

Mongolia: 2011 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Mongolia

Under Article IV of the IMF’s Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2011 Article IV consultation with Mongolia, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on February 1, 2011, with the officials of Mongolia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 1, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A Debt Sustainability Analysis.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its March 16, 2011 discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for Mongolia.

The document listed below has been or will be separately released.

Ex Post Evaluation of Exceptional Access Under the 2009 Stand-By Arrangement

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

MONGOLIA

Staff Report for the 2011 Article IV Consultation and Post-Program Monitoring

Prepared by the Staff Representatives for the 2011 Article IV Consultation

Approved by Nigel Chalk and James Roaf

March 1, 2011

Context. An 18-month Stand-By Arrangement was successfully completed in October 2010. The economy is growing robustly and mineral exports are booming. However, a highly expansionary 2011 budget has put the recovery at risk of overheating. Inflation ended last year at 14 percent and could reach 20 percent later this year. Surging export receipts helped push international reserves to an all time high and also fueled a sharp appreciation of the real exchange rate last year. Elections are set for June 2012.

Summary. The discussions focused on the following:

- *Fiscal spending.* The 2011 budget increased spending by nearly 7 percent of GDP more than the authorities' commitment under the Stand-By Arrangement. The budget represents a return to the boom-bust fiscal policies of the past, threatening macro-stability and fueling inflation. This combination of policies will take an especially hard toll on the poor. Staff advised amending the budget to substantially reduce spending.
- *Monetary policy.* The central bank can only do so much to counteract the inflationary pressures arising from fiscal policy. Nevertheless, staff advised it should actively use the tools at its disposal, starting with an increase in interest rates.
- *Exchange rate policy.* There was agreement that the flexible exchange rate regime is working well and should be continued.
- *Medium-term policies.* With two large mining projects in the pipeline, a substantial increase in mineral exports is projected for the coming years. This mineral wealth, however, will only lead to lasting prosperity if accompanied by sound macro-economic management, including strictly adhering to the Fiscal Responsibility Law, gearing monetary policy toward containing inflation, and safeguarding the banking system.

Discussions. A staff team visited Ulaanbaatar, January 20–February 1, 2011, consisting of S. Barnett (Head), Y. Ojima (APD), S. Park (FAD), F. Ramirez (APD), and P. Ramlogan (Resident Representative).

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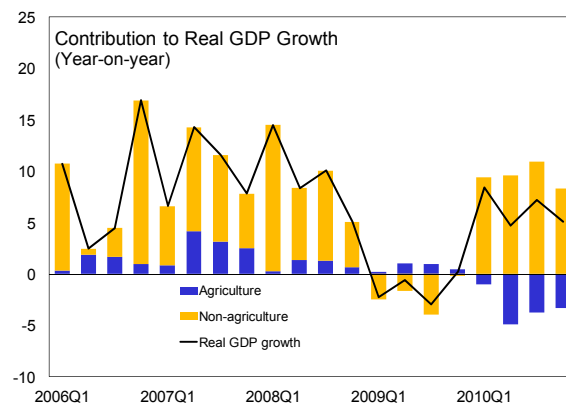
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I. BACKGROUND

1. **Context.** The Mongolian economy was hit hard by the global economic crisis, due to its high dependence on mineral exports and a history of pro-cyclical macroeconomic policies. By early 2009, the economy was on the verge of collapse: the central bank was running out of international reserves, the budget deficit was not financed, inflation was in the double digits, and the banking system was under stress. An 18-month Stand-by Arrangement (SBA) was approved on April 1, 2009, which succeeded in quickly stabilizing the economy thanks to the authorities' steadfast policy implementation, financial support from the donor community, and a rebound in global copper prices.

2. **Past advice.** The authorities have a mixed record with implementing past advice. Fiscal policy in 2010 was prudent, the central bank maintained a flexible exchange rate regime, a landmark Fiscal Responsibility Law was passed, and the SBA was successfully completed. In contrast, the 2011 budget increased spending sharply, a targeted poverty benefit has not been introduced, and a bank restructuring program is not in place.

3. **Recent developments.** Growth rebounded strongly last year to 6 percent. This recovery is all the more impressive in light of the severe winter that led to a sharp contraction in agriculture, especially animal husbandry. The shock to food supply, however, helped drive inflation into the double digits for much of the year, led by rising meat prices. Higher copper prices and a rapid increase in coal production are fueling strong export growth that has helped boost international reserves to an all-time high.



4. **Outlook.** Growth this year is projected to remain strong and accelerate to around 10 percent. The large increase in fiscal spending underway, however, is creating excess demand that will result in higher inflation and surging imports. Inflation could reach some 20 percent by year-end (Figure 1). The medium-term outlook is favorable, as production from Oyu Tolgoi and Tavan Tolgoi (a large coal project) is expected to start by 2013.

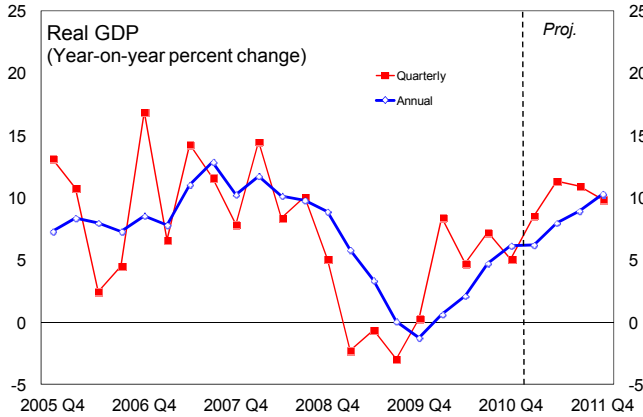
II. POLICY DISCUSSIONS

Fiscal policy is being loosened considerably in 2011, fueling inflation and signaling a return to boom-bust policies. Plans to open a development bank and once again permit government guarantees pose additional fiscal risks.

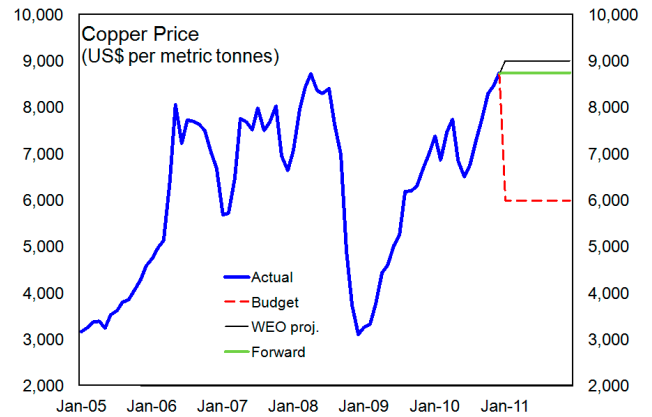
Figure 1. Mongolia—Macroeconomic Developments

Main Message: The economy has recovered and is growing briskly and, with inflation in the double-digits, overheating is a growing concern.

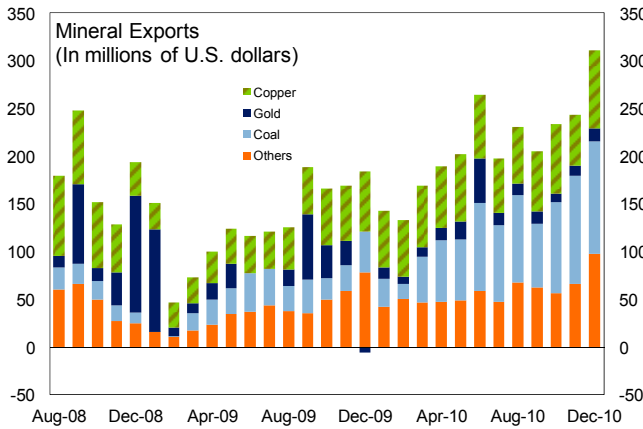
Notwithstanding the impact of the severe winter on agriculture, the economy has bounced back strongly...



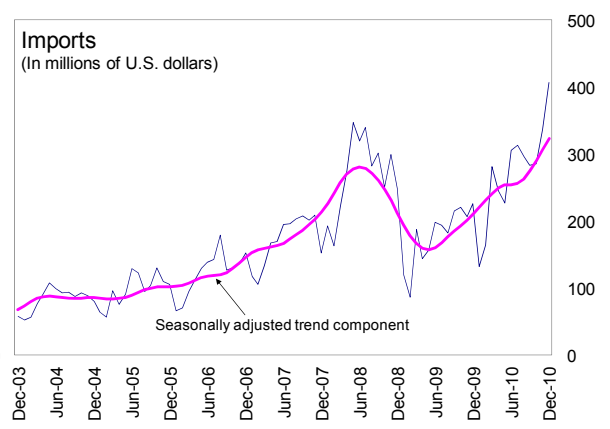
...aided by the sharp rebound in copper prices...



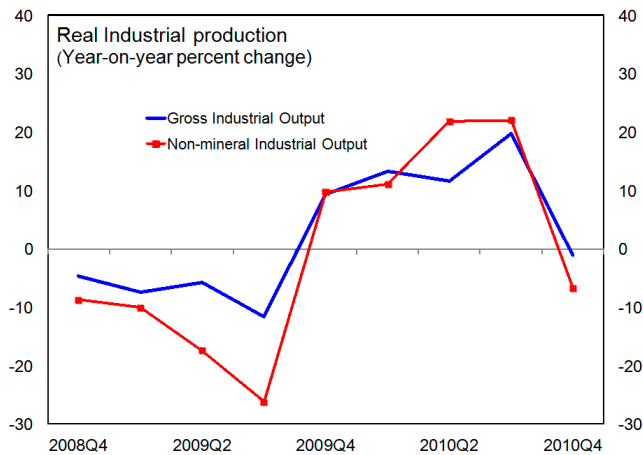
...that is driving export earnings along with a sharp increase in coal exports due to increased production.



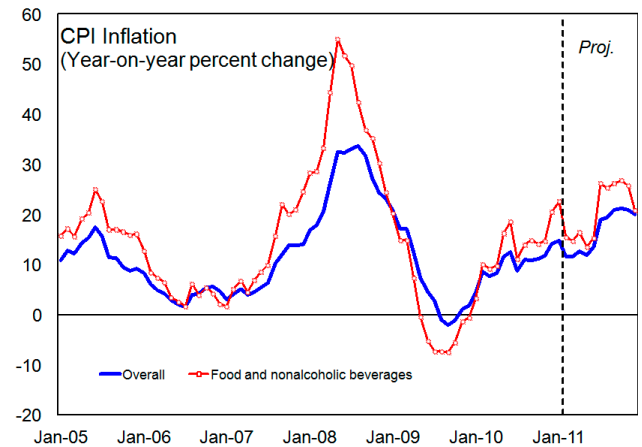
The recovery is showing in demand, with imports growing robustly...



...as well as production in both the mineral and non-mineral sectors.



Inflation, however, has also returned to the double-digits driven by food prices, though non-food inflation has also accelerated.

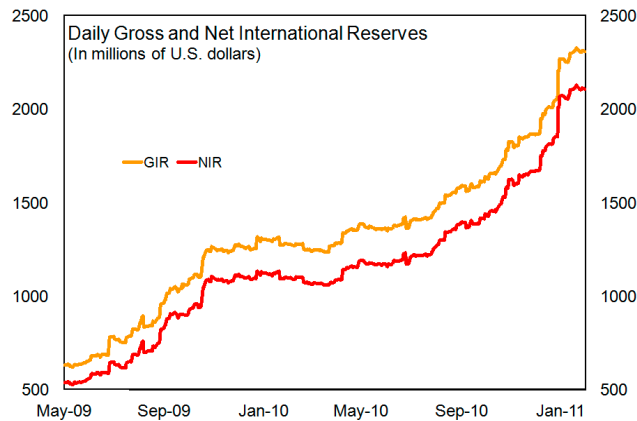


Sources: Mongolian authorities; and IMF staff estimates.

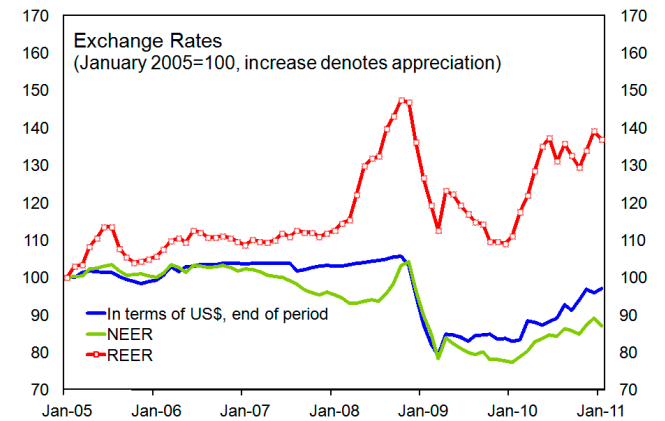
Figure 2. Mongolia—Policy Developments

Main Message: International reserves have reached an all-time high, with the monetary impact largely sterilized by issuance of central bank paper.

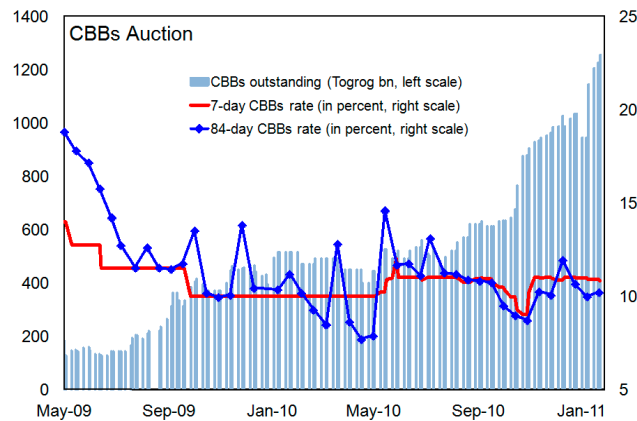
International reserves have been rebuilt including through central bank intervention in the foreign exchange market....



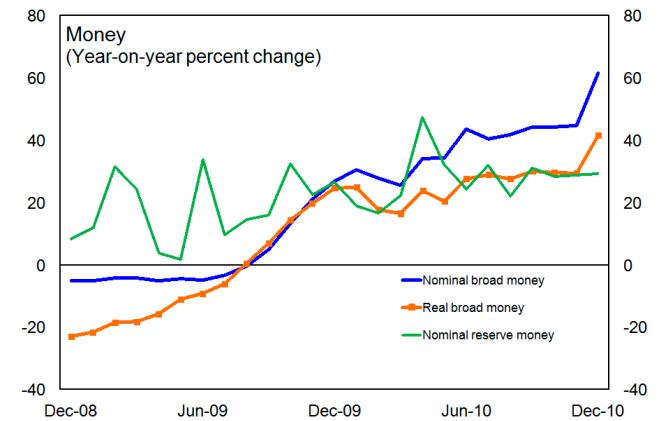
...that has helped to smooth the pace of currency appreciation as the local currency strengthened to post-crisis highs.



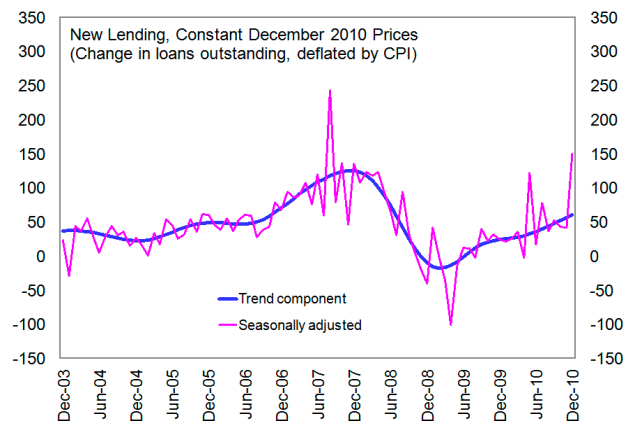
The foreign currency intervention has been largely sterilized through increase issuance of central bank bills...



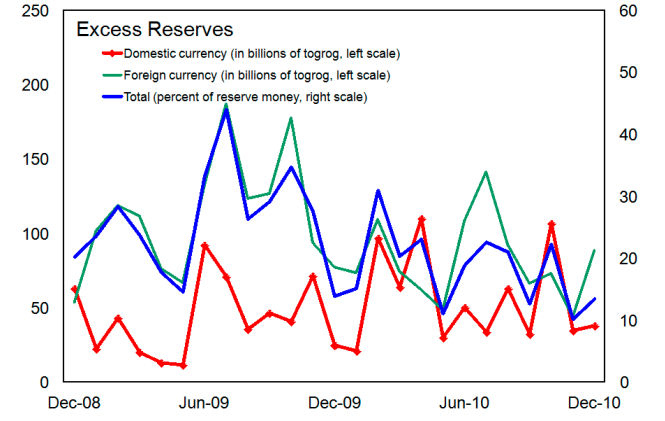
...and the economy is remonetizing with broad money growing faster than reserve money.



Credit growth has recovered but remains somewhat sluggish...



...as banks hold cash in central bank paper or excess reserves.



Sources: Mongolian authorities; and IMF staff estimates.

5. **Fiscal policy.** The government adopted a 2011 budget that substantially increased spending (by nearly 7 percent of GDP) relative to their commitment in the SBA. In order to fulfill a campaign promise, universal cash transfers are being increased by some 4 percent of GDP relative to 2010. Staff argued that the budget will prove costly to the economy by leading to higher inflation that is especially hard on the poor, driving up imports, and ultimately squeezing the private sector. The authorities agreed that the budget was risky, but highlighted the political necessity of fulfilling their campaign promise. The underlying fiscal position will deteriorate significantly in 2011. Nominal spending, which already accounts for more than 60 percent of non-mineral GDP, is set to increase by some 35 percent. In addition, the welcome replacement of the windfall profits tax with a less burdensome resource tax regime will reduce revenue by some 3½–4 percent of GDP.

Mongolia: Fiscal Indicators, 2006-14 1/
(In percent of non-mineral GDP)

	2006	2007	2008	2009	Projected				
					2010	2011	2012	2013	2014
Overall balance (In percent of GDP)	7.6	2.6	-4.5	-5.0	1.2	-3.5	-3.9	0.5	3.2
Structural balance (In percent of GDP)	0.2	-7.5	-10.1	-6.8	-2.8	-6.3	-6.5	-2.0	1.8
Non-mineral balance	-3.3	-16.1	-21.2	-17.9	-18.0	-21.9	-18.1	-13.4	-11.6
Non-mineral revenue	38.0	41.9	36.3	35.5	43.3	41.5	41.3	40.9	39.5
Total expenditure	41.3	58.0	57.6	53.5	61.2	63.3	59.4	54.3	51.1
Fiscal effort (change in cyclically adjusted) 2/	-0.9	-13.4	-8.5	7.8	-1.7	-5.1	4.9	4.9	1.8
Real expenditure growth	32.2	53.3	11.2	-11.4	16.3	15.5	2.1	0.6	1.3
Memorandum items:									
Real non-mineral GDP (growth in percent)	10.1	11.6	10.3	-2.6	5.0	9.0	5.5	7.0	7.0
Output gap of non-mineral GDP	-1.8	0.2	3.8	-2.8	0.2	2.0	0.3	0.0	0.0

Sources: Mongolian authorities; and IMF staff calculations.

1/ Staff forecasts based on application of the numerical rules in the Fiscal Responsibility Law.

2/ In percent of potential non-mineral GDP. The elasticity assumptions are 1 for revenue and 0 for spending.

6. **Fiscal Responsibility Law.** There was agreement on the importance of strictly adhering to the landmark Fiscal Responsibility Law adopted last summer. Unfortunately, the 2011 budget was inconsistent with the spirit as well as the letter of the law (since, as required by law, it was not in line with the medium-term fiscal framework that was submitted to parliament). The authorities, however, underscored their commitment to the Fiscal Responsibility Law and emphasized that they would fully comply with the law's numerical targets that take effect in 2013. They were prepared to exercise the necessary expenditure restraint, and noted that by simply scaling back the universal cash transfers—which are set to expire after the 2012 elections—they could achieve the needed adjustment. Consistent with this, staff fiscal projections assume that spending is sufficiently restrained in 2012–13 to meet the 2013 structural deficit target in the Fiscal Responsibility Law. More broadly, there was agreement that the Fiscal Responsibility Law would provide a welcome anchor for fiscal policy over the medium term.

7. **Fiscal risks.** The authorities are planning to end the ban on government guarantees, start implementing public-private partnerships (PPPs), and establish a development bank. Staff emphasized that these tools should not be used as a vehicle to circumvent the Fiscal Responsibility Law and highlighted how their use could increase fiscal risks, create large contingent liabilities, and reduce transparency. The authorities understood these risks, are

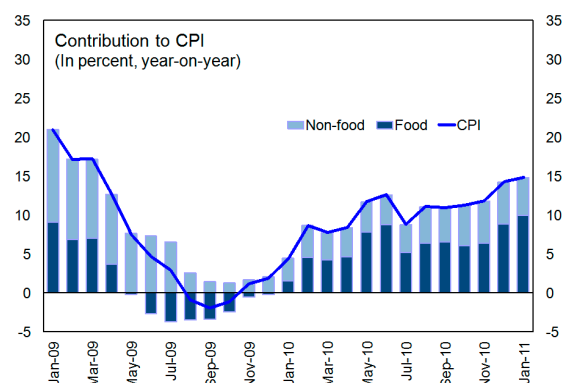
cooperating with donors to follow international good practices, and would proceed prudently by, for example, fully reporting all government guarantees as part of the government debt stock.

8. **Structural fiscal reforms.** There was agreement on the benefits of introducing a targeted poverty benefit to strengthen the social safety net, increase fiscal flexibility, and replace the inefficient system of universal transfers. With some one-third of Mongolians⁷ living in poverty, it is essential to have a well-functioning targeted benefit in place. The authorities, with support from the Asian Development Bank and World Bank, are working to forge the parliamentary consensus needed to pass the social transfer reform law that was submitted last summer. The authorities also aim to adopt a modern integrated budget law this year—FAD and the World Bank have provided technical assistance—that would provide a new financial framework for intergovernmental relations, direct central government budget planning towards a medium-term and programmatic orientation, outline a new public investment planning and budgeting process with clear responsibilities among agencies, and provide greater flexibility for line ministries and agencies in implementation of their budgets. In addition, the authorities have made progress in strengthening the large taxpayers' office and are committed to press ahead with these reforms, including further increasing the office's staffing with the aim to improve taxpayer services and increase revenue collection efficiency. Some parliamentarians are pushing to replace or weaken the VAT. Staff discussed the benefits of the VAT and emphasized that increasing exemptions or otherwise using the VAT to target preferred sectors would prove to be highly inefficient—as well as ineffective—yet come with the costs of substantially complicating tax administration and risking revenue leakage.

9. **Debt sustainability analysis.** The updated debt sustainability analysis (DSA) concludes that Mongolia continues to be classified as low risk of debt distress. Mongolia has a strong capacity to repay the Fund, as supported by the DSA, the favorable medium-term growth prospects, and projections of a continued rise in international reserves.

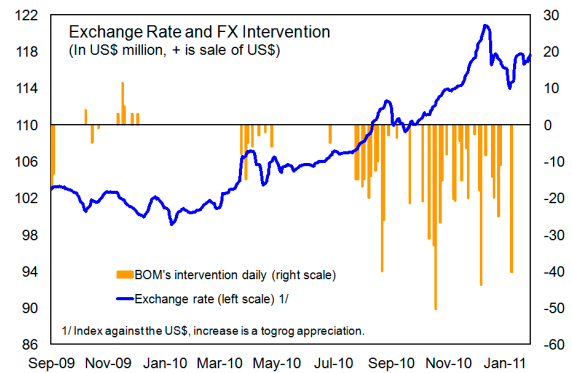
The central bank has not adjusted interest rates, even though inflation is already high and, as a result of the 2011 budget, price pressures are building. The flexible exchange rate, meanwhile, continues to work well and has helped tighten monetary conditions.

10. **Inflation.** Inflation has remained in the double digits for the past few months and is becoming more broad-based. Price pressures are likely to continue given strong demand, the 30 percent increase in pensions and civil servant wages implemented in October, and the large increase in budget spending planned for this year. On top of this, rising global and Chinese food prices, signs of resurgent credit growth, and the booming mineral sector would all add to



pressures. Staff projects that without scaling back budget spending, inflation would surpass 20 percent later this year. The authorities agreed that such a rise in inflation would impose significant economic and social costs, which fall disproportionately on the poor, but the central bank highlighted that there were limits to how much monetary policy could do to offset the fiscal impulse.

11. **Monetary policy.** The central bank policy rate has not been increased in line with the outlook for higher inflation, partly reflecting the public pressure for lower interest rates to help boost credit (Box 1). Staff argued that monetary policy has been too passive and a tightening was called for, starting with an immediate hike in interest rates, especially as the policy interest rate is negative in real terms. The central bank was hopeful that it could contain inflation pressures and would continue to watch incoming data to determine its next steps. There was agreement on the benefits of moving to a monetary policy regime with a more explicit focus on inflation, as the authorities plan to do in the medium term.



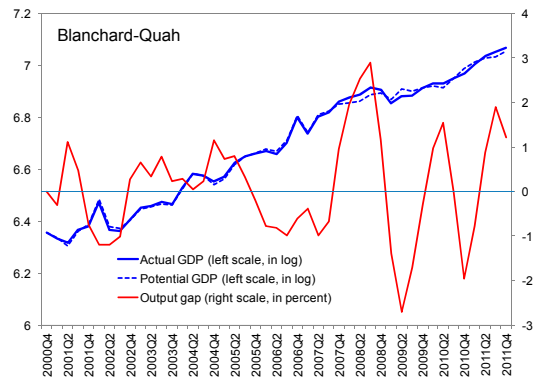
12. **Exchange rate policy.** The authorities remain committed to the flexible exchange rate regime, which has been working well over the past two years. There was agreement that intervention is necessary given the large and lumpy nature of foreign exchange inflows and the relatively thin interbank market. The foreign currency auction system has provided an effective means for central bank intervention and the authorities are now considering reforms that would help to better develop the interbank market. The nominal appreciation which took place in 2010 was also helpful in tightening monetary conditions and reducing inflation by allowing the adjustment in the real exchange rate to feed through the nominal exchange rate instead of prices (Box 2). The depreciation late last year was due in part to seasonal factors and the exchange rate has been fairly stable this year and the central bank has intervened sparingly.

13. **Real exchange rate.** Compared to many other resource dependent economies, Mongolia experienced relatively more real appreciation of the currency over the past five years, with the adjustment coming largely through inflation (Figure 3). The appreciation last year, moreover, was particularly sharp and the authorities understood the challenges this posed for the competitiveness and development of the non-mineral economy. They aim to pursue macroeconomic and structural policies that create an environment conducive to private sector development, including by smoothing the real exchange rate adjustment by restraining fiscal spending (per the Fiscal Responsibility Law), substantially improving infrastructure, and building up human capital. With the caveat that it is difficult to assess the

Box 1. Mongolia--Considerations for Raising Interest Rate

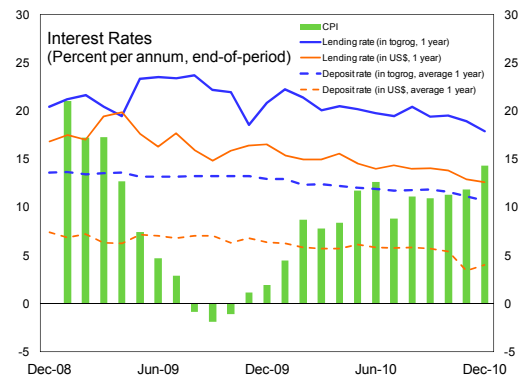
Is output growing faster than potential?

Measuring the output gap in Mongolia is challenging given data shortcomings, the volatility of output, structural changes, and the seemingly large role for supply shocks. With those caveats, the Blanchard-Quah method, which links the output gap directly with inflation, appears to perform better than standard filters.¹ According to this measure, the output gap, though negative at the end of last year, is projected to rise significantly in 2011.

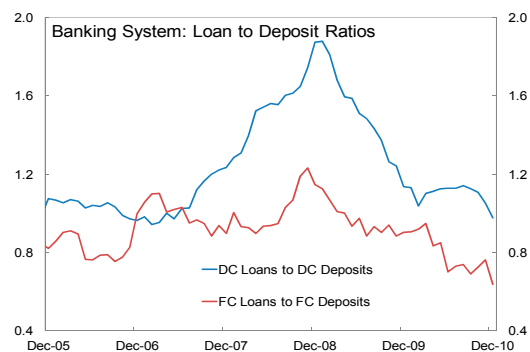


Does food inflation reflect demand or supply shocks? Food prices are a key driver of inflation, and clearly the severe winter and rising global and Chinese food prices are behind a good part of the current food inflation. However, econometric evidence finds that demand factors also play a role. Specifically, spending on social transfers is found to increase food prices and that the increase in universal transfers planned for 2011 could push up food prices by as much as 10 percentage points.

Are interest rates already too high? Interest rates in Mongolia are structurally high reflecting weaknesses in the banking system (as exemplified by high U.S. dollar interest rates) and inflation volatility. Thus, the best way to redress this is through reducing inflation volatility and strengthening the banking system. Moreover, the policy rate is negative in real terms (inflation was 14 percent in December a full 3 percentage points above the prevailing policy rate).



Higher interest rates would attract more capital inflows? This is a possibility, but at the moment there are no signs of widespread speculative inflows. For example, the loan to deposit ratio in foreign currency is falling (suggesting that agents are not shorting the U.S. dollar via domestic banks) and the exchange rate has been fairly stable the last few months during a period when intervention was minimal.



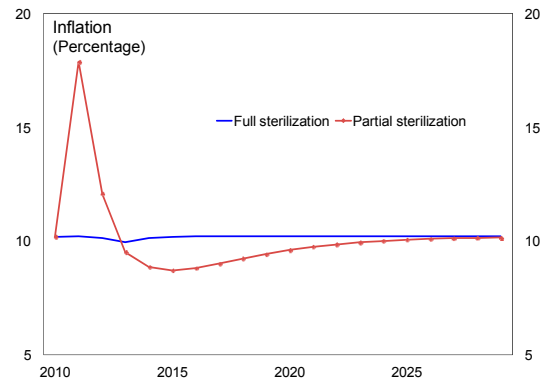
¹ J. Bersch and T. M. Sinclair, "Mongolia: Measuring the Output Gap," IMF Working Paper (forthcoming).

Box 2. Mongolia—General Equilibrium Model: Simulating a Mineral Boom

The Gleaneagles model of scaling up aid is used to simulate a mineral boom.¹ Export earnings in Mongolia are set to increase rapidly when the Oyu Tolgoi and Tavan Tolgoi mines start production in a few years. A large increase in foreign currency earnings, whether from scaling up aid or exports, will have similar economic effects that, in turn, depend on fiscal and monetary policies. The model helps illustrate the impact of the export boom, but the quantitative findings should be discounted as available research makes it difficult to calibrate the deep parameters more specifically to Mongolia.

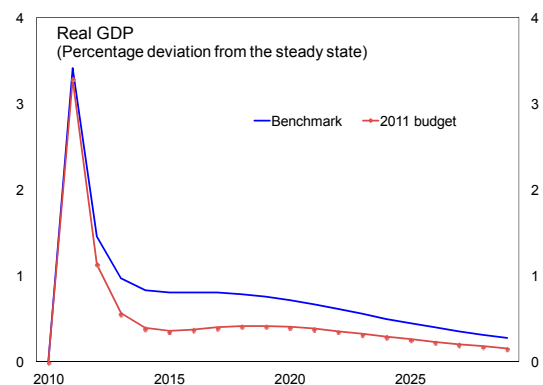
The model looks at an increase in government spending financed by fiscal revenue from a surge in mineral exports. The first simulations examine central bank sterilization and find:

- *Growth is broadly the same with or without sterilization.* Fiscal spending boosts growth, but the extent does not depend on sterilization.
- *Real currency appreciation is the same regardless of sterilization.* Higher government spending increases demand for non-tradables, driving up non-tradable prices and thereby appreciating the real exchange rate. The extent of real appreciation is not affected by sterilization.
- *Inflation is lower with sterilization.* Sterilization allows the adjustment of the real exchange rate to happen through the nominal exchange rate reducing domestic price pressures and inflation.



A second simulation looks at how the composition of fiscal spending. In particular, a scenario based on the increase in spending in the 2011 budget, which is tilted to cash transfers, is compared to one where a larger share of spending is on public capital expenditure (“Benchmark” in text figure). The main conclusion is:

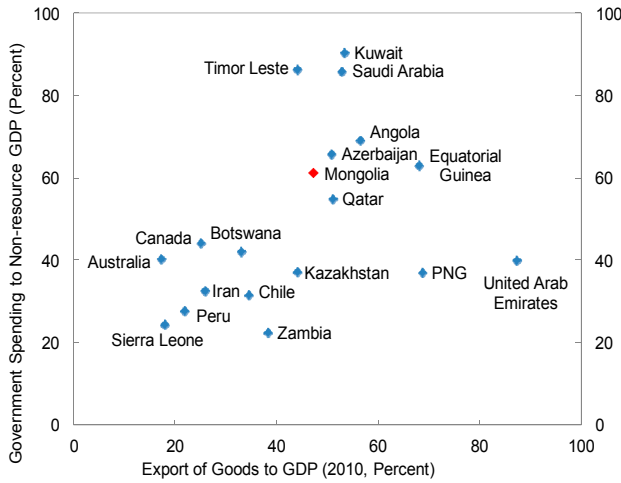
- *Tilting fiscal spending toward capital expenditure would yield higher growth.* This derives from the model’s inclusion of public capital as input to production. In the end, though, it is not public spending on capital that matters but rather how that spending is turned into productive public capital, which depends on the strength of governance, project selection, and procurement practices.



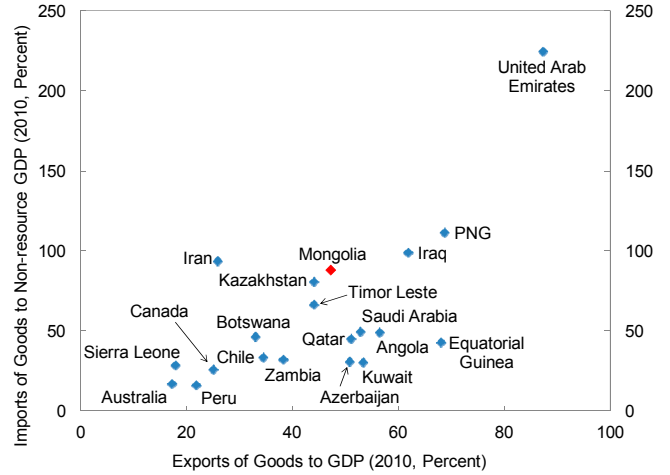
¹ The simulation results are based on S. Park, “Mongolia: Macroeconomic Impacts from a Large Scale Fiscal Spending,” IMF Working Paper (forthcoming). The Gleaneagles model is from A. Berg, J. Gottschalk, R. Portillo, and L. Zanna, “The Macroeconomics of Medium-Term Aid Scaling-Up Scenarios,” IMF Working Paper 10/160.

Figure 3. Cross-Country Perspective

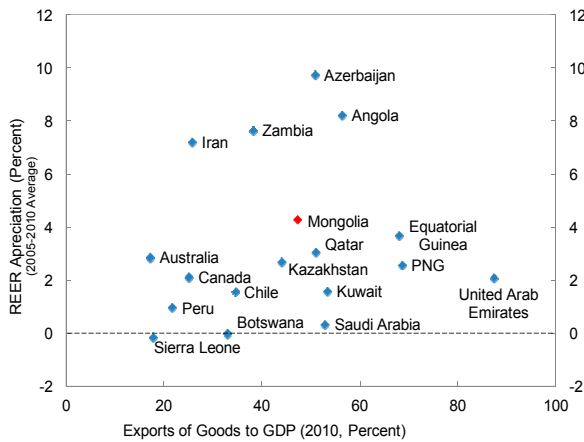
Government spending in Mongolia does not stand out relative to other resource dependent economies...



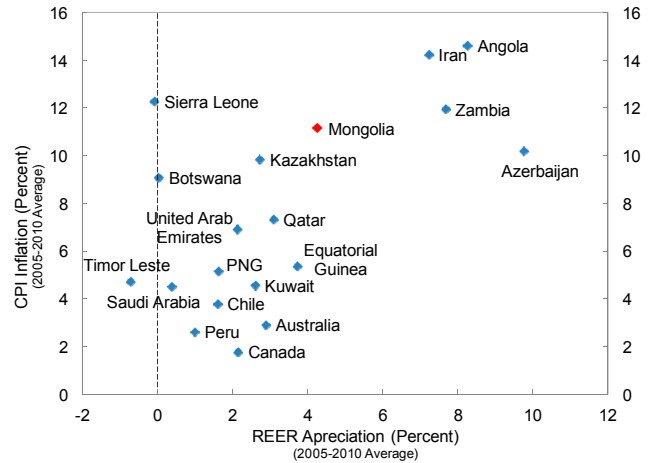
...though Mongolia seems more dependent on imports.



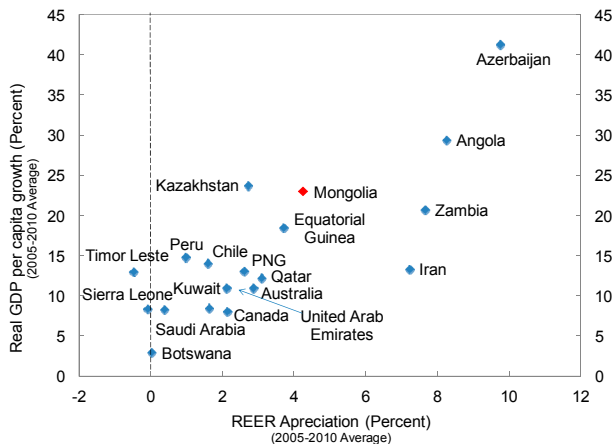
Mongolia experienced more real exchange rate appreciation than many other economies...



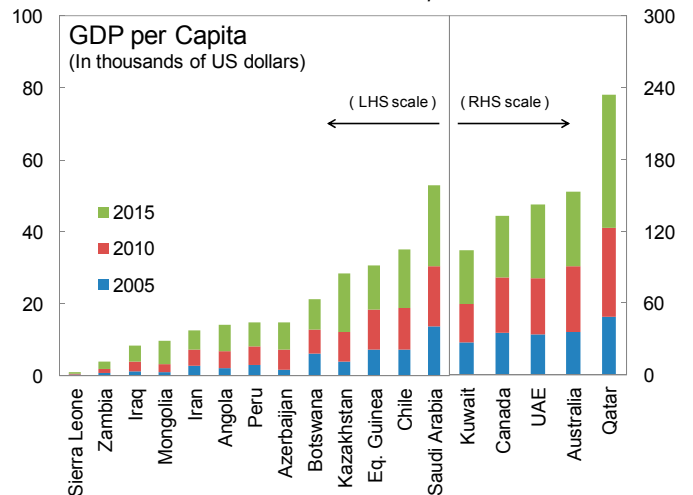
...and the adjustment occurred for the most part through higher inflation.



Growth was faster than many resource dependent economies...

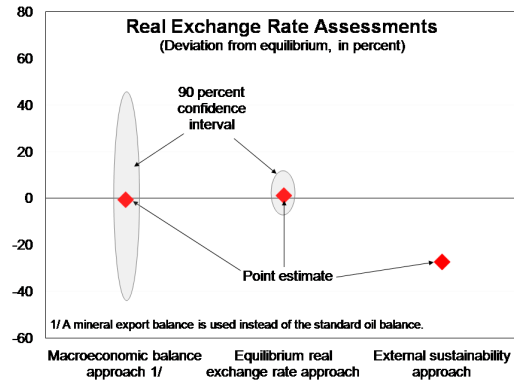


...but even with high growth in the coming years, income per capita would remain on the low side for resource dependent economies.



Sources: WEO database; APD LISC database; and IMF staff estimates.

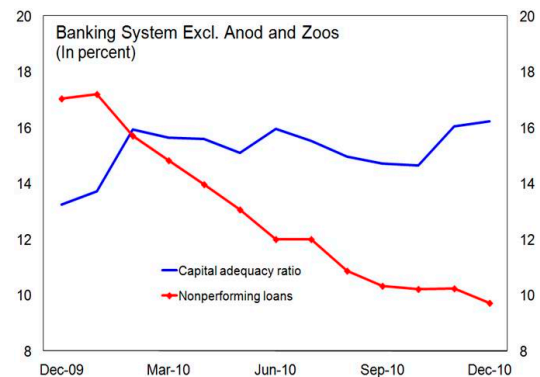
real exchange with such major structural transformations taking place, application of the CGER toolkit suggests that the real exchange rate is broadly in line with medium-term fundamentals. The current account, which had a sizeable deficit last year due to mining related imports, is expected to move to a considerable surplus over the medium term as exports from the new mines begin. However, for purposes of the exchange rate assessment, mineral exports are treated as part of the oil balance and therefore the currency is not considered to be undervalued despite the large current account surpluses projected for 2016.



14. **Multiple currency practices.** Mongolia maintains two multiple currency practices (MCPs) subject to Fund jurisdiction. One arises from the multi-price auction system since there is no mechanism in place that ensures the exchange rates of accepted bids at the multi-price auction do not deviate by more than 2 percent from the commercial rates.¹ Given that this MCP is non-discriminatory among IMF members, retained for balance of payment reasons, and temporary, staff recommends the Executive Board to approve a further extension of the maintenance by Mongolia of this measure until March 15, 2012, or the next Article IV consultation, whichever is earlier. The other MCP arises from the official exchange rate (reference rate), which the government is required to use for its transactions, because it lacks a mechanism to ensure that the commercial rates and the reference rate do not deviate by more than 2 percent. Given that the criteria for approval of this MCP are not present, staff does not recommend Executive Board approval of said measure.

Financial sector reform is moving ahead on some fronts, but the bank restructuring program has stalled in parliament.

15. **Banking system.** Although indicators of banking system soundness had improved by end-2010, these ratios are likely to deteriorate with the tighter rules on the treatment of lending to related parties and restructured loans that took effect January 1. Staff argued that implementation of the Empowering the Banking Sector and Capital Support Program would offer a transparent and fair means of providing temporary government capital



¹ The Executive Board approved the multi-price auction MCP until June 22, 2010 (Decision No. 14365 of June 23, 2009), and its further extension until June 22, 2011 or the next Article IV consultation whichever is earlier (Decision No. 14669 of June 23, 2010).

support to any bank that needs time to come into full compliance. The authorities agreed on the merits of the plan submitted to parliament, but explained that it lacks parliamentary support. As a second best, the central bank would start bank-by-bank negotiations with any banks that are out of compliance with prudential requirements and agree to time-bound restructuring plans. Staff emphasized the importance of strict enforcement of bank supervision regulations, which means replacing supervisory forbearance with resolute action to deal with distressed banks. Moreover, staff engaged in detailed discussions with the authorities as part of a Financial Sector Assessment Program update (see corresponding Financial System Stability Assessment). The authorities intend to have the budget cover all bank restructuring costs and reimburse the central bank for expenses already incurred.²

16. ***Financial sector reform.*** The authorities are working to strengthen the financial system. Planning has begun to replace the blanket deposit guarantee with a deposit insurance system as market conditions allow. At the same time, the authorities are working to expand and deepen the non-bank financial sector. This includes plans to strengthen the local equity market by partnering with a foreign stock exchange, improve the legal environment, and foster development of the insurance market.

III. STAFF APPRAISAL

17. ***2011 budget.*** The large increase in fiscal spending this year will do more economic harm than good. Any immediate benefits will be dissipated through higher inflation, crowding out of private sector activity, and faster real exchange rate appreciation. So, in the end, real household purchasing power could actually go down, imports will surge as they become cheaper relative to domestically produced goods, and local business will become less competitive with knock-on effects for investment and employment. International experience also shows that such high inflation—particularly given its concentration in staple food items—will have an especially hard impact on the poor whose consumption basket contains a high share of such foods and who have little means to shield themselves from the impact inflation has in eroding their real incomes. Therefore, the 2011 budget should be amended to reduce spending substantially.

18. ***Medium-term fiscal framework.*** A sound fiscal policy is necessary for ensuring that Mongolia's mineral wealth leads to lasting prosperity for all Mongolians. In practical terms, this means managing public spending growth in a way that (i) helps smooth economic growth (through a counter-cyclical fiscal policy); (ii) leaves room for the private sector to thrive; and (iii) provides buffers to insulate the budget—and the economy—against a downturn in global commodity prices. The adoption of the Fiscal Responsibility Law last year was a landmark achievement in this regard. However, the 2011 budget is a big step backwards. The Fiscal

² The costs of resolving the two intervened banks are included in the fiscal projections, but, in contrast to previous staff reports, in line with the authorities' plans, the staff projections no longer include any additional costs for bank restructuring.

Responsibility Law will succeed only if it is strictly adhered to in letter and spirit; failure to do so will undermine its credibility and limits its effectiveness in preventing a recurrence of the policy driven, boom-bust cycles that Mongolia has experienced in the past. Compliance will entail expenditure restraint in the coming years, for example, by keeping spending roughly frozen in real terms in order to reach the 2013 structural deficit target. Moreover, it is equally important not to circumvent the law by using off-budget vehicles or government guarantees that would, in effect, undo the economic benefits of adhering to the law and come with the additional costs of an increase in fiscal risks and a loss of transparency. The Development Bank, public-private partnerships, and public guarantees are sources of such quasi-fiscal risk and, if such operations are to proceed, need to be managed prudently and in line with international good practices.

19. ***Structural fiscal reforms.*** The efforts underway to advance structural fiscal reforms are welcome and should proceed. A top priority is the introduction of a targeted poverty benefit, as part of social transfer reform that would help Mongolia's most vulnerable citizens and increase fiscal flexibility. Other priority areas include plans to adopt an integrated budget law and strengthen the large taxpayer office.

20. ***Monetary policy.*** Inflation is already too high, and the substantial increase in fiscal spending underway will push it up further. There are limits to what monetary policy can achieve if budget spending this year is not scaled back. Nonetheless, the central bank should be more proactive in fighting inflation and promptly initiate a tightening cycle, starting with an up-front hike in interest rates. Inevitably, such a tighter monetary policy stance will lessen the availability of credit to the private sector and slow private activity. This crowding out of the private sector, while undesirable, is better than the alternative of allowing inflation pressures to build up further. However, responsibility for such crowding out lies firmly in the decision to put in place a very loose fiscal policy that the monetary authorities now need to offset with the tools at their disposal. This ongoing fight against inflation would be greatly helped by giving the central bank a more explicit mandate to make inflation the primary objective of monetary policy.

21. ***Macroeconomic policy mix.*** The expansionary fiscal policy and concomitant need for a tighter monetary policy is an inefficient policy mix. It results in macroeconomic volatility and higher inflation. The higher inflation also carries large social costs and it takes an especially hard toll on those already living in poverty, as the spike in prices reduces their purchasing power significantly. It also erodes the real value of savings and hurts those on a fixed income, such as retirees. A better macroeconomic mix would significantly scale back the increase in government spending this year and thereby reduce the amount of monetary tightening needed. This mix would result in lower inflation this year and next, a smoother growth path, lower interest rates, and less real exchange rate appreciation. Outcomes that would help improve the competitiveness of the local economy and create a better environment for the private sector.

22. **Exchange rate policy.** The flexible exchange rate regime has been working well over the past 1½ years. International reserves are at an all time high, and the nominal exchange rate has evolved in line with market conditions. The central bank has succeeded in dampening excess volatility in the exchange rate stemming from large and lumpy foreign exchange flows, and this intervention strategy remains fully appropriate for the period ahead. Moreover, the nominal appreciation that took place last year helped to tighten monetary conditions and reduced the increase in inflation. Looking forward, the flexible exchange rate regime will continue to be well suited for the Mongolian economy. Specifically, it will help control inflation, provide a shock absorber against external shocks, and facilitate the real exchange rate adjustment that is likely to take place over the medium term with the rapid growth in the mineral sector.

23. **Banking system.** A healthy banking system is important for promoting the development of the private sector. This includes ensuring that entrepreneurs, farmers, and businesses all have access to credit on reasonable terms while safeguarding depositors' money through effective supervision and regulation. The recent progress, therefore, in strengthening the framework for banking supervision is welcome. Now, it is critical to strictly enforce existing regulations and replace supervisory forbearance with resolute action against any banks that are not in compliance. In addition, prompt passage of Empowering the Banking Sector and Capital Support Program should be a top priority.

24. **Medium-term outlook.** The Mongolian economy has a bright economic future, as development of the mineral sector will lead to a substantial growth and an opportunity to spread prosperity to all Mongolian citizens. Such prosperity, however, is not guaranteed. Many countries have experienced the "resource curse" which underscores that the risk of failure is real, and Mongolia's recent crisis illustrates that the cost of failure is high. Success will require disciplined macroeconomic policies, including (i) containing fiscal spending pressures and strictly adhering to the Fiscal Responsibility Law; (ii) gearing monetary policy toward containing inflation, including by timely adjusting interest rates in line with the evolving price pressures; (iii) maintaining a flexible exchange rate regime; and (iv) safeguarding the banking system through strict supervision and enforcement of existing prudential regulations. Pursuing such a combination of policies would leave Mongolia well poised to ensure that its mineral wealth translates into strong, sustained, and equitable growth.

25. **Other.** Staff recommends that the next Article IV consultation takes place on the standard 12-month cycle and extension of the approval of Mongolia's MCP arising from the multi-price auction system.

Table 2. Mongolia: Summary Operations of the General Government, 2009–12

	2009	Prel. 2010	Proj.		5th & 6th Review	
			2011	2012	2010	2011
(In billions of togrogs)						
Total revenue and grants	1,993	3,073	3,639	4,259	2,762	2,850
Total expenditure and net lending	2,322	2,974	3,999	4,738	2,938	3,287
Overall balance (incl. grants)	-329	99	-360	-478	-176	-436
Non-mineral overall balance	-778	-873	-1,380	-1,440	-887	-751
Structural balance	-446	-229	-652	-796	...	...
Financing	329	-30	360	478	176	436
Foreign (net)	300	-74	48	39	19	114
Domestic (net)	29	44	311	440	157	322
Privatization receipts (valuation adj.)	26	1	1	1	6	6
Domestic bank financing (net)	76	-25	-50	439	115	189
Domestic non-bank financing (net)	-73	68	361	0	36	127
(In percent of GDP)						
Total revenue and grants	30.2	37.2	35.1	35.0	34.9	31.1
Current revenue	29.8	36.7	34.7	34.6	33.9	30.7
Tax revenue and social security contributions	24.5	32.4	30.4	29.5	29.9	26.9
Income taxes	7.9	11.8	8.1	7.5	11.2	6.4
Social security contributions	3.9	3.9	4.0	4.3	3.9	4.8
Sales tax and VAT	4.9	7.0	7.4	7.7	6.4	6.8
Excise taxes	2.5	3.3	3.1	3.0	2.7	2.7
Customs duties and export taxes	1.8	2.3	2.5	2.3	2.0	2.2
Other taxes	3.5	4.1	5.3	4.7	3.7	4.1
Non-tax revenue	5.3	4.3	4.3	5.1	4.0	3.8
Capital revenue and grants	0.4	0.5	0.4	0.4	1.0	0.4
Total expenditure and net lending	35.2	36.0	38.5	38.9	37.1	35.9
Current expenditure	27.2	27.3	30.3	27.9	29.6	26.3
Wages and salaries	8.8	7.9	7.6	8.2	8.2	8.5
Purchase of goods and services	5.9	6.3	6.1	6.1	6.5	5.7
Subsidies to public enterprises	0.6	1.0	0.9	0.9	1.1	0.5
Transfers 1/	11.5	11.7	15.3	12.4	13.1	11.0
Interest payments	0.4	0.5	0.4	0.3	0.7	0.6
Capital expenditure and net lending	8.0	8.7	8.2	11.1	7.5	9.6
Capital expenditure	6.9	6.9	7.3	10.0	6.7	7.8
Net lending	1.1	1.9	0.9	1.0	0.8	1.7
Overall balance (incl. grants)	-5.0	1.2	-3.5	-3.9	-2.2	-4.8
Non-mineral overall balance (incl. grants)	-11.8	-10.6	-13.3	-11.8	-11.2	-8.2
Structural balance	-6.8	-2.8	-6.3	-6.5	-5.6	-6.0
Financing	5.0	-0.4	3.5	3.9	2.2	4.8
Foreign (net)	4.5	-0.9	0.5	0.3	0.2	1.2
Disbursements	5.9	0.2	1.2	1.2	1.1	2.1
Project loans	1.4	0.9	1.2	1.2	1.5	2.1
Program loans	3.0	0.4	0.0	0.0	0.7	0.0
Gold financing loan	1.4	-1.1	0.0	0.0	-1.1	0.0
Amortization	1.3	-0.7	0.7	0.9	0.9	0.8
Domestic (net)	0.4	0.5	3.0	3.6	2.0	3.5
Banking system (net)	1.2	-0.3	-0.5	3.6	1.5	2.1
Non-bank	-0.7	0.8	3.5	0.0	0.5	1.5
Of which: Oyu Tolgoi tax-prepayment	2.2	0.8	1.2	0.0	0.9	1.4
Memorandum items:						
Overall balance incl. banking sector restructuring costs (percent of GDP) 2/	-5.0	-0.3	-4.6	-3.9	-8.8	-4.8
Mineral revenue (percent of GDP)	6.8	11.8	9.8	7.9	9.0	3.4
Non-mineral revenue (percent of GDP)	23.0	24.9	24.9	26.7	24.9	27.2
Nominal GDP (in billions of togrogs)	6,591	8,255	10,382	12,166	7,911	9,162
Copper price (US\$ per ton)	5,165	7,501	9,000	8,500	6,911	7,200

Sources: Ministry of Finance; and IMF staff projections.

1/ Includes reclassifications between goods and services and transfers starting in 2009, which accounts for about two-thirds of the increase in transfers relative to GDP in 2009.

2/ Includes the estimated fiscalization cost of bank restructuring.

Table 3. Mongolia: Monetary Aggregates, 2009–12 1/

	2009	Prel.	Proj.		5th & 6th Review	
		2010	2011	2012	2010	2011
(In billions of togrog; end of period)						
Monetary survey						
Broad money	2,880	4,655	6,750	8,333	3,772	4,463
Currency	285	390	675	833	377	446
Deposits	2,595	4,266	6,075	7,500	3,395	4,017
Net foreign assets	1,533	2,740	4,013	4,668	2,099	2,159
Net domestic assets	1,347	1,915	2,737	3,665	1,673	2,304
Domestic credit	1,987	2,448	3,553	4,244	2,881	3,588
Net credit to government 2/	-717	-836	-765	-326	-116	68
Claims on nonbanks	2,704	3,284	4,318	4,571	2,997	3,520
Other items, net	-640	-533	-816	-579	-1,208	-1,284
Monetary authorities						
Reserve money	733	947	1,231	1,477	903	1,068
Net foreign assets	1,539	2,530	3,803	4,458	1,851	1,903
BOM defined reserves 3/	1,652	2,628	4,269	4,993	1,964	2,016
Net international reserves (NIR) 4/	1,335	2,140	3,781	4,505	1,646	1,698
Other BOM defined reserves	318	488	488	488	318	318
Other assets, net	-114	-98	-466	-536	-113	-113
Net domestic assets	-806	-1,583	-2,572	-2,981	-949	-835
Net credit to government	-265	-493	-663	-324	-174	10
Claims on deposit money banks	198	131	15	16	-18	-18
Minus: Central bank bills (net)	393	1,101	1,777	2,628	496	499
Other items, net	-346	-120	-147	-45	-260	-327
Memorandum items: (In percent; unless otherwise indicated)						
Annual broad money growth	26.9	61.6	45.0	23.5	31.0	18.3
Annual reserve money growth	26.4	29.2	30.0	20.0	21.8	18.3
Velocity	2.3	1.8	1.5	1.5	2.1	2.1
Broad money/reserve money	3.9	4.9	5.5	5.6	4.2	4.2
Total loans/deposits	104.2	77.0	71.1	60.9	88.3	87.6
BOM defined reserves (in millions of US\$) 3/	1,145	2,092	3,392	3,967	1,361	1,397
Net international reserves (NIR, in millions of US\$) 4/	925	1,704	3,004	3,580	1,141	1,177

Sources: Mongolian authorities; and IMF staff projections.

1/ Previously based on program exchange rate (1,560 Tog/USD).

2/ Including bank restructuring cost

3/ Evaluated at end-2010 exchange rate for 2011 and 2012.

4/ Previously referred to as net international reserves under program definition. The definition of NIR has been revised in line with the recommendation of the IMF Safeguard Assessment, and does not include commercial bank foreign currency deposits and foreign currency current accounts held at the Bank of Mongolia. Evaluated at end-2010 exchange rate for 2011 and 2012.

Table 4. Mongolia: Balance of Payments, 2009–12

(In millions of US\$, unless indicated otherwise)

	2009	Prel. 2010	Proj.		5th & 6th Review	
			2011	2012	2010	2011
Current account balance (including official grants)	-410	-931	-1,302	-1,438	-805	-1,651
Trade balance	-194	-278	-1,049	-1,107	-639	-1,680
Exports	1,876	2,899	3,825	4,083	2,446	2,567
Mineral Export 1/	1,560	2,521	3,382	3,655	...	...
Non-mineral Export	316	378	443	428	...	...
Imports	-2,070	-3,177	-4,874	-5,190	-3,085	-4,247
Oil imports	-528	-676	-903	-1,005	-722	-873
Food imports	-311	-336	-534	-555	-385	-444
For investment in mining 2/	-143	-576	-1,517	-1,445	-576	-1,326
Other	-1,088	-1,589	-1,920	-2,186	-1,402	-1,603
Services, net	-164	-279	-268	-291	-157	-12
Income, net	-190	-561	-133	-197	-160	-106
Current transfers	138	186	147	158	151	147
General government 3/	-1	49	24	34	29	24
Other sectors	140	137	123	124	122	123
<i>Of which: workers remittances</i>	120	102	103	103	102	103
Capital and financial account	737	2,181	2,602	2,013	1,007	1,683
Capital account	208	175	96	96	118	96
Financial account	529	2,007	2,506	1,917	889	1,587
Direct investment	496	1,574	1,130	548	422	849
Portfolio investment	-93	879	457	343	-107	0
Trade credits, net	13	53	35	38	-19	-24
Currency and deposits, net	-45	-624	-506	-574	-38	-31
Loans, net	274	94	1,108	2,045	1,023	1,571
Other, net	-116	32	282	-483	-392	-777
Errors and omissions	187	-311	0	0	0	0
Overall balance	514	939	1,301	575	202	32
Financing	-514	-939	-1,301	-575	-202	-32
Gross official reserves (- increase)	-670	-962	-1,297	-540	-271	-32
Use of IMF credit (+)	156	23	-4	-35	69	0
Memoranda items:						
Current account balance (in percent of GDP)						
Including official grants	-9.0	-15.2	-15.1	-13.6	-13.9	-22.9
Excluding mining related imports	-5.8	-5.8	2.5	0.1	...	...
Excluding official grants	-8.9	-16.0	-15.4	-13.9	-14.4	-23.2
Gross official reserves (end-period)	1,328	2,290	3,586	4,127	1,599	1,631
(In months of imports of goods and services)	4.1	4.9	7.1	8.8	3.9	4.0
Copper price (in US\$ per ton)	5,165	7,501	9,000	8,500	6,911	7,200
Oil price (in US\$ per barrel)	62	79	90	90	77	80
Gold price (in US\$ per troy oz.)	973	1,225	1,362	1,405	1,183	1,221

Sources: Mongolian authorities; and IMF staff projections.

1/ Including copper, coal, gold and others.

2/ This covers Oyu Tolgoi copper project and Tavan Tolgoi coal project.

3/ Starting in 2009, investment-related grants have been reclassified in the capital account per BPM5.

Table 5. Mongolia: Selected Economic and Financial Indicators, 2008-16

	2008	2009	Prel. 2010	2011	2012	Proj. 2013	2014	2015	2016
(In percent of GDP; unless indicated otherwise)									
Real sector									
Nominal GDP (in billions of togrogs)	6,556	6,591	8,255	10,382	12,166	16,410	19,685	22,395	26,625
Per capita GDP (in US\$) 1/	2,108	1,688	2,194	3,046	3,689	4,952	5,819	6,329	7,587
Real GDP growth (percent change)	8.9	-1.3	6.1	10.3	7.6	22.9	15.7	9.0	15.5
Mineral real GDP growth	5.2	2.3	9.0	13.4	12.6	58.3	28.7	11.5	25.6
Non-mineral real GDP growth	10.3	-2.6	5.0	9.0	5.5	7.0	7.0	7.0	7.0
GDP deflator (percent change)	21.4	1.8	18.0	14.1	8.9	9.7	3.7	4.4	3.0
Mineral GDP deflator	7.9	-2.5	38.7	5.6	-8.5	3.7	0.6	3.5	-1.8
Non-mineral GDP deflator	25.9	5.4	6.5	19.2	19.7	11.7	5.6	5.1	7.6
Consumer prices (end-period; percent change)	23.2	1.9	14.3	20.0	12.0	5.0	5.0	5.0	5.0
Copper prices (US\$ per ton)	6,963.5	5,165.3	7,501.2	9,000.0	8,500.0	8,000.0	7,000.0	6,500.0	6,500.0
General government accounts									
Total revenue and grants	33.1	30.2	37.2	35.1	35.0	32.1	31.2	33.5	34.9
Mineral revenue	9.4	6.8	11.8	9.8	7.9	8.3	9.6	12.2	14.6
Non-mineral revenue	23.4	23.0	24.9	24.9	26.7	23.4	21.3	21.0	20.1
Total expenditure and net lending	37.6	35.2	36.0	38.5	38.9	31.5	28.0	32.4	35.1
Primary balance	-4.2	-4.5	1.7	-3.1	-3.7	1.9	4.4	1.8	0.3
Overall balance	-4.5	-5.0	1.2	-3.5	-3.9	0.5	3.2	1.1	-0.2
Non-mineral overall balance	-13.9	-11.8	-10.6	-13.3	-11.8	-7.8	-6.3	-11.1	-14.8
Structural balance	-10.1	-6.8	-2.8	-6.3	-6.5	-2.0	1.8	-0.1	-0.5
(In percent of non-mineral GDP)									
Non-mineral revenue and grants	36.2	35.5	43.1	41.3	41.2	40.7	39.3	39.3	38.7
Total expenditure and net lending	57.6	53.5	61.2	63.3	59.4	54.3	51.1	60.0	67.1
Non-mineral overall balance	-21.2	-17.9	-18.0	-21.9	-18.1	-13.4	-11.6	-20.5	-28.2
Monetary sector									
Broad money (percent change)	-5.1	26.9	61.6	45.0	23.5	39.7	24.4	18.1	23.6
Velocity (GDP/M2)	2.9	2.3	1.8	1.5	1.5	1.4	1.4	1.3	1.3
Balance of payments									
Current account balance	-12.9	-9.0	-15.2	-15.1	-13.6	1.9	6.0	12.0	12.2
Excluding mining related imports	-9.5	-5.8	-5.8	2.5	0.1	5.5	9.7	14.9	15.8
Gross official reserves (in millions of US\$)	658	1,328	2,290	3,586	4,127	4,452	4,601	5,399	6,136
(In months of next year's imports of goods and services)	3.0	4.1	4.9	7.1	8.8	8.8	8.8	8.8	8.8
Debt indicators									
Total public debt	31.0	46.6	43.0	38.6	37.1	27.3	23.9	19.6	14.6
Domestic public debt 2/	0.0	3.4	12.2	15.8	17.3	12.6	10.5	6.4	3.6
External public debt	31.0	43.3	30.8	22.8	19.8	14.7	13.4	13.2	11.0
(In millions of US\$)	1,602	1,977	2,023	2,064	2,097	2,149	2,271	2,469	2,654

Sources: Mongolian authorities; and IMF staff projections.

1/ Based on period average exchange rate.

2/ Includes the expected fiscalization cost of bank restructuring, the financing of the government's equity share in Oyu Tolgoi and the Oyu Tolgoi tax-prepayment.

INTERNATIONAL MONETARY FUND

MONGOLIA

**Staff Report for the 2011 Article IV Consultation and Post-Program Monitoring—
Informational Annex**

Prepared by the Asia and Pacific Department

March 1, 2011

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ANNEX I. MONGOLIA—FUND RELATIONS

(As of December 31, 2010)

I.	Membership Status:	Joined: February 14, 1991; Article VIII	
II.	General Resources Account:	SDR Million	Percent Quota
	Quota	51.10	100.00
	Fund Holdings of Currency	173.61	339.74
	Reserve Position in Fund	0.14	0.27
III.	SDR Department:	SDR Million	Percent Allocation
	Net cumulative allocation	48.76	100.00
	Holdings	47.23	96.87
IV.	Outstanding Purchases and Loans:	SDR Million	Percent Quota
	Stand-by Arrangements	122.64	240.00
	ESAF/PRGF Arrangements	5.70	11.15
V.	Latest Financial Arrangements:		

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	04/01/2009	10/01/2010	153.30	122.64
ECF 1/	09/28/2001	07/31/2005	28.49	12.21
ECF 1/	07/30/1997	07/29/2000	33.39	17.44

1/ Formerly PRGF.

VI. **Projected Obligations to Fund:** (SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2011	2012	2013	2014	2015
Principal	2.44	22.71	61.03	40.24	1.92
Charges/interest	1.65	1.60	1.10	0.34	0.02
Total	4.09	24.31	62.13	40.58	1.94

VII. **Safeguards Assessments:**

An update safeguards assessment of the Bank of Mongolia (BOM), conducted with respect to the Stand-by Arrangement approved in April 2009 was finalized on June 17, 2009. Previous safeguards assessments were completed in March 2002 and November 2003. The 2009 update assessment found that the BOM has continued to

improve its safeguards framework since the 2003 assessment. The BOM's financial reporting and audit practices generally comply with international standards. The assessment made recommendations to (i) strengthen certain aspects of the BOM's oversight mechanism, (ii) remove external audit qualifications caused by lack of access to central bank's vaults, and (iii) improve the timeliness of audit completion and publication of the bank's financial statements. The authorities have since confirmed that the auditors were granted access to its vaults at end-2009 and end-2010, and the timing of audit completion has improved.

VIII. **Exchange Arrangement:**

On May 27, 1993, Mongolia moved from a fixed exchange rate against the U.S. dollar to a floating exchange rate system. The de jure exchange rate arrangement is floating. BOM's official exchange rate is the midpoint of the same days' average buying and selling rates of transactions in the interbank market and transactions between banks and their clients. The official rate is announced each weekday except for national public holidays, and the BOM reserves the right to intervene in the foreign exchange market. Effective February 2, 2009, the classification of the de facto exchange rate arrangement had been changed from a conventional pegged arrangement to a stabilized arrangement, retroactively to April 30, 2008, due to the revision of the classification methodology. This change reflected only a methodological modification and did not imply a judgment that there had been a substantive alteration in the country's exchange arrangement or other policies. Due to rapid currency depreciation between October 2008 and February 2009, the exchange rate arrangement was reclassified to "other managed arrangement" from a stabilized arrangement as of November 1, 2008. On March 24, 2009, the BOM instituted a foreign exchange auction allowing the determination of the exchange rate mainly by market forces and therefore, effective March 24, 2009, the de facto exchange rate arrangement has been reclassified to floating. Since 2011, the authorities no longer disclose the quantity of foreign exchange bought or sold in the auction and just publish the cut off rate. Mongolia has no explicitly stated specific nominal anchor, but rather monitors various indicators in conducting monetary policy.

Mongolia accepted the obligations of Article VIII, Sections 2, 3, and 4 on February 1, 1996. Mongolia maintains two multiple currency practices (MCPs) subject to Fund jurisdiction. First, the modalities of the multi-price auction system give rise to an MCP since there is no mechanism in place that ensures that exchange rates of accepted bids at the multi-price auction do not deviate by more than 2 percent. The Executive Board approved the multi-price auction MCP until June 22, 2010 (Decision No. 14365 of June 23, 2009), and its further extension until June 22, 2011 or the next Article IV consultation whichever is earlier (Decision No. 14669 of June 23, 2010). Staff recommends the Executive Board to approve a further extension

of the maintenance by Mongolia of this measure until March 15, 2012, or the next Article IV consultation, whichever is earlier. In addition, Mongolia has an official exchange rate (reference rate) that is mandatorily used for government transactions (as opposed to the commercial market rate). Therefore, by way of official action, the authorities have created a market segmentation. While the recently approved Order No. 699 of the Central Bank of Mongolia sets forth that the reference rate is determined based on the weighted average of market rates used from 4 PM of the previous day to 4 PM of the current day, staff is of the view that this Order does not eliminate the market segmentation and the multiplicity of effective rates arising from it. Accordingly, in the absence of a mechanism to ensure that the commercial rates and the reference rate do not deviate by more than 2 percent, the way the reference rate is used in government transaction gives rise to an MCP subject to Fund approval. Since the criteria for approval of this MCP are not in place, it remains unapproved. Mongolia imposes exchange restrictions for security reasons in accordance with United Nations Security Council Resolution No. 92/757 concerning certain transactions with the Federal Republic of Yugoslavia (Serbia and Montenegro) that have been notified to the Fund under Decision 144 (11/4/94).

IX. Article IV Consultation:

The 2009 Article IV consultation (IMF Country Report No. 10/52) was concluded by the Executive Board on December 22, 2009. Mongolia is on a 12-month cycle.

X. ROSC Assessments:

- Data Dissemination, May 2001 (www.imf.org)
- Fiscal Transparency Module, November 2001 (Country Report No. 01/218)
- Fiscal update, May 2005 (www.imf.org)
- Data Dissemination, April 2008 (www.imf.org)
- Monetary and Fiscal Policy Transparency, September 2008 (www.imf.org)
- Banking Supervision, September 2008 (www.imf.org)

XI. Recent Financial Arrangements:

An 18-month Stand-by Arrangement in an amount of equivalent to SDR 153.3 million (300 percent of quota) was approved on April 1, 2009. Following the first review completed on June 23, 2009, the second on September 21, 2009, the third on December 22, 2009, the fourth on March 19, 2010, and the combined fifth and sixth on September 8, 2010, the program was successfully completed on October 1, 2010.

A three-year arrangement under the Enhanced Structural Adjustment Facility (ESAF) in an amount equivalent to SDR 40.81 million (80 percent of quota), with a first annual arrangement in an amount of SDR 18.55 million (36.3 percent of quota), was

approved on June 25, 1993. The second annual arrangement in an amount of SDR 11.13 million (21.8 percent of quota) was approved on November 23, 1994. The ESAF arrangement lapsed on June 24, 1996.

A three-year arrangement under the ESAF/PRGF in an amount equivalent to SDR 33.4 million (65.4 percent of quota), with a first annual arrangement in an amount of SDR 11.13 million (21.8 percent of quota), was approved by the Executive Board on July 30, 1997. The first year arrangement lapsed on July 30, 1998. The second annual arrangement of SDR 14.8 million (29 percent of quota) was approved on June 16, 1999. The first review under that arrangement was completed in January 2000 and the arrangement lapsed on June 15, 2000. The ESAF/PRGF arrangement lapsed on July 29, 2000.

A three-year arrangement under the PRGF in an amount equivalent to SDR 28.49 million (55.8 percent of quota), with the first year of the arrangement in an amount of SDR 12.21 million (23.9 percent of quota), was approved by the Executive Board on September 28, 2001. The first and second review under the PRGF was completed on September 12, 2003, and the Executive Board approved the extension of the PRGF through July 31, 2005. The arrangement expired on that date without the completion of the third and subsequent reviews.

XII. FSAP Participation:

Mongolia participates in the Financial Sector Assessment Program (FSAP). The first, second and third FSAP missions took place in May 2007, September 2007 and November 2010 respectively, and the latest report (IMF Country Report No. 08/300) was published in September 2008.

XIII. Technical Assistance:

Missions:

- Strengthening LTO operations (FAD), April, July and November 2010
- Monetary Policy (MCM), October 2010
- National Statistics (STA), August 2010
- Fiscal Decentralization (FAD), June–July 2010
- Tax Policy (FAD), June 2010
- Banking Supervision (MCM), January–February 2010
- Strengthening LTO operations (FAD), November 2009
- Budget Preparation and Budget Legal Reforms (FAD), January, June, July, and December 2009
- External Sector Statistics (STA), November 2009
- Banking Restructuring (MCM), October–November 2009
- Monetary and Financial Statistics (STA), September 2009

- Supervisory and Regulatory Capacity Building of the FRC (MCM), February, April, and September 2009
- Bank Restructuring (MCM), August 2009
- Foreign Exchange Market and Monetary Policy (MCM), May 2009
- Strengthening Forex Market Operations (MCM), March 2009
- Foreign Exchange Market (MCM), March 2009
- Fiscal Expenditure Review (FAD), January 2009
- Operational Framework of Monetary Policy (MCM), December 2008
- Supervisory and Regulatory Capacity Building of the FRC (MCM), September, November, and December 2008
- Banking Supervision and Accounting Framework (MCM), November 2008
- Budget and Legal Reforms (FAD), October 2008
- External Sector Statistics (STA), October 2008
- Real sector Statistics (STA), August 2008
- Monetary and Financial Statistics (STA), June 2008
- Budget Preparation (FAD), February–March 2008
- Budget Preparation (FAD), February 2008
- Bank Supervision (MCM), February 2008
- Enhancing Foreign Exchange Market (MCM), February 2008
- Monetary Operations (MCM), January 2008
- Real Sector Statistics (STA), November–December 2007
- Poverty and Social Impact Analysis (FAD), December 2007
- Measures to Combat Money Laundering and the Financing of Terrorism (LEG), December 2007
- ROSC Data Module (STA), October 2007
- Fiscal Affairs Department Scoping Mission (FAD), September 2007
- Real Sector Statistics (STA), June–July, 2007
- International Market Access (MCM), May 2007
- Bank Supervision and Reserves Management (MCM), April 2007
- Real Sector Statistics (STA), March–April 2007
- Government Finance Statistics (STA), March–April 2007
- Fiscal Regime for the Mining Sector and the Development Fund (FAD), January 2007
- Government Finance and Monetary and Financial Statistics (STA), September 2006
- Improving Banking Supervision and Reserve Management (MCM), September 2006
- Value Added Tax, Income Tax and Excise Tax Legislation (LEG), August 2006
- Cooperation between Mongolia's NSO and STA, May 2006
- Management Structure of the Bank of Mongolia (MFD), April 2006
- Monetary and Financial Statistics (STA), October 2005

- Banking Supervision and Payment Systems (MFD), June 2005
- Options for Expenditure Savings and Efficiency Improvements (FAD), January 2005
- Banking Supervision and Prudential Framework (MFD), October 2004
- Reforms of Tax Policies (FAD), October 2004
- Government Finance Statistics (STA), August 2004
- Balance of Payments Statistics (STA), July–August 2004
- Banking Supervision and Prudential Framework, (MFD), May–June 2004
- AML/CFT Action Plan and Legislative Awareness, May 2004
- Banking Supervision and Accounting (MFD), October 2003
- Government Finance Statistics (STA), August 2003
- AML/CFT (MFD), June 2003
- Banking Supervision and Accounting (MAE), November 2002
- Revenue Administration (FAD), September 2002
- Banking Supervision and Accounting (MAE), May 2002
- Review of Treasury and Intergovernmental Fiscal Reforms (FAD), August 2001
- Banking Supervision and Accounting (MAE), May–June 2001
- Money and Banking Statistics (STA), May 2001
- Government Finance Statistics (STA), March 2001
- Fiscal Transparency and ROSC (FAD), March 2001
- Intergovernmental Fiscal Relations and Budget Reform (FAD), January 2001
- Visits by MAE Peripatetic Experts on Banking Supervision, Payments System, Monetary Policy, and Accounting and Audit, November 2000
- Consumer Price Statistics (STA), September–October 2000
- ROSC Data Module (STA), May 2000
- Restructuring Bonds and Other Securities (MAE), March 2000
- National Accounts Statistics (STA), February 2000

Resident Advisors:

- Budget Planning (FAD), June 2009–June 2011
- National Accounts Statistics (STA), August 2001–September 2003
- Treasury Reform (FAD), June 1999–November 2003
- Balance of Payments (STA), March 1999–May 2001

Technical assistance for the period May 1995–October 1999 is reported in Annex II of the Staff Report for the 1999 Article IV consultation.

XIV. Resident Representative:

Mr. Parmeshwar Ramlogan has been the Fund’s resident representative in Mongolia since July 2009.

ANNEX II. MONGOLIA—WORLD BANK-IMF COLLABORATION

1. **The Bank and the Fund country teams led by Mr. Rogier van den Brink (Lead Economist, EASPR) and Mr. Steven Barnett (Mission Chief to Mongolia)** maintain a close working relationship and have an ongoing dialog on a range of macroeconomic and structural issues.
2. **The level of cooperation and coordination is exemplary in many respects and includes the following:**
 - **Stand-by Arrangement.** The World Bank participated in virtually all the negotiating missions' meetings with the authorities. This facilitated the discussions, especially as regards policies in areas of mutual interest such as bank restructuring, social welfare reform, and fiscal policy. The teams have also jointly participated in media events.
 - **Development Policy Credits.** In turn, the IMF participated in the design and review of the Bank's Development Policy Credits. For instance, the IMF Mission Chiefs were peer reviewers for the two Mongolia Development Policy Credits.
 - **Economic updates.** Fund staff regularly contributed text boxes to the World Bank Monthly Updates. These are public documents that inform the public about recent economic trends and selected topics. The Updates are an important tool to improve the public's understanding of the economic situation and the rationale of the government's policy reforms, thus helping to forge consensus around the policy reform agenda.
 - **Bank restructuring.** Both the World Bank and Fund country teams have been active in this area, including fielding numerous technical assistance missions. The teams coordinated closely to provide the authorities with consistent advice while avoiding unnecessary duplication of efforts. These efforts helped the authorities in passing a new Banking Law, adopting new banking regulations, strengthening supervision, and drafting the Banking Sector and Capital Support Program that was submitted to parliament in August 2010. The two teams have also worked to help educate the public and parliamentarians on the banking sector issues in an effort to build support for reform.
 - **Structural fiscal reforms.** Fund staff and the World Bank team have worked together successfully to provide technical assistance in expenditure management, the recently adopted Fiscal Responsibility Law, and taxation of the mineral sector. This included participation of World Bank staff in FAD technical assistance missions, and FAD backstopping of a World Bank financed long-term advisor. The efforts also include a broad outreach effort to the public and parliamentarians, including several workshops jointly organized by the World Bank and the IMF in DC for government officials and parliamentarians, and a high-level workshop in Mongolia attended by about one-half of parliament.

3. **Based on the above intensive partnership, the Bank and the Fund share a common view about Mongolia’s macroeconomic and structural reform priorities. These include:**

- **Promoting long-term growth.** Managing the mineral wealth to ensure strong, sustainable, and equitable growth with low inflation. This includes the importance of avoiding the “resource curse” and minimizing “Dutch disease” effects.
- **Sustaining the recovery.** This includes ensuring that the boom-bust policies of the past are not repeated. The recently adopted Fiscal Responsibility Law is a key step, and it is critical that it be strictly adhered to. At the same time, fiscal policy also has to be mindful of the macroeconomic policy mix and not over-burden monetary policy.
- **Monetary policy.** The central bank should continue to gear monetary policy to controlling inflation. The flexible exchange rate regime is working well and should also be maintained. Monetary and exchange rate policy could be strengthened by giving the central bank more independence.
- **Protecting the poor.** Introduction of a targeted poverty benefit remains a priority and would be a big step forward in strengthening the social safety net and increasing fiscal flexibility.
- **Strengthening the banking system.** Key steps include passage and implementation of the bank restructuring program, continued improvement in bank regulation and supervision, and eventual introduction of deposit insurance to replace the blanket guarantee.

4. **The teams agreed to continue the close cooperation going forward.** Appendix I details the specific activities planned by the two country teams over the period September 2010–August 2011 along with their expected deliveries. It was also agreed that further details on collaboration, as necessary, would be agreed at the technical level as work progresses.

Appendix I. Mongolia: Bank and Fund Planned Activities in Macro-Critical Structural Reform Areas, September 2010–August 2011

	Products	Expected Delivery Date
Bank Work Program	<ul style="list-style-type: none"> • Development Policy Credit 2 (DPC2) • Quarterly Economic Updates • Development Policy Credit 2 Implementation Completion Report • Policy notes on selected economic topics • Gender economic analysis • Banking sector restructuring TA • Supervision missions multi-sectoral TA Credit (Banking, social welfare, fiscal policy). • Study tours to Poland and Estonia for parliamentarians and government officials on budget systems and fiscal decentralization, coordinated with FAD • Supervision Governance Assistance Project and Economic Capacity TA Project, focused on fiscal reform agenda • Supervision Mongolia Statistical Capacity-Building Project 	<ul style="list-style-type: none"> • Oct. 2010 (done) • Oct. 2010 (done), Jan. 2011 (done), April 2011, July 2011 • Oct. 2011 • Ongoing until June 2011 • April 2011 • June 2011 • September 2010, February 2011, June 2011 • March 2011 • Ongoing • December 2010
Fund Work Program	<ul style="list-style-type: none"> • Article IV / PPM Mission • Article IV / PPM Staff Report and Board Meeting • PPM Mission • PPM Board meeting • STA: National account statistics • FAD: Tax administration for large taxpayers, mineral taxation regime • MCM: Banking supervision • Financial stability module FSAP mission 	<ul style="list-style-type: none"> • February 2011 • March 2011 • August 2011 • September 2011 • Ongoing • Ongoing • Ongoing • November 2010

ANNEX III. MONGOLIA—RELATIONS WITH THE ASIAN DEVELOPMENT BANK¹

Mongolia became a member of the Asian Development Bank (AsDB) in February 1991. In line with AsDB's poverty reduction strategy, AsDB entered into a Poverty Partnership Agreement (PPA) with the Government of Mongolia in 2000. Within the framework of the PPA, in October 2005, AsDB formulated its Country Strategy and Program for 2006–08. The 2006–08 country strategy and program focused on support for stable broad-based economic growth and inclusive social development. Currently AsDB is working on preparation of the Country Partnership Strategy (CPS) through 2015.

AsDB has been a leading development partner in Mongolia, which is eligible for, and borrows from AsDB's concessional Asian Development Fund (ADF) resources. AsDB allocates its concessional special fund resources to eligible member countries, including Mongolia, based on an annual country performance assessment. The assessment focuses on indicators of sustainable economic growth, socially inclusive development, governance and public sector management, and portfolio performance.

AsDB has provided loans for 37 projects totaling \$734.7 million in the agriculture, education, energy, financial, health, industry, telecommunications, transport, and urban development sectors as of December 15, 2010. AsDB also has an active technical assistance (TA) portfolio consisted of 25 TA projects totaling \$23.4 million and 11 Japan Fund for Poverty Reduction (JFPR) projects totaling \$24.79 million as of December 15, 2010.

Mongolia became eligible for ADF grant financing for the period 2007–10. Twelve grant projects/programs, totaling \$169.7 million, have been approved as of December 15, 2010. The total active loan and grant portfolio as of December 15, 2010 consists of 8 loans amounting to a net total of \$182.6 million and 12 grants totaling \$156.2 million.

All of the ongoing AsDB projects are expected to achieve their development outcomes. A total of 30 projects were completed and closed as of December 31, 2009. Of the 25 project completion reports, 8 of these have been rated as generally or highly successful, 10 as successful, 5 as partly successful, and one as unsuccessful; one had no rating. Project performance evaluations were conducted by AsDB's Independent Evaluation Department for 16 projects during 1996–2009. Out of these 16 projects, 3 were rated as highly successful, 7 as successful and 6 as partly successful.

Since late 2008, AsDB has worked with the government to formulate a response to the global economic crisis, in close cooperation with other development partners. When the economic

¹ Data provided by Asian Development Bank staff.

crisis struck, a new CPS covering the period 2009–13 was at an advanced stage of preparation. AsDB and the government agreed to postpone finalization of the CPS until the economy had stabilized and implementation of the government's medium-term plans resumed. Instead, the Country Operations Business Plan 2009–12 was prepared, which is specifically designed to address challenges posed by Mongolia's deteriorating economic environment.

A Social Sector Support Program (SSSP) was approved by AsDB on June 24, 2009 and has been effective since 15 July 2009. The SSSP aims at protecting the poor during the financial crisis by implementing a set of policy measures in the social welfare, health, and education sectors to provide essential social services, and to initiate longer-term reforms to improve the targeting of social assistance and living conditions of the poor, especially in ger areas of Ulaanbaatar. The Program is co-financed by AsDB and JICA. AsDB released its first tranche of \$40 million in July 2009. The second tranche is pending subject to passage of the social welfare law and completion of the nationwide identification of poor households through the proxy means test.

A total lending program of \$530 million for the initial period of 2010–13 is envisaged, of which \$200 million would be provided from ADF resources and \$184 million provided from OCR financing subject to Mongolia's reclassification from Group A to B, resource availability, access to regional ADF allocation and country-performance based allocation. An average of \$6 million in TA resources is expected to be provided annually.

ANNEX IV. MONGOLIA—STATISTICAL ISSUES

As of January 31, 2011

I. Assessment of Data Adequacy for Surveillance	
General: Data provision to the Fund is broadly adequate for surveillance. The priority areas for improvement are national accounts and government finance statistics.	
National Accounts: The national accounts statistics compiled by the National Statistics Office (NSO) are broadly in line with the guidelines of the 1993 SNA. They have improved the quality of national accounts data, but weaknesses remain, including in the estimation of capital formation, estimation of GDP price deflators, and coverage of the informal sector and small-scale activity (especially in the services sector). The compilation of constant price expenditure-based national accounts, in line with the pilot done in 2008, would serve as a useful check for the production side estimates. NSO plans to disseminate annual expenditure-based GDP series in value terms and to pilot quarterly estimates of GDP by expenditure in 2011.	
Price Statistics: The consumer price index (CPI) was rebased in January 2008 with expenditure-derived weights from the 2005 Household Income and Expenditure Survey. NSO has published a national CPI for Ulaanbaatar and 21 aimags (provinces) since January 2008, and a housing price index since October 2008. Priority areas for improvement are data on wages and earnings. NSO plans to disseminate a producer price index and a retail price index in 2011.	
External Sector Statistics: The Bank of Mongolia (BOM) follows the concepts and methods in the Balance of Payment Manual fifth edition and is expected to begin implementing the recommendations of the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) in 2012. The BOM disseminates the data according to the IMF standard presentation table. The coverage of the balance of payments statistics has been broadened by extending the International Transaction Reporting System (ITRS) to nonbank financial institutions and by increasing the number of direct reporting private enterprises. Priorities for improvement are in the analysis of balance of payments and the quarterly survey of foreign investment enterprises. The BOM compiled an experimental International Investment Position (IIP) for 2007, and plans to publish IIP in 2011.	
Monetary and Financial Statistics: BOM's monetary and financial statistics conform to the concepts and definitions of the MFSM methodology as the authorities implemented recommendations of the June 2008 and September 2009 missions. In particular, the monetary data were improved by the proper classification of repurchase agreements, accrued interest, and financial derivatives. The coverage of monetary statistics was expanded beginning in February 2010 to include data of Savings and Credit Cooperatives (SCCs) that collect deposits and since May 2010 data for other financial corporations (NBFIs) have been disseminated in the BOM monthly statistical bulletin. The September 2009 mission also provided recommendations to reconcile the BOM and the Ministry of Finance data on government financing, and finalized the standardized report forms for the data of the BOM and other depository corporations in International Financial Statistics beginning in November 2009.	
Government Finance Statistics: The concepts and definitions used to compile fiscal statistics generally follow the guidelines of the GFSM 1986. The classifications used for sub-annual and annual fiscal statistics also follow broadly its classifications. No formal decision has yet been taken on adopting a migration path to the GFSM 2001 methodology, but Mongolia has over several years availed itself on training, TA, and thus no substantial problems for achieving a GFSM 2001 presentation are anticipated	
II. Data Standards and Quality	
Mongolia participates in the General Data Dissemination System (GDDS), and maintains its efforts to subscribe the Special Data Dissemination Standards (SDDS).	A data ROSC mission visited Mongolia in September 2007 to update the May 2000 assessment of the macroeconomic statistics, complemented by an assessment of data quality based on the IMF's Data Quality Assessment Framework. The report was published in April 2008.

Mongolia—Table of Common Indicators Required for Surveillance
As of January 31, 2011

	Date of Latest Observation	Date Received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of Publication ⁶	Memo Items: ⁷	
						Data Quality-Methodological soundness ⁷	Data Quality – Accuracy and Reliability ⁸
Exchange rates	1/31/11	1/31/11	D	M	D		
International reserve assets and reserve liabilities of the Monetary Authorities ¹	1/31/11	1/31/11	D	M	M		
Reserve/base money	12/2010	1/20/11	M	M	M	O, LO, LO, LO	O, O, O, O, LNO
Broad money	12/2010	1/20/11	M	M	M		
Central bank balance sheet	12/2010	1/20/11	M	M	M		
Consolidated balance sheet of the banking system	12/2010	1/20/11	M	M	M		
Interest rates ²	12/2010	1/20/11	M	M	M		
Consumer price index	12/2010	1/20/11	M	M	M	O, LO, O, O	LO, LO, LO, O, O
Revenue, expenditure, balance and composition of financing ³ – general government ⁴	12/2010	1/20/11	M	M	M	LO, LNO, LO, O	LO, O, LO, LO, LNO
Revenue, expenditure, balance and composition of financing ³ – central government	12/2010	1/20/11	M	M	M		
Stocks of central government and central government-guaranteed debt ⁵	2009	2/2010	A	A	A		
External current account balance	Q4 2010	1/2011	Q	Q	Q	O, O, O, LO	LO, O, LO, LO, LO
Exports and imports of goods	12/2010	1/20/11	M	M	M		
GDP/GNI	2010	1/2011	A	A	A	O, LNO, O, LO	O, LO, LO, LO, LNO
Gross external debt	2009	2/2010	A	A	A		

¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

² Both market-based and officially determined, including discount rates, money market rates, and rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I), Not Available (NA).

⁷ Reflects the assessment provided in the data ROSC or the Substantive Update (published in April 2008, and based on the findings of the mission that took place during September 1–28) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

⁸ Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Annex V. Mongolia—Millennium Development Goals

	1995	2000	2005	2008
Goal 1: Eradicate extreme poverty and hunger				
Employment to population ratio, 15+, total (%)	52	51	52	52
Employment to population ratio, ages 15-24, total (%)	42	39	36	35
GDP per person employed (constant 1990 PPP \$)	..	..	..	..
Income share held by lowest 20%	7.0	7.0	7.0	7.0
Malnutrition prevalence, weight for age (% of children under 5)	..	12.0	5.0	..
Poverty gap at \$1.25 a day (PPP) (%)	5	4	6	0
Poverty headcount ratio at \$1.25 a day (PPP) (% of population)	19	15	..	2
Vulnerable employment, total (% of total employment)	..	57	60	..
Goal 2: Achieve universal primary education				
Literacy rate, youth female (% of females ages 15-24)	..	98	..	97
Literacy rate, youth male (% of males ages 15-24)	..	97	..	93
Persistence to last grade of primary, total (% of cohort)	..	89	84	95
Primary completion rate, total (% of relevant age group)	74	90	95	93
Total enrollment, primary (% net)	86	97	90	99
Goal 3: Promote gender equality and empower women				
Proportion of seats held by women in national parliaments (%)	8	8	7	4
Ratio of female to male primary enrollment (%)	105	102	100	99
Ratio of female to male secondary enrollment (%)	137	122	111	108
Ratio of female to male tertiary enrollment (%)	232	176	160	157
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	47.9	50.4	53.1	53.1
Goal 4: Reduce child mortality				
Immunization, measles (% of children ages 12-23 months)	85	92	97	97
Mortality rate, infant (per 1,000 live births)	61	49	33	26
Mortality rate, under-5 (per 1,000)	82	63	41	31
Goal 5: Improve maternal health				
Adolescent fertility rate (births per 1,000 women ages 15-19)	..	10	13	16
Births attended by skilled health staff (% of total)	..	97	99	100
Contraceptive prevalence (% of women ages 15-49)	65	67	66	66
Maternal mortality ratio (modeled estimate, per 100,000 live births)	110	93	79	65
Pregnant women receiving prenatal care (%)	..	97	99	89
Unmet need for contraception (% of married women ages 15-49)	..	..	14	..
Goal 6: Combat HIV/AIDS, malaria, and other diseases				
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	..	..	..	..
Condom use, population ages 15-24, female (% of females ages 15-24)	..	..	..	..
Condom use, population ages 15-24, male (% of males ages 15-24)	..	..	..	..
Incidence of tuberculosis (per 100,000 people)	210	210	210	210
Prevalence of HIV, female (% ages 15-24)	..	..	..	..
Prevalence of HIV, male (% ages 15-24)	..	..	0	0
Prevalence of HIV, total (% of population ages 15-49)	..	..	0	0
Tuberculosis case detection rate (all forms)	60	63	88.0	83.0
Goal 7: Ensure environmental sustainability				
CO2 emissions (kg per PPP \$ of GDP)	2.0	2.0	1.0	1
CO2 emissions (metric tons per capita)	3.0	3.0	3.0	4
Forest area (% of land area)	7	7	7	7
Improved sanitation facilities (% of population with access)	49	49	49	50
Improved water source (% of population with access)	59	66	73	76
Terrestrial protected areas (% of total surface area)	..	..	..	14.0
Goal 8: Develop a global partnership for development				
Net ODA received per capita (current US\$)	92	91	84	93
Debt service (PPG and IMF only, % of exports, excluding workers' remittances)	10	6	3	2
Internet users (per 100 people)	0	1	11	13
Mobile cellular subscriptions (per 100 people)	0	6	22	67
Telephone lines (per 100 people)	3	5	6	8

Source: World Bank, World Development Indicators database.

ANNEX VI. MONGOLIA—MAIN WEBSITES OF DATA**National Statistics Office (www.nso.mn)**

- National Accounts
- Consumer Price Inflation
- Agricultural and Industrial Production
- Petroleum Imports
- Electricity Production and Consumption
- Coal Production
- Retail Prices
- Employment
- Exports and Imports

Bank of Mongolia (www.mongolbank.mn)

- Monetary Survey
- Consolidated Balance Sheet of Commercial Banks
- Distribution of Bank Credit to the Nongovernment Sector
- Net Credit to Government
- Interest Rates
- Balance of Payments
- Services and Income Accounts
- Official Reserves of the Bank of Mongolia
- Selected Indicators of Commercial Bank Foreign Exchange Operations
- Nominal and Real Exchange Rates
- Securities Market Data
- Government Budget Accounts

Ministry of Finance (www.mof.gov.mn)

- Government Budgetary Operations

National Development and Innovation Committee (www.ndic.gov.mn)

- Long- and medium-term development strategy
- Economic and social policies
- Investment policy coordination
- Development Bank of Mongolia

Financial Regulatory Commission (www.frc.mn)

- FRC decisions
- Total assets of regulated entities (insurance companies, securities and broker firms, non-bank financial institutions, savings and credit unions)
- Consolidated income statements of regulated entities (insurance companies, securities and broker firms, non-bank financial institutions, savings and credit unions)

INTERNATIONAL MONETARY FUND
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MONGOLIA

Joint IMF/World Bank Debt Sustainability Analysis Under the Debt Sustainability Framework for Low-Income Countries¹

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Mongolia's risk of debt distress is low based on indicators of external and public debt. External and public debt ratios had risen during 2009 due to the government receiving front-loaded foreign financing to recover from major terms of trade shock in late 2008. With the economic recovery entrenched and a several large mining projects on the horizon, external and public debt ratios are projected to improve substantially over the medium term.

I. BACKGROUND

1. **This joint Debt Sustainability Analysis (DSA)² update reflects the latest fiscal developments and new assumptions on the development of the Tavan Tolgoi mine.** A landmark Fiscal Stability Law (FSL)³ was adopted in 2010 and adherence to it will help anchor fiscal discipline, prevent a repeat of boom-bust fiscal policy, and contribute toward achieving sustainable growth. Specifically the FSL calls for a 2 percent ceiling on the structural fiscal deficit, which is defined using smoothed mineral prices (based on a more

¹ The DSA has been produced jointly by the staffs of the International Monetary Fund and the World Bank, in consultation with the Asian Development Bank (AsDB) and the Mongolian authorities (Debt Management Department and Aid Coordination Department of the Ministry of Finance). The fiscal year for Mongolia is January–December.

² The DSAs presented in this document are based on the common standard low-income countries (LIC) DSA framework. Under the Country Policy and Institutional Assessment (CPIA), Mongolia is rated as a medium performer with an average rating of 3.4 between 2007–09, and the DSA uses the indicative threshold indicators for countries in this category. See “Debt Sustainability in Low-Income Countries: Proposal for an Operational Framework and Policy Implications” (<http://www.imf.org/external/np/pdr/sustain/2004/020304.htm> and IDA/SECM2004/0035, 2/3/04), “Debt Sustainability in Low-Income Countries: Further Considerations on an Operational Framework, Policy Implications” (<http://www.imf.org/external/np/pdr/sustain/2004/091004.htm> and IDA/SECM2004/0629, 9/10/04), and “Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief,” (8/11/06).

³ This is referred to as the Fiscal Responsibility Law in the IMF staff report.

than 10 year moving average) to calculate revenue, limits expenditure growth, and has a ceiling on debt (Box 1). The projections also incorporate updated assumptions on development of Tavan Tolgoi and fiscal projections based on the 2011 budget.

Box 1: Three Ceilings in the FSL

- *The floor of structural balance is the deficit of 2 percent of GDP.* The structural balance is calculated by using the moving average price of major minerals—currently copper and coal—over 16 years (past 12 years, current year, and future three years). This provision takes effect in 2013.
- *The ceiling of expenditure growth is the non-mineral GDP growth rate,* determined as the greater between its 12-year moving average value and the budget year’s GDP growth rate. This provision takes effect in 2013.
- *Net present value of public debt cannot exceed 40 percent of GDP.* This excludes any borrowing in which the government has agreed to contribute into the paid-in capital of a foreign invested mining entity and which is repayable from the future profits of the entity.⁴ The provision takes effect from 2014, with a transition period specified for the preceding years.

2. Mongolia’s stock of external debt as of end-2009 stood at US\$2.1 billion

(46 percent of GDP). This includes public or publicly guaranteed debt (PPG) of US\$2.0 billion as reported by the Ministry of Finance (MoF) and estimated private external debt of US\$0.1 billion. Most of

Mongolia’s public debt is external with about 63 percent

of external debt contracted with multilateral creditors on concessional terms, 33 percent with official bilateral creditors on relatively concessional terms, and 4 percent with commercial banks.

Mongolia: Structure of External Public Debt

	End-2009 Nominal		End-2009 Present Value
	USD mn	% of GDP	
Public debt	1,977	43.3	1,452
Multilaterals	1,253	27.4	878
IMF	182	4.0	160
World Bank	392	8.6	239
AsDB	627	13.7	447
Official bilaterals	650	14.2	494
Paris Club	508	11.3	380
Non-Paris Club	142	3.1	114
Commercial	75	1.6	80

Sources: Mongolian Ministry of Finance; AsDB; WB; and IMF staff estimates.

⁴ Although no government guarantees arising from public-private partnerships and development banks have yet been issued, they are required to be treated as part of the public debt stock.

3. **As in the previous DSA, the medium-term macroeconomic outlook remains bright, although an expansionary fiscal stance for 2011 poses a risk of overheating.** The economy has rebounded considerably since the last DSA, and growth has extended beyond the mineral sector to become more broad based. The IMF SBA-supported program was successfully completed on October 1, 2010. The overall fiscal balance recorded a small surplus at the end of 2010, the first since 2007, and international reserves are at an all time high. The growth profile has been updated in line with revised production estimates for the Oyu Tolgoi copper and gold mine and incorporation of the Tavan Tolgoi coal mine (Box 2). Government spending and the deficit are set to rise under the 2011 budget passed. The deficit will be financed through domestic borrowing, and prepayments from Oyu Tolgoi (US\$100 million) and Tavan Tolgoi (yet to be negotiated). A return to fiscal restraint is expected in 2012 as the budget transitions to the numerical targets set out under the FSL.

4. **This update continues to reflect the fiscalization of banking sector restructuring.** In 2010, the government issued bonds amounting to Tog 100 billion to recapitalize a bank. In 2011, the authorities plan to fiscalize the restructuring cost associated with Anod Bank, estimated to be around Tog 120 billion. No other costs of bank restructuring are included in the projections.

5. **During 2010, there have been some important improvements in debt management.** The MoF revised its debt management strategy, developing it as a formal medium-term strategy for 2010–12, which has been approved by Cabinet and published. In addition to external audits (including on performance), internal audits have also been introduced. Other key strengths in debt management include the provision of inputs on debt and borrowing from the debt management department during budget preparation, a clear separation between monetary policy and debt management, and information sharing between the MoF and the central bank. An area for improvement includes making more information publicly available. A Debt Management Performance Assessment is currently underway.

II. UNDERLYING DSA ASSUMPTIONS

6. **The baseline assumptions are similar to the previous DSA, but now include output from Tavan Tolgoi.** In particular, the assumptions of a strong institutional framework and macroeconomic policies to minimize Dutch Disease are maintained (Box 3). A restrained fiscal policy is projected over the medium to long term, supported by the FSL adopted in July 2010. As in the previous DSA, the baseline assumes that structural fiscal reforms including pensions, civil service, social transfers, and public investment management

Box 2. Mongolia—The Tavan Tolgoi Mining Project

Tavan Tolgoi is one of the largest undeveloped coking and thermal coal deposits in the world with total resources estimated in the range 6.0–6.5 billion tonnes. Development of the deposit, which is close to the border with China, would make Mongolia a major world coal producer. Initially, its development will increase equipment imports, FDI, and loan inflows, but soon after it will lead to a large increase in exports and corresponding improvement in the current account balance.

The deposit was discovered in the 1950s and drilled through the 1960s and 1970s, and during the economic transition, the area became available for private sector exploration. It was held initially by BHP but later acquired by Energy Resources LLC, a consortium of top Mongolian companies. In 2006, the government passed amendments to the Mineral Law creating a category of Strategic Deposits which included Tavan Tolgoi. These same amendments provided for the State to have a right to take up to 50 percent of any mine developed on deposits discovered using state-funded exploration.

In March 2008 the government assumed ownership of the majority of the Tavan Tolgoi deposit from Energy Resources LLC and placed the asset into a state-owned mining company: Erdenes MGL LLC. In 2009, expressions of interest were sought from major mine developers to take up a 49 percent interest in the deposit but these were not successful and in early 2010 the government announced that it would retain 100 percent ownership of the resource, seeking to enter into contract mining arrangements to develop the mine.

The government plans to develop the deposit initially in two different blocks, each potentially operating under different contracting arrangements. The first block is to be developed by Erdenes Tavan Tolgoi LLC, a wholly-owned subsidiary of Erdenes MGL, which will own and market the coal produced under a fee based contract. It is not clear yet how the infrastructure and working capital for the development of this first block will be financed. Currently Energy Resources LLC and Tavan Tolgoi LLC are exporting close to 3 million tonnes per year. Production is expected to quickly ramp up to over 10 million tonnes per year by 2014.

The second block is planned to be developed under a contract where the developer invests in the mine infrastructure, markets the coal independently, and provides a share of production to the license holder. Essentially the government would not have to provide any financing to develop the mine. The Minister for Mineral Resources and Energy recently stated that selection of this second contractor would also take into account infrastructure and possible downstream processing issues supporting the mine development. Key challenges include the completion of a draft contract and the competitive bidding process.

Source: World Bank.

Box 3. Mongolia—Macroeconomic Assumptions

The baseline macroeconomic framework assumes that the economy will be underpinned by the investment in the Oyu Tolgoi copper and gold mine and an expansion in output from the Tavan Tolgoi coal mine. The construction and exploitation of Oyu Tolgoi and Tavan Tolgoi are expected to lead to significant structural changes in the economy.

- The outlook for **real GDP growth** is dominated by Oyu Tolgoi and Tavan Tolgoi. The scaling up of mining will increase mineral GDP and will have significant knock-on effects on other sectors through a reallocation of resources and changes in relative prices. After bottoming out at minus 1.3 percent in 2009, real GDP growth hit 6.1 percent in 2010, fueled by mineral exports notably for copper and coal. Production from the Oyu Tolgoi mine is expected to start by 2013, while that from Tavan Tolgoi is expected to be gradually scaled up and to reach full capacity by 2016. GDP growth is expected to rise to over 20 percent in 2013 mainly as Oyu Tolgoi comes on stream and a further boost to GDP is expected when Tavan Tolgoi reaches full capacity. Real GDP growth is expected to average 13 percent over the medium term (2013–18), taking into account the impact on the non-mineral economy.
- The **copper and coal price** projections through 2016 are based on the WEO projections as of **December 17, 2010** and are assumed constant in real terms afterwards, but take into account transportation costs for Mongolia which reduce the price received by the country.
- In the near term, with the economy currently operating close to capacity and an expansionary fiscal stance envisaged for 2011, **inflation** will rise sharply in the near term. But with medium-term fiscal sustainability ensured by the FSL, and a tightening of monetary policy, it is projected to converge to about 5 percent over the long term.
- The **balance of payments** will go through large swings. The current account will remain in a deficit of around 14 percent in 2011 and 2012 due to large imports of mining-related investment goods and partly as expansionary fiscal policy feeds into higher non-mineral sector related imports. Once the Oyu Tolgoi and Tavan Tolgoi projects start producing, the current account will jump into a large surplus.
- **The fiscal deficit is expected to converge to the numerical targets specified in the FSL starting from 2013 (when the structural deficit and spending growth rules take effect).** **Fiscal revenues** will be boosted by the Oyu Tolgoi and Tavan Tolgoi project and are expected to reach around 35.5 percent of GDP in 2020. The Fiscal Stability Law will reduce pro-cyclicality by restraining **expenditure** growth during periods of high mineral revenues and enable the authorities to save a substantial fraction of mineral revenues in a Stabilization Fund to be established in 2011. As a result, the overall balance would gradually converge from surpluses to around zero by 2030.
- Prepayments for budget support from Tavan Tolgoi in 2011 are included, in line with the 2011 budget financing plans. The terms and repayment are assumed identical to those for Oyu Tolgoi.

reforms will contribute to an improved business climate and overall competitiveness of the economy.⁵

7. **With Mongolia rapidly moving towards middle-income status, non-concessional financing will replace concessional lending.** As the large mining projects come on stream, Mongolia is expected to become eligible for non-concessional borrowing from both the International Bank for Reconstruction and Development and the Asian Development Bank (AsDB), which would be phased in starting in 2013. After that point, the grant element of new external borrowing—as reflected by the grant-equivalent financing component—is projected to decline from 35 percent in 2011 to 24 percent by 2030.⁶ Interest rates reflect International Development Association (IDA) blend terms and AsDB terms for concessional borrowing and market conditions for commercial loans (although, with global financial markets still uncertain, present conditions on the international capital markets for low-rated, first-time issuers may not be favorable).

III. DEBT SUSTAINABILITY

A. External DSA

8. **Mongolia remains at low risk of debt distress.** A brighter medium-term macroeconomic outlook supported by a big increase in mineral production means that debt indicators remain below the relevant thresholds.⁷ This is mainly due to the fact that the country is undergoing a major structural shift with real GDP growth expected to rise sharply over the medium term with a concomitant impact on exports and revenues. The debt stock also falls sharply from 2013 as loan repayments come due, in particular to the Fund. The present value (PV) of external public debt is forecast to fall from 22.4 percent in 2010 to 6.4 percent of GDP at the end of the projection period.⁸

⁵ Note that in contrast to the previous DSA, current mineral GDP estimates are based on more improved mineral export methodology rather than mineral production estimates.

⁶ The process for IDA transition begins when a country exceeds its operational per capita income guidelines for a few years in a row. In Mongolia's case, 2009 was the third year in a row that it exceeded the minimum cutoff.

⁷ The *Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries* defines a “low risk of debt distress” when: All debt indicators are well below relevant country-specific debt-burden thresholds. Stress testing and country-specific alternative scenarios do not result in indicators significantly breaching thresholds. In case where only one indicator is above its benchmark, judgment is needed to determine whether there is a debt sustainability problem or some other issues.

⁸The debt burden thresholds for medium policy performer are 150, 40, and 250 for the PV of debt in percent of exports, GDP, and revenue, respectively. Under the same medium policy classification, thresholds for debt service are 20 percent and 30 percent of exports and revenue, respectively.

9. **Stress tests do not indicate any breach of the relevant debt thresholds.** Under the most extreme test—a combination of shocks including real GDP and export growth one-half of a standard deviation below historical averages in 2011–12—the PV of debt-GDP ratio climbs to 39 percent in 2012 but then falls back over the remainder of the projection period. As indicated in the previous DSA, the historical scenario with key variables at their historical averages is not especially relevant to Mongolia as the country is undergoing a major structural shift in terms of real GDP growth and current account balance. With the development of the Oyu Tolgoi mine advancing well, a slight delay in the Tavan Tolgoi mine reaching full capacity should not significantly impact the risk assessment.

B. Public DSA

10. **Baseline.** The public debt ratio peaked in 2009 at just below 50 percent of GDP, and is projected to fall substantially over the medium term as the budget benefits directly and indirectly from the increase in mineral output. Debt rose last year, in part, due to loans to the government from the local subsidiary of the Oyu Tolgoi mining conglomerate to finance the government’s investment share in Oyu Tolgoi; the 2011 budget plan includes advance payments from both Oyu Tolgoi and Tavan Tolgoi. The investment share borrowing will be repaid from expected dividends⁹ and the prepayments from the general budget. The baseline includes fiscalization of banking sector restructuring costs through domestic bond issuances, as described above. As a result, public sector domestic debt service ratios are projected to increase around 2014 when these payments fall due.

11. **Alternative scenarios and stress tests.** Under the most extreme test— GDP growth in 2011–12 is one standard deviation below its historical average —the PV of debt-GDP ratio rises from 35 percent in 2010 to 63 percent in 2030. In the near term it is more likely that the economy will overheat given budgetary spending plans for 2011, but downside risks still remain relating to volatility in commodity prices. This suggests that, before increased output and revenues from Oyu Tolgoi and Tavan Tolgoi materialize, fiscal policy should continue to adhere to the framework set out in the FSL.

IV. AUTHORITIES’ VIEW

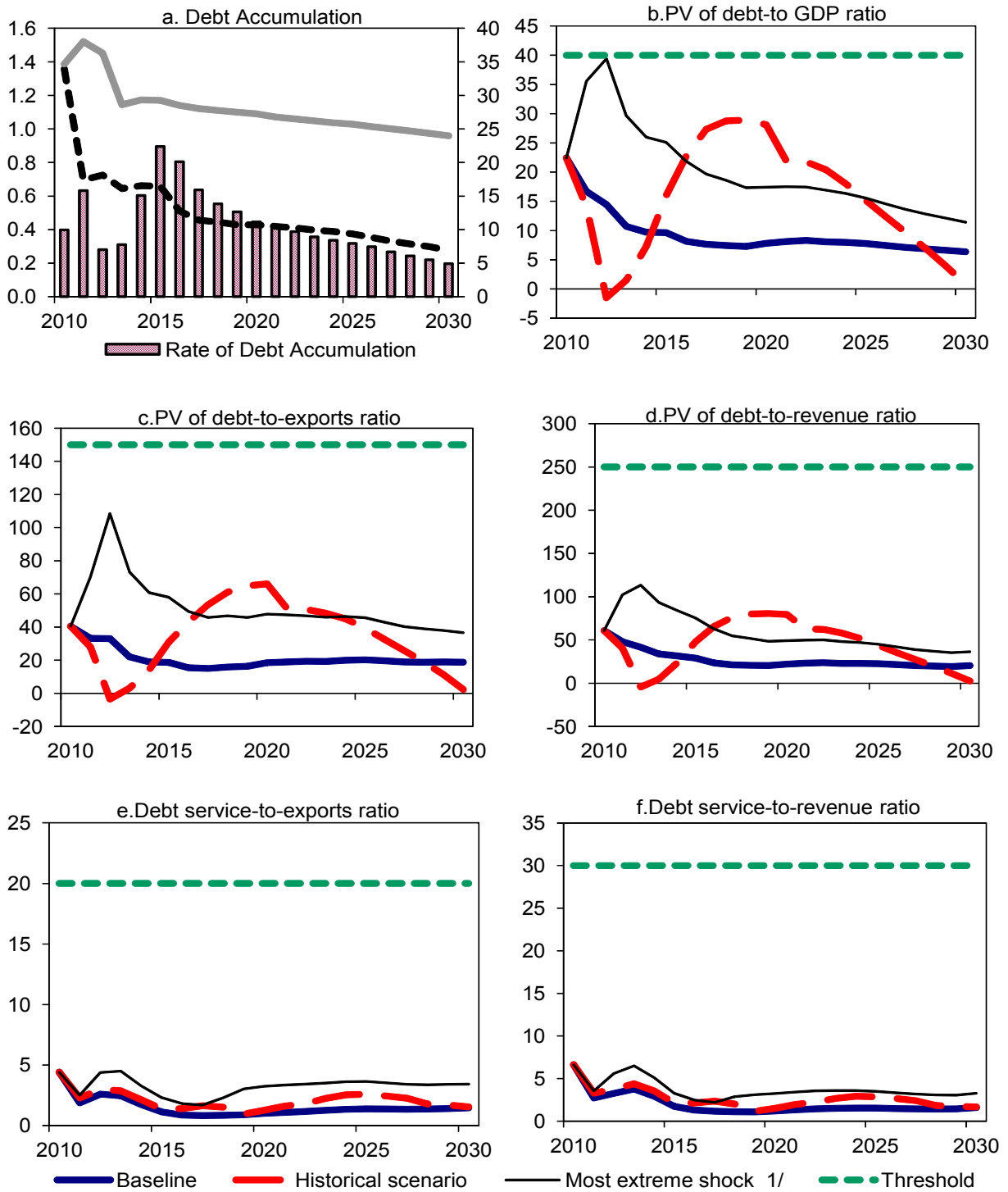
12. **The authorities concurred with the overall assessment.** They acknowledged that the bridging period till revenues from Oyu Tolgoi and Tavan Tolgoi enter the budget warrants a cautious approach and that fiscal consolidation will be needed. They recognized that high public debt makes the economy vulnerable to commodity price changes or financing constraints. At the same time, they also acknowledged that a debt ceiling rule in the FSL will help prevent excessive borrowing and that adherence to the numerical targets in the FSL will reinforce the government’s commitment to fiscal sustainability.

⁹ The government will not be liable for the loan in the unlikely event that dividends are insufficient.

V. CONCLUSIONS

13. **The overall assessment has not changed since the last DSA and the external DSA indicates that Mongolia remains at low risk of external debt distress.** Compared to the previous DSA, the overall medium- to long-term macroeconomic outlook has improved, as development of Tavan Tolgoi becomes nearer and is thus included in the projections. However, short-term risks remain, notably the budget remains vulnerable to financing shocks in the period before increased mining production (2013) and the expansionary 2011 fiscal stance risks overheating the economy. Meanwhile, public debt ratios are projected to have peaked last year and then fall steadily over the medium term with the rapid growth in the economy. They do not lead to a different assessment from external DSA.

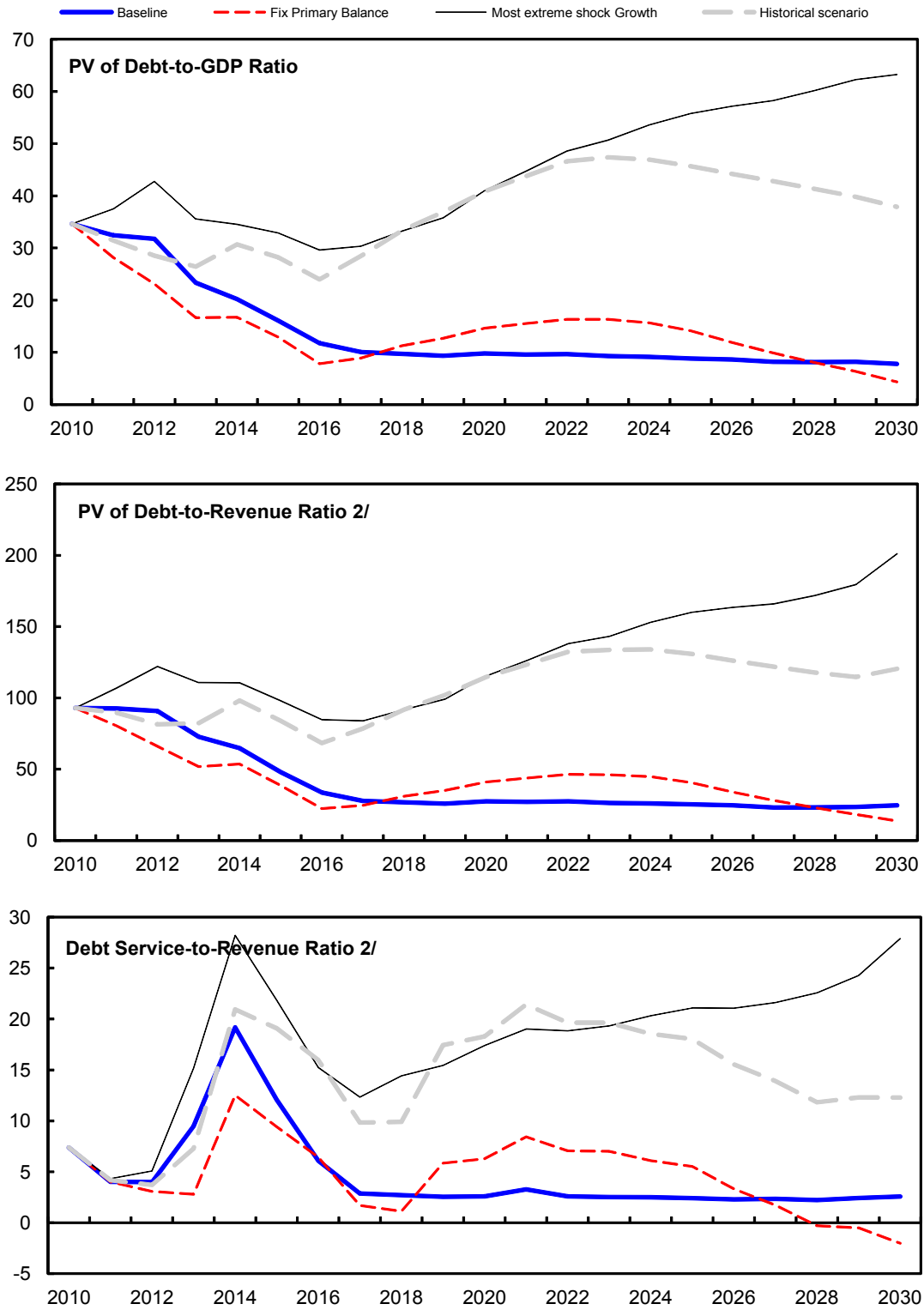
Figure 1. Mongolia: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2010-30 1/



Sources: Mongolian authorities; and IMF staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2020. In Figure b, it corresponds to a combination of shocks; in c, to a exports shock; in d, to a combination of shocks; in e, to a exports shock; and in f, to a combination of shocks.

Figure 2. Mongolia: Indicators of Public Debt Under Alternative Scenarios, 2010-30 1/



Sources: Mongolian authorities; and IMF staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2020 (growth).

2/ Revenues are defined inclusive of grants.

Table 1. Mongolia: External Debt Sustainability Framework, Baseline Scenario, 2007-30 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average	Standard 6/ Deviation	Projections									
	2007	2008	2009			2010	2011	2012	2013	2014	2015	2010-15 Average	2020	2030	2016-30 Average
External debt (nominal) 1/	37.2	31.8	45.9			41.6	42.9	55.1	40.9	30.9	25.8		12.1	8.1	
Of which: public and publicly guaranteed (PPG)	36.1	31.0	43.3			30.8	22.8	19.8	14.7	13.4	13.2		10.2	7.9	
Change in external debt	-4.4	-5.4	14.2			-4.4	1.3	12.2	-14.2	-10.0	-5.1		-0.5	-0.4	
Identified net debt-creating flows	-22.8	-11.1	5.3			-12.6	-1.0	5.7	-15.7	-13.9	-17.0		-7.6	-2.2	
Noninterest current account deficit	-6.6	12.6	8.5	2.7	6.8	14.7	14.8	13.2	-4.0	-7.8	-13.2		-6.8	-1.0	
Deficit in balance of goods and services	-2.5	14.3	7.8			9.1	15.3	13.2	-9.9	-16.1	-18.7		-11.9	-3.5	
Exports	59.6	53.5	49.9			55.3	50.3	43.6	48.8	51.3	51.7		42.5	33.9	
Imports	57.1	67.8	57.8			64.4	65.5	56.8	38.9	35.2	33.0		30.6	30.5	
Net current transfers (negative = inflow)	-5.1	-3.2	-2.6	-7.5	3.1	-2.5	-1.5	-1.3	-0.9	-0.7	-0.6		-0.4	-0.3	
Of which: official	-3.1	-1.5	0.0			-0.8	-0.3	-0.3	-0.2	-0.1	0.0		0.0	0.0	
Other current account flows (negative = net inflow)	1.0	1.5	3.3			8.1	1.0	1.3	6.8	9.0	6.1		5.5	2.9	
Net FDI (negative = inflow)	-8.5	-14.9	-10.8	-8.0	3.5	-25.7	-13.1	-5.2	-4.6	-2.5	-2.5		-1.0	-1.0	
Endogenous debt dynamics 2/	-7.6	-8.8	7.6			-1.6	-2.8	-2.3	-7.1	-3.5	-1.2		0.2	-0.3	
Contribution from nominal interest rate	0.4	0.3	0.4			0.5	0.3	0.4	2.2	1.9	1.3		0.3	0.1	
Contribution from real GDP growth	-3.4	-2.5	0.5			-2.1	-3.0	-2.7	-9.3	-5.4	-2.5		-0.1	-0.4	
Contribution from price and exchange rate changes	-4.5	-6.6	6.7			...	...	...	...	...	...		...	...
Residual (3-4) 3/	18.3	5.7	8.8			8.2	2.4	6.5	1.5	3.9	11.9		7.1	1.9	
Of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	34.4			33.1	36.8	49.8	36.9	27.3	22.3		9.6	6.6
In percent of exports	...	...	68.9			59.9	73.1	114.2	75.6	53.1	43.1		22.7	19.3
PV of PPG external debt	...	...	31.8			22.4	16.7	14.4	10.7	9.7	9.6		7.8	6.4
In percent of exports	...	...	63.6			40.5	33.2	33.1	22.0	19.0	18.6		18.4	18.8
In percent of government revenues	...	...	106.4			60.9	47.9	41.6	33.7	31.4	28.9		22.2	20.4
Debt service-to-exports ratio (in percent)	4.3	2.8	3.8			4.4	2.0	3.0	9.0	13.9	9.8		3.8	1.5	
PPG debt service-to-exports ratio (in percent)	2.0	2.0	3.8			4.4	1.9	2.6	2.5	1.8	1.1		1.0	1.5	
PPG debt service-to-revenue ratio (in percent)	3.2	3.3	6.3			6.6	2.7	3.3	3.8	2.9	1.8		1.2	1.6	
Total gross financing need (millions of U.S. dollars)	-531.9	-46.0	1.8			-502.5	272.4	1044.2	-542.5	-480.9	-1968.4		-2005.1	-779.8	
Noninterest current account deficit that stabilizes debt ratio	-2.2	18.0	-5.6			19.1	13.5	1.0	10.2	2.2	-8.1		-6.3	-0.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	10.2	8.9	-1.3	6.0	4.0	6.1	10.3	7.6	22.9	15.7	9.0		11.9	0.8	
GDP deflator in U.S. dollar terms (change in percent)	12.3	21.6	-17.4	10.0	11.7	26.2	27.8	14.3	10.8	3.1	1.3		13.9	1.6	
Effective interest rate (percent) 5/	1.1	1.1	1.2	1.6	0.6	1.4	0.9	1.0	5.4	5.4	4.7		3.1	2.4	
Growth of exports of G&S (U.S. dollar terms, in percent)	24.2	18.9	-23.8	17.1	20.7	48.4	28.0	6.7	52.5	25.4	11.1		28.7	-2.3	
Growth of imports of G&S (U.S. dollar terms, in percent)	28.5	57.4	-30.5	16.7	22.1	49.3	43.3	6.6	-6.6	7.9	3.3		17.3	1.9	
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	34.7	38.0	36.3	28.6	29.3	29.3		32.7	27.2
Government revenues (excluding grants, in percent of GDP)	37.5	32.9	29.9			36.8	34.8	34.7	31.8	31.0	33.3		35.3	31.3	
Aid flows (in millions of U.S. dollars) 7/	18.8	13.8	17.0			25.6	22.0	29.1	35.1	39.5	43.1		72.4	84.0	
Of which: Grants	18.8	13.8	17.0			25.6	22.0	29.1	35.1	39.5	43.1		72.4	84.0	
Of which: Concessional loans	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.4	0.7	0.7	0.6	0.7	0.7		0.4	0.3
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			43.5	49.2	47.8	39.2	38.8	38.6		42.7	38.9
Memorandum items:															
Nominal dollar GDP growth	23.8	32.4	-18.4			33.9	40.9	22.9	36.3	19.3	10.4		27.3	2.4	
PV of PPG external debt (in millions of U.S. dollars)	...	...	1452.1			1470.3	1509.0	1533.2	1566.1	1653.2	1807.5		2557.3	3796.4
(PV1-PV1-1)/GDPT-1 (in percent)	...	...	...			0.4	0.6	0.3	0.3	0.6	0.9		0.5	0.4
Gross remittances (Millions of U.S. dollars)	83.9	94.2	120.5			101.9	102.9	103.4	103.9	104.5	105.0		120.8	206.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	31.0			22.0	16.5	14.3	10.7	9.7	9.6		7.8	6.4
PV of PPG external debt (in percent of exports + remittances)	...	...	60.5			39.3	32.4	32.4	21.7	18.7	18.4		18.3	18.6
Debt service of PPG external debt (in percent of exports + remittances)	...	...	3.6			4.3	1.9	2.5	2.4	1.7	1.1		1.0	1.4

Sources: Mongolian authorities; and IMF staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - \rho(1+g)] / (1+g+\rho+gp)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Mongolia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2007-30
(In percent of GDP, unless otherwise indicated)

	Actual			Average	5/	Standard Deviation	5/	Estimate		Projections						
	2007	2008	2009					2010	2011	2012	2013	2014	2015	2010-15 Average	2020	2030	2016-30 Average
Public sector debt 1/	36.5	31.0	49.4					43.0	38.6	37.1	27.3	23.9	19.6		12.2	9.3
Of which: foreign-currency denominated	36.1	31.0	45.5					40.9	36.4	31.8	23.6	20.8	16.7		10.2	7.9
Change in public sector debt	-4.4	-5.5	18.4					-6.4	-4.5	-1.5	-9.8	-3.5	-4.3		0.5	-0.5
Identified debt-creating flows	-10.6	-2.2	8.7					-9.6	-8.2	-1.8	-10.6	-7.2	-3.4		-3.3	-0.2
Primary deficit	-3.1	4.2	4.6	0.6		4.1		-1.8	3.1	3.7	-1.8	-4.4	-1.8	-0.5	-3.6	0.3
Revenue and grants	37.9	33.1	30.2					37.2	35.1	35.0	32.1	31.2	33.5		35.5	31.4
Of which: grants	0.4	0.2	0.4					0.4	0.3	0.3	0.2	0.2	0.2		0.2	0.1
Primary (noninterest) expenditure	34.9	37.3	34.8					35.4	38.1	38.7	30.2	26.8	31.7		31.9	31.7
Automatic debt dynamics	-7.2	-6.3	4.5					-14.0	-11.3	-5.4	-8.8	-2.8	-1.6		0.3	-0.5
Contribution from interest rate/growth differential	-7.5	-8.6	7.5					-11.7	-12.0	-6.9	-8.6	-3.3	-1.6		-0.1	-0.5
Of which: contribution from average real interest rate	-3.7	-5.6	7.1					-8.8	-7.9	-4.1	-1.6	0.4	0.4		0.0	0.0
Of which: contribution from real GDP growth	-3.8	-3.0	0.4					-2.9	-4.0	-2.7	-6.9	-3.7	-2.0		-0.1	-0.5
Contribution from real exchange rate depreciation	0.3	2.3	-2.9					-2.3	0.6	1.4	-0.2	0.5	0.0		...	...
Other identified debt-creating flows	-0.4	-0.1	-0.4					6.3	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Privatization receipts (negative)	-0.4	-0.1	-0.4					0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0					0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Debt relief (HIPC and other)	0.0	0.0	0.0					0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Other (bank recapitalization)	0.0	0.0	0.0					6.3	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Residual, including asset changes	6.2	-3.3	9.7					3.2	3.8	0.3	0.8	3.7	-0.8		3.8	-0.3
Other Sustainability Indicators																
PV of public sector debt	0.4	0.0	37.9					34.6	32.4	31.8	23.3	20.2	16.1		9.8	7.8
Of which: foreign-currency denominated	0.0	0.0	34.0					32.5	30.3	26.5	19.6	17.1	13.2		7.8	6.4
Of which: external	...	...	31.8					22.4	16.7	14.4	10.7	9.7	9.6		7.8	6.4
PV of contingent liabilities (not included in public sector debt)	...	...	...					...	...	...	...	...	...		...	...
Gross financing need 2/	-1.0	6.0	6.5					3.1	4.5	5.1	1.2	1.6	2.2		-2.7	1.1
PV of public sector debt-to-revenue and grants ratio (in percent)	1.2	0.1	125.4					93.0	92.5	90.7	72.7	64.8	47.9		27.5	24.7
PV of public sector debt-to-revenue ratio (in percent)	1.2	0.1	126.9					94.0	93.2	91.4	73.3	65.3	48.3		27.7	24.8
Of which: external 3/	...	...	106.4					60.9	47.9	41.6	33.7	31.4	28.9		22.2	20.4
Debt service-to-revenue and grants ratio (in percent) 4/	5.5	4.5	6.4					7.4	4.0	4.0	9.5	19.2	12.1		2.6	2.6
Debt service-to-revenue ratio (in percent) 4/	5.5	4.5	6.5					7.5	4.0	4.0	9.6	19.3	12.2		2.6	2.6
Primary deficit that stabilizes the debt-to-GDP ratio	1.3	9.7	-13.9					4.6	7.6	5.2	8.0	-0.9	2.4		-4.1	0.8
Key macroeconomic and fiscal assumptions																
Real GDP growth (in percent)	10.2	8.9	-1.3	6.0		4.0		6.1	10.3	7.6	22.9	15.7	9.0	11.9	0.8	4.9
Average nominal interest rate on forex debt (in percent)	1.1	1.1	1.2	1.7		0.6		1.4	0.8	0.7	4.1	4.6	2.7	2.4	1.4	1.6
Real exchange rate depreciation (in percent, + indicates depreciation)	1.0	8.4	-7.6	-0.3		4.0		...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	11.6	21.4	1.8	13.3		6.7		18.0	14.1	8.9	9.7	3.7	4.4	9.8	5.6	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.5	0.2	-0.1	0.1		0.2		0.1	0.2	0.1	0.0	0.0	0.3	0.1	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	...		...		34.7	38.0	36.3	28.6	29.3	29.3	32.7	27.2	24.0

Sources: Mongolian authorities; and IMF staff estimates and projections.

1/ General government, on a gross basis.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium- and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 3a. Mongolia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2010-30
(In percent)

	Projections							
	2010	2011	2012	2013	2014	2015	2020	2030
PV of debt-to GDP ratio								
Baseline	22	17	14	11	10	10	8	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010-30 1/	22	14	-1	1	7	16	28	1
A2. New public sector loans on less favorable terms in 2010-30 2	22	18	15	12	11	11	9	9
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2011-12	22	19	16	12	11	11	9	7
B2. Export value growth at historical average minus one standard deviation in 2011-12 3/	22	27	32	24	21	20	14	8
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2011-12	22	23	22	16	14	14	11	9
B4. Net nondebt creating flows at historical average minus one standard deviation in 2011-12 4/	22	22	16	12	11	11	8	6
B5. Combination of B1-B4 using one-half standard deviation shocks	22	36	39	30	26	25	17	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	22	23	19	14	13	12	10	8
PV of debt-to-exports ratio								
Baseline	41	33	33	22	19	19	18	19
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010-30 1/	41	28	-3	3	14	31	66	2
A2. New public sector loans on less favorable terms in 2010-30 2	41	35	35	24	21	21	22	27
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2011-12	41	35	33	22	19	18	18	18
B2. Export value growth at historical average minus one standard deviation in 2011-12 3/	41	70	109	73	61	58	48	37
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2011-12	41	35	33	22	19	18	18	18
B4. Net nondebt creating flows at historical average minus one standard deviation in 2011-12 4/	41	43	37	25	21	20	19	19
B5. Combination of B1-B4 using one-half standard deviation shocks	41	65	73	49	41	39	33	27
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	41	35	33	22	19	18	18	18
PV of debt-to-revenue ratio								
Baseline	61	48	42	34	31	29	22	20
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010-30 1/	61	40	-4	5	24	48	80	3
A2. New public sector loans on less favorable terms in 2010-30 2/	61	51	43	36	34	33	27	30
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2011-12	61	54	47	39	35	32	24	23
B2. Export value growth at historical average minus one standard deviation in 2011-12 3/	61	76	93	76	69	61	39	27
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2011-12	61	65	63	51	47	43	32	30
B4. Net nondebt creating flows at historical average minus one standard deviation in 2011-12 4/	61	62	47	38	35	32	23	20
B5. Combination of B1-B4 using one-half standard deviation shocks	61	102	113	93	84	75	49	36
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	61	66	54	44	40	37	28	26

Table 3b. Mongolia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2010-30 (continued)
(In percent)

	Projections							
	2010	2011	2012	2013	2014	2015	2020	2030
Debt service-to-exports ratio								
Baseline	4	2	3	2	2	1	1	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010-30 1/	4	2	3	3	2	1	1	2
A2. New public sector loans on less favorable terms in 2010-30 2/	4	2	3	2	2	1	1	2
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2011-12	4	2	3	2	2	1	1	1
B2. Export value growth at historical average minus one standard deviation in 2011-12 3/	4	3	4	4	3	2	3	3
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2011-12	4	2	3	2	2	1	1	1
B4. Net nondebt creating flows at historical average minus one standard deviation in 2011-12 4/	4	2	3	3	2	1	1	2
B5. Combination of B1-B4 using one-half standard deviation shocks	4	2	4	3	3	2	2	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	4	2	3	2	2	1	1	1
Debt service-to-revenue ratio								
Baseline	7	3	3	4	3	2	1	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010-30 1/	7	3	4	4	4	2	2	2
A2. New public sector loans on less favorable terms in 2010-30 2/	7	3	3	4	3	2	2	2
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2011-12	7	3	4	4	3	2	1	2
B2. Export value growth at historical average minus one standard deviation in 2011-12 3/	7	3	4	5	4	2	3	3
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2011-12	7	4	5	6	4	3	2	2
B4. Net nondebt creating flows at historical average minus one standard deviation in 2011-12 4/	7	3	3	4	3	2	1	2
B5. Combination of B1-B4 using one-half standard deviation shocks	7	4	6	7	5	3	3	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	7	4	4	5	4	2	2	2
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	27	27	27	27	27	27	27	27

Sources: Mongolian authorities; and IMF staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), noninterest current account in percent of GDP, and nondebt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 4. Mongolia: Sensitivity Analysis for Key Indicators of Public Debt 2010-30

	Projections							
	2010	2011	2012	2013	2014	2015	2020	2030
PV of Debt-to-GDP Ratio								
Baseline	35	32	32	23	20	16	10	8
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	35	31	29	26	31	28	41	38
A2. Primary balance is unchanged from 2010	35	28	23	17	17	13	15	4
A3. Permanently lower GDP growth 1/	35	33	33	25	23	20	22	52
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-12	35	37	43	36	35	33	41	63
B2. Primary balance is at historical average minus one standard deviations in 2011-12	35	34	34	25	22	17	11	8
B3. Combination of B1-B2 using one half standard deviation shocks	35	34	33	27	26	24	29	44
B4. One-time 30 percent real depreciation in 2011	35	41	39	29	25	21	13	10
B5. 10 percent of GDP increase in other debt-creating flows in 2011	35	41	40	29	25	21	13	10
PV of Debt-to-Revenue Ratio 2/								
Baseline	93	93	91	73	65	48	27	25
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	93	90	81	82	98	84	115	120
A2. Primary balance is unchanged from 2010	93	80	66	52	54	39	41	14
A3. Permanently lower GDP growth 1/	93	94	94	78	73	58	62	165
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-12	93	107	122	111	111	98	115	201
B2. Primary balance is at historical average minus one standard deviations in 2011-12	93	96	97	78	69	52	30	27
B3. Combination of B1-B2 using one half standard deviation shocks	93	96	94	84	83	71	81	141
B4. One-time 30 percent real depreciation in 2011	93	118	113	91	82	62	36	33
B5. 10 percent of GDP increase in other debt-creating flows in 2011	150	182	179	181	192	158	74	36
Debt Service-to-Revenue Ratio 2/								
Baseline	7	4	4	9	19	12	3	3
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	7	4	4	7	21	19	18	12
A2. Primary balance is unchanged from 2010	7	4	3	3	13	9	6	-2
A3. Permanently lower GDP growth 1/	7	4	4	10	21	14	8	23
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-12	7	4	5	15	28	22	17	28
B2. Primary balance is at historical average minus one standard deviations in 2011-12	7	4	4	11	20	13	3	3
B3. Combination of B1-B2 using one half standard deviation shocks	7	4	4	9	20	17	12	19
B4. One-time 30 percent real depreciation in 2011	7	4	5	12	22	14	4	4
B5. 10 percent of GDP increase in other debt-creating flows in 2011	7	4	6	21	21	17	3	4

Sources: Mongolian authorities; and IMF staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.



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IMF Executive Board Concludes 2011 Article IV Consultation, Post Program Monitoring, and Ex Post Evaluation with Mongolia

On March 16, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation, Post Program Monitoring, and Ex Post Evaluation with Mongolia.¹

Background

The Mongolian economy was hit hard by the global economic crisis, due to its high dependence on mineral exports and a history of pro-cyclical macroeconomic policies. By early 2009, the economy was on the verge of collapse: the central bank was running out of international reserves, the budget deficit was not financed, inflation was in the double-digits, and the banking system was under stress. An 18-month Stand-by Arrangement (SBA) was approved on April 1, 2009, which succeeded in quickly stabilizing the economy thanks to the authorities' steadfast policy implementation, financial support from the donor community, and a rebound in global copper prices.

Growth rebounded strongly in 2010 and reached 6 percent. This recovery is all the more impressive in light of the severe winter that led to a sharp contraction in agriculture, especially animal husbandry. The shock to food supply, however, helped drive inflation into the double digits for much of the year, led by rising meat prices. Higher copper prices and a rapid increase in coal production are fueling strong export growth that has helped boost international reserves to an all-time high.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Growth this year is projected to remain strong and accelerate to around 10 percent. The large increase in fiscal spending underway, however, is creating excess demand that will result in higher inflation and surging imports. The medium-term growth prospects continue to be favorable, as production from two large mining projects is expected to start by 2013 and lead to a substantial increase in output.

In accordance with IMF procedures, the Executive Board also reviewed an Ex Post Evaluation (EPE) of Mongolia's experience with the exceptional access Stand-By Arrangement (SBA) approved in April 2009, the first Fund SBA in Asia since the Asian financial crisis. The EPE focused on program design and implementation, as well as key lessons from the experience. The report found that the SBA contributed to stabilizing a rapidly deteriorating macroeconomic situation during the global crisis, as well as facilitating structural reforms to strengthen the policy framework. Lessons learned include that large financing packages, combined with appropriately streamlined conditionality, can effectively stabilize crises; that timely technical assistance can greatly facilitate program implementation; and that securing a durable commitment to post-program reforms remains a future challenge.

Executive Board Assessment

Executive Directors welcomed the turnaround in economic growth following the completion of the Fund-supported program. Directors observed, however, that pro-cyclical policies are undermining hard-won macroeconomic stability, and overheating has become a key policy concern. This calls for fiscal restraint and tightened monetary conditions. Looking ahead, Directors considered that medium-term prospects are favorable but that a prudent management of Mongolia's vast mineral resources is necessary for sustainable growth and lasting prosperity.

Directors expressed concern that the large increase in fiscal spending envisaged for this year will further drive up inflation, with an adverse impact on the poor. They called on the authorities to amend the 2011 budget and cut public spending to bring the fiscal stance back in line with the cyclical requirements and the medium-term objectives of the Fiscal Responsibility Law. Directors also considered the adoption of a better targeted social transfer system to be a priority for the period ahead. Noting the potential for large quasi-fiscal liabilities, they urged caution with the planned establishment of a development bank, the provision of government guarantees, and the implementation of public-private partnerships.

Directors saw considerable scope for a more proactive monetary management to curb inflation, starting with an immediate hike in the policy interest rate. They also generally supported a move over the medium term toward a monetary framework with a more explicit focus on inflation. Measures to improve liquidity management and the economy's capacity to absorb capital inflows are also necessary.

Directors agreed that the flexible exchange rate regime has worked well. They welcomed the authorities' commitment to allow the exchange rate to adjust with market conditions, noting its benefits in providing a cushion against external shocks and the structural

changes underway. Directors encouraged the authorities to remove the remaining multiple currency practices as soon as conditions permit.

Directors welcomed progress in strengthening financial oversight and implementing the recommendations of the Financial Sector Assessment Program. They highlighted the importance of strict enforcement of existing regulations, and looked forward to the enactment of a law governing the provision of public support for bank restructuring and recapitalization. Directors also encouraged an early establishment of a deposit insurance system to replace the blanket deposit guarantee.

Directors concurred with the key messages of the ex post evaluation report. They noted that the Stand-By Arrangement had helped alleviate the effects of external shocks, by combining strong policy adjustment and a front-loaded use of Fund resources, catalyzing donor support for Mongolia. Advances had also been made in structural reforms. Going forward, Directors urged sustained efforts to complete the reforms initiated under the program in order to strengthen the resilience of the Mongolian economy. They welcomed the authorities' intention to remain closely engaged with the Fund under post-program monitoring.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Mongolia: Selected Economic and Financial Indicators, 2009–12

	2009	Prel. 2010	Proj. 2011	2012
Real sector		(Percent change)		
Real GDP growth	-1.3	6.1	10.3	7.6
Mineral	2.3	9.0	13.4	12.6
Non-mineral	-2.6	5.0	9.0	5.5
Consumer prices (period average)	6.3	10.2	16.4	16.0
Consumer prices (end-period)	1.9	14.3	20.0	12.0
GDP deflator	1.8	18.0	14.1	8.9
General government budget		(In percent of GDP)		
Revenue and grants	30.2	37.2	35.1	35.0
Expenditure and net lending	35.2	36.0	38.5	38.9
Current balance	2.6	9.4	4.4	6.8
Primary balance	-4.5	1.7	-3.1	-3.7
Overall balance (including grants)	-5.0	1.2	-3.5	-3.9
Non-mineral overall balance	-11.8	-10.6	-13.3	-11.8
Structural balance 1/	-6.8	-2.8	-6.3	-6.5
Money and credit		(Percent change)		
Broad money	26.9	61.6	45.0	23.5
Broad money velocity (GDP/BM)	2.3	1.8	1.5	1.5
Interest rate on 7-day central bank bills, end-period (percent)	10.0	11.0	...	...
Balance of payments		(In millions of US\$)		
Current account balance (including official transfers)	-410	-931	-1,302	-1,438
(In percent of GDP)	-9.0	-15.2	-15.1	-13.6
(In percent of GDP, excluding mining related imports)	-5.8	-5.8	2.5	0.1
Trade balance	-194	-278	-1,049	-1,107
Exports	1,876	2,899	3,825	4,083
Imports	-2,070	-3,177	-4,874	-5,190
Foreign direct investment	496	1,574	1,130	548
Gross official international reserves (end-period)	1,328	2,290	3,586	4,127
(In months of next year's imports of goods and services)	4.1	4.9	7.1	8.8
Trade prices				
Export prices (US\$, percent change)	-18.2	29.0	9.8	-1.4
Import prices (US\$, percent change)	-18.0	13.2	7.4	0.5
Terms of trade (percent change)	-0.2	14.0	2.3	-1.9
Public and publicly guaranteed debt		(In percent of GDP)		
Total public debt	46.6	43.0	38.6	37.1
Domestic debt 2/	3.4	12.2	15.8	17.3
External debt	43.3	30.8	22.8	19.8
(In millions of US\$)	1,977	2,023	2,064	2,097
Exchange rate				
Togrogs per US\$ (end-period)	1,443	1,259	...	...
Togrogs per US\$ (period average)	1,441	1,348	...	...
Nominal effective exchange rate (end-period; percent change)	-15.8	3.4	...	...
Real effective exchange rate (end-period; percent change)	-11.1	11.3	...	...
Nominal GDP (In billions of togrogs)	6,591	8,255	10,382	12,166

Sources: Mongolian authorities; and IMF staff projections.

1/ As defined in the Fiscal Responsibility Law, which uses smoothed instead of actual commodity prices to calculate revenue.

2/ Domestic debt in 2009 includes the Oyu Tolgoi tax-prepayment while the estimates for 2010 and the projections for 2011 additionally include the estimated fiscalization cost of bank restructuring and the financing of the government's equity share in Oyu Tolgoi.

**Statement by Heenam Choi, Alternate Executive Director for Mongolia
and Hoseung Lee, Senior Advisor
March 16, 2011**

The Mongolian economy has made a remarkable turnaround fueled by investment in the mining sector and rebound of copper and coal prices, following a sharp drop in the output in late 2008 and early 2009. The 18-month Stand-By Arrangement (SBA) for Mongolia completed successfully in October 2010. The 2011 Article IV Consultation took place against the backdrop of such a strong recovery and emerging signs of overheating. Discussions focused on the policies for avoiding a return to the boom and bust policies of the past and for ensuring the country's huge mineral deposits lead to sustainable and equitable growth. The authorities concede the risks to the outlook and share the staff's policy advice. They are trying to respond preemptively to rising inflation and capital inflows through fiscal, monetary and macro-prudential policy measures accompanied by structural reforms.

Recent Developments

Growth rebounded strongly in 2010 to 6.1 percent, following an outturn of minus 1.3 percent in 2009. The 2010 growth is a lot more impressive, given the fact that the last year's devastating winter conditions (a so-called "dzud") wiped out almost one-fourth of livestock. The shock to food supply, however, drove inflation into double digits, with January data showing a rise in the headline inflation to 14.8 percent year on year, following 14 percent increase in the previous month. Higher copper prices and surging coal exports to China have helped boost net international reserves to an all time high.

Outlook

This year's growth is projected to accelerate to around 10 percent, driven by the construction of the Oyu Tolgoi copper mine and related infrastructure projects, as well as base effects favorable to agricultural sector, accounting for over 20 percent of GDP. On the inflation front, the staff expected that inflation could reach 20 percent by year-end due to a combination of rising global food prices, expansionary 2011 budget, including cash handouts to the population, and mineral sector boom. On the other hand, the authorities expected that inflation might remain within 12 to 20 percent range, while they understood the high risks to inflation. They are planning to update their inflation forecast and adjust the scope and pace of policy response after confirming the inflation data of early months of 2011. The most recently released inflation data is 10.9 percent for February on a year on year basis.

Fiscal Policy

1. **2011 Budget.** The 2011 budget approved 35 percent increase in nominal spending. The staff claimed that the large increase in spending would do more economic harm than good through higher inflation and crowding out private sector activity. The authorities acknowledge that such an expansion of government expenditures may

have negative effects on macroeconomic stability. However, they view that they have made their efforts to secure medium-term fiscal sustainability under inevitable political pressure on spending increase, which had largely been incurred by the promise of the previous election campaign. Furthermore, the authorities are planning to amend the 2011 budget to secure more fiscal restraint if inflationary risks are aggravated. They are also committed to meeting the numerical target for structural budget deficit of 2 percent of GDP in 2013. When considering that universal cash transfers are increased by around 4 percent of GDP in 2011, and that those cash transfers will be expired after the 2012 elections, they have ample room to achieve the needed fiscal adjustment.

2. **Medium-term Fiscal Framework.** The adoption of the Fiscal Stability Law (FSL) last year was a landmark achievement for avoiding the boom and bust policies of the past. The staff assessed that the 2011 budget could be a big step backward and it could undermine the law's credibility. On the other hand, the authorities indicated that they are still committed to observing the FSL to enhance medium-term fiscal credibility and sustainability. They have tried to balance the economic and political considerations under the great pressure to show tangible benefits from the signing of the Oyu Tolgoi investment agreement in the aftermath of the hardship from the crisis. As shown in Debt Sustainability Analysis (DSA), Mongolia remains low risk of debt distress supported by a bright medium and long-term macroeconomic outlook, and public debt ratios are projected to fall steadily from 2011. In addition, the authorities have greatly improved debt management through introduction of internal audits, clear separation between monetary policy and debt management, and information sharing between the Ministry of Finance and the Bank of Mongolia.
3. **Structural Fiscal Reform.** Mongolia has made significant progress in improving budget transparency, but there is still a considerable room for improvement in public investment management. Several draft laws on public finance issues – the Integrated Budget Law and the Law on Development Policy and Planning, and a revised Law on Public Procurement – are under discussion, and implementation of public-private-partnerships (PPPs) is being considered. The authorities also plan to establish a Development Bank during this year. The bank will use a portion of the proceeds from the Fiscal Stability Fund to finance the country's essential infrastructure needs. The authorities concur with staff that PPPs and the Development Bank should not be used as a measure to increase off-budget activities and should be set up based on international good practices and transparency. On the other hand, the approval of the Social Transfer Reform Law, which was submitted to the parliament last year, will substantially strengthen the social safety net through introduction of a more targeted poverty benefit transfer system.

Monetary Policy

Although the Bank of Mongolia well recognizes the threat of escalating inflation, there are some limits to what monetary policy can contain inflation, given the substantial increase in fiscal spending and considerable pressure of capital inflows. The staff assessed that the crowding out effect of higher interest rate, while undesirable, would be better than the alternative of allowing inflation pressures to build up further. They supported giving the central bank a more explicit mandate to make inflation the primary objective of monetary policy. The central bank has sought to strike the right balance between various measures in its toolkit for combating inflation and managing capital inflows, which includes increasing reserve requirements of banks, raising the policy rate, and allowing greater exchange rate flexibility. In its meeting at the end of February, the Bank of Mongolia Board decided to keep the policy rate unchanged and increase the rate of reserve requirements by 400 basis points to 9 percent in order to tighten monetary policy stance and strengthen the banking sector's risk-resistance.

Exchange Rate Policy

The central bank has been trying to dampen excess volatility in exchange rate stemming from large and volatile capital inflows. The real appreciation of the Mongolian currency (MNT) last year was about 20 percent, which was helpful in reducing inflation. The exchange rate has been fairly stable this year, and foreign reserves have been maintained at an all time high. The authorities concur with staff that the flexible exchange rate regime will continue to be appropriate for the Mongolian economy, in terms of containing inflationary pressure and providing a buffer to external shock. At the same time, they are looking for structural ways to enhance the absorptive capacity of the economy and harness capital flows to support productive investment and potential growth through deepening financial markets and strengthening the institutional framework.

Banking System

Indicators for banking system health have improved and bank loans as a share of GDP has declined since the 2008 crisis thanks to a strong economic recovery, but NPLs and loans in arrear still stand high. While real interest rates on deposits are falling, MNT deposits continue to rise, fuelled by currency appreciation expectations under the blanket deposit guarantee system which was adopted during the crisis. At the same time interest rates on US dollar deposits are high, with time deposits offering rates reaching 14 percent, reflecting the continued perception of risk in the market.

The framework for banking supervision and restructuring has been strengthened as part of structural benchmarks under the SBA. The authorities are moving ahead with strict enforcement of prudential regulations against any banks that are not in compliance. A prompt passage of the Empowering the Banking Sector and Capital Support Program will offer a transparent means to provide a temporary financial support to the bank that needs time to come into full compliance. While fully agreeing with the importance of a speedy legislation to make progress in restructuring banking sector, the authorities admitted that their

fragmented decision-making system and the turnaround of economic situation could cause some delay in executing reform measures.

Medium-term Outlook

The Mongolian economy has a bright economic future, as development of the mineral sector will lead to a substantial growth and an opportunity to spread benefits from resource wealth to all Mongolian people, without harmful effect from “Resource Curse”. According to staff’s projection, per capita income of Mongolia will almost quadruple in 8~10 years, from current amount of just above US\$2,000, based on rapid growth in mining sector and currency appreciation. Such prosperity, however, is not guaranteed. The Mongolia’s recent crisis illustrates that so-called “Resource Curse” could not be ruled out. Increasing public awareness of such risks would be helpful in controlling excess demands from the people and focusing on macroeconomic stability in the long run.

Conclusion

Although Mongolian economy has succeeded in rapidly recovering from a severe downturn due to the global financial crisis and the country’s medium-term prospects are much favorable, the pro-cyclical fiscal stance in the pre-election period and ailing momentum for institutional reforms are challenging the authorities’ policy framework. The authorities admit that they have been recently under pressure to increase government spending, when the build-up fiscal financing constraints were alleviated by higher resource prices and a substantial payment from a major mining development project. The authorities remain, however, committed to continue implementing sound macroeconomic policies and a broad range of structural reforms. They are keenly aware of future opportunities and challenges from their abundant resource deposit. The Mongolian authorities, therefore, request continuous engagement and policy advice of the Fund to strengthen macroeconomic stability and sustain high growth with low inflation for poverty reduction and job creation, with keeping imminent overheating pressures in check.