

Safeguarding the economy

Tasked with promoting the balanced and sustainable development of the economy, Bank of Mongolia functions independently of government to ensure price stability and a robust financial sector.

Since the global crisis in 2008, which hit Mongolia hard due to a sudden and precipitous slump in mineral prices, the Bank has recovered gross international reserves to the tune of U.S.\$1.3 billion, thanks to strong macroeconomic policies and the support of the International Monetary Fund. By December 2009, annual inflation was contained at 2% and new reforms have been introduced.

"Bank of Mongolia welcomes a consolidation of the sector which would create a more sound and competitive environment for strategic foreign investors," Bank of Mongolia Governor Lkhanaasuren Purevdorj said.

"The revision of the deposit guarantee system, from general coverage to a more classical one, the capital adequacy ratio requirements increase for banks from 10 to 12 per cent and enhanced banking supervision would further stabilize the financial system. Bank of Mongolia is monitoring the credit quality closely and stands ready to take action, as needed, to secure stability and bolster confidence in the banking system."

Optimistic Economic Forecast

With the country's mining sector recently developed for expansion, the economic forecast is optimistic for this year. Expansion will bring new investment, jobs, export income and a surge in government revenue that could fund social and development spending, but there will be challenges, as the Governor explained.

"Increased demand for labor and materials, plus higher incomes and public spending, could easily spur inflation to double-digit rates, while wages in mining and public services are likely to go up," he said. "An increase in the role of mining in the country would also amplify the economy's vulnerability to fluctuations in global copper prices. Managing windfall revenue and smoothing public expenditure will be critical to avoid such boom-and-bust cycles."

The government has proposed strategies to combat these challenges, including the introduction of a fiscal responsibility law. It has also put in place a stabilization fund to manage revenue volatility, although it will



Lkhanaasuren
Purevdorj
Governor
Bank of
Mongolia

take several years to build up enough reserves to buffer the economy.

A Liberalized Economy

As one of the most open economies in the region, Mongolia benefits from a liberalized financial system and favorable investment legislation. The absence of capital

controls would, Governor Purevdorj believes, provide excellent and competitive investment opportunities.

"Mongolia is a country on the point of transformation. It has some of the richest mineral deposits of copper, coal, gold and uranium reserves, rivalling those of Kazakhstan and Australia," he said. "As these resources are brought to market, Mongolia stands a good chance of becoming the fastest-growing economy in the world over the next decade.

"The government has already taken action to pursue a policy to support foreign investors' interests in Mongolia by creating an attractive legal environment, upgrading the economic competitiveness of the country, making trade more efficient, increasing investment and involving foreign investment in proper ratios for the implementation of mining and other projects."

The recent abolition of the windfall profits tax law is further proof of the government's willingness to promote an attractive legal environment for foreign investors in the mining sector. Parliament is also expected to adopt an integrated budget law and a fiscal stability law that will put a framework for managing mining revenues in place.

Toward A Strong Financial Sector

While Mongolia's financial system has been growing rapidly, commercial banks hold 90 per cent of the financial sector's assets. Insufficient development of the sector has been a key constraint to stable and broad-based economic growth.

Early this year, Bank of Mongolia was given more powers to regulate the financial sector. A restructuring strategy has been submitted to improve the functioning of the banking sector and put in place a transparent mechanism for timely and cost-efficient bank resolution techniques. Meanwhile, the Financial Regulation Committee, set up in 2006, has undertaken several initiatives to improve the legal, regulatory and supervisory environment of the non-bank financial sector.