MONGOLIA MONTHLY BRIEF – JULY 2009

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

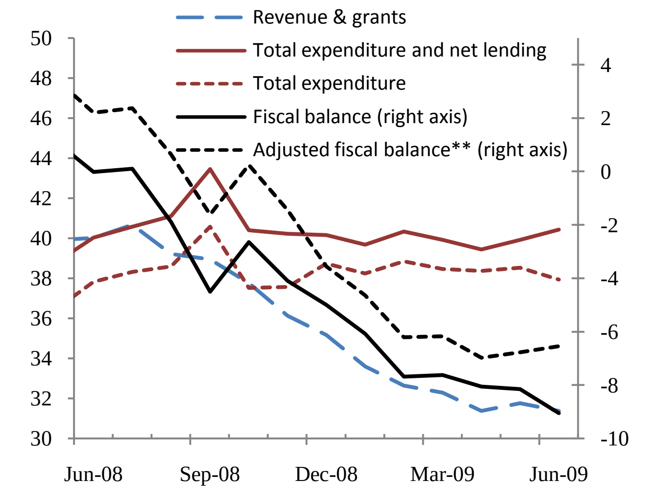
The economic slowdown continues to adversely affect the financial and the real sectors. The negative impact is felt across all major sectors in the real economy. And while some financial indicators were stable, risks exist in the banking sector going forward.

The fiscal situation continues to look grim in the first half of 2009. Revenues have fallen by nearly a third in real terms (29.2 percent) compared with the first half of 2008. Total expenditure was relatively stable, except for an increase in net lending by the government to the private sector. The resulting 12-month rolling fiscal deficit deteriorated to 9.0 percent of GDP in June, from 8.1 percent in May. However, the adjusted fiscal deficit (which excludes net lending) shows a slight improvement to 6.5 percent of GDP in June from 6.8 percent in May.

In June, Parliament amended the 2009 annual budget. Expenditure was increased by MNT 104.6 billion. MNT 47.4 billion was allocated to ensure payments for the Child Money Program for the remaining two quarters of 2009 from the Mongolian Development Fund (MDF), and MNT 57.2 billion was allocated to domestic investment from the MDF. The fiscal gap of the amended budget is now 5.8 percent of 2009 GDP, up from 5.4 percent under the March amendment.

The fiscal deficit (excluding net lending) improves slightly

% of GDP, 12-month rolling sum



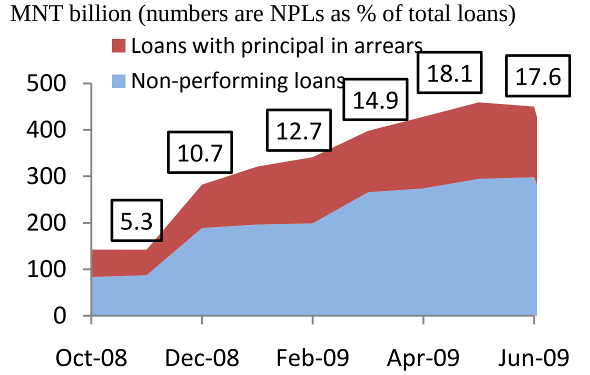
Notes and source: see Update

The 12-month rolling trade deficit is narrowing, because imports continue to fall faster than exports, pointing to a continued slowdown of the economy. Exports dropped by 40.2 percent compared with the first half of 2008 due to lower commodity prices. There were also no gold exports recorded in June. The exchange rate depreciated slightly against the USD, and the Bank of Mongolia (BoM) increased its net international reserves by $95 million to $648 million at the end of June. Commercial banks' net international reserves increased by $66 million to $715 million at the end June.

Inflation is down sharply to 4.7 percent year on year in June, from 7.4 percent yoy in May, led by a decrease in core inflation, giving further evidence of the economic slowdown. The BoM kept its policy rate unchanged at 11.5 percent. In real terms, the policy rate is now strongly positive. This may have contributed to increases in MNT deposits at commercial banks.

NPLs and loans with principal in arrears stabilize

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



Notes and source: see Update

Non-performing loans (NPLs) remained stable at 11.6 percent of outstanding loans while 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. 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.

Banks are still reluctant to lend to the private sector and are buying less risky central bank bills instead. 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.

Industrial production growth continued to be negative in year-on-year terms. This was mainly due to a continued contraction in manufacturing. Mining output also slowed down, because of a decrease in monthly output in June compared to May; monthly mining output had been growing since February. Important developments on the negotiations for one of the two large mining projects are summarized in the Update. Employment conditions are becoming less favorable for both urban and rural informal workers. Registered unemployment increased by 22.3 percent in June 2009 compared to June 2008.

Finally, this Update highlights the World Bank's $40 million in budget support, which was ratified by Parliament on July 2, 2009.