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Statement by IMF Staff at the Conclusion of the Post-Program Monitoring Discussions with Mongolia

An International Monetary Fund (IMF) mission visited Mongolia during September 14 – 20, 2011, to hold Post-Program Monitoring discussions. The team, led by Steven Barnett (Assistant Director of the IMF Office for Asia and the Pacific), met with the Mongolian authorities and others to discuss recent macroeconomic developments and policies.

At the conclusion of the visit, Mr. Barnett made the following statement:

"The Mongolian economy has made a remarkable turnaround from the recent crisis. This success reflected the authorities' commitment to pursue sound macroeconomic policies, a recovery in copper prices, and timely support from the international community. With coal output rapidly increasing and two massive mining projects in the pipeline, Mongolia has a bright economic future and an opportunity to spread prosperity to all of its citizens.

"Against this backdrop, we have decided to withdraw our resident representative at the end of the month. We would like to thank Mr. Ramlogan for his dedication and service over the past few years. Our decision reflects the Mongolian economy's speedy recovery from the recent crisis, rapidly rising income per capita, and our own budget constraints. We place great value on our relationship with the Mongolia and are fully committed to maintaining our close cooperation. Toward that end, we will maintain a local office that will be managed from our regional office in Tokyo. The director of this office, Mr. Ishii, joined our mission last week to reinforce our ongoing commitment to Mongolia.

"As for the current mission, we have had in-depth discussions with the authorities on the economic outlook and policy challenges. We believe that Mongolia has a bright economic future as it continues to develop its vast mineral resources. In the near term, however, we see substantial risks to the economic outlook. First, the economy is overheating. Inflation is already high and likely to rise further, which is exacting an especially heavy burden on the poor, and eroding the ability of Mongolia's private sector to operate effectively. Rather than contending with these pressures, macroeconomic policies have returned to the boom-bust approach that culminated in the last crisis in 2009. Second, this heightened domestic risks of macroeconomic instability come at a time when the global economic outlook is worsening. Should international commodity prices fall sharply Mongolia's exports and budget revenues would both be hit hard. The policies to address both high and rising inflation and to lessen vulnerabilities are clear: restrain fiscal spending and tighten monetary policy.

"The 2011 budget already included a sharp increase in spending of around 30 percent. This is a key factor behind the current overheating. Now the government has proposed a further increase in spending of 6½ percent of GDP just in the fourth quarter of this year. Such an increased would be highly risky and ill-advised. GDP growth in the second quarter already exceeded 17 percent and imports of consumer goods have risen by more than 80 percent. Further fiscal spending would only add to fuel to this overheating economy at a time when it least needs it.

"Similarly, in the 2012 budget, spending should be kept at or below the level that parliament already approved in the medium-term budget framework. Within that budget envelope the government should introduce a targeted system of social transfers.

"Finally, the newly created development bank is of significant concern. The development bank should not be used as a means to circumvent the fiscal stability law or as a vehicle for off-budget government spending. Doing so will add to fiscal risks, reduce fiscal transparency, and undermine the credibility of the landmark fiscal stability law passed last year.

"The recent tightening of monetary policy is welcome, but more needs to be done. The central bank should use a variety of tools. The policy interest rate should be further increased. For much of the year it has remained below the pace of increase of underlying inflation, allowing for a very rapid pace of credit growth (now reaching nearly 50 percent in real terms). Interest rate hikes alone, however, will not be sufficient. In addition, a range of macro-prudential measures should be implemented to help slow the pace of credit growth. These include measures to increase capital adequacy requirements, start to require provisions on new lending, raise reserve requirements, and tighten liquidity ratios. At this stage in the business cycle it is especially important to proactively manage risks and strictly enforce prudential regulations in order to prevent the buildup of future credit quality problems in the banking system (as become painfully evident in 2009).