

Impact of the Global Financial Crisis on Mongolia's Economy

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In less than 20 years of the transition from a centrally planned to a market-based economy Mongolia made a significant progress in undertaking fundamental economic reforms which led to a rapid growth in real terms (8.4% in the period 2004-06, and 10.2% in 2007 with the average inflation of 7% until very recent).

A large external shock due to the fall of the copper price caused by weak demand as a result of global financial crisis has a serious impact on Mongolia. This shock was exacerbated by expansive fiscal and monetary policies, a pegged exchange rate, overheated financial sector at the time of fall of copper price, and inadequate initial government response to the global downturn that led to a macroeconomic instability at the end of 2008. As Mongolia heavily depends on mining revenues (in 2008, the mining accounted 74 % of Mongolia's exports and 28.7 % of government revenues and more than two thirds (67% in 2007) of all foreign direct investments goes to mining sector), the global financial crisis hit Mongolia hard affecting:

Balance of payments. A trade deficit reached 11.4% of GDP and a current account deficit accounted for 13.7% of GDP in 2008; the net international reserves declined by more than one-half between mid 2008 and February 2009.

Fiscal accounts. The fiscal revenues in 2008 decreased by 31.4% or 10% of GDP from 2007 whereas spending remained high due to large increases in civil service wages over the last two years and social welfare transfers, which led to a fiscal deficit of 5% of GDP in 2008 after surplus for the last 3 consecutive years

Inflation. Inflation rose from 4.2% in January 2007 to 17.5% in January 2008, 27.2% in April 2008, and reached 34% in August 2008. In the first half of 2008 the main driver was food price accounting for 71% of inflation. Over the summer 2008, the inflation shifted from food to non-food items (for instance, bus and taxi fares increased by 50% and 39% respectively in August 2008, while tertiary education fees increased by an average of 66%).

Growth. The negative impact of the global slowdown has felt across all major sectors in the real economy. The growth rate is expected to fall to 0.5% in 2009 from 8.9% in 2008.

Financial system. The non-performing loan ratio in banks' loan portfolio increased reaching 7.4% in February 2009, 20.4% at end-July 2009 and 21.5% at end-August 2009 against 2.9% in September, 2008 showing a slowdown in the real sector and business growth.

Poverty and unemployment. The most suffered from the economic downturn were the poor as the economic slowdown had a widespread social and poverty impact in Mongolia. Unemployment increased from 2.9% in November 2008 to 3.7% in June 2009, and to 3.8% of labor force in July 2009 as a result of the contraction in the real sector. According to the World Bank study on the crisis implications for household livelihoods conducted in April 2009, a real effective income has fallen by about 60% in some informal urban labor markets, due to high inflation affecting real wages and due to reduced job availability. Poverty incidence in the country in 2007-2008 has increased to 35.2% of the total population against 32.2% in 2006.

The Government of Mongolia with the strong financial assistance of its key development partners has taken series of policy actions to address the crisis. However, the fiscal balance remains under the stress as expenditures remain still high when the revenues continue to decline. The government intends to

submit to the Parliament a new budget law and a new fiscal stability law in order to improve the fiscal responsibility framework. In the financial sector, the non-performing loans have continued to increase, and the bank lending to the private sector has almost stopped, as banks prefer to purchase safe Central Bank bills. This in turn puts further downward pressure on domestic activities. As of end September 2009, trade balance has slightly improved due to increasing mineral prices and due to contracting imports as a result of the economic downturn. Inflation decreased in 2009, reaching deflation of 0.9% in August 2009.

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