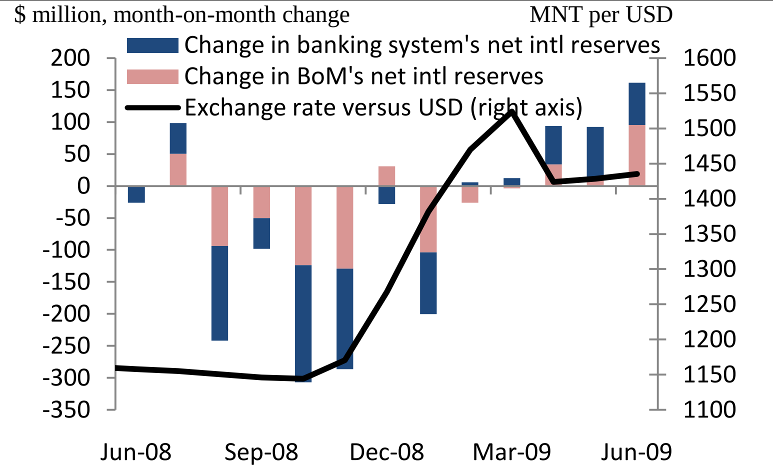


Source: National Statistical Office, World Bank

4. Exchange rate and international reserves

The exchange rate depreciated slightly, while international reserves increased

Figure 7. The exchange rate depreciated slightly, while the BoM and the banking system have added to their reserves



Source: Bank of Mongolia, World Bank

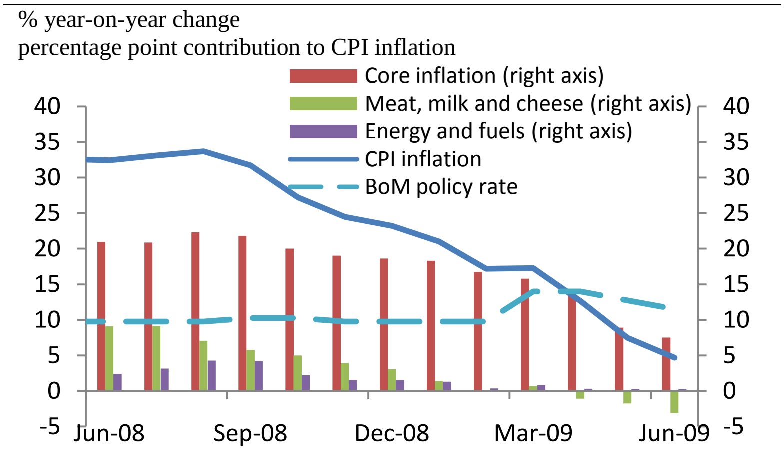
The exchange rate has depreciated slightly against the USD since the end of June. The BoM increased its net international reserves by $95 million to $648 million at the end June. This increase is thanks partly to gold purchases by the BoM. Dividends and corporate income tax, which are paid partly in FX, may have contributed as well. The banking system's (excluding the BoM) net international reserves increased $66 million to $715 million at the end of June (Figure 7).

5. Financial sector

Inflation has fallen further led by drops in core inflation and food inflation

CPI inflation declined to 4.7 percent year on year in June, from 7.4 percent yoy in May. Core inflation[10] has fallen further, reflecting weaker domestic demand pressures due to the slowdown, and contributed 7.5 percentage points to CPI inflation, whereas food prices declined, contributing -3.1 percentage points to CPI inflation. Energy items contributed 0.2 percentage points (Figure 8).

Figure 8. Inflation has fallen further led by drops in core inflation and food inflation



Source: Bank of Mongolia, National Statistical Office, World Bank

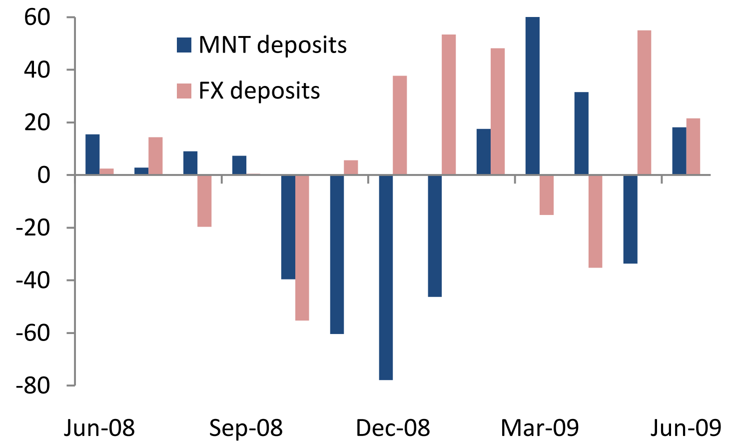
[10] Core inflation excludes volatile food and fuel prices, and is a proxy for domestically generated inflation.

Total deposits increased from May to June[11]

Total deposits at commercial banks increased by MNT 39.7 billion from May to June. MNT deposits increased by MNT 18.1 billion to MNT 982.4 billion, and FX deposits increased by MNT 21.6 billion to MNT 568.2 billion equivalent (Figure 9). The BoM policy rate has been at 11.5 percent since the middle of June, and is now highly positive in real terms. This may have contributed to the increase in MNT deposits at commercial banks.

Figure 9. Both MNT and FX deposits increased from May to June

MNT billion, change relative to previous month



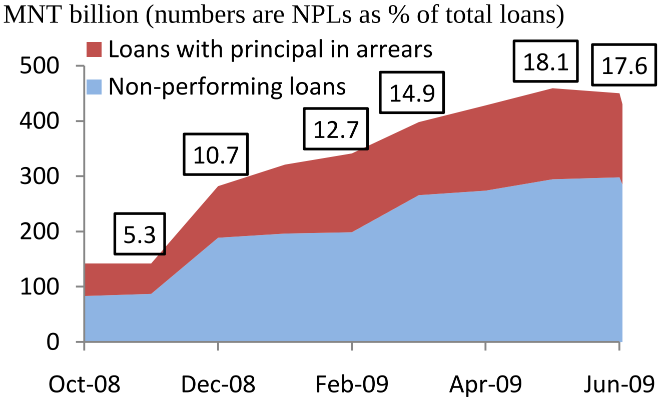
Source: Bank of Mongolia, World Bank

The amount of non-performing loans was stable and principal in arrears declined in June, but risks remain in the banking sector

The amount of non-performing loans (NPLs) remained stable at 11.6 percent of outstanding loans. Loans with principal in arrears fell slightly to 5.9 percent of outstanding loans at the end of June, compared to 6.5 percent of outstanding loans at the end of May. This level is still high, and with the continued slowdown in the real economy, it signals there could be more problematic loans down the road. NPLs and loans with principal in arrears together amount to 17.6 percent of total loans outstanding (Figure 10).

Figure 10. NPLs were stable and loans with principal in arrears decreased from May to June

MNT billion (numbers are NPLs as % of total loans)



Note: number in boxes is sum of NPLs and loans with principal in arrears as a percent of total loans outstanding
Source: Bank of Mongolia, World Bank

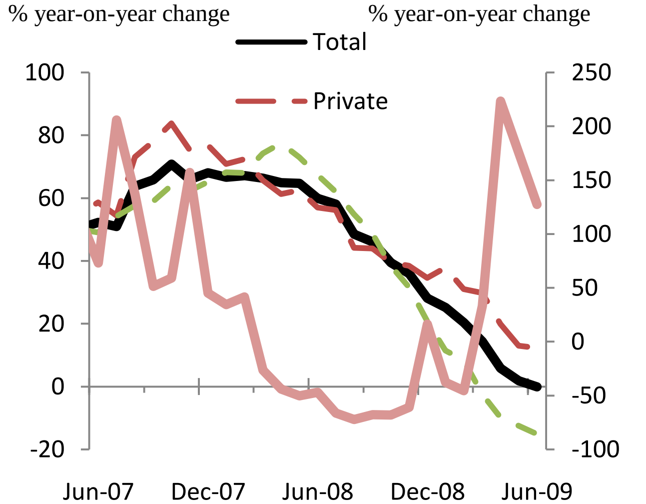
[11] The aggregate banking sector numbers in this section have been provided by the BoM. They include Anod Bank, the bank that the BoM took under conservatorship in December 2008.

Looking at the components of loans with principal in arrears, the value of loans to the private sector in MNT and to individuals in FX and MNT fell, and was only partly offset by an increase in the value of loans in FX to the private sector.

Outstanding loans have fallen to their June 2008 level, with CB bills offering an attractive alternative

The year-on-year growth rate of total outstanding loans fell to zero in June 2009, i.e., the value of outstanding loans is back at its June 2008 level. Loans to individuals shrunk by 15 percent year on year, and the growth in loans to the private sector fell to 12 percent year on year. Central bank bills holdings, yielding an attractive risk free 11.5 percent in nominal terms with inflation on a downward trend, were 127 percent higher than a year before (Figure 11).

Figure 11. Banks have shifted from lending to the private sector and individuals to purchasing central bank bills

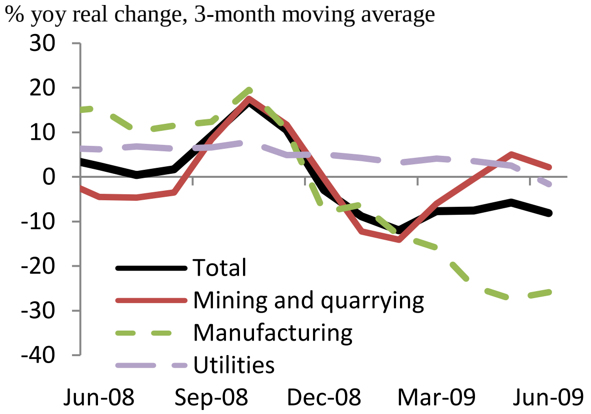


Source: Bank of Mongolia, World Bank

6. Growth and unemployment

Industrial production growth continues to be negative

Figure 12. Industrial production growth continues to be negative



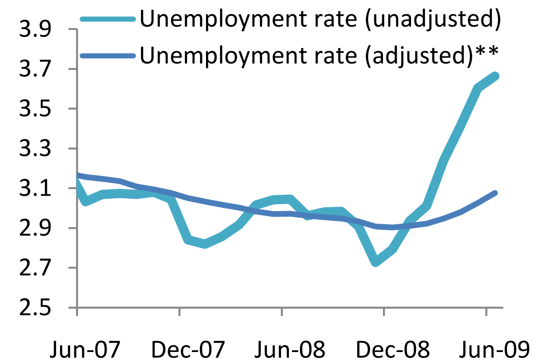
Source: National Statistical Office, World Bank

The three-month moving average of industrial production was 8.2 percent lower in real terms in June 2009 compared to June 2008. This was mainly due to the continued contraction in manufacturing. Although many sectors within manufacturing are contracting, manufacturing of basic metals accounts for the largest part of the contraction in overall manufacturing.

Mining output also slowed down on a 3-month moving average basis, because of a decrease in monthly output in June compared to May; monthly mining output had been growing since February. Monthly utilities output exhibits strong seasonal fluctuations, with the output reaching its peak in December-January and reaching its trough in July-

August. Part of the secular decline in year-on-year terms is due to the economic slowdown, leading to lower demand for utilities, such as electricity (Figure 12).

Figure 13. Registered unemployment* increased, albeit at a slower rate



* Defined as working-age population currently not working in a paid job and not self-employed, actively looking for job and registered at the Employment Office. ** Seasonally adjusted, by dividing 12-month moving average number of unemployed by linearly interpolated labor force.
Source: National Statistical Office, World Bank

This has led to a further increase in unemployment, although at a slower rate

The number of formally registered unemployed increased 22.3 percent compared to June 2008, and by 1.8 percent from May to June 2009. This has led to a registered unemployment rate of 3.7 percent of labor force, but this number excludes those who are not registered at the Employment Office, but still actively looking for work or available to work immediately. The actual rate of unemployment may be as high as 9 to 12 percent of labor force (Figure 13).[12]

A recent survey of the informal urban sector and a recently commissioned study on the crisis implications for household livelihoods informal sector found that the effects of the economic slowdown have a widespread social and poverty impact in Mongolia. Real effective income has fallen by about 60 percent in some informal urban labor markets, due to high inflation eroding real wages and due to reduced job availability.[13] Employment conditions are also becoming less favorable for informal workers in the rural regions, and herders and informal mining workers are barely able to cope with the decreasing job availability, falling wages and increasing living expenses.[14]

Finally, there were important developments on one of the two large mining projects which, once implemented, will make a substantial contribution to the economic growth of Mongolia. Parliament discussed the Oyu Tolgoi project and approved a resolution for the government to conclude negotiations with Ivanhoe Mines and Rio Tinto, provided the agreement complies with Mongolian law. This will require some brinkmanship by the two parties involved (Box 2).

[12] The NSO has indicated that it will soon publish unemployment figures that include the unregistered unemployed as well.
[13] Box 2 in World Bank (2009), *Mongolia May Monthly Economic Update*.
[14] World Bank (2009) *Study on the Crisis Implications for Household Livelihood*, Final Report, May 20-June 30.

Box 2. Oyu Tolgoi negotiations

- OT deal remains under discussion. Parliament approved a resolution for Cabinet to conclude negotiations with Ivanhoe Mines and Rio Tinto, with the following conditions:
  - All taxes must follow the existing law, i.e. no concessions on duties, loss carried forward provisions, dividend withholding tax, or the Windfall Profits Tax (WPT)
  - However, the current draft agreement does contain certain concessions (e.g. on the WPT), which would logically imply that a renegotiation of the existing draft agreement will be necessary.
- Key aspects of the draft agreement:
  - The parties have agreed on how to share the overall Net Present Value of the project, which is an important basis for reaching a final agreement
  - The government will receive royalties of 5 percent of gross revenues, which is considered a favorable condition)
  - There is a reference to a prepayment to the government in the latest draft agreement, but the amount is now left undefined.
  - Mongolia's 34 percent ownership of sunk cost and future cash calls for the development of the mine will be financed by Ivanhoe at an interest rate of 9.9 percent + US CPI (currently only 0.6 percent).
  - This will result in Mongolia contracting $1.7 billion in debt at 9.9percent plus US CPI which will approximately equal US$2.3 billion at commencement of commercial production.
  - Mongolia's debt can only be re-financed approximately 3 years after the agreement is signed

7. Conclusion

The overall budget situation still looks grim. The economic slowdown continues to cause imports to fall faster than exports and is apparent in the financial and real sectors. The real economy continues to disappoint, and its adverse impact is deeply felt by both the urban and rural population.

Although some financial sector indicators were stable, it is too early to tell if this will persist, given the strong links between the financial and real sectors. Banks are still reluctant to lend to individuals and the private sector, instead purchasing central bank bills. Therefore, a cautious outlook remains in the banking sector.

Table 7. Mongolia: Key Indicators

	2003	2004	2005	2006	2007	2008e	2009f
Output, Employment and Prices							
Real GDP (% yoy change)	7.0	10.6	7.3	8.6	10.2	8.9	2.7
Industrial production index	..	..	..	100.0	110.4	113.4	..
(% yoy change)	..	..	..	..	10.4	2.8	..
Unemployment (%)	3.4	3.6	3.3	3.2	2.8	2.8	..
Consumer price index (% yoy change)	4.6	10.9	9.6	5.9	14.1	23.2	9.0
Public Sector							
Government balance (% of GDP)	-3.7	-1.8	2.6	8.1	2.8	-5.0	-6.0
Non-mining balance (% of GDP)(1)	-5.9	-5.8	-1.3	-7.3	-13.4	-15.3	-10.4
Domestic public sector debt (% of GDP)	3.1	1.4	0.1	1.0	0.5	0.0	0.0
Foreign Trade, BOP and External Debt							
Trade balance ($ mn)	-199.6	-99.2	-99.5	136.2	-52.4	-596.5	-331.0
Exports of goods ($ mn)	627.3	872.1	1066.1	1543.9	1950.7	2532.5	1863.0
(% yoy change)	19.7	39.0	22.2	44.8	26.4	29.8	-26.4
Copper exports (% yoy change)	..	..	14.7	94.8	27.7	3.0	..
Imports of goods ($ mn)	826.9	971.3	1165.6	1407.7	2003.1	3128.9	2194.0
(% yoy change)	21.6	17.5	20.0	20.8	42.3	56.2	-29.9
Current account balance ($ mn)(2)	-102.4	24.1	29.7	221.6	264.8	-502.7	-261.8
(% of GDP)	-7.1	1.3	1.3	7.0	6.7	-9.6	-6.5
Foreign direct investment ($ mn)	131.5	128.9	257.6	289.6	360.0	682.5	316.5
External debt ($ mn)	1240.3	1311.8	1360.0	1413.9	1528.7	1600.5	1795.8
(% of GDP)	87.3	73.7	59.7	44.3	38.9	33.1	46.8
Short-term debt ($ mn)(3)	0.0	0.0	0.0	0.0	0.0	0.0	..
Debt service ratio (% of exports of g&s)(3)	13.4	9.4	7.6	5.4	4.3	3.5	4.3
Foreign exchange reserves, gross ($ mn)	203.5	207.8	333.1	718.0	1,000.6	656.7	822.1
(month of imports of g&s)	2.3	1.8	2.5	4.6	5.0	2.1	3.7
Financial Markets							
Domestic credit (% yoy change)	157.3	25.8	18.8	-3.1	78.4	60.6	..
Short-term interest rate (% per annum)(4)	..	15.8	3.7	5.1	8.4	9.8	..
Exchange rate (MNT/USD, eop)	1168.0	1209.0	1221.0	1165.0	1170.0	1267.5	1640.0
Real effective exchange rate (2000=100)(5)	96.9	95.4	101.8	107.1	109.0	130.2	..
(% yoy change)	-4.8	-1.5	6.7	5.2	1.8	19.5	..
Stock market index (2000=100)(6)	151.5	120.8	203.6	382.0	2048.0	1181.6	..
Memo:							
Nominal GDP (MNT bn)	1,660	2,152	2,780	3,715	4,600	6,130	6,294
Nominal GDP ($ mn)	1,448	1,,814	2,307	3,156	3,930	5,258	4,035

(1) Non-mining balance excludes revenues from corporate income tax and dividends from mining companies, the Windfall Profits Tax and royalties. (2) The 2009 projections for the external sector are based on the previous 2008 current account estimate, rather than the recently published final 2008 figure (which was mentioned in the text). (3) On public and publicly guaranteed debt. (4) Yield of 14-day bills until 2006 and of 7-day bills for 2007. (5) Increase is appreciation. (6) Top-20 index, eop, index=100 in Dec-2000.

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