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

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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 (EPE) 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.

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

[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.

substantial increase in output.

In accordance with IMF procedures, the Executive Board also reviewed an EPE of Mongolia's experience with the exceptional access 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 EPE report. They noted that the Shad 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.

Mongolia: Selected Economic and Financial Indicators, 2009–12

		Prel.	Proj.	
	2009	2010	2011	2012
Real sector	(Percent change)			
Real GDP growth	-1.3	6.1	10.3	7.6
Mineral	2.3	9	13.4	12.6
Non-mineral	-2.6	5	9	5.5
Consumer prices (period average)	6.3	10.2	16.4	16
Consumer prices (end-period)	1.9	14.3	20	12
GDP deflator	1.8	18	14.1	8.9
General government budget	(In percent of GDP)			
Revenue and grants	30.2	37.2	35.1	35
Expenditure and net lending	35.2	36	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	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	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	11	...	...
Balance of payments	(In millions of US$)			
Current account balance (including official transfers)	-410	-931	-1,302	-1,438
(In percent of GDP)	-9	-15.2	-15.1	-13.6
(In percent of GDP, excluding mining related imports)	-5.8	-5.8	2.5	0.1
Trade balance	-194	-278	-1,049	-1,107
Exports	1,876	2,899	3,825	4,083
Imports	-2,070	-3,177	-4,874	-5,190
Foreign direct investment	496	1,574	1,130	548
Gross official international reserves (end-period)	1,328	2,290	3,586	4,127
(In months of next year's imports of goods and services)	4.1	4.9	7.1	8.8
Trade prices				
Export prices (US$, percent change)	-18.2	29	9.8	-1.4
Import prices (US$, percent change)	-18	13.2	7.4	0.5
Terms of trade (percent change)	-0.2	14	2.3	-1.9
Public and publicly guaranteed debt	(In percent of GDP)			
Total public debt	46.6	43	38.6	37.1
Domestic debt 2/	3.4	12.2	15.8	17.3
External debt	43.3	30.8	22.8	19.8
(In millions of US$)	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.