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Mongolia: 2006 Article IV Consultation—Staff Report; 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 2006 Article IV consultation with Mongolia, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on September 12, 2006, 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 December 18, 2006. 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 Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 10, 2007 discussion of the staff report that concluded the Article IV consultation; and

- a statement by the Executive Director for Mongolia.

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

Selected Issues Paper

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publcationpolicy@imf.org.

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MONGOLIA

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for the 2006 Article IV Consultation

Approved by Daniel Citrin and Adnan Mazarei

December 18, 2006

- The 2006 Article IV consultation discussions were held in Ulaanbaatar during August 30-September 12. The staff team comprised Messrs. Kronenberg (Head), Marciniak, S. Lee (all APD), Wu (PDR), and Klemm (EP-FAD) and was assisted by Mr. Jang (Resident Representative). Mr. H.C. Lee (OED) attended some of the policy meetings. The staff team closely liaised with overlapping MCM and STA technical assistance missions.

- The 2005 Article IV Consultation and discussion of the Ex-Post Assessment of Longer-Term Program Engagement were completed on September 21, 2005, http://www.imf.org/external/np/sec/pn/2005/pn05140htm. Directors considered that a successor PRGF arrangement could provide a useful framework for the authorities to carry forward their reform agenda.

- Discussions on a new PRGF-supported program were conducted in February and May 2006. Resuming program discussions would be contingent upon adopting a 2007 budget consistent with ensuring fiscal sustainability.

- Mongolia's flexible exchange rate regime has served well in absorbing external shocks and the existing arrangement should be maintained.

- Mongolia accepted the obligations of Article VIII, Sections 2, 3, and 4 on February 1, 1996, and has maintained an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

- Mongolia's statistical framework is generally adequate for surveillance and program monitoring purposes. Efforts are underway with STA support to address the remaining weaknesses in the areas of monetary and government finance statistics.

- The authorities are expected to approve the publication of the Staff Report, as occurred for the last consultation, and all accompanying documents.

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EXECUTIVE SUMMARY

Background

- **Mongolia's economic performance has been very strong in recent years.** Annual real GDP growth has averaged 7 percent since 2002, underpinned by a run up on copper and gold prices; inflation has been reduced to mid-single digit levels; and the budget and current account balances recorded growing surpluses in 2005-06.
- **The fiscal position is expected to weaken in 2007 due to social spending and wage increases, tax cuts, and somewhat lower copper prices**.
- **Although inflation currently is moderate, there is a clear risk that continued rapid monetary growth and fiscal stimulus could increase inflationary pressures.**
- **The nominal and real effective exchange rates of the togrog have appreciated moderately, reflecting the strong balance of payments and improvement in the terms of trade**. International reserves have increased to nearly 3½ months of imports of goods and services.
- **The authorities have taken initial steps to strengthen central bank governance, in line with Fund recommendations.**

Key Issues and Policy Discussions

- **Mongolia's mineral resource endowment and its location between two large, fast-growing economies provide a good basis for sustained medium-term growth.** Nevertheless, the economy remains vulnerable to external shocks, including the possibility of declining copper prices, and poverty remains troublingly high. Overcoming these vulnerabilities will require continued macroeconomic stability, as well as improvements in infrastructure and structural reforms to promote private sector development.
- **Fiscal policy needs to preserve the recent reduction in the public debt burden.** To do so, there is a need to target social welfare spending more effectively and move forward with civil service reforms. Some of the tax cuts coming into effect in 2007—particularly the 5 percentage point VAT cut—may need to be partly reversed in the future, if copper prices fall as much as the WEO projections.
- **Monetary policy should aim at mopping up excess liquidity.** Also, the central bank should continue its governance reforms, ensure prudent management of its international reserves, develop an exit strategy from gold operations over the medium term, and fully enforce prudential supervision, particularly of banks with rapid lending growth.

I. Background

1. **Mongolia is experiencing an unprecedented period of strong economic performance (Table 1 and Figures 1-4).** Real GDP growth has averaged 7 percent since 2002, aided by sharp increases in copper and gold prices and a recovery of livestock herds after three devastating winters. As incomes have grown, the expansion has spilled over to other sectors of the economy, including construction, financial services, and the retail sector. After a brief upward spike in 2005, inflation has been brought back down to the mid-single digits, and the budget and external current account balances have moved into surplus. International reserves, which were heavily drawn down in late 2003 in connection with the settlement of Mongolia's pre-1991 debt to Russia, have been reconstituted to more comfortable levels. Near-term economic prospects remain favorable, with growth likely to be sustained by still-high minerals prices and large-scale foreign investment in a major new mining project (Box 1). Despite these significant achievements, poverty remains high (36 percent), and much remains to be done to achieve the Millennium Development Goals.

2. **Looking ahead, the authorities' ability to achieve strong growth over the longer term will require the sustained implementation of policies to support macroeconomic stability, address structural weaknesses, and reduce Mongolia's vulnerability to large external shocks.** In particular, there is a need to keep public debt on a stable or downward path. Achievement of these objectives could be made more difficult if copper prices were to decline significantly over the medium term, as currently projected. Other vulnerabilities include a still-high level of public debt, a harsh climate, a large, landlocked and sparsely populated territory, and weak economic infrastructure.

3. **The current coalition government was formed in January 2006.** It comprises the Mongolian People's Revolutionary Party (MPRP) and members from three smaller parties. Although the MPRP gained an absolute (one-seat) majority in Parliament following a local by-election in September 2006, the coalition has remained intact. The Democratic Party (DP), which was a member of the governing coalition prior to January 2006, is now the main opposition party. The government's ability to set and implement its economic reform agenda has sometimes been constrained by the willingness of individual members of Parliament, including some from the governing parties, to break ranks with their party leadership on important issues. Recent examples include Parliament's actions to impose a windfall tax on copper and gold revenues, cut the VAT rate, and increase untargeted social spending, all of which were initially opposed by the government. The next national elections are slated for mid-2008.

4. **The authorities have expressed strong interest in a new PRGF arrangement.** In preliminary discussions, the staff has taken the position that the government should save most of the large revenue windfall from high commodity prices in order to achieve fiscal sustainability without requiring large future cuts in government expenditure, which could disrupt medium-term growth prospects. The staff has also highlighted the need for further reforms to improve central bank governance and strengthen the financial system. Mongolia's track record under the previous PRGF arrangement that expired in July 2005 was mixed, with only two reviews completed. Although the authorities have, in some instances, been unable to implement fully the policies recommended by Executive Directors at last year's Article IV

Box 1. Mongolia: Mining Sector Prospects

Background: Mongolia's non-fuel mineral sector has been the main pillar of Mongolia's development. It is the fourth largest sector, contributing 25 percent of GDP but accounting for about 70 percent of export earnings and 16 percent of tax revenue. Its output, however, is highly vulnerable to mineral price volatility and its direct contribution to employment has been limited (2.4 percent of labor force), due to its highly capital intensive nature. Dutch disease risks are limited because of idle capacity, including high unemployment but continued appreciation of the togrog in connection with increasing capital flows and foreign exchange earnings may impact nonmineral sector competitiveness in the longer run.

There has been an upturn in mineral exploration since 2001, in the wake of the discovery of the large *Oyu Tolgoi* copper/gold deposit and in response to strong world prices for copper and gold since 2004. Exploration, however, has been hampered by poor infrastructure and uncertainties on the new mining tax regime.

Stability Agreements/Investment Contracts. These are important for some mining companies to remove long-term uncertainties on mining taxation, thereby strengthening foreign investors confidence. Eight mining companies have entered Stability Agreements under the previous 1997 Minerals Law. Under the 2006 Minerals Law, such agreements renamed Investment Contracts link agreements' maturities to the investment's size.

Copper output (30 percent of exports in 2005), is currently derived exclusively from the Erdenet mine but is expected to be boosted in the medium term by the coming on stream of the *Oyu Tolgoi* mine and the development of the *Tsagaan Suvarga* deposit.

Erdenet. Mongolia's largest mine, has been in operation since 1978 under a Russian-Mongolian government joint venture. The mine produces copper concentrate together with molybdenum and is also engaged in a variety of non-mining activities (e.g., farming) and provides extensive local social support. The mine's output has been declining and is expected to deteriorate further as copper grade decreases with depth. However, investments are underway to compensate the output decline by producing higher value copper cathode. Erdenet's annual copper concentrate output is about 130,000 tons; its ore reserves of 1.54 billion tons have a 30-year lifespan.

Oyu Tolgoi copper and gold deposit (Ivanhoe). Discussions are underway between the government and Ivanhoe, a Canadian company, to reach agreement on an investment contract that would pave the way for beginning mining the *Oyu Tolgoi* deposit in 2009. Initial annual copper concentrate output would be 300,000 tons with a 1 million ton peak to be reached within six years. Its copper ore reserves would provide for a 40-year lifespan.

Gold output (31 percent of exports in 2005) is also widely mined by Mongolian and Mongolian-Russian joint ventures, comes as a by-product of the Erdenet copper mine and is subject to widespread artisanal mining ("ninjas" miners). Gold prospects depend on timely development of the Oyu Tolgoi (Ivanhoe) and *Gatsuurt* (Boroo) deposits, both of which are critically hinging upon finalizing investment contracts with the government.

Other minerals. Mongolia is also a significant producer of fluorite under *Mongolrostsvetmet*, a Russian-Mongolian joint venture and Mongolia's second largest mining company. In addition, the *Tumurtiinovoo* zinc mine, a Chinese-Mongolian joint venture has been operational since 2005 with an expected 14-year lifespan. Phosphate mining from the *Burenkhaan* deposit is in the process of being developed. In the longer term, considerable coal reserves from the *Tavan Tolgoi* deposit (5 billion tons), and the *Turmurtei* iron deposit (229 million tons), as well as identified natural gas and petroleum reserves are expected to provide further growth impetus.

consultation, they consider that Fund advice and support continue to provide a critically important policy framework which facilitates the development of consensus and political support for reforms.

II. Recent Economic Developments and The Near-Term Outlook

5. **Recent economic performance has been very robust, with strong, broad-based growth, declining inflation, growing budget and balance of payments surpluses, and improving confidence in the banking system.** Real GDP is estimated to have risen by 7 percent in 2006, the same as the average pace achieved during 2002-05. The minerals sector has been a key engine of growth, supported by record high prices for copper and gold, some increases in production volumes, and investment at the new Ivanhoe copper and gold mine, which has not yet come on stream. Outside the mining sector, growth has also been supported by favorable weather conditions, buoyant residential and commercial construction, and rapid growth in financial services. Growth is projected to remain at about 7 percent in 2007.

6. **After spiking higher in the first half of 2005, inflation has since slowed to a moderate rate.** The year-on-year inflation rate jumped from 10½ percent in December 2004 to 17½ percent in June 2005, due partly to a temporary shortage in the supply of meat which sent prices soaring. As the supply shock was reversed, inflation declined to 1.8 percent (year-on-year) in July 2006, the lowest level in four years. With the impact of the supply shock falling, inflation subsequently picked up to 6.5 percent in October 2006, reflecting increases in the prices of petroleum products, and rapid monetary growth.[1]

7. **The fiscal position has improved markedly in recent years, driven by the rapid run up in copper prices and by faster-than-expected economic growth (Table 2, Box 2, and Figure 2).** The overall budget balance shifted from a deficit of 4 percent of GDP in 2003 to a surplus of 3 percent in 2005, which is now projected to widen to 9 percent of GDP in 2006. Underlying the dramatic improvement in fiscal performance has been a sevenfold increase in mining revenues between 2003 and 2006 due to both sharply higher copper and gold prices, as well as the imposition of a new windfall tax on copper and gold in June 2006. Meanwhile, total expenditure has fallen from 42 percent of GDP in 2003 to an estimated 31½ percent in 2006, despite the 2006 introduction of a 30 percent wage increase and an expansion of social welfare transfers. Delays in the execution of some investment projects also slowed the pace of spending. As fiscal performance has improved, the net present value (NPV) of public debt dropped from 80 percent of GDP at end-2003 to 45 percent at end-2005. It is expected to fall further to 35 percent at end-2006.

8. **Monetary aggregates have been growing rapidly (Table 3 and Figure 3).** Reserve money growth picked up from 20 percent (year-on-year) in December 2005 to 27 percent in September 2006. The acceleration in reserve money reflected strong foreign exchange inflows, which more-than-offset a substantial decline in net central bank credit to government. For the banking system as a whole, broad money increased by 38 percent in the year to September

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[1] The determinants of inflation in Mongolia are examined in the Selected Issues Paper, Chapter I.

Box 2. Mongolia: The Evolving Fiscal Framework

Mongolia's fiscal framework has evolved significantly since the beginning of 2006. Changes include the addition of new spending measures in the amended budget passed in June, a new mining law, and new personal income tax, corporate income tax, and VAT laws which go into effect on January 1, 2007.

The ***"windfall" tax*** introduced in June 2006 is intended to capture a higher share of the revenues accruing to mining companies from high export prices. The 68 percent tax rate applies to copper revenues from prices exceeding the sum of a base price (US$2,600 per ton) and smelting costs (projected at US$1,580 per ton), and gold revenues from prices exceeding US$500 per ounce.

In addition to the "windfall" tax, the new ***mining regime*** enacted in July 2006 provides for: (i) a ***doubling of royalties*** on metals from 2.5 percent to 5 percent; (ii) an increase in ***mining license fees*** and a shortening of the license's duration to discourage speculation and under-utilization of mining licenses; and (iii) a doubling (up to 30 years) of the maximum duration for ***investment contracts,*** which may include stability clauses on the tax regime. The mining law also establishes the possibility of ***government equity participation*** up to 34 percent in mines deemed to be "strategic deposits," and up to 50 percent for strategic deposits discovered with government support. A ***Development Fund*** was also established to ensure that revenues from the "windfall" tax are allocated as follows: (i) one third of total for saving; (ii) one third for capital expenditure; and (iii) one third for children and family allowances.

On the ***expenditure side***, the amended 2006 budget contained several important measures: (i) ***wages and salaries*** were raised by 30 percent (retroactive to February 1); (ii) ***minimum pensions*** were increased, and the pensions paid to retirees under different systems were aligned; (iii) ***domestically-financed investment*** was budgeted to more-than-double; and (iv) ***social welfare transfers*** were raised through an increase in the monthly child allowance and the elimination of its means testing, the introduction of lump sum allowances for newlyweds and newborns, and a modest school lunch program.

The amended 2006 budget officially calls for an overall deficit of 3.4 percent of GDP. However, this estimate does not reflect the increase in the mining royalty rate. It also treats all revenue accruing to the Development Fund as expenditure, although on a consolidated central government basis, this is not the case. Taking account of these factors, ***the staff and authorities project that the budget will record a surplus of about 9 percent of GDP in 2006.***

The 2007 budget calls for an overall deficit of 5 percent of GDP. Reflecting the ***new tax laws*** that go into effect on January 1, tax revenues are projected to cost some 3.9 percent of GDP. These measures include: (i) a cut in the **VAT rate** from 15 percent to 10 percent and the abolition of a range of VAT exemptions at an estimated cost of 1.7 percent of GDP; (ii) unification of the **personal income tax** (PIT) at the lowest of the previous rates (10 percent) at an estimated cost of 0.5 percent of GDP; (iii) a five percentage point cut in each of the two corporate income tax (CIT) rates along with a thirty-fold increase in the higher rate's threshold, the elimination of tax holidays for foreign investors, the introduction of loss carry-forward provisions, and the use of investment tax credits in priority sector, at an estimated cost of 1.7 percent of GDP; and increases in excises on vehicles and gambling for an estimated revenue gain of 0.1 percent of GDP. On the ***expenditure side,*** the 2007 budget provides for a further 30 percent increase in civil service wages and a 0.8 percent increase in civil service employment, a substantial additional increase to the child allowance, and an increase in capital spending by 4.4 percent of GDP to address infrastructure needs in areas such as roads and housing.

Looking beyond 2007, Parliament calls for the overall deficit to remain constant at 4 percent of GDP through 2009, which is the deficit ceiling in the government's ***Medium-Term Budget Framework*** (MTBF).

2006, driven entirely by foreign assets. Net domestic assets of the banking system declined in the year to September 2006, as a sharp drop in net credit to government exceeded the impact of rapid growth in credit to the private sector. The subdued response to date of inflation to this rapid monetary growth reflects an ongoing process of reintermediation as incomes have risen and confidence in the banking system has improved and the gradual appreciation of the exchange rate, which has helped keep a lid on the prices of imported goods.

9. **The external current account surplus (including official transfers) is expected to widen from 1½ percent of GDP in 2005 to 5 percent of GDP in 2006 (Table 4 and Figure 4).** The increase in the surplus has been driven by a marked improvement in the terms of trade, which more than offset a pick up in import volume growth and higher investment income payments. With increased inflows of direct investment in the mining sector and a recovery in disbursements of concessional official loans, gross international reserves are expected to reach US$626 million (3½ months of imports of goods and services) by end-2006, while the NPV of external public debt is expected to fall to 32 percent of GDP, half the level at end-2003. Looking ahead to 2007, the current account balance is expected to revert to a deficit (2 percent of GDP) owing to strong growth in investment imports financed by increased foreign direct investment. Gross official reserves are projected to reach 4 months of import cover at end-2007.

10. **Exchange rate developments have reflected the improvements in the terms of trade and capital inflows.** The real effective exchange rate (REER) of the togrog has appreciated by about 18 percent since end-2004. In terms of the U.S. dollar, the togrog depreciated by ½ percent in 2005 but appreciated by 4½ percent during the first nine months of 2006.

III. Policy Discussions

A. Overview of Policy Issues and Macroeconomic Framework

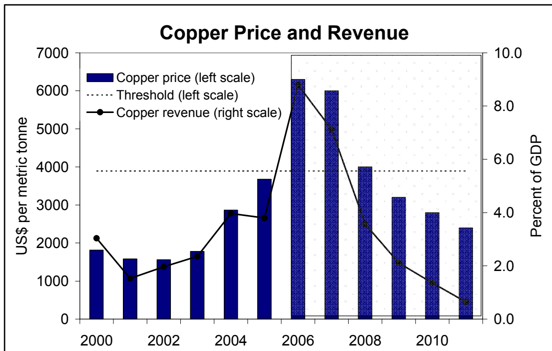
11. **With its ample mineral endowment and location between two large, fast-growing economies, Mongolia has the potential to achieve strong, sustainable growth.** At the same time, the economy remains very vulnerable to external shocks, including the possibility of substantially lower copper prices over the medium term. The discussions, therefore, focused on policies to safeguard recent gains in macroeconomic stability, improve the governance of public sector institutions, strengthen confidence in the financial system, and promote private sector development. The mission encouraged the authorities to save most of the large revenue windfall from high commodity prices to keep public debt on a sustainable path, and it advised the Bank of Mongolia to rein in the rapid pace of monetary growth to bolster confidence in the financial system and prevent an upturn in inflation.

12. **The authorities noted that economic performance has significantly surpassed expectations in recent years.** While partly the result of favorable external factors, this strong performance has also reflected the sustained implementation of far-ranging structural and financial sector reforms and the government's cautious approach to budget planning. While the authorities remained strongly committed to macroeconomic stability, they also stressed that Mongolia would require large-scale infrastructure investments to achieve its growth potential.

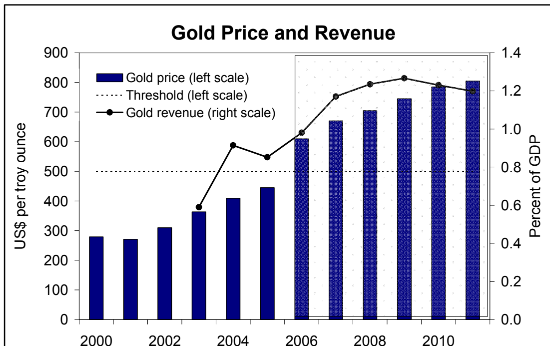
13. **The staff's medium-term scenario (Annex I) envisages that real GDP growth can average 6-7 percent over the medium term, if appropriate policies are pursued.** Inflation is targeted to be contained to 5 percent throughout the period, provided that fiscal and monetary discipline is maintained. Mongolia's external debt is still moderately high, but debt dynamics have improved markedly in recent years. To keep the debt burden manageable, the authorities should continue borrowing solely on concessional terms. Under a baseline scenario providing for sustained output and export growth and continued access to concessional borrowing, Mongolia's external debt ratios would decline in the long term. However, debt distress indicators could deteriorate and become unsustainable under a variety of plausible shocks, especially under a severe terms of trade shock.

B. Fiscal Policy

14. **The latest data suggest that the budget surplus could widen to 9 percent of GDP in 2006.** There are two main reasons for the sharp revision from the 3½ percent of GDP deficit in the amended budget. First, copper prices have remained much stronger than the authorities expected at the time of the amended budget, and collections of the windfall tax and other mining revenues have been correspondingly larger.[2] Secondly, capital spending has continued to fall far short of the amounts budgeted, due in part to teething problems with the introduction of new government procurement procedures.



Sources: IMF, *World Economic Outlook*; and Fund staff estimates.



Sources: IMF, *World Economic Outlook*; and Fund staff estimates.

15. **In sharp contrast, the 2007 budget projects an overall deficit of nearly 5 percent of GDP.** While a part of this deterioration would be due to a decline in copper prices, the nonmineral deficit would also widen from 4½ percent of GDP in 2006 to 16½ percent in 2007.[3] With growth remaining robust, most of the deterioration in the fiscal balance would reflect policy measures in the budget which include: (i) cuts in the Value Added Tax (VAT), the personal income tax (PIT), and the corporate income tax (CIT) which will go into effect on January 1 (Box 2) (a revenue loss of 4 percent of GDP); (ii) a large increase in the untargeted child

[2] The amended 2006 budget copper price assumption is US$5,200 per ton, while the actual price has generally remained above US$7,000 per ton for the second half of the year.

[3] The authorities assume that the average copper price in 2007 will be US$6,000 per ton. Although this is somewhat higher than the September WEO projection, actual prices in recent months have remained around US$7,000.

allowance (from 1 percent of GDP in 2006 to about 4 percent of GDP in 2007); (iii) a 20 percent increase in civil services wages (30 percent increase for those earning minimum wage) and an increase in civil service employment (raising the wage bill by 1 percent of GDP); and (iv) a sharp pickup in capital spending (4½ percent of GDP).

16. **The mission considered that the loosening of fiscal policy implied by the budget would stimulate demand at a time of generally high resource utilization which would be ill-advised.** Moreover, the budget would set in motion spending policies that could be difficult to reverse over the medium term. The mission believed that it would be feasible and desirable to contain the overall deficit to 2 percent of GDP (a nonmineral deficit of 13½ percent) in 2007. Such a deficit could be financed entirely by concessional foreign borrowing.

17. **Most of the short-term fiscal adjustment recommended by the mission could take place on the expenditure side.** The mission encouraged the authorities to focus new spending on infrastructure improvements and poverty reduction. Therefore, the mission recommends that the very large increase in the child allowance be scaled back and means testing for the benefit be reintroduced.[4] It is also crucial to accelerate the pace of civil service reform. Given the large wage increases granted in 2006 and 2007, the mission recommended that the authorities cap the size of the civil service at current levels until the authorities implement the civil service census and functional ministerial reviews that are being conducted with World Bank assistance. Notwithstanding Mongolia's large infrastructure needs, the mission believes that the country lacks the implementation and absorptive capacities to raise public investment spending by more than 2 percentage points of GDP in the near term.

18. **On revenues, the mission welcomed the important steps taken in the 2007 budget to reduce distortions in the tax system, including the elimination of VAT exemptions and tax holidays.** However, it suggested that the authorities should be prepared to reverse some of the tax rate cuts if minerals prices fall by more than the authorities now project. The mission emphasized that the cuts in nonminerals taxes will make the budget increasingly sensitive to conditions in the minerals sector. With copper prices projected to decline in 2007 and over the medium term, the tax cuts could put pressure on the fiscal position. Should this occur, the mission recommended that the authorities reverse at least part of the 5 percentage point cut in the VAT rate. At the same time, the authorities should ensure that the mining tax regime leaves Mongolia an internationally competitive producer. The authorities' request for technical assistance from the Fund on mining taxation was, therefore, timely. The mission also strongly encouraged the authorities to resist proposals that had been made by some members of Parliament to compensate for the tax cuts by raising import duties.

19. **The mission stressed that fiscal policy should be firmly grounded in a transparent medium-term framework designed to ensure sustainability, reduce the economy's vulnerabilities to shocks, and avoid procyclical impulses to demand.** To reduce vulnerability to a downturn in copper prices, it would be prudent to bring the nonmineral deficit back down to around 7 percent of GDP over the medium term. This would be consistent with a

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[4] The child allowance contained in the 2007 budget would provide the equivalent of 10 percent of per capita GDP to 40 percent of the population.

gradual reduction in the NPV of public debt to below 30 percent of GDP. The mission noted that achievement of such a medium-term objective is likely to require concerted policy action to maintain a broad tax base and contain the growth in spending, as noted above.

20. **The authorities pointed out that budget performance had exceeded expectations by wide margins in recent years, and they said the government remained committed to following prudent fiscal policies.** However, they also emphasized the importance of infrastructure improvements, low tax rates, and social consensus to sustain strong growth. For a resource-rich low-income country, the authorities considered that a budget deficit on the order of 4 percent of GDP would be sustainable and appropriate over the medium term. While acknowledging the need for social programs to focus on poverty alleviation, they considered that there was also a need for the population at large to share the dividends from strong growth and high minerals prices.

21. **The staff team recognized that fiscal performance had been consistently stronger than expected, but it noted that continued large deviations between budget projections and outturns could eventually have an adverse impact on policy credibility.** To help improve transparency, the authorities should consolidate (both numerically and conceptually) the Development Fund with the rest of the budget and clarify how much of the windfall revenues it intends to spend, over what timeframe, and for what purposes. They should also fully align spending of the Development Fund with overall spending priorities. There is also a need to base budget projections on more realistic assessments of capacity constraints and estimates of the pace at which the government will be able to able to implement investment projects.

C. Monetary Policy

22. **Although inflation has come down from the double-digit rates hit in 2005, the authorities and mission team agreed that continuation of the current rapid growth in broad money would eventually feed into higher inflation.** A relaxation of fiscal policy, excessive wage increases, or a depreciation of the exchange rate could further add to inflationary pressures. Against this background, the mission encouraged the authorities to contain reserve money growth to 15 percent in 2007 to keep inflation in the mid-single digits. The authorities agreed that these targets for inflation and reserve money were feasible and appropriate. To achieve this objective, the BOM should increase the issuance of CBBs at market-clearing interest rates.

23. **Institutional strengthening can help improve the effectiveness of monetary policy instruments. The government, in turn, should ensure that the central bank remains adequately capitalized.** The government's recent action of converting a noninterest-bearing central bank advance to government into interest-bearing bonds was a positive step in this regard.[5] The mission also recommended that the BOM should better integrate the operations of

[5] The BOM had provided a 10-year noninterest-bearing advance to the government of US$100 million and a US$37 million, interest free, short-term loan at end-2003 to help finance the government's settlement of the pre-1991 Transferable Ruble debt.

its International and Monetary Policy Departments to ensure that changes to reserve money driven by purchases of gold from domestic producers are appropriately sterilized. A technical assistance mission by MCM to advise on monetary policy instruments is scheduled to take place in December 2006.

24. **The authorities noted the recent decision by the BOM and 10 commercial banks to establish the Mongolian Mortgage Corporation (MIC).** The MIC is expected to provide well-secured lending to the private sector and facilitate the development of a secondary market, which were both seen as important for sustained economic development. The mission welcomed the plans to broaden the capital market but cautioned that the BOM should refrain from providing guarantees or large liquidity injections to support MIC operations.

D. External Policies

25. **Mongolia's flexible exchange rate has facilitated adjustment to large real shocks.** Commodity exports account for more than two thirds of Mongolia's total merchandise exports, and export performance has been closely associated with the movements in the terms of trade. Despite the real appreciation of the togrog over the past two years, the external position looks sustainable, and inflation is lower than it would have been under a less flexible exchange-rate regime. Given these factors, the level of the exchange rate appears to be broadly appropriate and the authorities and mission team agreed that foreign exchange market interventions should remain limited to the smoothing of short-term volatility.[6] Recent business surveys conducted by USAID and the World Bank have highlighted inefficient government administration, burdensome tax and customs regulations, inadequate infrastructure, and corruption as the business community's main concerns for competitiveness. Therefore, the staff team stressed that maintaining competitiveness and promoting export diversification over the medium term will require a combination of sound macroeconomic policies and continued progress in structural reforms aimed at streamlining regulation and eliminating corruption.

26. **Given the relatively high level of external debt and the large amount of borrowing that will continue to be needed to improve infrastructure and strengthen growth prospects, the mission advised the authorities to continue borrowing exclusively on concessional terms.** The mission also recommended that the government should refrain from granting external loan guarantees on behalf of domestic borrowers, and it welcomed the government's ongoing efforts to strengthen the collection of on-lent funds. The authorities stressed that they remained committed to prudent debt management, and they endorsed the assessment under the joint Bank-Fund debt sustainability analysis (Annex I). While the authorities had no immediate plans to tap international capital markets, the central bank saw potential benefits in establishing a good credit rating based on actual experience in the market.

27. **Important steps have been taken to settle some longstanding disputes with foreign creditors.** The pre-1991 transferable ruble debts to Russia and Poland have been settled and discussions are also underway on the arrears of post-1991 Russian debt. Loan arrears to an

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[6] Foreign exchange market operations are described in the accompanying Selected Issues Paper, Chapter III.

Italian supplier were cleared in mid-2006 but two longstanding Finnish suppliers' credits remain under dispute.

28. **Mongolia maintains open trade and investment regimes, but pressures for increased protection are on the rise.** The authorities expressed concerns about the potential negative impact on local industries that could result from lowering the export tax on cashmere, and Mongolia's WTO commitment to eliminate the tax by January 2007 is likely to be missed. Some parliamentarians also favor offsetting part of the revenue loss from the VAT rate decline by increasing import duties. The staff urged the authorities to adhere to their original schedule to eliminate the raw cashmere export tax and to resist pressures to raise import duties.

E. Central Bank Governance and Financial Sector Reforms

29. **Weaknesses in central bank governance, in areas including central bank oversight, banking supervision, and the management of international reserves have been viewed as potential risks to financial stability.** The mission was, therefore, encouraged to note that the BOM had made a good start in implementing reforms to strengthen its governance structures. In September 2006, the BOM appointed two non-executive directors to its Board of Directors, in line with technical assistance advice from the Fund. The authorities are also examining possible changes in the Central Bank Law to shift key decision-making authority from the Governor to the Board of Directors, another Fund staff recommendation. The mission welcomed these steps and encouraged the authorities to move forward with other governance reforms, including the strengthening of the BOM's external Supervisory Board, which conducts oversight of the central bank. While commending recent progress in strengthening the BOM governance, the staff encouraged the BOM to move toward full compliance with the 2003 Safeguards Assessment.

30. **Prudent management of international reserves is crucial for safeguarding financial stability.** The staff team stressed that international reserves should be held in low risk, unencumbered assets, and it noted that the BOM's exposures in the gold market could raise risks in this respect. In view of the still-limited capacity and appetite of banks to engage in complex gold operations, there was agreement that an immediate withdrawal of the BOM from domestic gold purchases was not necessarily desirable. However, the BOM should begin preparing a timely exit strategy from the market. Meanwhile, the mission advised the BOM to adopt more prudent guidelines for its gold risk exposures and to cease immediately from taking risky positions in gold derivatives and other speculative instruments.

31. **Progress has been made in strengthening the banking system, although important risks still remain.** Nonperforming loans (NPLs) of the banking system were reduced from 23½ percent of total loans at end-2000 to 9 percent at end-2005, and the ratio has remained relatively stable in 2006. However, NPLs at some small and medium-sized banks have increased, and their profitability has deteriorated. The mission noted that it can be more difficult to detect incipient loan quality problems when loan growth is very rapid, and it encouraged the authorities to intensify their supervision of banks with high credit growth or rising NPLs. Contingency plans should also be drawn up for the resolution of problem banks, and the mission advised the authorities to proceed very cautiously with plans to introduce a bank deposit insurance scheme.

32. **The authorities said they were taking additional steps to strengthen banking supervision.** Several banks with rapid credit growth were already subject to intensified supervision, and the BOM is strengthening its capacity to enforce fit and proper requirements for major bank shareholders. In addition, all 16 banks have complied with the doubling of the minimum capital requirement set by the BOM. The authorities also reported that some progress had been achieved in identifying final borrowers in a fraud scheme involving letters of credit from a Korean supplier.

33. **Solvency problems have emerged at a number of saving and credit cooperatives (SCCs).** The Financial Regulatory Commission (FRC) was established in 2006 to supervise these and other nonbank financial institutions. The FRC is reviewing applications for licenses from SCCs, some of which have already been rejected, and it has initiated on-site examinations. The FRC also plans to intensify the supervision of securities firms, insurance companies, and other nonbank financial institutions. The mission stressed that SCCs and other nonbank financial institutions should be excluded from any deposit insurance scheme for the banking system, if one is developed.

34. **The mission welcomed the recent adoption the AML/CFT Law and the authorities' plans to establish a Financial Intelligence Unit (FIU) within the BOM.** It noted that some issues still needed to be addressed to ensure full compliance with FATF recommendations. The authorities stressed their intention to strengthen further the AML/CFT framework as needed to meet international standards.

F. Structural Reforms, Poverty Reduction, and Statistical Issues

35. **Tax administration, regulatory and public enterprise reforms have been designed to help strengthen private sector development.** The adoption of the Anti-Corruption Law is also expected to pave the way for removing a major impediment to doing business in Mongolia, although the law still needs further strengthening to meet international requirements. The authorities have endorsed the Extractive Industries Transparency Initiative (EITI) to improve governance in mineral resources management. Public enterprise reforms are being pursued. Savings Bank was recently privatized, bidding is underway for the privatization of Gobi Cashmere, and enterprises in the energy sector are slated to undergo comprehensive restructuring under a forthcoming World Bank-supported energy sector reform project.

36. **Socio-Economic Guidelines have been recently finalized with a view to strengthening the poverty reduction strategy.** To address high poverty and widening income gaps, the staff reiterated that poorly targeted social welfare programs, such as the universal child allowance and lump-sum awards to newlyweds and newborns, seriously diluted resources for poverty alleviation.

37. **Mongolia accords high priority to the collection and dissemination of economic statistics, and efforts are underway to further upgrade the statistical base.** Work is well underway to expand the coverage of national accounts data. An STA mission in September 2006 made good progress in reconciling discrepancies on domestic bank financing in the monetary data and government finance statistics. Mongolia is participating in the pilot program for the introduction of the *Government Finance Statistics Manual (GFSM) 2001*

methodology. The authorities have requested World Bank and Fund support to implement their *Program of Official Statistics Development (2006-2010)*.

IV. Staff Appraisal

38. **Mongolia is experiencing a period of unprecedented strong economic performance.** Real GDP growth has averaged 7 percent since 2002, and inflation has been brought back down to the mid-single digits. The budget surplus is expected to widen to over 9 percent of GDP in 2006. The external current account is also in surplus, public debt ratios have declined, and international reserves have been rebuilt to more comfortable levels.

39. **Looking forward, the economy faces both significant opportunities and risks.** Mongolia's rich endowment of mineral resources and its location between two large, fast-growing economies provide a good foundation for strong, sustained growth. Nevertheless, daunting medium-term challenges need to be addressed: infrastructure is weak, the territory is landlocked and sparsely populated, the climate can be extremely harsh, and poverty remains troublingly high. Moreover, the large run up in copper prices on the world market, which has helped fuel the recent vigorous expansion, could be at least partly reversed in coming years. Overcoming these obstacles to sustained growth will require policies conducive to maintaining macroeconomic stability, improving infrastructure, reducing structural rigidities and other impediments to private sector development, and effectively utilizing the strong natural resource base.

40. **The fiscal position has improved markedly in recent years due to strong economic growth, a sharp increase in mining sector revenues, and improved tax administration** However, maintaining these gains, with public debt remaining on a gradually declining path may require policy adjustments, particularly if copper prices decline significantly over the medium term, as expected. The loosening of fiscal policy implied by the 2007 budget would be ill-advised. It could also set in motion spending policies that could be difficult to reverse over the medium term. Therefore, the staff considers that it would be feasible and desirable to contain the overall budget deficit to 2 percent of GDP in 2007.

41. **On the revenue side, the challenge will be to maintain a broadly based tax regime that does not discourage investment and growth and is not overly sensitive to commodity price shocks.** Many of the elements of the tax reform package coming into effect on January 1, 2007, including the elimination of tax holidays, the introduction of loss carry forward, and the deductibility of a fuller range of business expenses, are consistent with this objective and with past technical and policy advice from the Fund. However, the government's decision to place increased reliance on mining taxation while cutting nonmining taxes entails risks. To maintain medium-term fiscal sustainability, the authorities may need to undo some of the tax rate cuts, particularly if copper prices decline significantly. Reversing part of the 5 percentage point cut in the VAT rate would be the least distortionary way to accomplish this. The government should also keep the mining regime under close review to ensure that it is appropriately designed to limit risks to the public sector balance sheet to maintain an internationally competitive fiscal regime.

42. **Expenditure reform should also be an important part of a sustainable fiscal policy strategy.** Government expenditure in Mongolia accounts for a higher share in GDP than in many other low income countries. Although this is warranted, to some degree, by structural factors, there is a need to improve the efficiency and effectiveness of government. Social welfare programs need particular attention. The universal coverage of some welfare benefits, such as the awards for newlyweds and newborns, and the child allowance, is placing a strain on the budget, limiting the government's ability to focus on poverty alleviation for the most vulnerable groups. The staff encourages the authorities to reintroduce means testing, where possible, for social welfare programs. Meanwhile, the very large increase in the child allowance provided in the 2007 budget should be scaled back significantly, and further reductions may be needed in the future. The staff also urges the authorities to move forward more forcefully with civil service reforms to pay for increases in public sector wages.

43. **Rapid monetary growth is an indication of reintermediation and improving confidence in the banking system.** However, a continuation of monetary growth at recent rates will eventually feed into higher inflation. To preclude this, the authorities should step up sales of central bank bills in order to slow the growth in reserve money. The staff welcomes the BOM's request for technical assistance from the Fund to develop additional monetary policy instruments and strengthen liquidity management.

44. **Mongolia's flexible exchange rate regime, prudent external borrowing policies, and open trade regime have facilitated orderly adjustment to external shocks, and these policies should be retained.** The strengthening of the togrog has been warranted by commodity price developments and the strong balance of payments. Achieving this through flexibility in the nominal exchange rate has helped keep inflation lower than it might otherwise have been. Intervention in the foreign exchange market should remain limited to smoothing short-term movements. To prevent an increase in the external debt service burden, the government and central bank should continue to refrain from nonconcessional external borrowing. The staff encourages the authorities to reach prompt agreement with foreign creditors on outstanding obligations and debt disputes. The staff also urges the authorities to phase out the export duty on raw cashmere and to resist calls to raise import duties to protect domestic industries.

45. **The authorities have made a good start at strengthening central bank governance.** The recent appointment of non-executive members to the BOM's Board of Directors was a positive step that should be followed by actions to shift more decision-making authority from the BOM Governor to the Board of Directors. Prudent management of international reserves is crucial for safeguarding Mongolia's financial stability. This should include a reduction in gold risk exposures and preparation of an exit strategy from the gold market .

46. **Further actions are needed to strengthen the financial system.** Rapid credit growth and the case of the fraudulent LCs illustrate the need for vigilant enforcement of prudential regulations. High priority should be given to the monitoring of banks with fast credit growth and rising NPLs, strengthening banks' governance, and establishing contingency plans for problem banks. High bank lending rates reflect the still-high risk premia in the market. The staff urges the authorities to continue resisting calls for administrative measures to reduce these

rates. The public sector should not bail out insolvent savings and credit cooperatives, and these institutions are not to be included in any future insurance deposit scheme for banks.

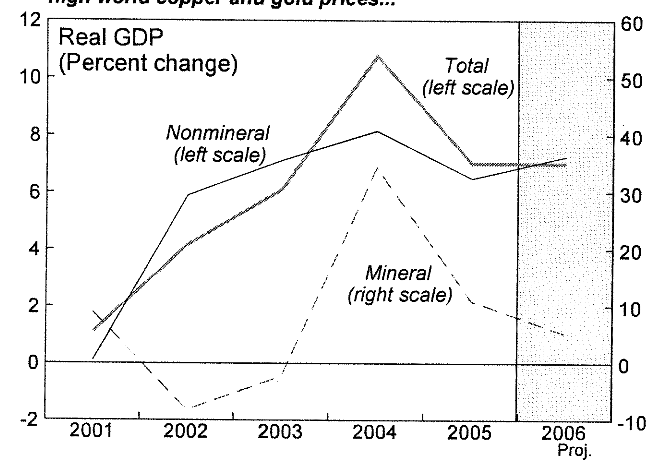
47. **The staff welcomes actions to strengthen the institutional environment for private sector development.** Important recent steps include the adoption of the Anti-Money Laundering Law and the Anti-Corruption Law, although the latter still needs further strengthening. Recent progress in privatization of two of the remaining large public enterprises is also welcome. Further efforts, however, are needed to strengthen the operations of the remaining public enterprises, mainly in the energy sector.

48. **The staff welcomes efforts underway to strengthen data quality for surveillance purposes, including the broadened coverage of national accounts, reconciliation of discrepancies between fiscal and monetary data, and Mongolia's participation in the *GFSM 2001* pilot project.** Further technical assistance will be important to the success of these efforts.

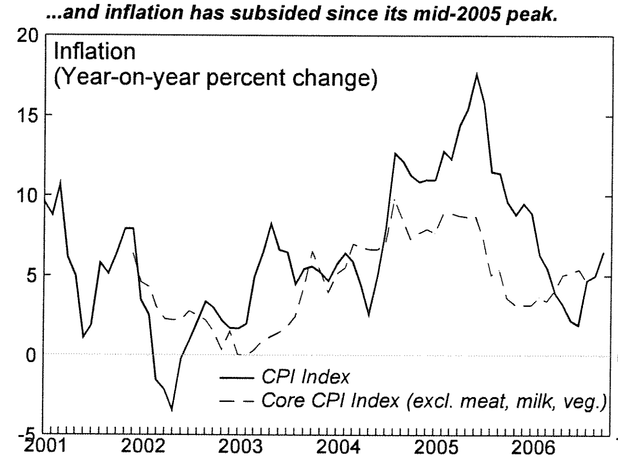
49. **The staff recommends that the next Article IV consultation with Mongolia take place on the standard 12-month cycle.**

Figure 1. Mongolia: Economic Developments, 2001-06

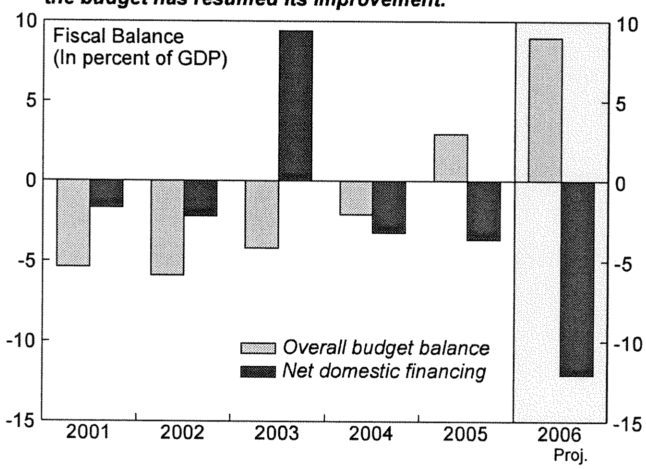
Economic growth since 2004 has been boosted by high world copper and gold prices...



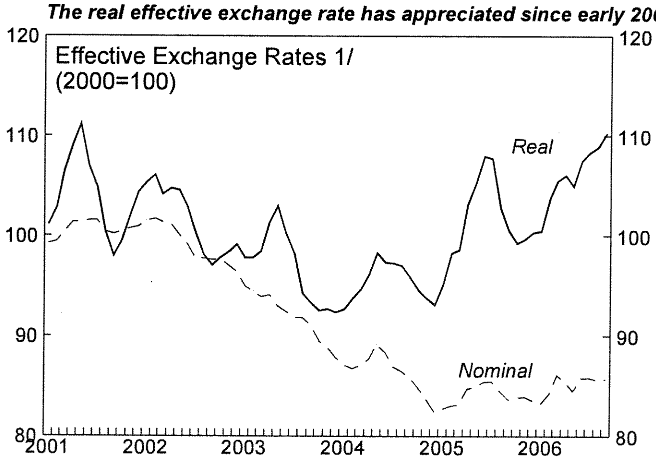
...and inflation has subsided since its mid-2005 peak.



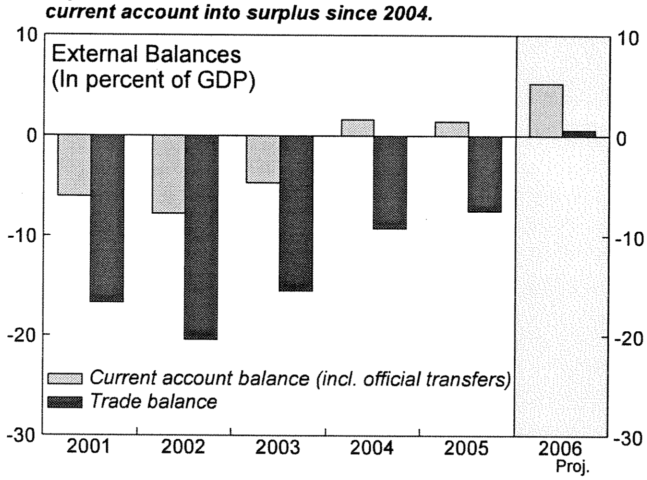
After financing the Russian debt deal in 2003, the budget has resumed its improvement.



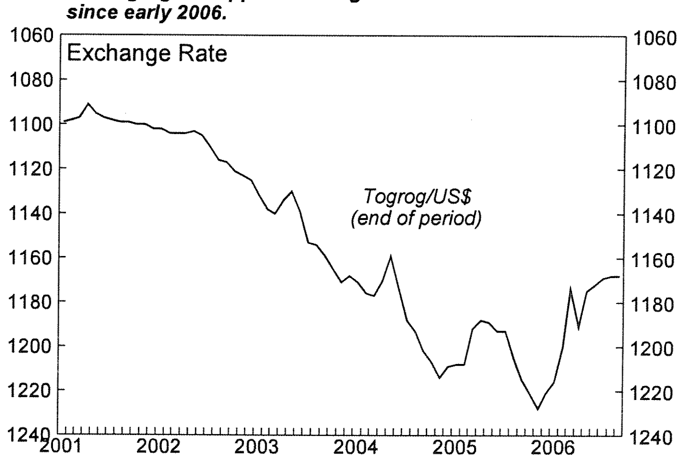
The real effective exchange rate has appreciated since early 2005.



Improved terms of trade has shifted the current account into surplus since 2004.



The Togrog has appreciated against the U.S. dollar since early 2006.

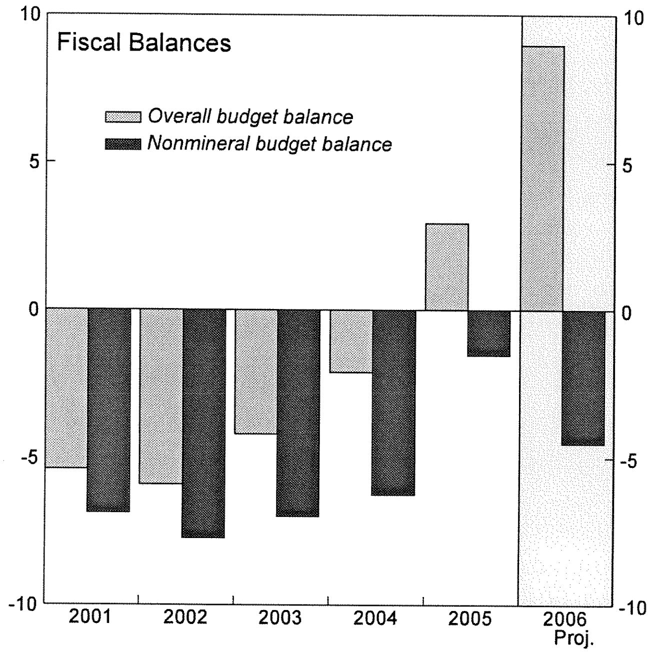


Sources: Mongolian authorities; and Fund staff estimates.

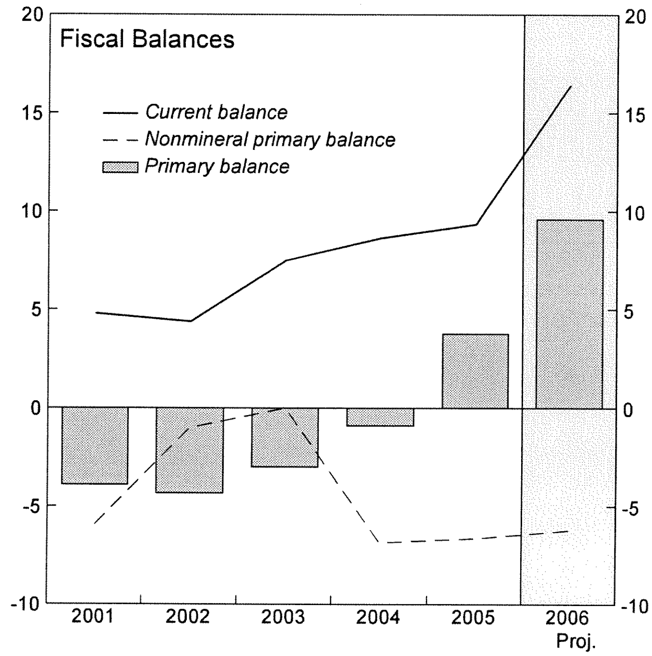
1/ An increase indicates appreciation.

Figure 2. Mongolia: Fiscal Indicators, 2001-06
(In percent of GDP)

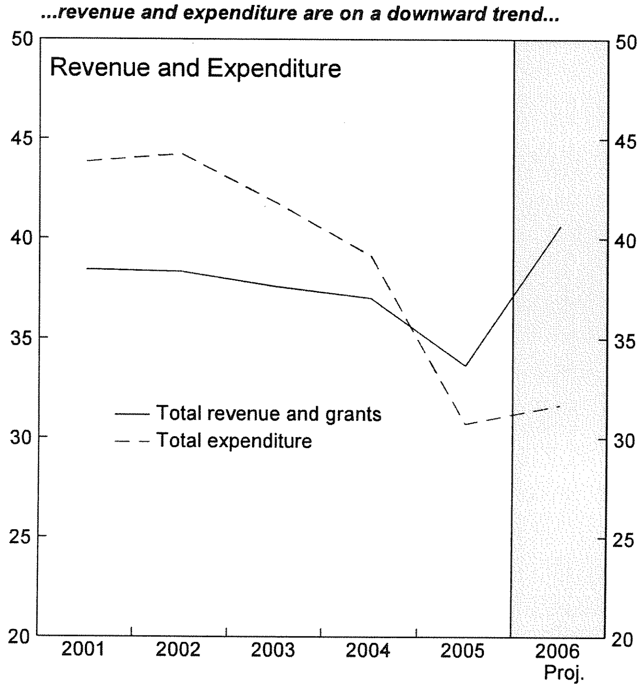
The overall balance switched to a surplus in 2005...



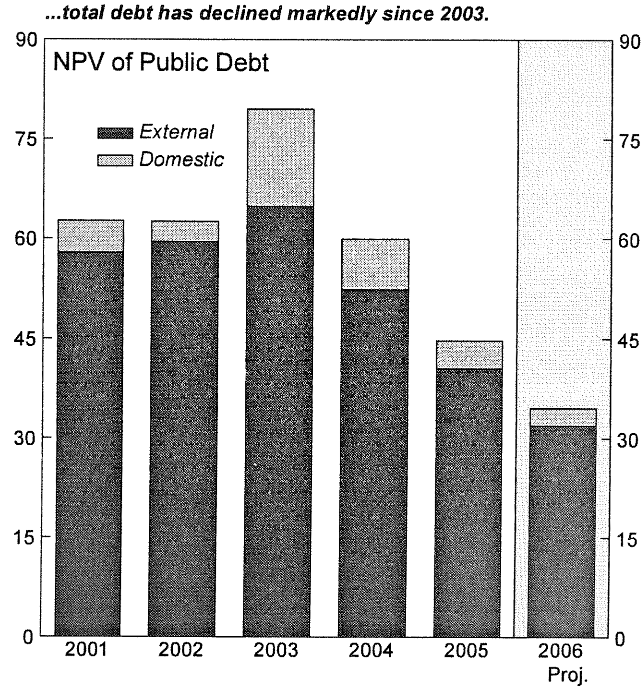
...primary balances have improved through high current balances...



...revenue and expenditure are on a downward trend...

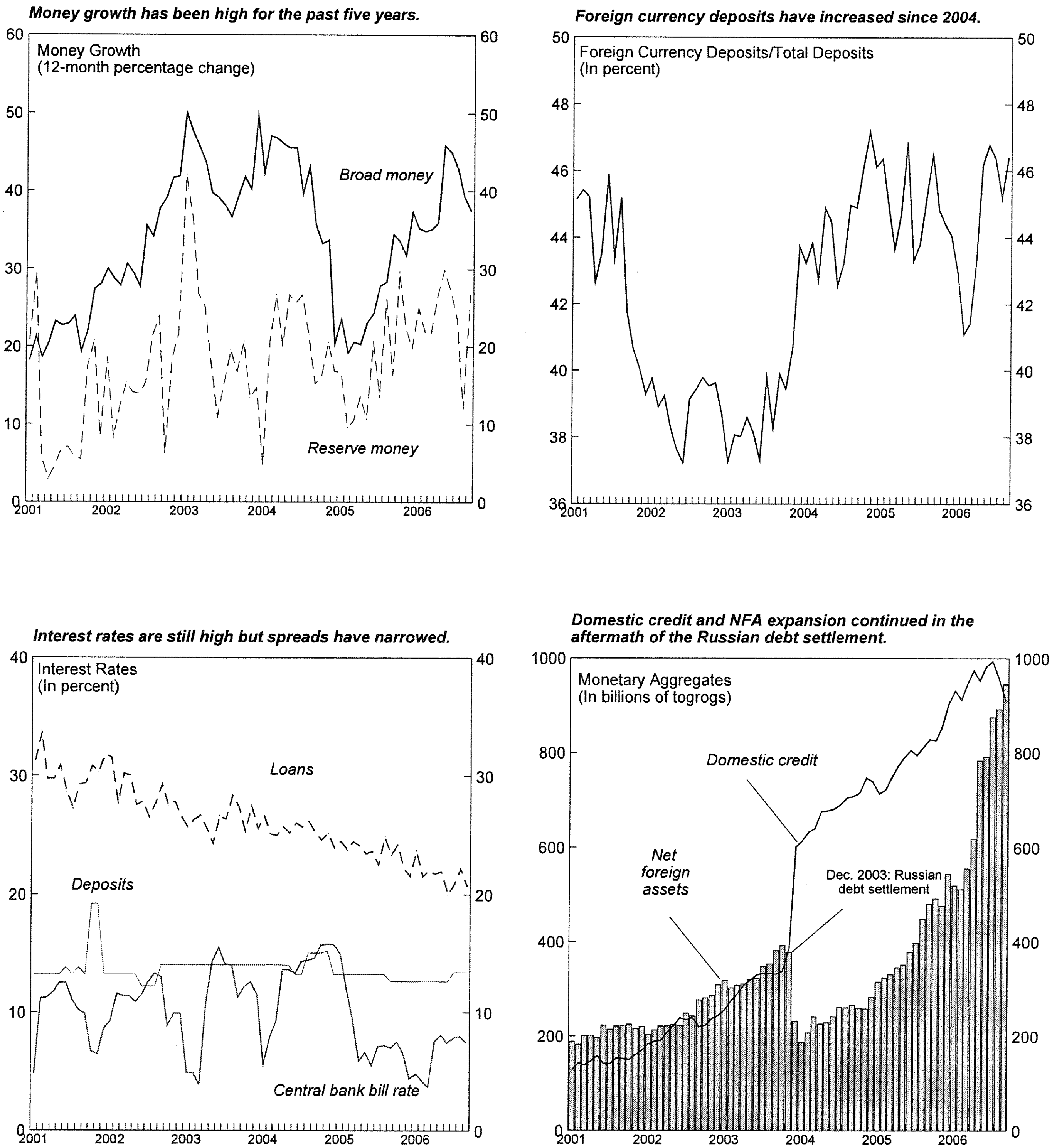


...total debt has declined markedly since 2003.



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

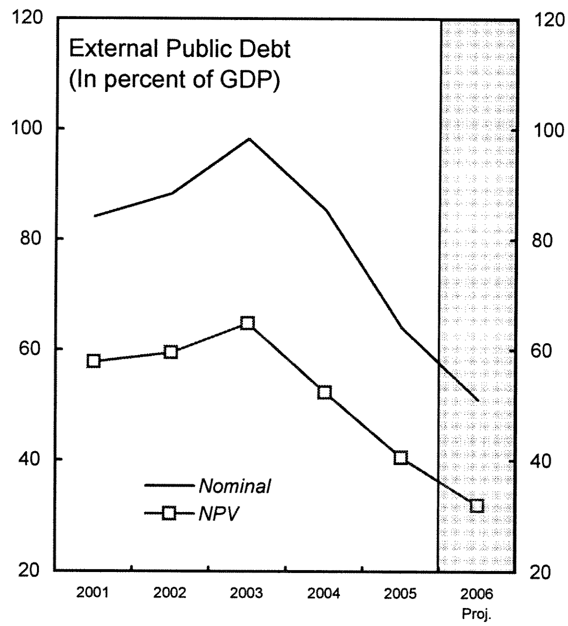
Figure 3. Mongolia: Monetary Developments, 2001-06



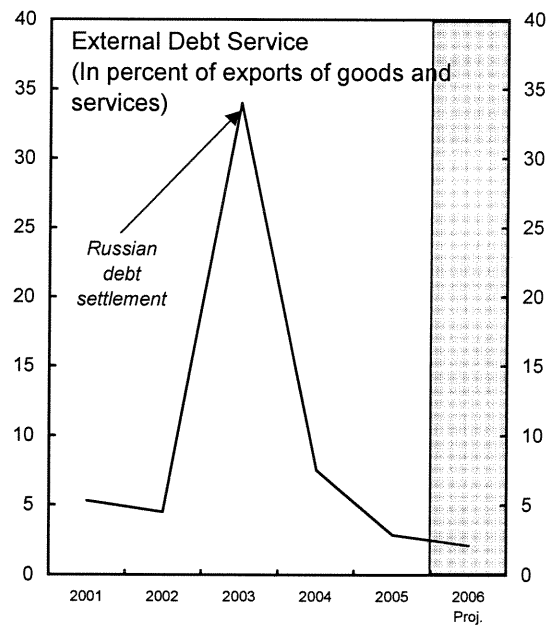
Sources: Mongolian authorities; and Fund staff estimates.

Figure 4. Mongolia: External Developments, 2001-06

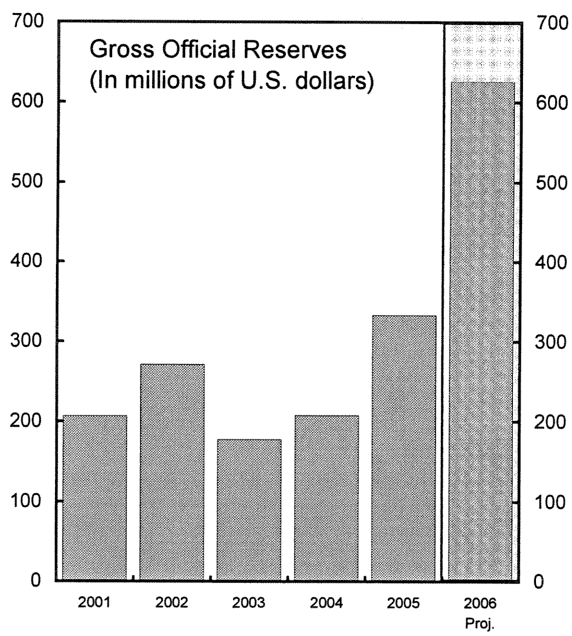
Total public debt has declined steadily since 2004



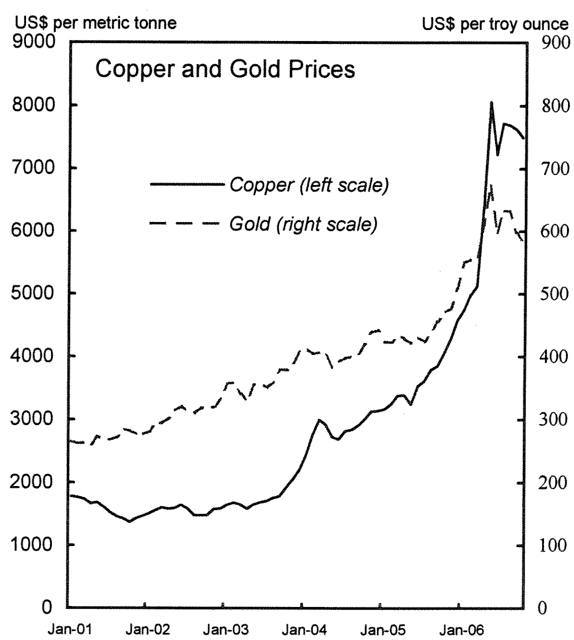
Debt service excluding the Russian debt settlement is low.



Reserves have built up rapidly since 2003.



Commodity prices have continued to rise to unprecedented levels in 2006.



Sources: Mongolian authorities, Fund staff estimates; and *International Financial Statistics*: IMF.

Table 1. Mongolia: Selected Economic and Financial Indicators, 2003-07

Nominal GDP (2005): $2,066 million
Population (2005): 2.56 million
Per capita GDP (2005): $806
Poverty incidence: 36 percent 1/
Quota: SDR 51.1 million

	2003 2/	2004	2005	2006		2007	
				Amended Budget	Est.	Budget 3/	Proj. 4/
			(Percent change)				
Real sector							
Real GDP growth	6.1	10.8	7.0	6.8	7.0	8.6	7.0
Mineral	-2.3	34.3	10.9	...	5.2	...	5.2
Nonmineral	7.1	8.1	6.5	...	7.3	...	7.3
Consumer prices (period average)	5.1	8.3	12.1	5.6	5.6	...	5.3
Consumer prices (end-period)	4.7	11.0	9.5	7.0	7.0	5.0	5.0
GDP deflator	11.6	18.0	20.7	24.1	24.1	...	6.5
			(In percent of GDP)				
General government budget							
Revenue and grants	37.6	37.0	33.7	33.2	40.6	35.9	35.5
Expenditure and net lending	41.8	39.1	30.7	36.6	31.7	40.9	37.5
Current balance	7.5	8.6	9.3	6.5	16.4	6.8	7.8
Primary balance	-3.0	-0.9	3.8	-2.6	9.6	-4.4	-1.4
Overall balance (including grants)	-4.2	-2.1	2.9	-3.4	9.0	-5.0	-2.0
Nonmineral overall balance	-7.0	-6.3	-1.5	-11.1	-4.5	-16.3	-13.6
Net domestic bank credit to government	9.4	-3.2	-5.8	-1.6	-12.1	2.6	-0.9
			(Percent change)				
Money and credit							
Net foreign assets	-24.9	22.0	92.4	...	85.5	...	33.7
Net domestic assets	191.6	19.5	9.6	...	-9.7	...	30.5
Domestic credit	147.0	23.0	22.3	...	-5.0	...	26.8
Of which: claims on nonbanks	90.3	43.7	40.1	...	39.2	...	20.9
Broad money	49.7	20.3	37.3	...	34.9	...	32.5
Reserve money	14.7	16.8	19.7	...	16.5	...	15.0
Broad money velocity (GDP/BM) 5/	2.1	2.3	2.3	...	2.2	...	1.9
Annual interest rate on central bank bills (percent) 6/	15.0	15.8	3.7	...	5.8	...	...
			(In millions of US dollars; unless otherwise indicated)				
Balance of payments							
Current account balance (excluding official transfers)	-148	-60	-59	...	55	...	-159
(In percent of GDP)	-11.5	-3.7	-2.8	...	2.0	...	-5.2
Current account balance (including official transfers) 7/	-99	27	29	...	145	...	-67
(In percent of GDP)	-7.7	1.6	1.4	...	5.2	...	-2.2
Trade balance	-199	-149	-155	...	16	...	-169
(In percent of GDP)	-15.5	-9.2	-7.5	...	0.6	...	-5.5
Exports, f.o.b.	627	872	1,069	...	1,548	...	1,635
(Percent change)	19.7	39.0	22.5	...	44.8	...	5.6
Imports, cif	827	1,021	1,224	...	1,532	...	1,804
(Percent change)	9.8	23.5	19.8	...	25.2	...	17.7
Foreign direct investment	132	129	258	...	329	...	499
Gross official international reserves (end-period)	178	208	333	...	626	...	800
(In months of next year's imports of goods and services)	1.5	1.6	2.1	...	3.4	...	3.9
Trade prices				...			
Export prices (U.S. dollar, percent change)	6.6	23.1	13.6	...	40.4	...	0.0
Import prices (U.S. dollar, percent change)	5.4	15.1	11.0	...	11.6	...	-0.5
Terms of trade (percent change)	1.1	7.0	2.3	...	25.8	...	0.5
			(In millions of US dollars; unless otherwise indicated)				
Public and publicly guaranteed debt							
Total public debt (In percent of GDP) 8/9/	113.0	93.0	68.3	...	53.6		50.6
Domestic debt (In percent of GDP)	14.8	7.6	4.2	...	2.6		2.0
External debt 7/	1,237	1,361	1,308	...	1,405	...	1,480
(In percent of GDP)	98.2	85.4	64.1	...	51.0	...	48.6
(In percent of total public debt)	86.9	91.8	93.9	...	95.1	...	96.1
Net public debt (In percent of GDP)	105.2	88.0	62.4	50.1	41.2	...	36.9
NPV of total public debt (In percent of GDP) 8/9/10/	79.5	59.9	44.7	...	34.6	...	32.5
Debt service	284.0	91.2	42.8	...	41.8	...	49.8
(In percent of exports of goods and services)	34.0	7.5	2.9	...	2.1	...	2.4
Exchange rate							
Togrogs per US dollar (end-period)	1,170	1,209	1,221	...	1,164		...
Togrogs per U.S. dollar (period-average)	1,147	1,193	1,205	...	1,186		...
Real effective exchange rate (end-period; percent change)	-6.8	0.8	7.7	...	...	...	...
Nominal GDP (billion togrogs)	1,474	1,926	2,489	3,306	3,306	3,768	3,768
Nominal GDP (million U.S. dollars)	1,285	1,615	2,066	2,788	2,788	3,092	3,092

Sources: Data provided by the Mongolian authorities; and Fund staff estimates and projections.

1/ Share of households below national poverty line, 2003 Household Income and Expenditure Survey.
2/ The outturn for 2003 reflects the impact on fiscal, monetary and external accounts of the $250 million settlement of the TR debt.
3/ As approved by Parliament, but subject to ratification by the President.
4/ Fund staff projections based on policy recommendations.
5/ Seasonally adjusted figures for broad money velocity.
6/ Annualized yield on end-period auction of 14-day bills; as of end-September 2006.
7/ From 2004 onwards, revised estimates for remittances in the current account, offset by adjustments, mainly in the capital account.
8/ Includes IMF loans, guarantees and arrears.
9/ Includes treasury bills outstanding, and gross claims of the BoM on the government.
10/ Based on 5 percent discount rate from 2004 onwards.

Table 2. Mongolia: Summary Operations of the General Government, 2003−07

	2003	2004	2005	2006		2007	
				Amended Budget	Est.	Budget 1/	Proj. 2/
				(In billions of togrogs)			
Total revenue and grants	553.9	713.1	837.9	1,097.6	1,343.4	1,353.0	1,336.2
Total expenditure and net lending	615.8	753.7	764.6	1,209.2	1,046.5	1,542.9	1,412.8
Overall balance (incl. grants)	-61.9	-40.6	73.3	-111.6	296.8	-189.9	-76.6
Nonmineral overall balance	-103.1	-120.4	-37.9	-367.9	-149.3	-615.5	-511.1
Financing	51.1	33.8	3.5	111.6	-296.8	189.9	76.6
Foreign (net)	-115.8	81.0	89.8	148.8	87.1	78.2	94.5
Domestic (net)	166.9	-47.1	-86.2	-37.2	-384.0	111.7	-17.9
				(In percent of GDP)			
Total revenue and grants	37.6	37.0	33.7	33.2	40.6	35.9	35.5
Current revenue	37.0	36.7	33.4	33.0	40.5	35.8	35.3
Mineral revenue	2.8	4.1	4.5	7.8	13.5	11.3	11.5
Nonmineral revenue	34.2	32.5	29.0	25.3	27.0	24.5	23.8
Tax revenue and social security contributions	28.6	30.3	27.8	26.6	33.8	30.0	29.5
Income taxes	6.6	7.5	7.2	9.6	15.1	12.1	11.6
Enterprise income tax	4.7	5.1	4.8	4.8	7.0	4.5	4.1
Personal income tax	2.0	2.4	2.3	2.1	2.1	1.8	1.8
"Windfall" tax	0.0	0.0	0.0	2.6	5.9	5.8	5.7
Social security contributions	4.4	4.3	3.8	3.2	3.2	3.6	3.6
Sales tax and VAT	8.3	8.5	7.3	6.3	6.8	5.4	5.3
Excise taxes	4.0	3.6	3.2	2.7	2.8	2.7	2.8
Customs duties and export taxes	2.2	2.3	2.3	1.7	2.1	2.3	2.2
Other taxes	3.1	4.1	4.1	3.2	3.9	4.0	4.0
Nontax revenue	8.4	6.4	5.6	6.4	6.6	5.8	5.8
Capital revenue and grants	0.6	0.4	0.2	0.2	0.2	0.1	0.1
Total expenditure and net lending	41.8	39.1	30.7	36.6	31.7	40.9	37.5
Current expenditure	29.5	28.0	24.1	26.5	24.1	28.9	27.5
Wages and salaries	7.9	7.2	6.2	6.0	5.9	7.1	6.8
Purchase of goods and services	11.9	11.3	9.3	11.7	9.4	8.8	8.8
Subsidies to public enterprises	0.6	0.6	0.3	0.4	0.4	0.4	0.4
Transfers	7.9	7.7	7.4	7.7	7.8	12.0	10.8
Interest payments	1.2	1.2	0.8	0.8	0.6	0.6	0.6
Contingency allocation	...	...	0.0	0.0	0.0	0.0	0.0
Capital expenditure and net lending	12.3	11.1	6.6	10.0	7.6	12.0	10.0
Capital expenditure	6.1	5.4	3.6	6.3	5.4	10.3	8.2
Domestically-financed	4.6	4.3	3.2	5.0	5.1	9.3	7.3
Foreign-financed	1.6	1.2	0.4	1.3	0.3	0.9	0.9
Net lending	6.1	5.7	3.0	3.7	2.2	1.8	1.8
On-lent foreign project loans	5.7	5.5	3.6	4.2	2.7	2.4	2.4
Domestic lending minus repayments	0.4	0.1	-0.6	-0.5	-0.5	-0.7	-0.7
Current balance (excl. privatization receipts)	7.5	8.6	9.3	6.5	16.4	6.8	7.8
Primary Balance	-3.0	-0.9	3.8	-2.6	9.6	-4.4	-1.4
Overall balance (incl. grants)	-4.2	-2.1	2.9	-3.4	9.0	-5.0	-2.0
Nonmineral overall balance	-7.0	-6.3	-1.5	-11.1	-4.5	-16.3	-13.6
Discrepancy between deficit from above and below the li	-0.7	-0.3	0.8	0.0	0.0	0.0	0.0
Financing	3.5	1.8	-2.1	3.4	-9.0	5.0	2.0
Foreign (net)	-7.9	4.2	3.6	4.5	2.6	2.1	2.5
External borrowing (net)	-7.9	3.5	3.4	4.5	2.6	2.1	2.5
Disbursements	13.1	4.9	4.4	5.8	3.3	3.4	3.4
Amortization	20.9	1.4	1.0	1.3	0.7	1.3	0.9
External arrears	0.0	0.7	0.2	0.0	0.0	0.0	0.0
Domestic (net)	11.3	-2.4	-5.7	-1.1	-11.6	3.0	-0.5
Banking system (net)	9.4	-3.2	-5.8	-1.6	-12.1	2.6	-0.9
Nonbank	1.9	0.8	0.0	0.5	0.5	0.4	0.4
Privatization receipts	1.5	0.8	0.2	0.5	0.5	0.4	0.4
Other nonbank (net)	0.5	-0.1	-0.2	0.0	0.0	0.0	0.0
Memoranda items:							
Mineral revenue/total revenue and grants (in percent)	7.4	11.2	13.3	23.4	33.2	31.5	32.6
Nonmineral overall balance 3/	-8.0	-7.7	-2.0	-16.3	-6.6	-23.1	-19.2
Nonmineral primary balance 3/	-6.6	-6.2	-0.9	-15.1	-5.7	-22.2	-18.3
Total public debt (incl. IMF)/GDP	113.0	93.0	68.3	55.4	53.6	50.6	50.6
Foreign debt (incl. IMF)/GDP	98.2	85.4	64.1	52.8	51.0	48.6	48.6
Domestic debt/GDP	14.8	7.6	4.2	2.6	2.6	2.0	2.0
Governments deposits	7.8	5.0	5.9	5.3	16.0	11.2	10.5
Net public debt	105.2	88.0	62.4	50.1	37.6	39.4	40.1
NPV of total public debt	79.5	59.9	44.7	35.7	34.6	33.1	32.5
Nominal GDP	1,474	1,926	2,489	3,306	3,306	3,768	3,768

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Including Development Fund operations. As approved by Parliament, but subject to ratification by the President.
2/ Fund staff projections based on policy recommendations.
3/ In percent of nonmineral GDP.

Table 3. Mongolia: Monetary Aggregates, 2003-07

	2003	2004	2005				2006				2007
	Dec.	Dec.	Mar.	June	Sept.	Dec.	Mar.	Jun.	Sept.	Dec. Est.	Dec. Proj. 1/
	(In billions of togrog; end of period)										
Monetary survey											
Broad Money	704	846	892	1,009	1,112	1,162	1,205	1,463	1,528	1,567	2,076
Currency	131	144	133	177	174	152	145	198	189	165	189
Deposits	572	703	760	832	937	1,009	1,061	1,265	1,339	1,402	1,887
Net foreign assets	232	283	330	377	480	544	555	791	945	1,009	1,348
Net international reserves	278	294	342	389	488	551	564	782	942	1,015	1,355
Bank of Mongolia	151	198	222	253	310	364	411	449	595	696	907
Commercial banks	128	96	120	136	178	187	153	333	347	319	447
Other foreign assets, net	-47	-11	-12	-12	-8	-7	-9	10	3	-7	-7
Net domestic assets	472	564	562	632	632	618	650	672	583	558	728
Domestic credit	601	740	747	805	828	904	946	983	910	859	1,089
Net credit to government 2/	152	94	65	48	7	-1	-50	-121	-267	-400	-434
Claims on nonbanks	449	646	682	757	821	905	996	1,103	1,177	1,260	1,523
Of which:											
Claims on public enterprises	16	13	14	22	21	34	29	30	33	...	...
Claims on the private sector	390	552	581	647	701	776	858	966	1,011	...	...
Nonperforming loans	37	71	76	76	82	79	90	89	110	...	...
Other items, net	-129	-176	-185	-174	-197	-286	-296	-311	-326	-301	-361
Monetary authorities											
Reserve money	201	235	253	296	297	281	308	376	377	328	377
Net foreign assets	151	199	224	254	315	372	415	469	609	704	915
Net international reserves	151	198	222	253	310	364	411	449	595	696	907
Other assets, net	0	1	1	1	5	8	4	20	14	7	7
Net domestic assets	50	36	30	41	-18	-91	-107	-93	-233	-376	-538
Net credit to government	128	106	84	87	45	52	-2	-72	-190	-323	-367
Claims on deposit money banks	13	22	22	19	18	18	18	18	18	18	18
Minus: Central bank bills (net)	76	69	70	82	84	126	110	69	84	104	167
Other items, net	-15	-23	-7	16	3	-35	-13	30	23	33	-22
Of which : precious metals	8	6	12	34	37	10	11	51	43	...	...
Memoranda items:	(In percent; except otherwise indicated)										
Annual broad money growth	49.7	20.3	20.6	24.3	34.4	37.3	35.1	45.0	37.4	34.9	32.5
Annual growth of credit to nonbanks 3/	90.3	43.7	34.1	33.5	34.7	40.1	46.0	45.7	43.3	39.2	20.9
Annual reserve money growth	14.7	16.8	10.5	20.4	16.3	19.7	21.7	27.2	26.8	16.5	15.0
Velocity, seasonally adjusted	2.1	2.3	2.6	2.5	2.4	2.3	2.6	2.2	2.1	2.2	1.9
Broad money/Reserve money	3.5	3.6	3.5	3.4	3.7	4.1	3.9	3.9	4.1	4.8	5.5
Nonperforming loans/total loans (percent)	8.2	10.9	11.2	10.0	10.0	8.8	9.0	8.1	9.3	...	...
Excess reserves (billions of togrogs)	6.4	3.0	33.9	18.3	5.2	15.3	58.0	18.4	18.4	...	...

Sources: Data provided by the Mongolian authorities; and Fund staff estimates and projections.

1/ Fund staff projections based on policy recommendations.
2/ Valued at actual exchange rates and gold prices.
3/ Includes nonperforming loans.

Table 4. Mongolia: Balance of Payments, 2003-11

(In millions of US dollars; unless otherwise indicated)

	2003	2004	2005	2006	2007	2008	2009	2010	2011
				Est.	Proj. 1/		Proj. 1/		
Current account balance (including official transfers)	-99	27	29	145	-67	-479	-255	-174	-213
Trade balance	-199	-149	-155	16	-169	-554	-492	-161	-76
Exports, f.o.b.	627	872	1,069	1,548	1,635	1,483	1,426	1,835	1,993
Copper	162	284	326	648	623	419	415	533	483
Gold	157	240	331	318	399	441	372	646	821
Imports, c.i.f.	-827	-1,021	-1,224	-1,532	-1,804	-2,037	-1,917	-1,995	-2,069
Services, net	-49	-46	65	66	61	50	68	72	66
Receipts	208	338	414	447	471	497	524	552	580
Payments	-257	-383	-350	-380	-409	-447	-456	-480	-514
Income, net	-12	-48	-106	-191	-224	-251	-119	-393	-522
Official medium- and long-term interest payments	-12	-15	-15	-16	-17	-18	-19	-20	-21
Transfers, net	74	146	134	140	147	156	165	181	190
Official	49	87	88	90	92	94	96	98	100
Private	38	36	3	25	26	27	27	28	29
Financial and capital account	-30	10	88	153	248	575	379	368	365
Direct investment	132	129	258	329	499	727	395	360	360
Portfolio investment	50	-53	0	0	0	0	0	0	0
Loans	-187	49	-14	82	48	73	74	83	81
Medium- and long-term, net	-170	75	61	90	78	103	104	113	111
Disbursements	176	157	91	130	126	157	162	174	175
Public	101	129	90	110	105	135	139	150	150
Private	74	29	1	20	21	22	23	24	26
Amortization	-346	-82	-31	-40	-48	-55	-58	-61	-65
Public	-264	-18	-22	-20	-27	-33	-37	-38	-42
Private	-82	-64	-9	-20	-21	-21	-22	-23	-23
Short-term, net	-17	-27	-75	-8	-30	-30	-30	-30	-30
Currency and deposits, net	-21	-120	-162	-266	-309	-237	-105	-95	-97
Commercial banks, net	-21	0	-72	-120	-110	-40	-40	-60	-60
Other	0	-119	-91	-146	-199	-197	-65	-35	-37
Trade credits, net	-4	4	7	8	10	12	15	20	21
Errors and omissions	31	-5	9	0	0	0	0	0	0
Overall balance	-98	32	126	298	181	96	124	194	152
Financing	98	-32	-126	-298	-181	-96	-124	-194	-152
Increase in net official reserves (-)	97	-37	-131	-298	-181	-96	-124	-194	-152
Use of IMF credit (+)	3	-7	-6	-6	-6	-5	-6	-5	-4
Increase in gross official reserves (-)	94	-30	-125	-292	-174	-91	-118	-190	-148
Arrears accumulation (+) / payments (-) (net) 2/	1	5	5	0	0	0	0	0	0
Exceptional financing / rescheduling	0	0	0	0	0	0	0	0	0
Financing gap	...	...	...	...	0	0	0	0	0
Memoranda items:									
Current account balance (in percent of GDP)									
Excluding official transfers	-11.5	-3.7	-2.8	2.0	-5.2	-17.7	-10.1	-6.9	-7.4
Including official transfers	-7.7	1.6	1.4	5.2	-2.2	-14.8	-7.3	-4.5	-5.1
Exports, f.o.b. (annual growth)	19.7	39.0	22.5	44.8	5.6	-9.3	-3.9	28.7	8.6
Imports, c.i.f. (annual growth)	9.8	23.5	19.8	25.2	17.7	12.9	-5.9	4.1	3.7
Export volume growth	12.3	13.8	7.8	3.1	5.6	4.1	1.4	33.4	9.8
Import volume growth	4.2	7.7	7.9	12.2	18.3	14.2	-4.4	5.4	3.2
Export price index change	6.6	23.1	13.6	40.4	0.0	-12.9	-5.2	-3.5	-3.5
Import price index change	5.4	15.1	11.0	11.6	-0.5	-1.1	-1.6	-1.3	-0.6
Trade balance (in percent of GDP)	-15.5	-9.2	-7.5	0.6	-5.5	-17.2	-14.1	-4.1	-1.8
Gross official reserves (end-period)	178	208	333	626	800	891	1,009	1,198	1,346
(In months of next year's imports of goods and services)	1.5	1.6	2.1	3.4	3.9	4.5	4.9	5.6	5.9
Debt service (in percent of exports of goods and services) 3/	34.0	7.5	2.9	2.1	2.4	2.8	3.2	2.6	2.6

Sources: Data provided by the Mongolian authorities; and Fund staff estimates and projections.

1/ Fund staff projections based on policy recommendations.
2/ Arrears on post-1991 Russian debt. Excluding disputed amounts with Finland.
3/ Public external debt service only.

Table 5. Mongolia: External Debt and Debt Service, 2003–11

	2003	2004	2005	2006	2007	2008	2009	2010	2011
				Est.			Proj. 1/		
	(In millions of U.S. dollars; unless otherwise indicated)								
Nominal Debt Stock 2/	1,237	1,361	1,308	1,405	1,480	1,582	1,681	1,792	1,896
IMF	49	44	36	29	23	19	13	8	5
Non-IMF	1,188	1,317	1,271	1,376	1,457	1,563	1,668	1,783	1,892
of which: current outstanding	1,188	1,317	1,271	1,265	1,241	1,211	1,176	1,140	1,097
Multilateral	669	797	770	772	763	750	734	718	700
Official bilateral	456	507	488	493	478	461	442	421	398
Treasury bill in US$ to nonresident	50	0	0	0	0	0	0	0	0
Commercial	13	13	13	0	0	0	0	0	0
of which: additional	0	0	0	111	216	352	492	644	794
Total Debt Service (including TR debt resolution)	284	91	43	42	50	56	62	63	67
Amortization	272	75	28	26	33	38	43	43	45
Interest	12	16	15	16	17	18	19	20	21
Debt Service on Existing Debt									
Amortization	21	25	28	26	33	38	43	43	45
Medium and long term	21	25	28	26	33	38	43	43	45
Multilateral	10	11	12	13	16.7	20	24	23	23
Official Bilateral	11	14	16	13	16.5	18	19	20	22
Commercial	0	0	0	0	0	0	0	0	0
Interest	12	15	15	15	14	14	14	13	13
Medium and long term	12	15	15	15	14	14	14	13	13
Multilateral	6	7	7	7	7	7	7	7	7
Official Bilateral	6	8	8	7	7	7	6	6	6
Commercial	0	0	0	0	0	0	0	0	0
Debt Service on TR settlement									
Amortization	251	50	0	0	0	0	0	0	0
Russia	250	0	0	0	0	0	0	0	0
Slovakia	1	0	0	0	0	0	0	0	0
N. Korea	0	0	0	0	0	0	0	0	0
Treasury Bill	0	50	0	0	0	0	0	0	0
Interest	0	1	0	0	0	0	0	0	0
Russia	0	0	0	0	0	0	0	0	0
Treasury Bill	0	1	0	0	0	0	0	0	0
Debt Service on New Borrowing	0	0	0	1	2	4	5	7	8
Amortization	0	0	0	0	0	0	0	0	0
Interest	0	0	0	1	2	4	5	7	8
Memoranda items:									
Total debt service									
In percent of exports of goods and services	34.0	7.5	2.9	2.1	2.4	2.8	3.2	2.6	2.6
In percent of GDP	22.1	5.6	2.1	1.5	1.6	1.7	1.8	1.6	1.6
Total debt stock									
In percent of exports of goods and services	148.1	112.5	88.2	70.5	70.3	79.9	86.2	75.1	73.7
In percent of GDP	98.2	85.4	64.1	51.0	48.6	49.8	49.1	46.4	45.9
Net present value of debt	808	834	827	872	929	1,001	1,072	1,151	1,228
In percent of exports of goods and services	96.8	68.9	55.8	43.7	44.1	50.6	55.0	48.2	47.7
In percent of GDP	64.2	52.3	40.3	31.7	30.5	31.5	31.3	29.8	29.7

Sources: Data provided by the Mongolian authorities; and IMF staff estimates and projections.

1/ Excluding TR11.4 billion debt to Russia settled in December 2003 with an upfront payment of U.S. $250 million.

Table 6. Mongolia: Medium-Term Macroeconomic Framework, 2003–11

	2003	2004	2005	2006	2007	2008	2009	2010	2011
				Est.			Proj. 1/		
	(In percent of GDP; unless otherwise indicated)								
Real sector									
Nominal GDP (in billions of togrogs)	1,474	1,926	2,489	3,306	3,768	4,055	4,504	5,231	5,780
Nominal GDP (in millions of U.S. dollars)	1,285	1,615	2,066	2,788	3,092	3,228	3,477	3,917	4,199
Per capita GDP (in U.S. dollars)	513	637	806	1,075	1,179	1,217	1,296	1,443	1,529
Real GDP (percent change)	6.1	10.8	7.0	7.0	7.0	7.0	7.0	11.0	6.0
Mineral real GDP	-2.3	34.3	10.9	5.2	5.2	5.2	6.5	30.0	4.6
Nonmineral real GDP	7.1	8.1	6.5	7.3	7.3	7.2	7.1	8.4	6.2
GDP deflator (percent change)	11.6	18.0	20.7	24.1	6.5	0.6	3.8	4.6	4.2
Consumer prices (period average; percent change)	5.1	7.9	12.5	5.6	5.3	5.0	5.0	5.0	5.0
Consumer prices (end-period; percent change)	4.7	10.6	9.2	7.0	5.0	5.0	5.0	5.0	5.0
General government accounts									
Total revenue and grants	37.6	37.0	33.7	40.6	35.5	31.4	29.4	27.8	27.3
Mineral revenue	2.8	4.1	4.5	13.5	11.5	4.3	4.2	3.9	2.7
Nonmineral revenue	34.2	32.5	29.0	27.0	23.8	26.9	25.0	23.8	24.5
Capital revenue and grants	0.6	0.4	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Total expenditure and net lending	41.8	39.1	30.7	31.7	37.5	35.5	32.4	30.8	30.4
Current expenditure	29.5	28.0	24.1	24.1	27.5	26.5	24.4	22.8	22.4
Wages and salaries	7.9	7.2	6.2	5.9	6.8	6.7	6.6	6.3	6.3
Goods and services	11.9	11.3	9.3	9.4	8.8	8.6	8.2	7.5	7.2
Interest payments	1.2	1.2	0.8	0.6	0.6	0.7	0.7	0.6	0.6
Other	8.5	8.3	7.7	8.1	11.2	10.5	8.9	8.4	8.3
Capital expenditure and net lending	12.3	11.1	6.6	7.6	10.0	9.0	8.0	8.0	8.0
Current balance	7.5	8.6	9.3	16.4	7.8	4.7	4.9	4.9	4.8
Overall balance (including grants)	-4.2	-2.1	2.9	9.0	-2.0	-4.1	-3.0	-3.0	-3.1
Nonmineral overall balance	-7.0	-6.3	-1.5	-4.5	-13.6	-9.6	-7.3	-7.2	-6.9
Foreign financing (including gap financing)	-7.9	4.2	3.6	2.6	2.5	3.2	3.0	2.8	2.6
Monetary sector									
Broad money (percent change)	49.7	20.3	37.3	34.9	32.5	24.2	20.7	17.3	15.1
Velocity (GDP/M2)	2.1	2.3	2.3	2.2	1.9	1.6	1.4	1.4	1.4
Balance of payments									
Exports (percent change)	19.7	39.0	22.5	44.8	5.6	-9.3	-3.9	28.7	8.6
Imports (percent change)	9.8	23.5	19.8	25.2	17.7	12.9	-5.9	4.1	3.7
Current account balance (excluding official transfers)	-11.5	-3.7	-2.8	2.0	-5.2	-17.7	-10.1	-6.9	-7.4
Current account balance (including official transfers)	-7.7	1.6	1.4	5.2	-2.2	-14.8	-7.3	-4.5	-5.1
Gross official reserves									
(in millions of U.S. dollars)	178	208	333	626	800	891	1,009	1,198	1,346
(in months of next year's imports of goods and services)	1.5	1.6	2.1	3.4	3.9	4.5	4.9	5.6	5.9
Debt indicators									
Total public debt	113.0	93.0	68.3	53.6	50.6	51.3	50.2	47.2	46.3
Domestic debt	14.8	7.6	4.2	2.6	2.0	1.6	1.1	0.8	0.5
External debt	98.2	85.4	64.1	51.0	48.6	49.8	49.1	46.4	45.9
(in millions of U.S. dollars)	1,237	1,361	1,308	1,405	1,480	1,582	1,681	1,792	1,896
NPV of total public debt	79.5	59.9	44.7	34.6	32.5	32.6	31.7	29.6	29.0
of which: external debt	64.2	52.3	40.3	31.7	30.5	31.5	31.3	29.8	29.7
Government deposits in the banking system	7.8	5.0	5.9	16.0	14.4	12.2	10.8	9.0	7.5
External public debt service 2/	34.0	7.5	2.9	2.1	2.4	2.8	3.2	2.6	2.6
Memoranda items									
Copper prices (US$ per ton)	1,779	2,863	3,676	6,300	6,000	4,000	3,200	2,800	2,400
Gold prices (US$ per ounce)	364	409	445	610	670	705	745	785	805

Sources: Data provided by the Mongolian authorities; and Fund staff estimates and projections.

1/ Fund staff projections based on policy recommendations.
2/ In percent of exports of goods and services.

Table 7. Mongolia: Indicators for Vulnerability and Financial Soundness, 2001-05

	2001	2002	2003	2004	2005
Key Economic and Market Indicators					
Real GDP growth (in percent)	1.1	4.2	6.1	10.8	7.0
CPI inflation (end of period; in percent)	7.9	1.7	4.7	10.6	9.2
Short-term interest rate (in percent) 1/	8.8	8.0	15.0	15.8	3.7
Exchange rate, Togrog/US$ (end of period)	1,102	1,125	1,170	1,209	1,221
External Sector					
Exchange rate regime			Floating		
Current account balance (in percent of GDP) 2/	-7.6	-9.6	-7.7	1.6	1.4
Direct investment (in percent of GDP)	4.2	6.9	10.2	8.0	12.5
Export growth (US$ value, percent change)	-2.4	0.1	19.7	39.0	22.5
Real effective exchange rate (end of period; 2000=100)	104.6	99.2	92.4	93.2	100.6
Gross international reserves (in US$ million)	206.8	271.5	177.7	207.8	333.2
NPV of external debt (in percent of GDP)	57.7	59.5	64.2	52.3	40.3
General Government					
Overall balance (in percent of GDP)	-5.4	-5.9	-4.2	-2.1	2.9
Primary balance (in percent of GDP)	-3.9	-4.3	-3.0	-0.9	3.8
General government financing (in percent of GDP)					
Foreign (net)	5.9	6.6	-7.9	4.2	3.6
Domestic (net)	-0.5	-0.9	11.3	-2.4	-5.7
Financial Sector					
Capital adequacy ratio					
Tier I capital ratio	21.6	17.7	18.5	17.4	15.8
Total regulatory capital/risk-weighted assets	24.6	20.0	20.4	20.0	18.2
Total regulatory capital/total assets	14.2	12.4	13.4	15.6	13.6
Asset quality					
Foreign exchange loans/total loans	35.2	32.5	42.8	45.6	47.0
NPLs/total loans	7.9	7.0	8.2	10.9	8.8
Provisions/NPLs 3/	85.8	74.0	57.6	53.9	63.8
Earnings and profitability					
Return on (average) assets	5.9	4.3	3.1	2.5	2.2
Interest margin/gross income	41.3	39.8	35.9	31.5	30.9
Non-interest expenses/gross income	55.4	50.3	49.1	58.8	54.3
Personnel expenses to non-interest expenses	26.0	22.4	22.3	26.7	28.5
Liquidity					
Loans to deposits	92.8	100.0	113.1	116.6	121.8
Liquid assets/total assets	41.3	39.9	35.3	31.6	36.0
Liquid assets/short-term liabilities 4/	80.6	90.9	83.5	28.8	37.7

Sources: Data provided by the Mongolian authorities; and Fund staff estimates.

1/ Annual interest rate on central bank bills at the end of period.
2/ Including official transfers.
3/ NPLs includes past due loans.
4/ Short-term liabilities are defined as the sum of current account and demand deposits.

ANNEX I. Mongolia—Debt Sustainability Analysis

A. Introduction

1. This appendix presents the joint debt sustainability analysis (DSA) of the IMF and the World Bank staff. Mongolia is rated as a medium performer with regard to its policies and institutions under the joint IMF-WB DSA framework for low-income countries (LICs)[7]. The debt sustainability is analyzed in relation to the threshold indicators for countries in this category.

B. Baseline scenario

Assumptions

2. **The baseline scenario is built on the assumption of sustained output and export growth.** Real GDP is assumed to grow by 7 percent in 2006 as well as from 2007 to 2009, partly underpinned by the ongoing development of the Oyu Tolgoi (Ivanhoe) Mine. Real GDP growth is expected to reach 11 percent in 2010 when the main Ivanhoe Mines' production starts, and declines to 6-5.5 percent between 2010 and 2014, before further slowing down to 5 percent after 2015. The growth scenario assumes the start up of additional new mining sector and infrastructure projects and the continued development of the service sector over the medium term and beyond. Regarding the fiscal projections, the 2007 overall budget deficit is assumed to be 2 percent of GDP. This is 3 percentage points lower than the 2007 budget proposal of the Government and assumes that the additional policy measures recommended in the Article IV document are implemented. In the balance of payments, export growth is expected to remain strong in 2006, followed by a slowdown in 2007-09, as copper prices revert to their long-term trend, in line with WEO assumptions. Export growth would then pick up substantially in 2010 when the main Ivanhoe Mine begins production. Imports will also be higher, mainly of equipment associated with mining operations and infrastructure development. Beyond 2015, export growth is assumed to be 6.5-7.5 percent, while imports are assumed to grow at about 7 percent over the long term.

3. **New borrowing is assumed to be only on concessional terms.** New borrowing is projected to remain at around US$150 million annually over the medium term, and to increase by about 2½ percent annually over the longer term. The average concessionality level of new external borrowing is assumed at around 40 percent, which is slightly lower than the current level.

Fiscal DSA (Table 1a)

4. **Under the baseline scenario, public sector debt remain on a downward trend (Table 1a).** Public debt falls from about 68.3 percent of GDP at end-2005 to 46.3 percent at

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[7] In the LIC DSA framework, the quality of a country' s policies and institutions is measured by the World Bank's Country Policy and Institutional Assessment (CPIA) index, and classified into three categories: strong, medium and poor. Compared to last year, the overall CPIA index for Mongolia has remained unchanged.

end-2011 and continues to decline thereafter. In net present value (NPV) term, however, public debt, which temporarily decreases to 84.4 percent of revenues in 2006, is expected to rebound to 110.6 percent by the end of the decade, mainly because of the sharp decline in mineral revenue. The debt service-to-revenue ratio is also expected to follow the same pattern, declining below 3.3 percent in 2006 followed by steady increase through the entire forecast period. The NPV of government debt as a share of GDP, however, declines to 30 percent by the end of this decade and remains below 30 percent thereafter (Figure 1).

External DSA (Table 2a)

5. **The NPV of the debt-to-GDP ratio (40 percent at end-2005), which is the only indicator initially above its threshold, is expected to decline to 32 percent in 2006, mostly as a result of the substantial nominal GDP growth.** Nominal GDP (in US dollar) is expected to increase substantially in 2006 (33 percent) driven by high GDP deflator growth as a result of the buoyant export prices. The ratio is expected to stay at similar levels in the near term before further dropping down in the longer term. Reflecting Mongolia's high export-to-GDP ratio, the NPV of debt-to-export ratio would stay well below the corresponding threshold (150 percent) during the entire projection period, although it is expected to increase in the near term with the slowdown of export growth. Also, given that most of the external debt is on concessional terms, the debt service ratio would stay below 3.5 percent of exports under the baseline scenario, against the 20 percent threshold. Finally, the NPV of debt-to-revenue ratio and debt service-to-revenue ratio would also stay well below the 250 percent and 30 percent thresholds, respectively.

C. Alternative scenarios and bound tests

Fiscal DSA (Table 1b)

6. **The debt indicators based on alternative scenarios imply that a decline in GDP growth would be the main risk to fiscal debt sustainability (Table 2a).** A decline in growth rates to the last decade's average would push up debt levels, so that the NPV of debt-to-revenue ratio would reach around 170 percent at end-2011 and continue to increase to an alarming level of about 270 percent at end-2026. The scenario assuming an unchanged nonmineral primary balance,[8] however, yields much lower debt indicators. This is because this scenario does not include the recently passed tax cuts, which will apply from 2007.

7. **The bound tests confirm that the largest deterioration of debt indicators could be observed with lower growth rates.** Against this background, the authorities should continue to strengthen competitiveness of their private sectors and improve the business climate to support baseline growth.

[8] The assumption of an unchanged primary balance, which is typically used in debt sustainability assessments to represent a scenario without policy reforms, is not considered relevant for Mongolia, because export prices are currently exceptionally high and the budget has a substantial surplus. Instead, the no-reform scenario assumes an unchanged nonmineral balance.

External DSA (Table 2b)

8. **The bound tests suggest that external debt indicators could deteriorate considerably in the face of adverse external developments, especially terms of trade shocks.** Given that copper and gold account for more than half of Mongolia's total exports, the impact of exogenous shocks on these commodities is simulated as a Mongolia-specific bound test. Specifically, the test assumes that copper and gold prices decline by 35 and 25 percent, respectively, in 2010, and each rises by 1 percent annually thereafter (case B.2 in Table 2b). The test also assumes that as a consequence of these terms of trade shocks and their income effects, the real GDP growth rate is reduced by 0.5 percent in 2010, and by 0.25 percent thereafter compared with the baseline scenario. Under these assumptions, both NPV of debt-to-GDP ratio and debt-to-export ratio would deteriorate substantially: NPV of debt-to-GDP ratio will stay above the 40 percent threshold even in the long term, and debt-to-export ratio will reach 119 percent by 2026.

9. **Other adverse shocks would also lead to heavier debt burden in the medium term, although debt level would remain manageable in the long term.** For example, if the interest rate on new borrowing is 2 percentage points higher than in the baseline (with unchanged grace and maturity periods), the NPV of debt-to-GDP ratio would reach 34 percent by 2009, before declining to 25 percent by 2026. Lower growth and current account balance, as well as lower non-debt inflows, among others, would also lead to higher debt distress in the medium term.

D. Conclusion

10. **Mongolia is at moderate risk of debt distress over the medium term, although the debt burden is likely to remain sustainable over the long term, if the authorities continue to borrow exclusively on concessional terms and the external economic environment evolves broadly as envisaged in the baseline scenario.**[9] Under this scenario, all debt indicators would stay below their respective thresholds through the medium-to-long term. However, the NPV of debt-to-GDP ratio would breach its threshold in the medium term under various shock scenarios. In particular, debt sustainability is vulnerable to severe terms-of-trade shocks. The analysis calls for continued prudent debt management and close watch of debt sustainability. The government should also refrain from any nonconcessional borrowing or loan guarantees.

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[9] This risk classification will not change if the three-year-average CPIA Index is used (2003-05) instead of the 2005 CPIA Index.

Table 1a. Mongolia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2003-26

	Actual					Projections									
	2003	2004	2005	Historical Average 5/	Standard Deviation 5/	2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2026	2012-26 Average
Public sector debt 1/	113.0	93.0	68.3			53.6	50.6	51.3	50.2	47.2	46.3		38.6	36.9	
o/w foreign-currency denominated	98.2	85.4	64.1			51.0	48.6	49.8	49.1	46.4	45.9		38.9	24.3	
Change in public sector debt	21.6	-19.9	-24.7			-14.7	-3.0	0.7	-1.1	-3.0	-0.9		-1.0	0.2	
Identified debt-creating flows	-8.4	-22.7	-23.5			-27.2	-3.6	1.7	-0.9	-2.9	-0.3		-0.8	0.5	
Primary deficit	3.0	0.9	-3.8	5.1	4.7	-9.6	1.4	3.5	2.3	2.4	2.5	0.4	2.0	2.5	2.5
Revenue and grants	37.6	37.0	33.7			40.6	35.5	31.4	29.4	27.8	27.3		26.9	25.1	
of which: grants	0.6	0.3	0.2			0.1	0.1	0.1	0.1	0.1	0.1		0.1	0.1	
Primary (noninterest) expenditure	40.6	37.9	29.9			31.0	36.8	34.8	31.7	30.2	29.8		28.8	27.7	
Automatic debt dynamics	-10.0	-22.8	-19.5			-17.1	-4.5	-1.5	-3.1	-5.0	-2.6		-2.7	-2.0	
Contribution from interest rate/growth differential	-5.9	-13.9	-8.5			-6.1	-3.9	-3.6	-3.7	-5.3	-2.9		-2.2	-1.6	
of which: contribution from average real interest rate	-0.7	-3.0	-2.4			-1.7	-0.4	-0.3	-0.3	-0.3	-0.3		-0.3	0.1	
of which: contribution from real GDP growth	-5.3	-11.0	-6.1			-4.5	-3.5	-3.3	-3.4	-5.0	-2.7		-1.9	-1.7	
Contribution from real exchange rate depreciation	-4.0	-8.9	-11.0			-11.0	-0.6	2.1	0.6	0.2	0.4		...	...	
Other identified debt-creating flows	-1.5	-0.8	-0.2			-0.5	-0.4	-0.2	-0.2	-0.2	-0.2		-0.1	0.0	
Privatization receipts (negative)	-1.5	-0.8	-0.2			-0.5	-0.4	-0.2	-0.2	-0.2	-0.2		-0.1	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 (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	30.0	2.8	-1.2			12.5	0.5	-1.0	-0.1	-0.2	-0.6		-0.2	-0.3	
NPV of public sector debt	14.8	7.6	44.5			34.3	32.5	33.1	32.4	30.6	30.2		25.9	29.6	
o/w foreign-currency denominated	0.0	0.0	40.3			31.7	30.5	31.5	31.3	29.8	29.7		26.2	17.0	
o/w external	...	...	40.3			31.7	30.5	31.5	31.3	29.8	29.7		26.2	17.0	
NPV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	24.7	3.2	-1.9			-8.3	2.9	5.2	4.0	4.0	4.1		3.2	4.5	
NPV of public sector debt-to-revenue ratio (in percent) 3/	39.3	20.5	132.2			84.4	91.6	105.4	110.3	110.0	110.6		96.5	117.8	
o/w external	…	…	119.8			77.9	86.0	100.4	106.4	107.2	108.8		97.5	67.6	
Debt service-to-revenue ratio (in percent) 3/ 4/	57.8	6.3	5.6			3.3	4.3	5.4	5.8	5.8	5.9		4.7	7.8	
Primary deficit that stabilizes the debt-to-GDP ratio	-18.6	20.8	20.9			5.1	4.4	2.7	3.4	5.4	3.3		3.0	2.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.1	10.8	7.0	4.3	2.9	7.0	7.0	7.0	7.0	11.0	6.0	7.5	5.0	5.0	5.1
Average nominal interest rate on forex debt (in percent)	1.2	1.2	1.1	1.4	0.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.1	1.2
Average real interest rate on domestic currency debt (in percent)	-0.9	-13.0	-15.9	-2.7	8.5	-18.3	-1.8	5.1	3.6	5.9	5.3	0.0	3.4	3.1	3.1
Real exchange rate depreciation (in percent, + indicates depreciatior	-4.9	-10.1	-14.0	1.3	13.7	-18.6	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	11.6	18.0	20.7	11.8	8.2	24.1	6.5	0.6	3.8	4.6	4.2	7.3	6.5	6.7	6.6
Growth of real primary spending (deflated by GDP deflator, in percer	1.0	3.5	-15.7	4.4	11.6	11.1	27.0	1.1	-2.5	5.5	4.6	7.8	4.4	4.7	4.6
Grant element of new external borrowing (in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...

Sources: Data provided by the Mongolian authorities; and Fund staff estimates and projections.

1/ Gross debt of the general government sector.
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 including 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.

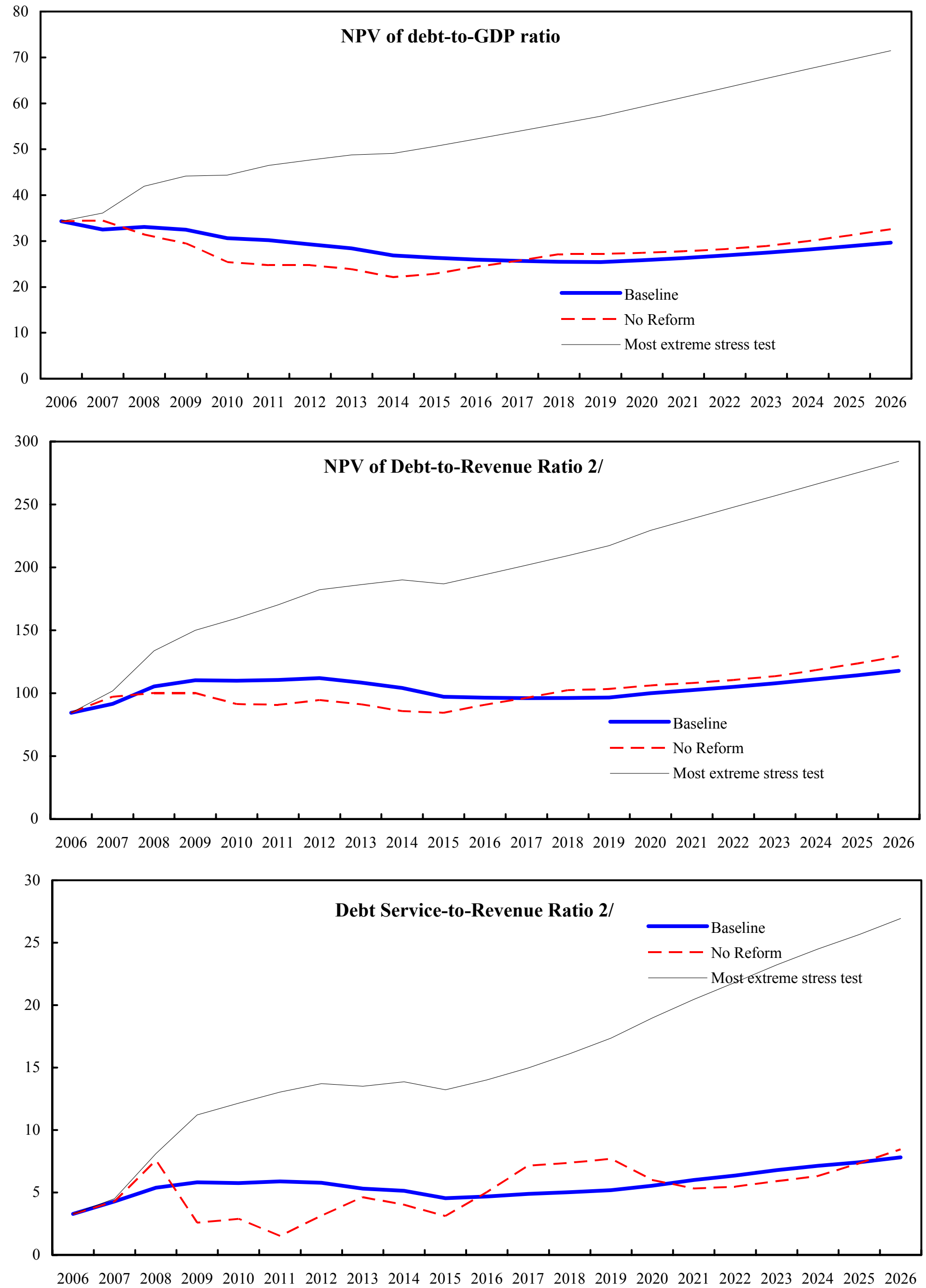
Table 1b. Mongolia: Sensitivity Analysis for Key Indicators of Public Debt, 2006-26

	Projections							
	2006	2007	2008	2009	2010	2011	2016	2026
NPV of Debt-to-GDP Ratio								
Baseline	34	32	33	32	31	30	26	30
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	34	37	39	42	44	46	49	67
A2. Primary nonmineral balance is unchanged from 2006	34	34	31	29	25	25	24	33
A3. Permanently lower GDP growth 1/	34	33	34	34	33	33	35	60
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	34	36	42	44	44	46	52	71
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	34	40	46	45	43	42	36	36
B3. Combination of B1-B2 using one half standard deviation shocks	34	39	45	44	41	40	33	34
B4. One-time 30 percent real depreciation in 2007	34	45	45	44	41	40	33	35
B5. 10 percent of GDP increase in other debt-creating flows in 2007	34	42	42	41	39	38	32	34
NPV of Debt-to-Revenue Ratio 2/								
Baseline	84	92	105	110	110	111	96	118
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	84	103	126	143	159	169	181	266
A2. Primary nonmineral balance is unchanged from 2006	84	97	100	100	91	91	91	129
A3. Permanently lower GDP growth 1/	84	93	108	116	118	123	132	240
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	84	102	134	150	159	170	194	284
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	84	114	148	154	153	153	132	143
B3. Combination of B1-B2 using one half standard deviation shocks	84	111	143	148	147	146	123	134
B4. One-time 30 percent real depreciation in 2007	84	128	145	149	146	145	122	138
B5. 10 percent of GDP increase in other debt-creating flows in 2007	84	118	134	140	139	140	121	135
Debt Service-to-Revenue Ratio 2/								
Baseline	3.3	4.3	5.4	5.8	5.8	5.9	4.7	7.8
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	3.3	4.4	9.5	9.5	11.3	12.1	12.1	23.4
A2. Primary nonmineral balance is unchanged from 2006	3.3	4.3	7.6	2.6	2.9	1.5	5.0	8.5
A3. Permanently lower GDP growth 1/	3.3	4.3	5.7	6.4	6.7	7.3	8.5	21.0
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	3.3	4.5	8.1	11.2	12.1	13.0	14.0	26.9
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	3.3	4.3	13.9	16.3	10.6	9.1	6.8	11.8
B3. Combination of B1-B2 using one half standard deviation shocks	3.3	4.5	12.2	12.9	9.1	8.1	5.9	9.9
B4. One-time 30 percent real depreciation in 2007	3.3	4.6	6.3	7.0	7.0	7.2	6.0	9.4
B5. 10 percent of GDP increase in other debt-creating flows in 2007	3.3	4.3	15.6	10.1	8.2	7.8	6.1	10.5

Sources: Data provided by the Mongolian authorities; and Fund staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).
2/ Revenues are defined inclusive of grants.

Figure 1a. Mongolia: Indicators of Public Debt Under Alternative Scenarios, 2006-26 1/



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2016.
2/ Revenue including grants.

Table 2a. Mongolia: External Debt Sustainability Framework, Baseline Scenario, 2006-26 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2003	2004	2005			2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2026	2012-26 Average
External debt (nominal) 1/	**98.2**	**85.4**	**64.1**			**51.0**	**48.6**	**49.8**	**49.1**	**46.4**	**45.9**		**38.9**	**24.3**	
o/w public and publicly guaranteed (PPG)	98.2	85.4	64.1			51.0	48.6	49.8	49.1	46.4	45.9		38.9	24.3	
Change in external debt	9.2	-12.8	-21.3			-13.1	-2.4	1.2	-0.7	-2.7	-0.6		-1.4	-1.4	
Identified net debt-creating flows	-13.4	-30.3	-32.7			-20.6	-17.4	-11.1	-7.3	-9.6	-6.2		-3.8	-2.6	
Non-interest current account deficit	**6.9**	**-2.6**	**-2.2**	**3.1**	**5.8**	**-5.9**	**1.7**	**14.5**	**6.9**	**4.0**	**4.6**	4.3	**1.1**	**0.2**	1.3
Deficit in balance of goods and services	19.7	12.2	4.4			-3.0	3.5	15.9	12.4	2.3	0.2		-2.5	-0.2	
Exports	66.3	75.9	72.7			72.4	69.1	62.3	56.9	61.9	62.2		56.7	46.4	
Imports	86.0	88.2	77.2			69.4	72.7	78.1	69.3	64.2	62.4		54.3	46.1	
Net current transfers (negative = inflow)	-12.8	-14.6	-10.9	-10.2	2.9	-8.3	-7.8	-7.8	-7.6	-7.2	-7.0		-5.2	-2.6	-4.4
Other current account flows (negative = net inflow)	0.0	-0.2	4.3			5.5	6.0	6.5	2.1	8.9	11.3		8.8	3.0	
Net FDI (negative = inflow)	**-10.4**	**-8.1**	**-12.6**	**-5.6**	**3.8**	**-12.0**	**-16.4**	**-22.9**	**-11.5**	**-9.3**	**-8.7**		**-3.6**	**-2.0**	-3.3
Endogenous debt dynamics 2/	**-9.9**	**-19.6**	**-17.9**			**-2.7**	**-2.7**	**-2.7**	**-2.7**	**-4.2**	**-2.0**		**-1.3**	**-0.8**	
Contribution from nominal interest rate	0.9	1.0	0.8			0.6	0.5	0.6	0.6	0.6	0.6		0.5	0.4	
Contribution from real GDP growth	-4.8	-8.4	-4.7			-3.3	-3.2	-3.3	-3.2	-4.8	-2.6		-1.9	-1.2	
Contribution from price and exchange rate changes	-6.0	-12.2	-14.0			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**22.6**	**17.6**	**11.5**			**7.4**	**15.0**	**12.2**	**6.7**	**6.9**	**5.6**		**2.4**	**1.2**	
o/w exceptional financing	-0.1	-0.3	-0.2			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
change in gross foreign assets	-5.7	9.3	13.9			20.0	15.6	10.2	6.4	7.3	5.8		4.1	2.6	
NPV of external debt 4/	...	...	40.3			31.7	30.5	31.5	31.3	29.8	29.7		26.2	17.0	
In percent of exports	...	...	55.5			43.7	44.1	50.6	55.0	48.2	47.7		46.2	36.7	
NPV of PPG external debt	**...**	**...**	**40.3**			**31.7**	**30.5**	**31.5**	**31.3**	**29.8**	**29.7**		**26.2**	**17.0**	
In percent of exports	...	...	55.5			43.7	44.1	50.6	55.0	48.2	47.7		46.2	36.7	
Debt service-to-exports ratio (in percent)	33.9	7.5	2.9			2.1	2.3	2.8	3.2	2.7	2.7		2.5	2.4	
PPG debt service-to-exports ratio (in percent)	33.9	7.5	2.9			2.1	2.3	2.8	3.2	2.7	2.7		2.5	2.4	
Total gross financing need (billions of U.S. dollars)	0.2	0.0	-0.3			-0.4	-0.4	-0.2	-0.1	-0.1	-0.1		-0.1	-0.1	
Non-interest current account deficit that stabilizes debt ratio	-2.2	10.1	19.1			7.3	4.1	13.3	7.5	6.6	5.1		2.5	1.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.1	10.8	7.0	4.3	2.9	7.0	7.0	7.0	7.0	11.0	6.0	7.5	5.0	5.0	5.1
GDP deflator in US dollar terms (change in percent)	7.3	14.2	19.6	2.2	12.8	26.3	3.3	-2.5	0.7	1.5	1.1	5.1	3.3	3.5	3.4
Effective interest rate (percent) 5/	1.1	1.2	1.1	1.2	0.1	1.2	1.2	1.2	1.3	1.3	1.3	1.2	1.5	1.6	1.5
Growth of exports of G&S (US dollar terms, in percent)	17.9	44.9	22.6	12.4	19.1	34.5	5.6	-6.0	-1.5	22.4	7.8	10.5	6.4	7.4	6.6
Growth of imports of G&S (US dollar terms, in percent)	14.2	29.6	12.0	11.3	8.3	21.6	15.7	12.2	-4.5	4.3	4.3	9.0	6.9	6.8	6.5
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	39	39	40	40	40	40	40	40	40	40
Memorandum item:															
Nominal GDP (billions of US dollars)	1.3	1.6	2.0			2.8	3.0	3.2	3.4	3.9	4.1		6.3	14.4	

Sources: Data provided by the Mongolian authorities; and Fund staff estimates and projections.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = 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 (of the central bank, commercial banks, and enterprises); and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV 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.

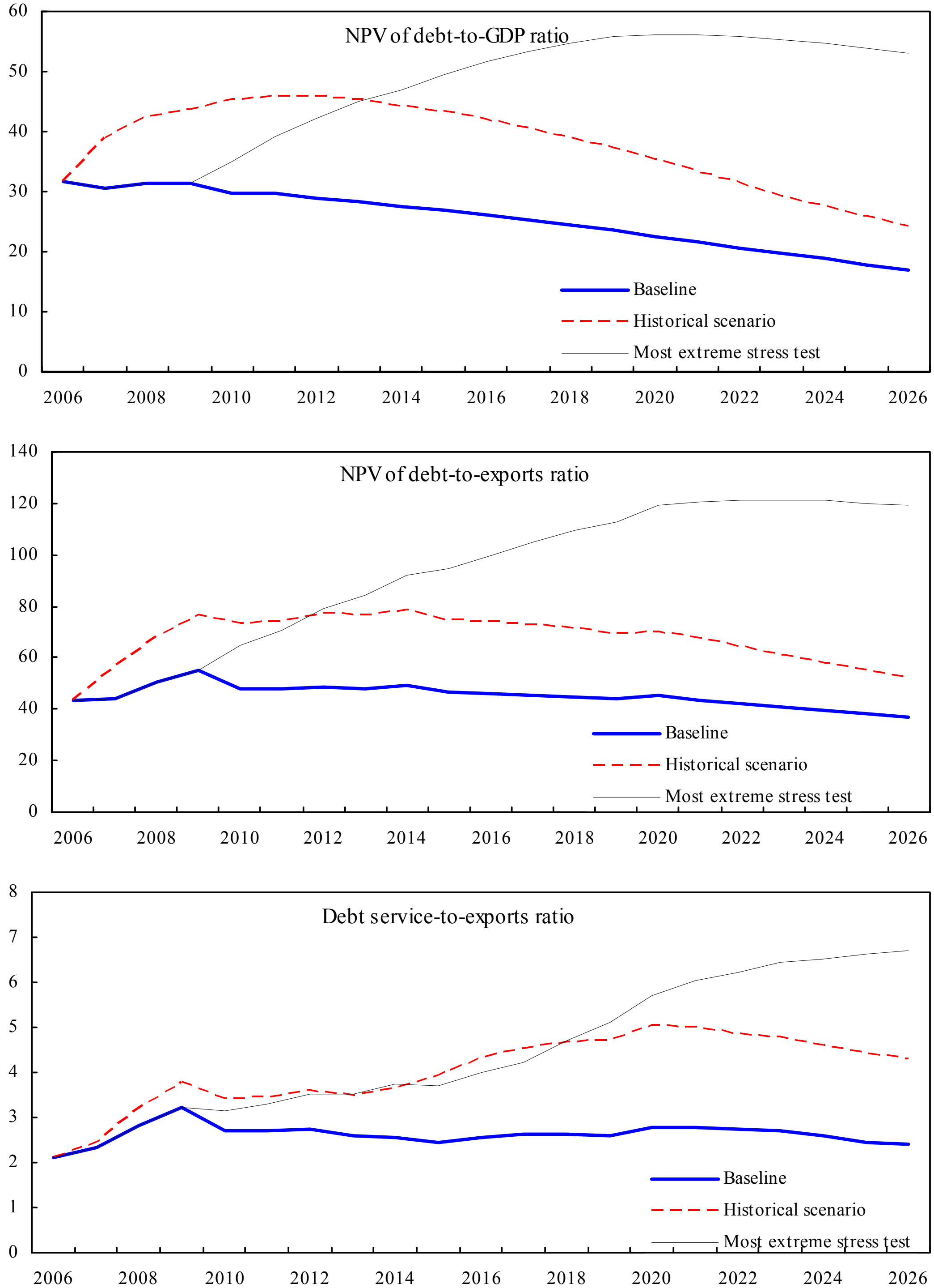
Table 2b. Mongolia: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006-26
(In percent)

	Projections							
	2006	2007	2008	2009	2010	2011	**2016**	2026
NPV of debt-to-GDP ratio								
Baseline	32	30	31	31	30	30	**26**	17
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	32	39	43	44	45	46	**42**	24
A2. New public sector loans on less favorable terms in 2007-26 2/	32	31	33	34	33	34	**33**	25
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	32	32	35	35	33	33	**29**	19
B2. Terms of trade shocks on copper and gold exports in 2010 and lower growth thereafter 3/	32	30	31	31	35	39	**52**	53
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	32	35	40	40	38	37	**33**	21
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4	32	40	54	53	49	49	**40**	22
B5. Combination of B1-B4 using one-half standard deviation shocks	32	35	36	36	34	34	**30**	20
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	32	43	44	44	42	42	**37**	24
NPV of debt-to-exports ratio								
Baseline	44	44	51	55	48	48	**46**	37
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	44	56	68	77	73	74	**74**	52
A2. New public sector loans on less favorable terms in 2007-26 2/	44	45	54	60	54	55	**58**	55
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	44	44	51	55	48	48	**46**	37
B2. Terms of trade shocks on copper and gold exports in 2010 and lower growth thereafter 3/	44	44	51	55	65	71	**100**	119
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	44	44	51	55	48	48	**46**	37
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4	44	57	86	92	80	78	**71**	48
B5. Combination of B1-B4 using one-half standard deviation shocks	44	47	46	50	44	44	**42**	34
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	44	44	51	55	48	48	**46**	37
Debt service ratio								
Baseline	2.1	2.3	2.8	3.2	2.7	2.7	**2.5**	2.4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	2.1	2.4	3.2	3.8	3.4	3.5	**4.3**	4.3
A2. New public sector loans on less favorable terms in 2007-26 2/	2.1	2.3	2.8	3.4	3.0	3.0	**3.2**	3.7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	2.1	2.3	2.8	3.2	2.7	2.7	**2.6**	2.5
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	2.1	2.3	2.8	3.2	3.1	3.3	**4.0**	6.7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	2.1	2.3	2.8	3.2	2.7	2.7	**2.6**	2.5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4	2.1	2.3	3.2	4.2	3.5	3.5	**4.5**	3.6
B5. Combination of B1-B4 using one-half standard deviation shocks	2.1	2.4	2.7	3.0	2.5	2.5	**2.4**	2.3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	2.1	2.3	2.8	3.2	2.7	2.7	**2.6**	2.5
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	40	40	40	40	40	40	**40**	40

Sources: Data provided by the Mongolian authorities; and Fund staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt 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/ Assumes that copper and gold prices decline by 35 percent and 25 percent respectively in 2010 on top of the WEO assumptions of sharp decline in copper prices through 2007-09, and each rises by 1 percent in 2011-26. As a consequence of these terms of trade shocks, assumes that the real GDP growth rate is less by 0.5 percent in 2010 and by 0.25 percent thereafter compared to baseline scenario.
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.

Figure 2a. Mongolia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2006-26
(In percent)



Source: Staff projections and simulations. Thresholds for the three indicators are 40 percent, 150 percent, and 20 percent, respectively.

ANNEX II. Mongolia—Fund Relations
(As of November 30, 2006)

I. **Membership Status**: Joined: 02/14/1991; Article VIII

II. **General Resources Account**:	**SDR Million**	**percent Quota**
Quota	51.10	100.0
Fund Holdings of Currency	50.97	99.74
Reserve Position in Fund	0.14	0.27

III. **SDR Department**:	**SDR Million**	**percent Allocation**
Holdings	0.06	N/A

IV. **Outstanding Purchases and Loans**:	**SDR Million**	**Percent Quota**
ESAF/PRGF Arrangements	21.04	41.17

V. **Financial Arrangements**:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
PRGF	09/28/2001	07/31/2005	28.49	12.21
ESAF/PRGF	07/30/1997	07/29/2000	33.39	17.44
ESAF	06/25/1993	06/24/1996	40.81	29.68

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

	Forthcoming				
	2006	**2007**	**2008**	**2009**	**2010**
Principal	0.59	4.30	3.19	4.22	3.04
Charges/interest	0.05	0.09	0.07	0.05	0.03
Total	0.65	4.39	3.26	4.28	3.07

VII. **Safeguards Assessments**:

Under the Fund’s safeguards assessment policy, the Bank of Mongolia (BOM) was subject to a full safeguards assessment with respect to the PRGF arrangement that was approved by the Executive Board on September 28, 2001. An on-site safeguards assessment of the BOM was completed on September 10, 2003. Staff recommended that the BOM implement measures to strengthen its external audit mechanism and financial reporting framework. The BOM has so far implemented several of the recommendations. Staff continues to monitor the BOM’s efforts to: (i) commit to the full adoption of International Accounting Standards (IAS) and to disclose its guarantees and pledges in its financial statements; and (ii) disclose the fair value of derivatives in its net international reserve position and financial statements. At the conclusion of the December 2002 PRGF discussions, the BOM agreed to implement special semi-annual audits of NIR to provide further assurance on the NIR position and to identify any related pledges or guarantees.

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 official exchange rate is now set daily on the basis of transactions in the interbank market. At end-November 2006, the official midpoint rate was Tog 1,164 per U.S. dollar. The official exchange rate is applied to State budget and customs transactions, including debt-service payments, and to trade and service transactions conducted under bilateral payments arrangements. Mongolia accepted the obligations of Article VIII, Sections 2, 3, and 4 on February 1, 1996, and maintains an exchange system that is free from restrictions on payments and transfers for current international transactions. 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-(52/51).

IX. **Article IV Consultation**:

The 2005 Article IV consultation (Country Report No. 05/396) was concluded by the Executive Board on September 21, 2005. Mongolia will be on the 12–month cycle.

X. **ROSC Assessments**:

- ROSC, Data Module, May 4, 2001 (www.imf.org)
- ROSC, Fiscal Transparency Module, November 8, 2001 (Country Report No. 01/218)
- ROSC, Fiscal update, May, 2005

XI. **Recent Financial Arrangements**:

A three-year arrangement under the Enhanced Structural Adjustment Facility 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. **Technical Assistance**:

Missions:
- 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:

- 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.

XIII. **Resident Representative**:

Mr. Jang has been the Fund's resident representative in Mongolia since April 1, 2006.

ANNEX III. Mongolia—Relations with the World Bank Group[10]

Mongolia, an IDA only country, became a member of the World Bank Group in February 1991. Bank lending to Mongolia currently represents about 11 percent of the country's overall official development assistance flows. The current Country Assistance Strategy (CAS), covering the period 2004-07, was approved by the World Bank Board on 29 April 2004. The CAS is broadly aligned with Mongolia's Economic Growth Support and Poverty Reduction Strategy (EGSPRS) and supports policies in areas where the World Bank has a comparative advantage. The CAS uses a "results-based approach" that relates outcomes to the country's longer-term goals, including the MDGs.

A Governance Assistance Project was approved on May 23, 2006 to pave the way for a possible series of annual Poverty Reduction Support Credits (PRSCs), as envisaged initially in the CAS. The project will help improve governance in the areas of public financial management (budget execution, debt management, civil service), transparency and accountability, anti-corruption, poverty monitoring, and the investment climate.

The Bank's main sectoral activities also include:

- *Public Sector and Fiscal framework*. The Bank is working with the Government to strengthen the public finance management framework and civil service administration through the provision of analytical advice, and an investment and technical assistance project (The Economic Capacity building Technical Assistance project).

- *Financial sector*. After closure of a Financial Sector Adjustment Credit, the Bank continues working with the government and selected commercial banks to strengthen the banking system's capacity in credit risk management, automated payments system and Savings Bank resolution under the Financial Capacity Development Project (FCDP). Meanwhile, the second Private Sector Development Credit (PSDC II) continues to provide technical assistance in developing risk management and term-lending capacity in selected Mongolian banks, and enhancing central bank supervision capacity, in addition to financing private sector capital investment. A mid-term review is under way with a view to updating the Bank's assistance program to address the new challenges, and renewing the government's long-term strategy for financial sector reform and development.

- *Private Sector Development (PSD)*. The findings from an Investment Climate study initiated in mid-2004 will feed directly into the development of a PSD strategy and measures in the series of PRSCs to improve the business environment. New lending operations to encourage private sector participation in infrastructure sector are also being considered for the next three to four years.

- *Social sectors*. A Poverty Assessment was completed in 2006. In *education*, the Bank launched a rural education project that will build classroom libraries in all rural elementary

[10] Questions may be addressed to Ms. Boyreau, 473-8541.

schools. In addition, the analysis of the 2005 Public Expenditure Tracking Survey was completed. Analytical work by the Bank is underway on the quality of the educational system in Mongolia and the implications of the ongoing transition to an 11-grade system. In *social protection,* a study was carried out to assess the targeting efficiency of the *social assistance* schemes and of the Child Money Program. The Bank also supported the creation of a beneficiary data base for monitoring and evaluation of this program.

- *Rural and Urban development*. The Bank is assisting the government in the development of rural strategies and promotes secure and sustainable livelihoods through activities in pastoral risk management, microfinance services, basic infrastructure investment (through community-driven approaches), and the piloting of a new index-based livestock insurance product. In the area of urban development, the focus is on city development strategy. The Bank is also supporting the improvement of services delivery, particularly on improvement of water supply and *ger* area upgrading.[11]

- *Infrastructure.* An Information and Communication Infrastructure Development Project was approved on June 8, 2006. The Bank is working with the government in improving the technical and financial operation of electricity and water utilities through two projects: Energy Project and UB2 respectively. A Renewable Energy and Access Project is expected to be approved in November, 2006. The Infrastructure Strategy report—including sectoral background notes is under preparation.

- *Judicial and legal reforms*. The Bank is supporting efforts to enhance public confidence in the legal system, with a focus on the judiciary system. Challenges remain in enhancing access to justice, especially for the poor; disseminating new laws to the public; and enforcing existing laws.

- *Supreme Audit Institutions*. The Bank continues to work with the Mongolia National Audit Office to strengthen its technical audit capacity.

IFC became a minority owner of two Mongolian banks in 2004. The IFC is also providing technical assistance for developing a leasing industry.

MIGA: Mongolia signed the MIGA convention in 1991 and ratified it the following year. MIGA will be able to assist the country in attracting foreign investment through its marketing and guarantee activities.

[11] A Ger is the traditional dwelling tent of Mongolian people.

ANNEX IV. Mongolia—Relations with the Asian Development Bank[12]

Mongolia became a member of the Asian Development Bank (ADB) in February 1991. In line with ADB's poverty reduction strategy, ADB entered into a Poverty Partnership Agreement (PPA) with the Government of Mongolia in 2000. Within the framework of the PPA, ADB formulated in October 2005, its Country Strategy and Program (CSP) for 2006–08. The new CSP concentrates on achieving poverty reduction by supporting (i) stable, broad based growth and (ii) socially inclusive development. An indicative lending level of $85 million from ADB's concessional Asian Development Fund resources is programmed for 2006-2008, supplemented by an additional $40 million from ADB's regional fund. The CSP formulates a program that includes assistance in agriculture, transport, education, health, and urban development and support for administrative consolidation in support of interventions in these sectors. A CSP Update for 2007-2009 maintains the overall directions of the CSP while increasing the focus of projects on the Government's own strategic objectives, accounting for the need for better governance, the potential for increased levels of grant funding from other agencies, and ADB's own Medium Term Strategy II and its Managing for Development Results Agenda. Since March 2002, Mongolia has been a full member of the ADB-supported Central Asia Regional Economic Cooperation program for the Central Asian Republics and People's Republic of China (PRC).

ADB has provided loans for 36 projects totaling $615.8 million in the agriculture, education, energy, financial, health, industry, telecommunications, transport, and urban development sectors. Fourteen loans were active at the end of 2005. ADB has also provided one private sector equity investment in the amount of $6.1 million. Technical assistance grants have totaled close to $60 million, and grants funded by the Japan Fund for Poverty Reduction and Japan Fund for Information and Communication Technology total $8.2 million. Most early ADB support was in the form of quick-disbursing loans and investments in ailing infrastructure sectors. Governance and poverty were identified as the major development objectives in later years.

ADB allocates its concessional ADF 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.

[12] Prepared by Asian Development Bank staff.

ANNEX V. Mongolia: Statistical Issues

1. Progress to Date

The authorities have established a framework for monitoring macroeconomic developments and made substantial improvements in all statistical areas with extensive technical assistance, including from the Fund. Core data are provided to the Fund on a timely basis and are adequate for surveillance, but some outstanding issues remain, as detailed below. Mongolia has been participating in the General Data Dissemination System (GDDS) since August 2000. A data ROSC mission visited Mongolia in May 2000 to assess data dissemination practices in relation to the *GDDS;* the data ROSC report was published on the IMF website in May 2001.[13]

An advisor assisted the National Statistical Office (NSO) during August 2001-September 2003, in improving primary data collection and compilation systems for **national accounts** (NA) and price statistics. While much was achieved, deficiencies persist in the annual and quarterly production accounts that detract from the accuracy of the data, including the use of inappropriate techniques to estimate capital formation and inconsistent deflators to derive the annual estimates of GDP volumes. The advisor also assisted the NSO in preparing a work program for developing a producer price index (PPI), useful for deriving constant price GDP estimates.

The IMF Statistics Department is providing support to the NSO in implementing its Program of Statistics Development for 2006–2010. It aims to strengthen the statistical capacity in conformity with the GDDS plans for improvement and to place Mongolia in a position to subscribe the Special Data Dissemination Standard.

Based on the recommendations of the 2000 STA mission on **consumer price statistics**, the methodology utilized to compile the CPI was substantially revised in January 2001, and included: (i) the CPI basket was updated with the results of the 1999 Household Income and Expenditure Survey (HIES); (ii) the CPI weights were updated using the results of the 1999 HIES and the 2000 HIES, with the latter update done in March 2002; and (iii) the CPI was rebased from December 1995 to December 2000. The CPI was recently rebased from December 2000 to December 2005.

For the **fiscal statistics**, the authorities have adopted systematic procedures for compiling annual reports for the general government and each of its subsectors. Government Finance Statistics (GFS) are also compiled on a monthly basis for all subsectors, except the extrabudgetary central government. All extrabudgetary agencies and funds should be examined to determine whether they should be included in the central government sector or the public corporations sector. The authorities also completed an inventory of all

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[13] As the ROSC was not prepared on the basis of the Data Quality Assessment Framework, no ratings were given. Consequently, the Table of Common Indicators Required for Surveillance (TCIRS) does not include memo items on data quality.

government bank accounts and instituted stricter standards for registering bank accounts for government agencies to facilitate reconciliation between the government accounts and banking data. However, complete reconciliation of monetary and fiscal data and implementation of other technical assistance recommendations are pending.

In September 2006, a **government finance and monetary and financial statistics** mission found that the underreporting of government deposits by five commercial banks to the Bank of Mongolia (BOM), coupled with the overestimation of government deposits by the Ministry of Finance, had given rise to a significant discrepancy on the level of bank financing to the government sector for 2005. The mission identified sources of this discrepancy on both monetary and fiscal sides, and prepared a work plan for its resolution. Moreover, the mission made progress on the implementation of projects in both GFS and MFS: it advanced the Pilot Project on the application of *GFSM2001* methodology with Mongolian data, and also prepared monetary data based on the Standardized Report Forms (SRFs) which could be used in future for reporting monetary statistics to STA.

Improvements to **balance of payments** statistics have been made subsequent to a short-term technical assistance mission to the BOM in 2004. The coverage of balance of payments statistics has been expanded through the introduction of a survey of enterprises. Key improvements include: implementation of a revised standard format for balance of payments reporting; implementation of 19 new surveys to improve the collection of external statistics in weak areas, including surveys of enterprises, travel, workers' remittances, the international investment position, private sector external debt, the cost and insurance component of imports c.i.f., services, income, aid transfers, foreign direct investment, government debt forgiveness, and the foreign exchange reporting system; and preparation of a balance of payments sources and methods manual. In addition, a working group with key official and private data providers and users has been established and commercial bank staff has been given training in data reporting.

2. **Outstanding Issues**

While some progress has been made in developing a national accounts framework, the quality of GDP estimates, particularly with respect to the current deflation methods for constant price estimates, could be improved further. While a proper methodological treatment of animal losses due to harsh winters has been finalized, efforts are needed to improve coverage of the informal sector and small-scale activity, especially in the services sector. Raw data could be refined with a view to producing reliable quarterly estimates of GDP. Furthermore, the construction of expenditure-based national accounts in constant price terms would serve as a useful check for the production side estimates.

Progress in implementing STA recommendations to develop a producer price index has been limited mainly due to resource and capacity constraints.

There are deficiencies in the data on wages and earnings. The development of labor market statistics through the establishment of quarterly sample surveys would help mitigate these shortcomings. The government conducted a survey of the civil service in May 2002, which should help to produce a detailed database on civil service employment and wages.

The September 2006 GFS and MFS mission identified a number of issues to ensure that the monetary statistics would conform with the *Monetary and Financial Statistics Manual*, and the fiscal data with the *GFSM2001* methodology. The BOM and MOF are following up on the recommendations of the mission and, as noted above, these agencies are also addressing the large discrepancy between the fiscal and monetary statistics for 2005.

Work has commenced on revising the register of businesses for balance of payments statistics, which was last updated in 2002. Also, the authorities plan to produce and publish a complete international investment position statement in the period ahead.

3. **Publications**

The NSO publishes monthly and annual *Statistical Bulletins* in English and Mongolian. These bulletins include data on population, employment, national accounts, prices, household income and expenditure, central and local government revenue and expenditure, and external trade. The BOM publishes a monthly *Statistical Bulletin* (within 15 days of the end of the month, which includes summary statistics for the central bank, consolidated balance sheet of commercial banks, and interest and exchange rate data) and *Annual Reports*.

ANNEX V. Mongolia: Table of Common Indicators Required for Surveillance
As of November 30, 2006

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	11/29/06	11/30/06	D	M	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/31/06	11/14/06	D	M	M
Reserve/Base Money	10/31/06	11/14/06	W	M	M
Broad Money	10/31/06	11/14/06	M	M	M
Central Bank Balance Sheet	10/31/06	11/14/06	W	M	M
Consolidated Balance Sheet of the Banking System	10/31/06	11/14/06	M	M	M
Interest Rates[2]	10/31/06	11/14/06	W	M	M
Consumer Price Index	Oct. 2006	11/09/06	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Oct. 2006	11/08/2006	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Oct. 2006	11/08/2006	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2005	Feb 2006	A	A	A
External Current Account Balance	Q2 2006	9/5/06	Q	Q	Q
Exports and Imports of Goods	Oct. 2006	11/13/05	M	M	M
GDP/GNI	2005	May 2006	A	A	A
Gross External Debt	2005	Feb 2006	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, 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)

ANNEX VI. Mongolia—Millennium Development Goals

	1990	1995	1998	2001	2004
Eradicate extreme poverty and hunger 1/	(2015 target = halve 1990 $1 a day poverty and malnutrition rates)				
Population below $1 a day (in percent)	..	14	27	..	..
Prevalence of undernourishment (in percent of population)	..	..	45	..	28
Poverty gap ratio at $1 a day (in percent)	..	3	8	..	..
Poverty headcount, national (in percent of population)	..	36	43	..	36
Malnutrition prevalence, underweight children (in percent of children under 5)	..	..	13	13	..
Achieve universal primary education 2/	(2015 target = net enrollment to 100)				
Net primary enrollment ratio (in percent of relevant age group)	90	..	90	90	84
Primary completion rate, total (in percent of relevant age group)	..	..	87	91	96
Youth literacy rate (in percent ages 15-24)	..	..	..	..	98
Promote gender equality and empower women 3/	(2005 target = education rate to 100)				
Proportion of seats held by women in national parliament (in percent)	25	..	8	11	11
Ratio of girls to boys in primary and secondary education (in percent)	109	..	117	112	108
Ratio of young literate females to males (in percent ages 15-24)	..	..	..	..	102
Share of women employed in the nonagricultural sector (in percent)	48	47	48	49	49
Reduce child mortality 4/	(2015 target = reduce 1990 under 5 motality by two thirds)				
Immunization, measles (in percent of children ages 12-23 months)	92	85	93	95	96
Infant mortality rate (per 1,000 live births)	78	64	..	50	41
Under 5 mortality rate (per 1,000)	108	87	..	65	52
Improved maternal health 5/	(2015 target = reduce 1990 maternal mortality by three fourths)				
Births attended by skilled health staff (in percent of total)	..	..	94	97	99
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	110	..
Combat HIV/AIDS, malaria, and other diseases 6/	(2015 target = halt, and begin to reverse, AIDS, etc.)				
Contraceptive prevalence rate (in percent of women ages 15-49)	..	..	60	67	69
Incidence of tuberculosis (per 100,000 people)	220	..	..	..	192
Tuberculosis cases detected under DOTS (in percent)	..	7	60	73	80
Ensure environmental sustainability 7/	(2015 target = various)				
Access to an improved water source (in percent of population)	63	..	..	..	62
Access to improved sanitation (in percent of population)	..	..	..	..	59
CO2 emissions (metric tons per capita)	5	4	3	3	..
Forest area (in percent of total land area)	7	..	..	7	7
Nationally protected areas (in percent of total land area)	..	..	..	..	12
Develop a global partnership for development 8/	(2015 target = various)				
Aid per capita (current US$)	6	93	87	87	104
Debt service (in percent of exports of goods and services)	0	10	5	7	3
Fixed line and mobile phone subscribers (per 1,000 people)	32	34	48	132	184
Internet users (per 1,000 people)	..	0	1	17	80
Personal computers (per 1,000 people)	..	3	8	17	124
Total debt service (in percent of exports of goods, services and income)	..	10	6	7	3
Unemployment, youth female (in percent of female labor force ages 15-24)	..	..	..	21	..
Unemployment, youth male (in percent of male labor force ages 15-24)	..	..	..	20	..
Unemployment, youth total (in percent of total labor force ages 15-24)	..	..	..	20	..
General indicators					
Fertility rate, total (births per woman)	4	3	3	2	2
GNI per capita, Atlas method (current US$)	..	330	460	400	600
GNI, Atlas method (current US$, in billions)	..	0.7	1.1	1.0	1.5
Gross capital formation (in percent of GDP)	38	32	35	36	37
Life expectancy at birth, total (years)	63	64	65	63	65
Literacy rate, adult total (in percent of people ages 15 and above)	..	..	..	..	98
Population, total (in thousands)	2,106	2,275	2,398	2,480	2,500
Trade (in percent of GDP)	77	97	124	120	162

Source: World Bank: *World Development Indicators Database* , and UNDP and NSO: Living Standard Measurement Survey 2002/2003.

1/ Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day, and the proportion of people who suffer from hunger.

2/ Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

3/ Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

4/ Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

5/ Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

6/ Have halted by 2015, and begun to reverse, the spread of HIV/AIDS and the incidence of malaria and other major diseases.

7/ Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water.

8/ Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the special needs of the least developed countries. Address the special needs of landlocked countries and small island developing states.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2006 Article IV Consultation with Mongolia

On January 10, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Mongolia.[1]

Background

Mongolia's macroeconomic performance in 2005-06 has been robust, underpinned by a run-up on copper and gold prices, declining inflation, and budget and external current account surpluses. Real GDP growth in 2005-06 is estimated at 7 percent, in line with the average pace since 2002. The mineral sector has been a key engine of growth, supported by favorable weather conditions, and buoyant recovery in the construction and services sectors. Inflation has eased to about 7 percent in October 2006 (year-on-year), following a spike at about 17½ percent in June 2005. The current account balance (including official transfers) recorded a surplus (1.4 percent of GDP) in 2005, which is expected to widen further to 5.2 percent of GDP in 2006. Gross international reserves have been rebuilt from their end-2003 low level in the aftermath of the settlement of the pre-1991 Russian debt, and are expected to reach this year about 3.4 months of next year's imports of goods and services.

The fiscal position has improved markedly in 2005-06. The budget deficit, which had narrowed significantly during 2000-04, switched to a 2.9 percent of GDP surplus in 2005 for the first time ever, and is expected to widen to 9.0 percent of GDP in 2006. This reflected a sevenfold increase in mining revenue since 2003 in concert with a 10 percentage point of GDP decline in

[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.

total expenditure over the period, despite a 30 percent public sector wage increase and a significant expansion in social welfare transfers in 2006. Mirroring the improved fiscal performance, the debt burden has eased significantly, with the net present value (NPV) of public external debt halved from 64 percent of GDP end-2003 to an estimated 32 percent at end-2006. The 2007 budget calls for a significant easing in the fiscal policy stance, reflecting large tax cuts and further increases in wages and social welfare transfers.

Monetary aggregates have expanded rapidly in recent years, driven by strong foreign exchange inflows and improved confidence in the banking system. Broad money and reserve money growth accelerated to 37.3 percent and 19.7 percent, respectively, in 2005 and are expected to slow only slightly in 2006. Private credit continued to expand rapidly (40 percent) in 2005, and is expected to rise broadly at the same pace in 2006. Fast private credit growth in 2006, however, has been broadly offset by a sharp decline in net credit to government, as government deposits built up markedly and debt to the central bank was partly redeemed. The subdued inflationary response to date to rapid monetary growth primarily reflects a strong reintermediation process and a gradual exchange rate appreciation.

Strides have been made in strengthening the banking system, but vulnerabilities remain. Nonperforming loans (NPLs) were reduced from 23.4 percent of total loans at end-2000 to 8.8 percent at end-2005, and the ratio has remained broadly stable in 2006. To safeguard the soundness of the banking system, the enforcement of prudential requirements has been intensified, especially for banks with rapid credit growth. Actions are also underway, under the newly-created Financial Regulatory Commission, to address the solvency of a number of credit and saving cooperatives and to strengthen the supervisory framework for nonbanks.

On the structural front, progress has been made to strengthen central bank governance and promote private sector development. The Bank of Mongolia appointed in September 2006 two non-executive directors to its Board of Directors, thus paving the way for further changes to shift decision-making authority from the Governor to the Board of Directors. An AML/CFT Law was adopted in mid-2006, providing for the establishment of a Financial Intelligence Unit within the Bank of Mongolia. An Anti-Corruption Law aimed at strengthening the business environment was also adopted at that time. Public sector reform is proceeding, with the recent privatization of the Savings Bank and bidding underway for the Gobi cashmere factory.

Mongolia’s medium-term outlook for sustained growth and poverty reduction is broadly favorable, but subject to risks. With its considerable mineral endowment and location between two large and fast-growing economies, Mongolia has the potential to achieve real GDP growth averaging 6-7 percent of GDP over the medium term. Inflation could be contained to below 5 percent, provided that appropriate fiscal and monetary policies are in place. The main challenge, however, will be to ensure fiscal sustainability through sound management of the country’s mineral resources and steadfast expenditure restructuring, especially civil service reform and social expenditure restraint. Assuming continued fiscal consolidation, Mongolia’s external debt ratio would decline substantially over the medium term. In addition to policy risks, medium-term prospects are vulnerable to adverse weather conditions, and terms-of-trade shocks triggered by sharp declines in copper and gold prices and soaring oil prices.

Executive Board Assessment

Executive Directors commended the authorities for Mongolia's robust economic performance in recent years, including vigorous growth, a decline in inflation, the emergence of fiscal and current account surpluses, and reduced debt ratios. Mongolia's mineral wealth and improved macroeconomic stability provide a good foundation for sustained growth. Nevertheless, challenges remain to mitigate the economy's vulnerability to shocks, including harsh weather and a decline in copper prices, and to reduce the high poverty rate. Directors encouraged the authorities to focus on managing mineral wealth efficiently, improving infrastructure and the business environment, and targeting poverty alleviation policies carefully, in the context of continued macroeconomic stability.

Directors welcomed the marked improvement in the fiscal position in recent years. They cautioned, however, that the loosening of the fiscal stance in the 2007 budget could jeopardize fiscal sustainability and revive inflationary pressures. To ensure that public debt remains on a declining path, the non-mineral fiscal deficit should be reduced by containing the growth in the civil service wage bill, better targeting social welfare spending, and moving forward with civil service reforms. Directors stressed the importance of realistically planning and prioritizing capital spending. They recommended that the authorities consider formulating a medium-term fiscal framework, which could facilitate consistency in budget preparation.

Directors broadly supported the recent efficiency-enhancing tax reform, including the elimination of most VAT exemptions and new tax holidays, but observed that some tax cuts might need to be partially reversed to ensure fiscal sustainability, starting with the cut in the VAT rate. Also, cuts in non-mining tax rates could increase the sensitivity of revenues to commodity price shocks. Directors encouraged the authorities to keep the mining regime under review to ensure an internationally competitive tax regime, and they supported Fund technical assistance in this area.

Directors welcomed signs of improving confidence in the banking system, including significant reintermediation. They cautioned, however, that continued rapid monetary growth could raise inflationary pressures, and called for increased sales of central bank bills to absorb excess liquidity. They welcomed Fund technical assistance to upgrade the monetary policy framework and develop sound liquidity management instruments.

Directors commended recent steps to strengthen central bank governance, including the appointment of outside members to the Bank of Mongolia's Board of Directors, and they encouraged the authorities to move forward with plans to shift decision-making authority to the Bank of Mongolia's Board of Directors. Directors called for upgrading the management of international reserves, including reducing gold risk exposures and preparing a strategy to exit the gold market over the medium term.

Directors emphasized that, despite recent progress, the financial system remains vulnerable. As rapid credit growth can cause loan quality to deteriorate, enforcement of prudential regulations at weaker banks should be strengthened. Directors counseled the authorities against using administrative measures to lower bank lending rates, bailing out insolvent savings and credit cooperatives, or including these cooperatives in any future bank deposit insurance scheme.

Directors considered that Mongolia’s flexible exchange rate has facilitated orderly adjustments to external shocks, and that the recent appreciation of the togrog reflects the improving external position. They supported the authorities’ plan to continue limiting interventions in the foreign exchange market to smoothing short-term volatility. While welcoming Mongolia’s continued commitment to an open trade regime, Directors encouraged the authorities to phase out the export duty on raw cashmere and resist pressures to raise import duties to protect domestic industries. Directors underscored the importance of maintaining a prudent debt management strategy, with most Directors emphasizing reliance on concessional borrowing. Directors also looked forward to the resolution of remaining outstanding obligations to foreign creditors.

Directors supported actions to foster good governance and private sector development, including the adoption of Anti-Money Laundering and Anti-Corruption Laws, and the privatization of two large public enterprises. They urged the authorities to proceed further with energy sector reform.

Directors welcomed the progress made in strengthening data quality for surveillance, and called for continued efforts to improve national account, fiscal, and monetary data.

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 Indicators, 2003-06

	2003	2004	2005	2006 Est.
Real Sector (percent change)				
Real GDP growth	6.1	10.8	7.0	7.0
Mineral	-2.3	34.3	10.9	5.2
Nonmineral	7.1	8.1	6.5	7.3
Consumer prices (end-period)	4.7	11.0	9.5	7.0
General Government Budget (in percent of GDP)				
Revenue and grants	37.6	37.0	33.7	40.6
Mineral revenue	2.8	4.1	4.5	13.5
Nonmineral revenue	34.2	32.5	29.0	27.0
Expenditure and net lending	41.8	39.1	30.7	31.7
Overall balance (including grants)	-4.2	-2.1	2.9	9.0
Nonmineral overall balance	-7.0	-6.3	-1.5	-4.5
Money and Credit (percent change)				
Broad money	49.7	20.3	37.3	34.9
Domestic credit	147.0	23.0	22.3	-5.0
Of which: claims on nonbanks	90.3	43.7	40.1	39.2
Reserve money	14.7	16.8	19.7	16.5
Interest rate on central bank bills (percent per annum) 1/	15.0	15.8	3.7	5.8
	(in millions US dollars; unless otherwise indicated)			
Balance of Payments				
Current account balance (in percent of GDP)				
Including official transfers	-7.7	1.6	1.4	5.2
Excluding official transfers	-11.5	-3.7	-2.8	2.0
Exports, f.o.b.	627	872	1,069	1,548
Mineral (in percent of total exports)	58.5	65.1	71.0	...
Nonmineral (in percent of total exports)	41.5	34.9	29.0	...
Imports, c.i.f.	827	1,021	1,224	1,532
Terms of trade (percent change)	1.1	7.0	2.3	25.8
Gross international reserves (end-period)	178	208	333	626
(in months of next year's imports of goods and services)	1.5	1.6	2.1	3.4
Public and Publicly Guaranteed Debt (in percent of GDP)				
Total public debt	113.0	93.0	68.3	53.6
External debt	98.2	85.4	64.1	51.0
Domestic debt	14.8	7.6	4.2	2.6
NPV of external debt	64.2	52.3	40.3	31.7
External debt service (in percent of exports of goods and services)	34.0	7.5	2.9	2.1
Exchange Rate				
Togrogs per US dollar (end-period)	1,170	1,209	1,221	1,164
Real effective exchange rate (end-period; percent change)	-6.8	0.8	7.7	...

Sources: Data provided by the Mongolian authorities; and IMF staff estimates.
1/ Annualized yield on end-period auction of 14-day bills; as of end-September 2006.

Statement by Richard Murray, Executive Director for Mongolia
and Hyun Cheol Lee, Advisor to the Executive Director
January 10, 2007

Overall Economic Performance and Medium-Term Outlook

Mongolia's recent economic performance has been solid. Real GDP growth has averaged 7 percent annually since 2002. After the Russian debt settlement in December 2003, total debt has declined steadily and substantially. Since 2004, the external current account has shifted into surplus. In 2005 the overall and primary fiscal balance moved markedly into surplus. Inflation peaked in mid-2005 mainly owing to the devastating weather conditions and the consequent meat shortage. The solid economic performance is mainly attributable to the record-high world copper and gold prices as well as the authorities' commitment to prudent macroeconomic policies in line with the policy recommendations and technical assistance by the Fund and Bank.

In 2006, Mongolia's economy has shown even more solid performance. It is commendable not just because the growth was fueled by "unprecedented" high mineral prices, but because the growth was also broad-based, in particular in non-mineral sectors, such as construction and financial services. By mid-year, inflation had declined to the lowest level (1.8 percent y-o-y) in four years and now remains at a moderate level in the order of 6 percent. The overall fiscal balance is estimated again as a solid surplus and the NPV of total public debt continues on its downwards projectory.

The near-term outlook for the economy remains very positive. As the mineral sector has been the main engine of Mongolia's growth, economic prospects will be substantially affected by commodity price developments. While the WEO projection of copper prices in 2007 is US$5,500 per ton, the authorities assume that the average copper price in 2007 will be US$6,000 per ton. The authorities' projection is also supported by the fact that the 15-month future (buyers) price for copper recorded on January 2, 2007 in the London Metal Exchange was US$6,050 per ton. While the projected price may look much lower than recent market prices, it still is more than three-times the price level during 2000 to 2003. The staff's medium-term scenario envisages that real GDP growth can average 6-7 percent over the medium-term, if appropriate policies are pursued. Furthermore, in addition to already-rich mineral production, Mongolia has a long list of projects for development, including Oyu Tolgoi (copper and gold), Burenkhaan (phosphate), Tavan Tolgoi (5 billion tons of coal), Turmurtei (229 million tons of iron), as well as yet to be developed natural gas and petroleum reserves.

Fiscal policy

The staff assesses Mongolia's 2007 fiscal stance as a "loosening of fiscal policy." However, it should be recalled that the amended 2006 budget had projected the overall fiscal deficit at 3½ percent of GDP, whereas the overall fiscal outcome for 2006 is significantly better than budgeted, mainly due to substantially stronger-than-expected world mineral prices, a surge in windfall tax collections and the under execution of capital spending. This 2006 surplus outcome is obviously not sustainable as the commodity price cycle matures in 2007 and beyond. The 2007 budget projects an overall deficit of 3.9 percent of GDP[1]. Mongolia's Parliament calls for the overall deficit to remain constant at 4 percent of GDP through to 2009, which would allow a sharing of the benefits of the terms of trade across the community, while still maintaining a steady decline in public debt to GDP.

On the public expenditure side, the staff argues against the large increase in child allowances. However, the Mongolian authorities have established the Development Fund specifically for the deposit of the windfall tax proceeds, and the authorities have agreed in principle to allocate expenditures from the Development Fund to areas such as infrastructure and child allowance only after the revenues to the Fund are accumulated. Mongolia is a sparsely populated country with a high poverty ratio. Only 2.5 million people are living in a country with the territory equal to one-sixth of that of China. Mainly due to a nomadic life style, the authorities had no resident registration system until recently. The child allowance has helped establish the resident registration system as well as the tax paper database. More importantly, it shifts part of the windfall from the highly non labor-intensive mineral sector (employing only 2.4 percent of the labor force) to all under 18 year olds in a non-discriminating manner. In that sense, the child allowance is redistributive rather than "untargeted" as the staff states. Means testing would require a substantial administrative apparatus for a relatively small fiscal saving.

The 2007 budget provides for a 20 percent increase in civil service wages. While the private sector salary and consumer prices have increased substantially in recent years, public sector salaries have been suppressed. Even with the proposed increase, the absolute level of the public sector wages is still relatively low. The Mongolian authorities recognize the need for on-going public sector reform as part of medium term improvements for the delivery of public sector services.

On the revenue side, it should be noted that the authorities have taken measures for broadening the non-mineral tax base and cutting tax rates. It should help diversify and increase efficiency of the economy through reducing distortions in the tax system. The

[1] It is based on the final 2007 budget approved by Parliament. The 5 percent fiscal deficit of GDP in 2007 in the staff paper is calculated by the staff using Fund methodology.

reforms are intended to create favorable conditions for entrepreneurs, individuals and foreign and domestic investors and are viewed by the authorities as an important step towards supporting economic growth and the future expansion of the tax base. The staff recommends that the authorities reverse at least part of the 5 percentage point cut in the VAT rate. This simply seems to be politically impracticable at this stage and would risk unraveling other parts of tax reform. Nevertheless, the Mongolian authorities are keeping the whole tax area under review and are seeking FAD technical assistance on addressing the mineral tax issues.

In terms of further addressing medium to longer term fiscal sustainability, the Mongolian authorities agree with the approach of seeking to stabilize usable revenues and to provide for the accumulation of financial resources that would make up for the depletion of national resources. Moreover, the authorities recognize the steady upward trend in budget expenditures, and are planning to implement budget expenditure reforms which aims at ensuring a rational allocation of budget financing.

Monetary policy and Financial System

The authorities share the staff's concern that the current rapid growth in broad money could fuel higher inflation. They note, however, that rapid monetary growth is an indication of deepening intermediation and improving confidence in the banking system. The authorities note the staff's recommendations that the Bank of Mongolia (BOM) should increase the issuance of CBBs at market-clearing interest rates as a monetary policy tool.

The BOM has taken many important steps to strengthen its governance structure. Two non-executive directors were appointed to the BOM's Board of Directors. The authorities agree with the staff that the shift of weight from the Governor to the Board of Directors and strengthening of the external Supervisory Board will help improve the central bank governance.

The authorities maintain ongoing commitments to the flexible exchange rate, including limiting foreign exchange market interventions to the smoothing of short-term volatility. The exchange rate regime has let the economy cope with terms of trade movements through the cycle. As the staff rightly pointed out, international reserves should be held in low risk, unencumbered assets. In this regard, the authorities agree that the BOM should phase down the domestic gold purchases as practicable in the medium to long term.

Progress in strengthening the banking system is one of the most notable developments of the economy in 2006. Nonperforming loans (NPLs) of the banking system as a whole have been substantially reduced during recent years. High priority will be given to monitoring banks with fast credit growth and bank lending rates should continue to reflect market forces. The authorities agree with the staff that the plans to introduce a bank deposit insurance scheme should be preceded with in a very cautious manner. Against this background, the BOM has now requested to subscribe to the Financial Sector Assessment Program (FSAP) and for the assessment to commence as soon as possible.

Structural reforms

All structural reform measures are geared toward improving the climate for private investment and diversifying the economy. The Anti-Corruption Law was newly adopted. Privatization of State Owned Enterprises (SOEs) is slowly but steadily being pursued. In particular, SOEs in the energy sector are planned for comprehensive restructuring under a Bank-supported energy sector reform project.

In order to strengthen the poverty reduction strategy, the Socio-Economic Guidelines have been finalized. The authorities are trying to have social welfare programs more targeted in line with the Fund recommendations.

Public Debt

The authorities are trying to reach agreements with bilateral creditors on disputed claims. Loan arrears to an Italian supplier were cleared in mid-2006. Bilateral discussions are underway with Russia on the arrears of post-1991 Russian debt (US$16.7 million in principal as of end-2005). The authorities are seeking to reach agreement with Finnvera, the export credit guarantee agency of Finland, to normalize a loan dating back to the early 1990s.

According to the Debt Sustainability Analysis (DSA) by the Fund and Bank staff, under the baseline scenario, all public and publicly guaranteed external debt indicators would be in downward trends and stay well below their respective thresholds through the medium-to-long term.

Public and Publicly Guaranteed External Debt Sustainability Analysis

	NPV of debt in percent of		Debt Service in percent of
	Exports	GDP	Exports
Thresholds for Medium Performer	**150**	**40**	**20**
2007 Baseline Projections	44	30	2.3
2016 Baseline Projections	46	26	2.5

*source: Fund staff paper

The staff should be commended for the DSA, which will be very useful in informing public debate on the need for continuing fiscal prudence particularly given the risks of debt distress in the face of adverse external developments, particularly terms of trade shocks. The authorities have noted the Fund advice on refraining from non-concessional external borrowings. They have also pointed out, however, the benefits of some market exposure on external borrowings at some point in the future in order to establish a good credit rating.

AML/CFT

Last year Mongolia passed the legislation for anti-money laundering and combating the financing of terrorism (AML/CFT). To further strengthen the AML/CFT framework in compliance with international standards, the authorities recently set up a Financial Intelligence Unit within the BOM. The Legal Department is having dialogue with the authorities about possible technical assistance.

Statistics

While there are still outstanding issues like the quality of GDP estimates, the authorities have achieved continued improvement in statistics. For further progress, the authorities are seeking ongoing technical assistance from the Fund's Statistical Department.