According to leading Mongolian portal gogo.mn on November 1, 2011, during discussion of a bill of state Monetary Policy in 2012 by Economic Standing committee of Parliament of Mongolia, Governor of Bank of Mongolia L. Purevdorj has informed:

- It can be observed that economic growth this year is to be about 20 per cent. This expansion of the economy is influencing increase of the inflation
- Currently inflation is about 10% and by year end is to be about 13%
- Last week's parliament approval of budget amendment by increase of budget by 1 trillion MNT is increase of 46% yoy. We have no choice but to warn that this kind of expansion and growth is bringing risk of a turn of a decline
- If Bank of Mongolia does not take any measure inflation in next year is forecasted at 14-27% or on average reach 19%.
- The Governor requested MP-s to trim substantially 2012 budget
- While worldwide there is a practice of saving money during economic stability Mongolia's spending of all its income is creating significant overheating and rising inflation
- About 3% of current inflation is caused by growth in meat prices. If Government can accomplish work on meat supply inflation can be reduced by 3%. Although there can be such actions on macro level economic over expansion is influencing this inflation. Therefore next year's budget should be trimmed at the very minimum by a 1 trillion MNT

Conclusion

- Inflation is already double digit and likely to rise further to 13% by year-end. This is in line with our forecast earlier this year of 14% by year end.
- This exacts an especially heavy burden on the poor and erodes the ability of Mongolia's private sector including foreign invested enterprises to operate effectively.
- Rather than contending with these pressures, macroeconomic policies have returned to the boom-bust approach that culminated in the last crisis in 2009.
- The 2011 budget already included a sharp increase in spending of around 30 percent. This is a key factor behind the current overheating. Now the government has proposed a further increase in current budget expenditures spending of 1.5 trillion MNT in 2012. Such an increase will be highly risky and ill-advised. GDP growth in the third quarter already exceeded 16 percent and imports have risen by than 2.1 times. Further fiscal spending would only add to fuel to this overheating economy at a time when it least needs it.

• Such large increase in public expenditures risks throwing Mongolia back to a pro-cyclical fiscal stance. In the 2012 budget, spending should have been kept at or below the level that parliament already approved in the medium-term budget framework.

• To counteract this tendency, the Fiscal Stability Law (FSL), passed in 2010, locked in counter-cyclical policies. However, because the core of the FSL—the structural balance of minus 2 percent of GDP—only starts in 2013, risks exist concerning its implementation, especially with elections around the corner in 2012.

- The recent tightening of monetary policy is welcome, but more needs to be done. We believe that the policy interest rate will be further increased, which will lead to increase in policy rate, lending rates and deposits rates. In some scenarios rising inflation might lead possibly to depreciation of MNT, increase in deposits and lending in USD, i.e so called "dollarization".

- For much of the year policy rate has remained below the pace of increase of underlying inflation, allowing for a very rapid pace of credit growth (now reaching nearly 50 percent in real terms).
- besides increased government spending, inflation is being also stoked by high spending by the private sector—producers and consumers alike—as reflected in the large import bill relative to last year: imports are up by 2.1 times.
- real interest rates on local currency deposits are currently close to a zero territory because of rising inflation, the attractiveness of local currency deposits is due to a fact that this is most accessible investment for local population

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About Frontier Securities

Frontier Securities, based in Ulaanbaatar, Mongolia is a Mongolia's pioneer boutique international investment bank with a seat on Mongolian Stock Exchange working to provide clients with best of both worlds: investment bank with on-the-ground presence and expertise in frontier markets with full cross border service capabilities and international financial markets experience/know-how with particular strengths in Asian financial markets of Hong Kong, Tokyo and Singapore. Information about the firm is available at www.frontier.mn .