August 2009
IMF Country Report No. 09/254

Mongolia: First Review Under the Stand-By Arrangement—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Mongolia

In the context of the first review under the Stand-by Arrangement, the following documents have been released and are included in this package:

- The staff report for the first review under the Stand-by Arrangement, prepared by a staff team of the IMF, following discussions that ended on June 5, 2009, 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 June 17, 2009. 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 Press Release summarizing the views of the Executive Board as expressed during its June 23, 2009 discussion of the staff report that completed the review.

- A statement by the Executive Director for Mongolia.

The documents listed below will be separately released.

Letter of Intent sent to the IMF by the authorities of Mongolia*
Technical Memorandum of Understanding*
*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

MONGOLIA

First Review under the Stand-By Arrangement

Prepared by the Asia and Pacific Department in Consultation with Other Departments

Approved by Nigel Chalk and Anthony R. Boote

June 17, 2009

Stand-By Arrangement: A 18-month Stand-by Arrangement in the amount of SDR 153.3 million (300 percent of quota) was approved by the Executive Board (Country Report No. 09/130) on April 1, 2009, and a first purchase of SDR 51.1 million was made following the Board meeting. All end-April performance criteria were met.

Summary: Economic activity is slowing and inflation is falling, broadly in line with what was anticipated at the time the program was approved. The authorities' strong policy implementation is working to stabilize the economy. The biweekly foreign exchange auctions are also working well and the authorities remain committed to allowing exchange rate flexibility in line with market conditions. Liquidity conditions, however, have been tight and, with confidence returning, inflation falling, and international reserve buffers being built, the central bank appropriately lowered interest rates and has space to further gradually ease monetary conditions. Private sector credit has been shrinking and the risks in the banking system are increasing. The authorities reiterated their commitment to take decisive actions, as needed, to ensure banking system stability. Fiscal performance has been strong, with expenditure restraint containing the deficit despite weakness in revenue. The government remains committed to achieving this year's 6 percent of GDP deficit target.

Discussions: A staff team visited Ulaanbaatar, June 1–5, 2009 consisting of S. Barnett (Head), J. Bersch, T. Feridhanusetyawan (APD), J. Hartley (SPR), J. Gottschalk (FAD), I. W. Song (MCM), and B. Jang (Resident Representative). Mr. Na (OED) joined the discussions. The team held discussions with the Speaker of Parliament, heads of various parliamentary committees, the Finance Minister, the Governor of the Bank of Mongolia, Minister of Social Welfare and Labour, Minister of Mineral Resources and Energy, commercial banks, and other officials.

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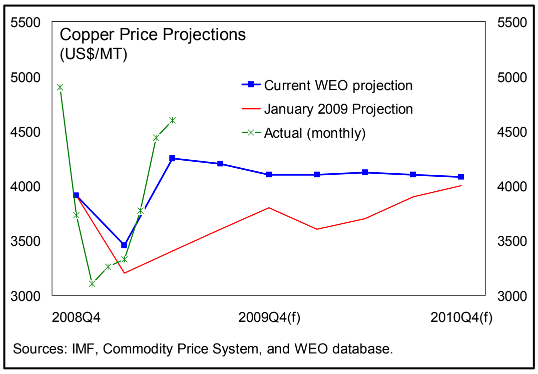
I. Background

1. **Context.** Economic developments have been broadly in line with those anticipated at the time the program was approved. Economic activity is slowing and inflation is falling. However, copper prices, which are critical for the economy, have strengthened considerably. On the other hand, first quarter growth was somewhat lower than expected. On balance, and given the downside risks to world copper prices, the assumptions and macroeconomic framework underpinning the program have been left unchanged.



Sources: IMF, Commodity Price System, and WEO database.

2. **Politics**. Presidential elections were held on May 24 and each of the two major parties, which together make up the coalition government, ran candidates. Mr. Tsakhia Elbegdorj of the Democratic Party, the junior member of the governing coalition, was elected President. The process was free of the disruptions that followed last year's parliamentary elections and has had little impact on the direction of economic policy.

3. **Monetary and exchange rate.** The central bank has continued with biweekly foreign exchange auctions, which are working well. International reserves have increased and the exchange rate has appreciated. With market conditions stabilizing and inflation falling, the Bank of Mongolia lowered the policy interest rate by 125 basis points in early-May, feeding through to lower rates on central bank debt. The central bank lowered the policy interest rate a further 125 basis points on June 11.

4. **Fiscal policy.** The authorities succeeded in restraining expenditure through end-April, and thus were able to contain the deficit despite weakness in revenue. Revenue is declining, reflecting the slowdown in economic activity and imports. Spending restraint was concentrated on current expenditure, as investment is already seasonally low in the early part of the year.

5. **Program performance**. All performance criteria for the first review were met (Letter of Intent, Table 1). However, the performance criterion on domestic payment arrears could not be measured as currently defined. The definition has been clarified in a revised Technical Memorandum of Understanding. Based on the new definition, there would have been a negligible (Tog 0.2 billion) accumulation of arrears through end-April, while the net credit to government performance criterion overperformed by a margin of some 20 billion.

II. Policies and Discussions

A. Monetary and Exchange Rate Policies

6. **Monetary policy.** Since the March increase in the policy rate, market conditions have stabilized, inflation has come down, and NIR buffers have been built. Staff supports

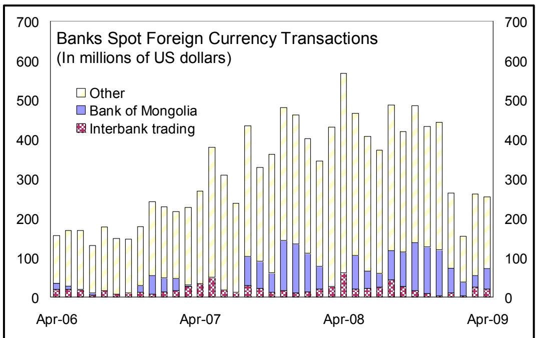
the Bank of Mongolia's recent lowering of the policy rate and agreed with the authorities that there is probably scope for further easing of monetary conditions, including through providing liquidity to the financial system and lowering rates along the yield curve. The central bank plans to proceed carefully with a gradual relaxation of monetary conditions, cautiously testing the water and observing the impact on the banks, exchange rate, inflation, and reserves.

7. **Monetary operations.** Managing liquidity has proved difficult. Reserve money is running well below program assumptions with knock-on effects for private sector credit (see below). Drawing on MCM's technical assistance, the Bank of Mongolia has moved to a quantity-based auction for the seven-day central bank bills (CBBs), which should better help control the level of monetary aggregates. The central bank is still considering whether to convert the seven-day CBB policy rate into a policy target, which would allow banks to bid within a band around the target interest rate. At present, both the interest rate and quantity of seven-day CBBs are fixed and bids filled on a pro-rata basis.

8. **Private sector credit.** The authorities are concerned about tight financing conditions, especially for the construction sector. The monetary program was designed to preserve adequate space for private sector credit. However, credit has been shrinking reflecting a variety of factors including tighter-than-envisaged liquidity, the cooling economy, a credit overhang from the boom years, and concerns about corporate creditworthiness. Authorities and staff agreed that a further easing of monetary and liquidity conditions would be helpful.

9. **Exchange rate.** Staff reiterated the importance of continuing to allow for exchange rate flexibility within the floating system. The exchange rate has recently been stable, reflecting a normalization of market conditions and the central bank has opportunistically intervened to build reserves. The authorities remain committed to allowing exchange rate flexibility in line with market conditions and confirmed that the recent stability does not reflect any policy intention to target a particular level of the exchange rate.

10. **Exchange market.** Market infrastructure is improving, but the interbank foreign exchange market is still developing with transaction volumes still low. The introduction of a screen-based system (end-June Structural Benchmark) for the interbank market will help in this regard, but the authorities indicated that developing the institutional framework (for example, code of conduct and master agreement for transactions) to support such a system would take until end-September. However, the central bank has appropriately decided to maintain the foreign currency auctions until the interbank market is deep enough to allow for the central bank to effectively transact in that market.



Sources: Mongolian authorities; and IMF staff estimates.

11. **Monetary policy coordination.** There is a critical need for better coordination between the central bank's foreign exchange activities and monetary operations. The authorities intend to strengthen coordination by combining foreign exchange operations, monetary operations, and central bank paper issuance into a single unit. This would help ensure that money market operations and foreign exchange auctions work in a coordinated way toward achieving the Bank of Mongolia's policy objectives.

B. Fiscal Policy

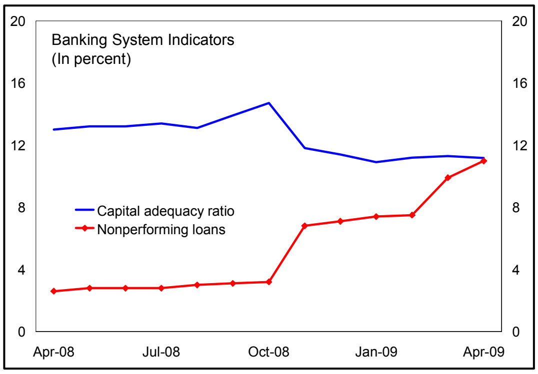
12. **Fiscal policy.** The authorities remain committed to achieving the 6 percent of GDP deficit target for 2009. Expenditure restraint remains the centerpiece of their strategy, and capital spending will be strictly controlled in the upcoming period when new projects would normally be started. At the same time, contingent measures—primarily on the spending side—are also being explored to be implemented in the event of a revenue shortfall. Looking forward, the authorities reaffirmed their commitment to achieve a 4 percent of GDP deficit in 2010 and to put in place a Fiscal Responsibility Law to protect against repeating the boom-bust policies of the past.

13. **Social transfers.** In consultation with the World Bank and Asian Development Bank, a reform of the social transfer system is being designed that will have lower fiscal costs while safeguarding the poor through better targeting. The authorities recognize that the current system of untargeted transfers is neither sustainable nor efficient, and is in need of urgent reform. The authorities are preparing a plan for a comprehensive reform to be announced in the coming weeks (end-June Structural Benchmark), and will strive to begin implementation as soon as possible, possibly by the fall of this year.

14. **Erdenet and mining.** The government remains committed to using its voting rights in Erdenet, the main copper exporter, to ensure that it pays taxes and dividends on schedule. In addition, legislation has been submitted to parliament that would require Erdenet to pay all taxes in local currency (end-June Structural Benchmark). More broadly, the authorities are fully committed to ensuring a predictable and stable environment for mining operations, and are pressing ahead to finalize contracts for two large mining projects.

C. Banking System

15. **Anod Bank.** The external audit of Anod Bank was completed, and the authorities will announce a resolution plan by end-June (Structural Benchmark). Several restructuring options were identified by USAID funded experts, and staff reiterated the importance of carefully balancing the fiscal consequences, fairness, and implications for financial stability. Early estimates indicate that the total fiscal cost would be in the range of 3 to 6 percent of GDP.



16. **Banking system.** The authorities recognize the risks in the banking system are rising, as underscored by the rising NPL ratio. The authorities, however, reiterated their commitment to take decisive action, as needed, to ensure banking system stability. Banks that have not achieved a 12 percent capital adequacy ratio have submitted plans to reach 12 percent, and these are currently being reviewed by the central bank. The authorities indicated that, in the event a bank becomes noncompliant with prudential supervisory requirements, they would be ready to act promptly and transparently. In addition, the authorities are taking steps to amend the legal framework for bank supervision and resolution in line with the end-June Structural Benchmark.

D. Other Issues

17. **Safeguards assessment.** A Safeguards Assessment is being finalized. It concluded that the Bank of Mongolia's financial reporting and auditing practices generally comply with international standards. The central bank will consider staff recommendations that external auditors be given access to the central bank's vaults and that the audit oversight of the Supervisory Board be enhanced.

18. **Gold mining operations.** The authorities contracted a US$100 million, one-year loan with a foreign commercial bank to finance lending to gold mining companies. The first tranche of US$18 million was disbursed in May. While the loan is within the performance criteria for nonconcessional borrowing, staff reiterated that the contracting of such loans should be approached cautiously, with careful consideration given to the costs, risks, debt sustainability implications, and impact on the 2009 fiscal deficit. The authorities responded that lending to mining would be repaid during the course of the year and would not impact the 6 percent of GDP deficit target for the year as a whole.

19. **External loans.** The authorities have been considering various other nonconcessional external loans and loan guarantees. Staff advised that external borrowing should be sought on concessional terms, and that the authorities should avoid guaranteeing any external loans to domestic entities. Instead, such lending should take place on a purely commercial basis. Government guarantees on external lending has led to problems in the past, and are currently prohibited by law. Staff recommended maintaining the current system of blanket prohibition on loan guarantees given the potential fiscal risks and past experience.

20. **China swap.** The authorities are negotiating a swap agreement with China that could be signed in the near future. However, they have committed not to sign any such agreement until Fund staff can verify that its terms are consistent with Article VIII obligations. They will also ensure that any drawings under the swap arrangement are consistent with program ceilings on nonconcessional borrowing. The Technical Memorandum of Understanding has been revised accordingly.

21. **Article VIII issues**. The authorities removed the limitation in the foreign exchange auction regulation according to which foreign exchange could only be purchased for import transactions. The modalities of the multi-price auction system give rise to multiple currency practices (MCP) subject to Fund jurisdiction, since there is no mechanism in place that ensures that exchange rates of accepted bids at the multi-price auction do not deviate by more than 2 percent. In addition, given the way the official exchange rate (reference rate) is determined (based on the previous days' weighted average exchange rates) and the fact that the official rate must be used for the government's current international transactions, the absence of a mechanism that ensures that the official rate does not deviate by more than 2 percent from the commercial rate also gives rise to an MCP subject to Fund jurisdiction.

22. **Donors.** The Asian Development Bank, the World Bank, and Japan together have agreed to provide US$130 million of support this year. Other donors are still considering providing support but are unable to announce concrete sums at present. Staff are optimistic that the US$145 million in donor financing for 2009 that is assumed in the program could be exceeded.

23. **External arrears.** Good progress has been made to settle the arrears with Paris Club creditors. Arrears to Spain have already been cleared, the authorities have resumed negotiations with Finland, and they have indicated their intention to repay part of the debt owed to Russia.

III. Staff Assessment

24. **Overview.** The program is working in stabilizing the economy, and the authorities' success in meeting the program's quantitative targets is commendable.[1] At the same time, there are still important challenges ahead and, as such, this would be entirely the wrong time for complacency. Efforts should focus on safeguarding the recent hard-earned stability, while continuing to implement the reforms outlined in the program. Doing so would help secure sustainable and equitable growth with low inflation.

25. **Exchange rate.** The floating exchange rate system is working well. The exchange rate has been stable recently, reflecting underlying market conditions, but it is essential that the central bank continues to allow the currency to move flexibly as market conditions evolve.

26. **Monetary policy.** Tight monetary policy was instrumental in stabilizing market conditions, while allowing the central bank to accumulate welcome buffers in international reserves. However, with inflation coming down, confidence returning, and credit conditions tight, the central bank has appropriately decided to lower the policy rate. There is still space to further ease liquidity conditions, a process that would be facilitated

[1] The staff judges that the performance criterion on domestic arrears as drafted was not monitorable and hence no waiver is required.

by strengthening monetary operations and greater coordination with foreign exchange intervention to better manage liquidity. Nonetheless, the central bank should remain prepared to raise interest rates quickly if market conditions were to deteriorate.

27. **Fiscal policy.** The authorities succeeded in controlling spending so as to achieve the program fiscal targets. Continued restraint will be needed in the period ahead and it is welcome that the authorities are considering contingent measures to ensure attainment of this year's deficit target. It will be critical that any gold mining loans are paid back to the government within the course of the year. The government should also proceed expeditiously on a comprehensive reform of the social transfer system that protects the needy through improved targeting. Adoption of a fiscal responsibility law will help prevent a repeat of the excessively procyclical policies that contributed to the recent crisis.

28. **Financial sector.** Managing the risks in the banking system is a critical task in the period ahead and the Bank of Mongolia should be prepared to act quickly, if needed, to secure stability. Announcing and then pressing ahead with a restructuring plan for Anod Bank will be essential. At the same time, reforms underway to strengthen supervision and the institutional framework are critical for securing the health of the banking system over time.

29. **External financing.** The government should be conservative in undertaking any new external borrowing particularly given the prospects for donor support imply that the fiscal position should be fully financed for this year. To avoid contingent fiscal liabilities, the current prohibition on government guarantees should be maintained.

30. **Risks.** While some of the risk described in the last staff report have diminished through the authorities' steadfast program implementation, others are still front and center. Key in this regard are the fiscal risks related to revenue shortfalls and gold mining operations. The government will need to watch carefully fiscal developments in the coming months and adjust spending, as needed, to ensure the fiscal program remains on track. An additional risk is that the economy could slow more than anticipated, which could put further stress on the banking system.

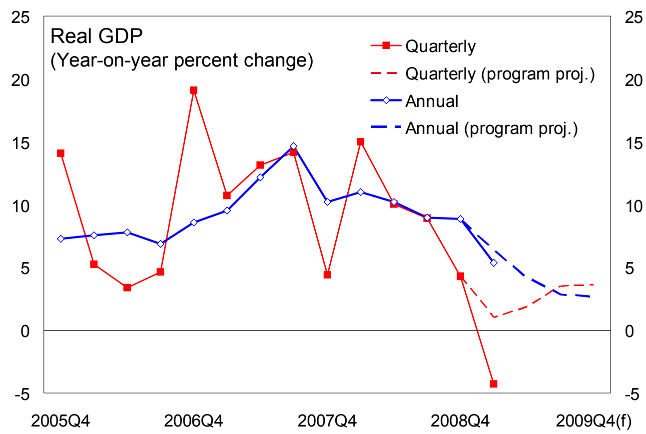
31. Since the multi-price auction MCP subject to Fund jurisdiction is maintained temporarily, nondiscriminatorily; and for balance of payments reasons, staff recommends approval of such MCP. There is no program implication of such finding since the multi-price auction MCP was introduced before the approval of the SBA and any modifications were carved out from the standard PC on MCPs at the approval of the SBA arrangement. The official exchange rate MCP may not be approved because the criteria for approval are not present. There is also no program implication since such a MCP has been maintained since before the approval of the SBA for Mongolia.

32. The Mongolian authorities' strong performance so far under the program is encouraging and, while the program remains ambitious, its objectives are within reach. Staff recommends the approval of the First Review.

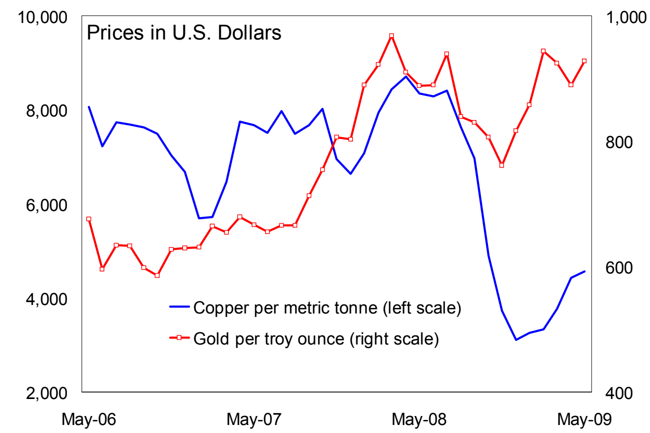
Figure 1. Macroeconomic Trends

Main Message: *Following a period of overheating fueled by high commodity prices and procyclical policies, the economy has now slowed markedly, triggered by a sharp fall in copper prices.*

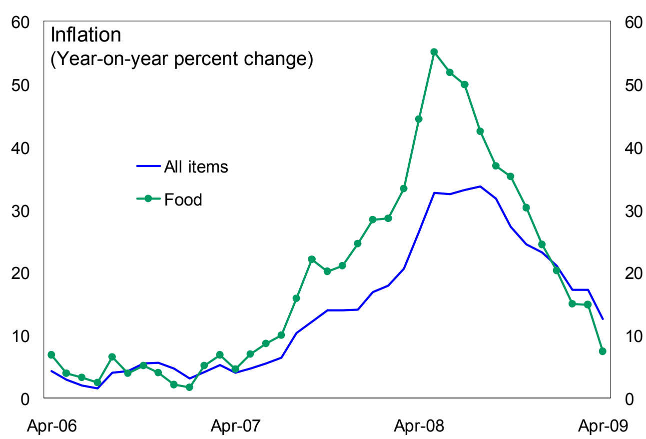
The economy is projected to slow this year…



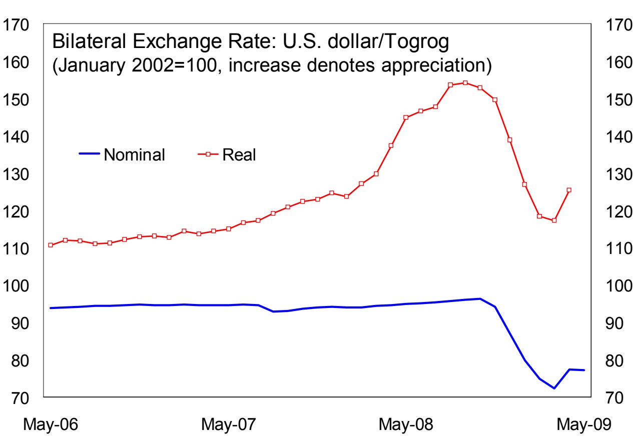
…due mainly to a worsening global environment, a necessary tightening of policies, and a sharp decline in copper prices.



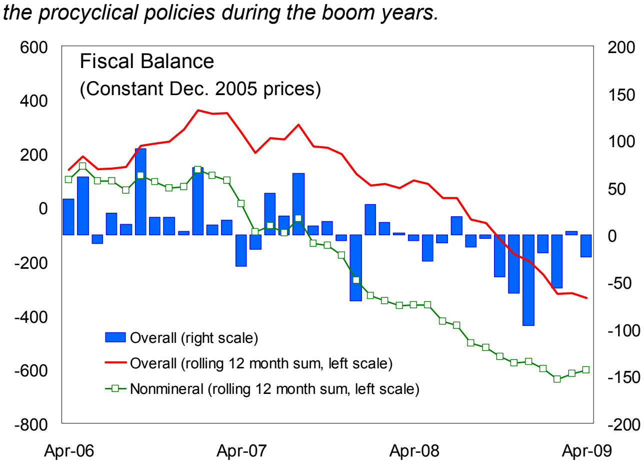
The slowing economy, policy tightening, and global price declines have helped drive inflation down.



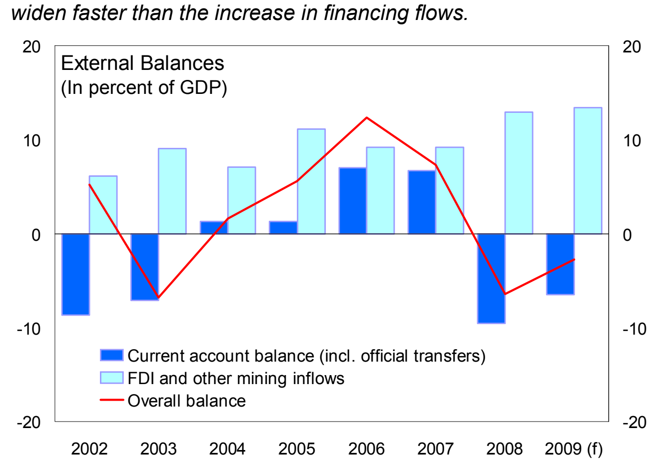
Downward pressure on the currency seems to have abated.



A big adjustment in the nonmineral balance is underway, unwinding the procyclical policies during the boom years.



Falling export earnings are causing the current account deficit to widen faster than the increase in financing flows.

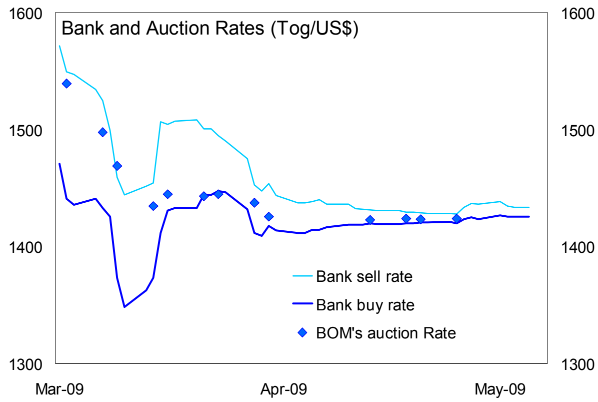


Sources: Mongolian authorities; and IMF staff estimates.

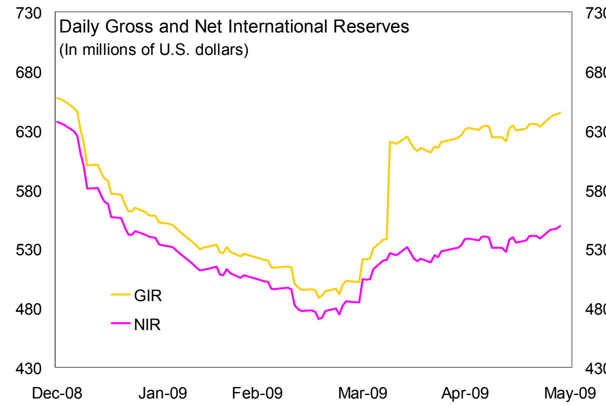
Figure 2. Recent Developments

Main Message: *Recent monetary policy and foreign exchange measures have worked well to stabilize market conditions, allowing the Bank of Mongolia to build international reserves. Private sector credit, however, is being squeezed.*

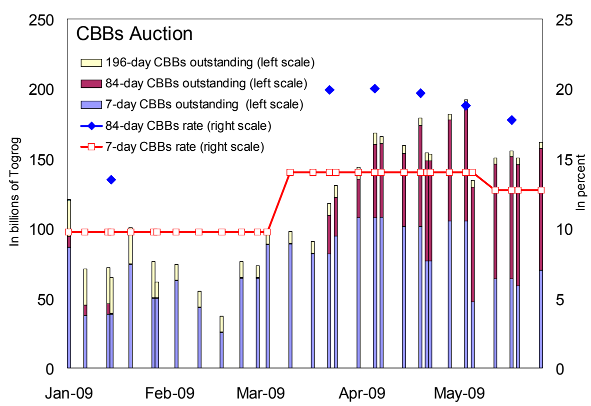
The foreign exchange auction system is working well, and interbank spreads have shrunk…



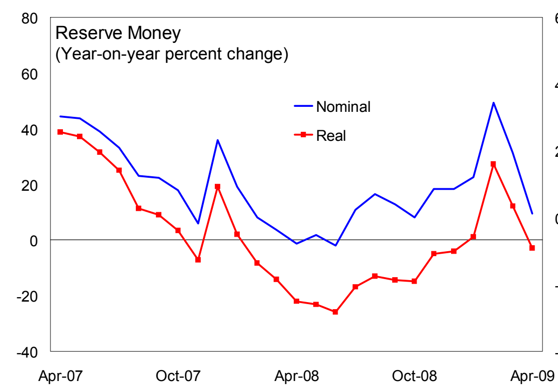
…while the Bank of Mongolia has been able to build foreign exchange reserves



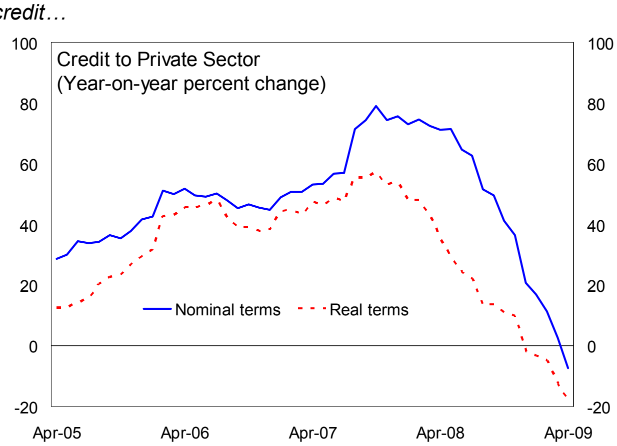
Liquidity remains tight following the hike in interest rates and continued issuance of CBB bills…



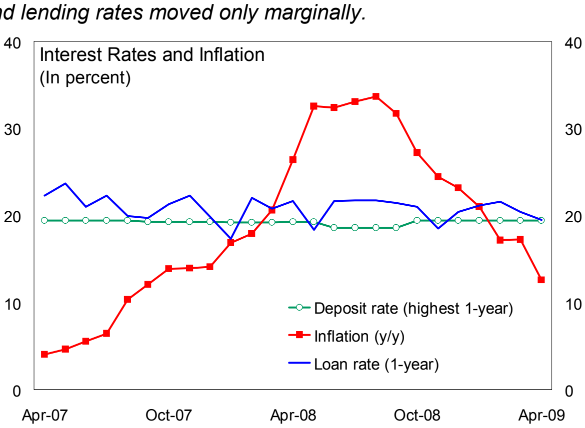
…leading to a sharp slowdown in reserve money growth.



…this is contributing to a substantial slowdown in private sector credit…



…with disinflation pushing up real interest rates as nominal deposit and lending rates moved only marginally.



Sources: Mongolian authorities; and IMF staff estimates.

Table 1. Mongolia: Selected Economic and Financial Indicators, 2006–10

Nominal GDP (2008): $5,258 million 1/
Population, end-year (2007): 2.64 million
Per capita GDP (2008): $1,981 2/
Poverty incidence (2007/08): 35.2 percent 3/
Quota: SDR 51.1 million

	2006	2007	2008 4/	2009 IMF CR//09/130	2010 IMF CR//09/130
			(Percent change)		
Real sector					
Real GDP growth	8.6	10.2	8.9	2.7	4.3
Mineral	6.3	2.9	0.1	0.0	1.0
Nonmineral	9.2	12.2	11.0	3.2	5.0
Consumer prices (period average)	4.5	8.2	26.8	10.1	7.9
Consumer prices (end-period)	4.8	14.1	23.2	9.6	7.0
GDP deflator	23.1	12.3	22.4	0.0	9.4
			(In percent of GDP)		
General government budget					
Revenue and grants	36.6	40.9	35.4	30.8	31.6
Expenditure and net lending	28.5	38.0	40.2	36.8	35.6
Current balance	14.8	14.1	6.4	1.9	4.5
Primary balance	8.6	3.2	-4.5	-4.7	-3.8
Overall balance (including grants)	8.1	2.8	-4.8	-6.0	-4.0
Nonmineral overall balance	-2.4	-11.5	-14.9	-9.9	-9.1
			(Percent change)		
Money and credit 5/					
Net foreign assets	98.4	19.1	-49.3	39.1	32.5
Net domestic assets	-32.5	157.6	52.1	19.3	22.0
Domestic credit	-7.1	71.0	52.6	13.6	18.0
Broad money	31.3	55.6	-5.1	25.1	25.4
Reserve money	40.0	35.9	18.4	12.1	17.7
Broad money velocity (GDP/BM)	2.4	1.9	2.7	2.2	2.0
Interest rate on central bank bills, end-period (percent) 6/	5.1	8.4	9.8	…	…
			(In millions of U.S. dollar)		
Balance of payments					
Current account balance (including official transfers)	222	265	-503	-262	-268
(In percent of GDP)	7.0	6.7	-9.6	-6.5	-6.2
Trade balance	30	-54	-464	-201	-245
Exports	1,545	1,949	2,667	1,858	2,211
Imports	-1,516	-2,003	-3,131	-2,059	-2,457
Foreign direct investment	290	360	682	317	330
Gross official international reserves (end-period)	718	1001	657	822	1075
(In months of next year's imports of goods and services)	3.6	3.2	3.0	3.3	3.7
Trade prices					
Export prices (U.S. dollar, percent change)	39.9	26.0	3.9	-27.0	5.5
Import prices (U.S. dollar, percent change)	12.2	9.6	19.1	-25.3	4.9
Terms of trade (percent change)	24.7	15.0	-12.8	-2.2	0.6
			(In percent of GDP)		
Public and publicly guaranteed debt					
Total public debt	45.4	39.4	33.1	46.8	47.8
Domestic debt	1.0	0.5	0.0	0.0	0.0
External debt 7/	44.3	38.9	33.1	46.8	47.8
(In million U.S. dollar)	1,414	1,529	1,601	1,796	2,048
Exchange rate					
Togrogs per U.S. dollar (end-period)	1,165	1,170	1,268	...	...
Togrogs per U.S. dollar (period average)	1,177	1,170	1,166	...	...
Nominal effective exchange rate (end-period; percent change)	1.9	-4.0	-2.5	...	...
Real effective exchange rate (end-period; percent change)	5.5	6.4	19.5	...	...
Nominal GDP (billions of togrogs)	3,715	4,600	6,130	6,294	7,180

Sources: Mongolian authorities; and Fund staff projections.

1/ Based on period average exchange rate.
2/ Estimate, based on period average exchange rate.
3/ Based on The Household Socio-Economic Survey 2007-08.
4/ Incorporates revised fiscal and monetary data for 2008.
5/ For 2009-10, valued at the programmed exchange rate and gold price.
6/ Yield of 14-day bills until 2006 and of 7-day bills from 2007 onward.
7/ Includes prospective Fund credit under the SBA.

Table 2. Mongolia: Summary Operations of the General Government, 2006–10

	2006	2007	2008 IMF CR//09/130	2008 Revised 1/	2009 IMF CR//09/130	2010 IMF CR//09/130
			(In billions of togrogs)			
Total revenue and grants	1,360	1,880	2,156	2,170	1,936	2,269
Total expenditure and net lending	1,059	1,750	2,462	2,467	2,316	2,559
Overall balance (incl. grants)	301	131	-305	-296	-380	-290
Nonmineral overall balance	-88	-527	-925	-911	-621	-653
Financing	-336	-131	305	296	380	290
Foreign (net)	87	47	43	39	53	150
Domestic (net)	-423	-178	262	258	101	40
Donor support	0	0	0	0	227	100
			(In percent of GDP)			
Total revenue and grants	36.6	40.9	35.2	35.4	30.8	31.6
Current revenue	36.4	40.4	34.8	35.1	30.4	31.2
Tax revenue and social security contributions	30.4	32.7	30.8	30.8	25.2	26.3
Income taxes	12.8	14.1	12.4	12.3	6.0	6.8
Enterprise income tax	6.0	4.8	4.1	4.1	3.5	4.0
Personal income tax	2.1	1.6	1.9	1.9	1.6	1.6
"Windfall" tax	4.8	7.7	6.3	6.3	0.9	1.2
Social security contributions	3.0	3.5	3.6	3.7	3.9	3.9
Sales tax and VAT	6.5	5.8	5.8	6.0	6.2	6.0
Excise taxes	2.7	2.9	2.9	2.9	3.2	3.6
Customs duties and export taxes	1.9	2.2	2.5	2.3	2.5	2.4
Other taxes	3.4	4.2	3.6	3.6	3.4	3.6
Nontax revenue	6.1	7.7	4.0	4.2	5.2	4.9
Capital revenue and grants	0.2	0.5	0.3	0.3	0.4	0.4
Total expenditure and net lending	28.5	38.0	40.2	40.2	36.8	35.6
Current expenditure	21.7	26.3	28.5	28.7	28.5	26.7
Wages and salaries	5.3	6.4	8.9	8.9	9.0	9.0
Purchase of goods and services	8.6	8.5	8.0	8.3	5.5	5.5
Subsidies to public enterprises	0.3	0.3	1.2	1.2	0.7	0.7
Transfers 2/	7.0	10.6	10.2	10.0	12.0	11.2
Interest payments	0.5	0.4	0.3	0.3	1.3	0.3
Contingency allocation	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure and net lending	6.9	11.8	11.6	11.5	8.3	8.9
Capital expenditure	4.7	10.0	10.2	10.2	6.7	6.7
Domestically-financed	4.5	9.5	9.9	9.9	6.2	5.9
Foreign-financed	0.2	0.5	0.3	0.3	0.5	0.7
Net lending	2.1	1.7	1.4	1.3	1.6	2.3
On-lent foreign project loans	2.4	1.6	1.1	1.1	1.9	2.6
Domestic lending minus repayments	-0.3	0.2	0.3	0.3	-0.3	-0.3
Current balance (excl. privatization receipts)	14.8	14.1	6.3	6.4	1.9	4.5
Primary balance	8.6	3.2	-4.7	-4.5	-4.7	-3.8
Overall balance (incl. grants)	8.1	2.8	-5.0	-4.8	-6.0	-4.0
Nonmineral overall balance	-2.4	-11.5	-15.1	-14.9	-9.9	-9.1
Discrepancy between above and below the line	-1.0	0.0	0.0	0.0	0.0	0.0
Financing	-9.1	-2.8	5.0	4.8	6.0	4.0
Foreign (net)	2.3	1.0	0.7	0.6	0.8	2.1
External borrowing (net)	2.3	1.0	0.7	0.6	0.8	2.1
Project loans	2.7	2.1	1.4	1.4	2.4	3.3
Program loans	0.3	0.0	0.0	0.0	0.0	0.0
Amortization	0.6	1.1	0.7	0.7	1.6	1.2
Domestic (net)	-11.4	-3.9	4.3	4.2	1.6	0.6
Banking system (net)	-11.8	-3.8	4.2	4.1	1.3	0.6
Nonbank	0.4	0.0	0.1	0.1	0.3	0.0
Donor support	0.0	0.0	0.0	0.0	3.6	1.4
Memorandum items:						
Mineral revenue	10.5	14.3	10.1	10.0	3.8	5.1
Of which: tax and royalty	9.5	11.3	9.8	9.7	2.5	4.0
Nonmineral revenue	26.0	26.1	24.7	25.1	26.5	26.2
Mineral revenue/total revenue and grants (in perc	28.6	35.0	29.2	29.2	12.5	16.0
Nominal GDP (in billions of togrogs)	3,715	4,600	6,130	6,130	6,294	7,180
Copper price (US$ per ton)	6,731	7,132	6,963	6,963	3,500	3,800

Sources: Ministry of Finance; and Fund staff projections.

1/ Incorporates revised fiscal data for end-2008.

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

Table 3. Mongolia: Monetary Aggregates, 2006−10 1/

	2006	2007	2008	2008	2009		2010
			IMF CR//09/130	Revised 2/	April	IMF CR//09/130	IMF CR//09/130
	(In billions of togrog; end of period)						
Monetary survey							
Broad Money	1,537	2,391	2,319	2,270	2,421	2,900	3,637
Currency	185	283	329	329	288	390	489
Deposits	1,351	2,108	1,990	1,941	2,133	2,510	3,148
Net foreign assets	1,132	1,348	677	683	801	942	1,248
Net international reserves	1,079	1,399	747	747	888	1,002	1,279
Bank of Mongolia	801	1,137	808	808	837	1,045	1,301
Commercial banks	278	261	-60	-60	52	-43	-22
Other foreign assets, net	53	-50	-70	-64	-88	-60	-31
Net domestic assets	405	1,043	1,642	1,587	1,620	1,958	2,389
Domestic credit	812	1,389	2,196	2,119	2,229	2,495	2,943
Net credit to government	-435	-703	-497	-574	-491	-416	-376
Claims on nonbanks	1,247	2,092	2,692	2,692	2,720	2,910	3,319
Other items, net	-408	-346	-554	-532	-609	-537	-554
Monetary authorities							
Reserve money	394	535	633	634	545	710	836
Net foreign assets	798	1,134	805	805	832	1,042	1,298
Net international reserves	801	1,137	808	808	837	1,045	1,301
Other assets, net	-3	-4	-3	-3	-5	-3	-3
Net domestic assets	-404	-599	-172	-171	-287	-332	-462
Net credit to government	-335	-573	-185	-183	-101	-74	-74
Claims on deposit money banks	18	19	243	243	208	165	165
Minus: Central bank bills (net)	71	103	120	120	180	303	475
Other items, net	-17	59	-110	-112	-214	-120	-78
Memorandum items:	(In percent; unless otherwise indicated)						
Annual broad money growth	31.3	55.6	-3.0	-5.1	-1.9	25.1	25.4
Annual growth of credit to nonbanks	42.5	67.7	28.7	28.7	9.4	8.1	14.0
Annual reserve money growth	40.0	35.9	18.4	18.4	11.5	12.1	17.7
Velocity	2.4	1.9	2.6	2.7	2.6	2.2	2.0
Broad money/reserve money	3.9	4.5	3.7	3.6	4.4	4.1	4.3
Total loans/deposits	92.3	99.3	135.3	138.7	127.5	116.0	105.4
Net international reserve (in millions of US$)	687	972	637	637	536	670	834
Net international reserve under program definition (in millions of US$) 3/	…	…	520	495	441	575	739

Sources: Mongolian authorities; and Fund staff projections.

1/ Valued at the programmed exchange rate and gold price.

2/ Incorporates revised monetary data and reclassification of government deposits as of December 2008.

3/ Consistent with the recommendation of the IMF Safeguard Assessment, and does not include commercial bank foreign currency deposits and foreign currency current accounts held at the Bank of Mongolia.

Table 4. Mongolia: Balance of Payments, 2006–10

(In millions of U.S. dollars, unless indicated otherwise)

	2006	2007	2008	2009	2010
			Prel.	IMF CR//09/130	IMF CR//09/130
Current account balance (including official grants)	222	265	-503	-262	-268
Trade balance	30	-54	-464	-201	-245
Exports	1,545	1,949	2,667	1,858	2,211
Of which : copper concentrate	635	812	836	430	478
Of which: gold	270	235	600	575	727
Imports 1/	-1,516	-2,003	-3,131	-2,059	-2,457
Of which: oil imports	-423	-560	-966	-388	-542
Of which: food imports	-180	-266	-391	-273	-329
Services, net	122	161	-152	-266	-230
Receipts	486	574	469	319	343
Income, net	-144	-79	-91	-124	-135
Current transfers	215	237	205	329	342
General government	112	133	74	240	230
Other sectors	103	104	131	89	112
Of which: workers remittances	77	84	100	50	72
Capital and financial account	100	236	396	150	373
Direct investment 2/	290	360	682	317	330
Portfolio investment	1	75	-13	1	1
Trade credits, net	28	-13	72	-53	-37
Currency and deposits, net	-244	-268	-293	-259	-245
Loans, net 2/	37	45	114	377	441
Other, net	-11	37	-167	-233	-118
Errors and omissions	68	-212	-231	0	0
Overall balance	389	288	-338	-112	104
Increase in gross official reserves (-)	-385	-283	343	-165	-253
Use of IMF credit (+)	-4	-5	-5	-6	-5
Increase in net official reserves (-)	-389	-288	338	-33	-164
Financing need	0	0	0	284	153
Expected sources of financing					
Donors support	0	0	0	145	60
IMF: SBA	0	0	0	139	93
Memoranda items:					
Current account balance (in percent of GDP)					
Including official grants	7.0	6.7	-9.6	-6.5	-6.2
Excluding official grants	3.5	3.3	-11.0	-12.4	-11.5
Gross official reserves (end-period)	718	1,001	657	822	1,075
(In months of imports of goods and services)	3.6	3.2	3.0	3.3	3.7
(In months of nonmining imports) 3/	4.2	3.9	3.4	3.7	4.2
Copper price (in US$ per ton)	6,731	7,132	6,963	3,500	3,800
Oil price (in US$ per barrel)	64	71	97	44	52
Gold price (in US$ per troy oz.)	604	697	872	880	890

Sources: Mongolian authorities; and Fund staff projections.

1/ As of 2007 includes valuation adjustment from c.i.f. value to f.o.b.

2/ Includes the assumed financing of Oyu Tolgoi project of about $4 billion, financed by FDI and loans during 2008–13. The project can be exploited in two stages: open pit section commencing in 2012 and a larger underground reserve in 2015.

3/ Nonmining imports of goods and services are approximated by total imports minus foreign direct investment.

Table 5. Mongolia: Reviews and Disbursements under the 18-month Stand-By Arrangement

Date	Amount of Purchase: In percent of quota	Amount of Purchase: In SDRs	Condition
April 1, 2009	100	51,100,000	Approved Stand-By Arrangement.
June 23, 2009	50	25,550,000	Completion of the first review and observance of end-April 2009 performance criteria.
September 15, 2009	30	15,330,000	Completion of the second review and observance of end-June 2009 performance criteria.
December 15, 2009	30	15,330,000	Completion of the third review and observance of end-September 2009 performance criteria.
March 15, 2010	30	15,330,000	Completion of the fourth review and observance of end-December 2009 performance criteria.
June 15, 2010	30	15,330,000	Completion of the fifth review and observance of end-March 2010 performance criteria.
September 15, 2010	30	15,330,000	Completion of the sixth review and observance of end-June 2010 performance criteria.
Total	300	153,300,000	

ATTACHMENT 1

June 17, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

Mongolia has benefited greatly from the sound economic policies that the government has pursued, supported by the Stand-By Arrangement with the International Monetary Fund. Market conditions have stabilized and we are rebuilding international reserves while maintaining a flexible approach to exchange rate management. Our goals continue to be to restore health to public finances; maintain a fiscal deficit of under 6 percent of GDP this year; reform the supervisory and regulatory framework as part of ongoing efforts to monitor and support financial system stability; and protect the poor during this period of adjustment.

We are committed to implementing the program described in the Memorandum of Economic Policies (MEP). The thrust of our policy agenda remains as described in the MEP. We have made, however, a minor amendment to the Technical Memorandum of Understanding to define more fully domestic arrears for program monitoring purposes.

Given the success to date of the program, we request the completion of the first review in light of the observance of the end-April program targets.

The program will continue to be monitored through quantitative performance criteria and indicative targets, as well as structural benchmarks and quarterly reviews (see attached Tables 1 and 2). The second review will take place on or after September 15, 2009 and the third review will take place on or after December 15, 2009. The government is considering the possibility of transitioning from this emergency support, once conditions have sufficiently stabilized, to a program supported by concessional resources of the IMF.

We are considering entering into a bilateral swap arrangement with China. However, we will not sign any such agreement until Fund staff can verify that its terms are consistent with Article VIII obligations. Also, we will ensure that any drawings under the swap arrangement are consistent with program ceilings on nonconcessional borrowing.

We intend to maintain a close policy dialogue with the Fund. We also stand ready to take additional measures, as appropriate, to ensure the achievement of the government's social and economic objectives under the Stand-By Arrangement. We will consult with the Fund on the adoption of measures, and in advance of revisions to the policies contained in the MEP, in accordance with the Fund's policies on such consultation. Further, we will provide the Fund with such information as it may request on policy implementation an achievement of the program objectives.

Sincerely yours,

/s/	/s/
S. Bayartsogt	L. Purevdorj
Minister of Finance	Governor of Bank of Mongolia

Attachment: Revised Technical Memorandum of Understanding

Table 1. Mongolia: Quantitative Performance Criteria (PC) and Indicative Targets (IT)

	12/31/2008 (Actual)		4/30/2009		6/30/2009	9/30/2009	12/31/2009
	IMF CR//09/130	Revised 4/	IMF CR//09/130	Outcome	IMF CR//09/130	IMF CR//09/130	IMF CR//09/130
Performance criteria 1/							
Net international reserves (NIR) of the Bank of Mongolia (BOM) (floor, eop stock, in million US$) 2/	520	495	335	441	315	455	575
Net domestic asset (NDA) of the BOM (ceiling, eop stock, in billion togrog) 3/	-172	-171	-32	-287	14	-195	-332
Net-bank credit to general government (NBCGG) from the banking system (ceiling, cumulative from the beginning of the fiscal year, in billion togrog) 3/	206	130	105	82	156	72	81
New nonconcessional external debt maturing in one year or more, contracted or guaranteed by the government or the BOM (ceiling, eop stock, in million US$).	0	0	200	0	200	200	200
New nonconcessional external debt maturing in less than one year, contracted or guaranteed by the government or the BOM (ceiling, eop stock, in million US$).	0	0	0	0	0	0	0
Accumulation of new external payment arrears (ceiling, eop, in million US$).	…	…	0	0	0	0	0
Accumulation of domestic payment arrears (ceiling, eop, in billion togrog).	0	0	0	…	0	0	0
Indicative targets							
General government fiscal deficit (ceiling, cumulative since the beginning of fiscal year, in billion togrog).	305	296	250	144	325	290	380
Memorandum items:							
Support from bilateral and multilateral donors excluding IMF (cumulative since the beginning of the year, in million US$)	0	0	0	0	30	80	145
Program exchange rate (togrog/U.S. dollar)	1,268		1,560		1,560	1,560	1,560
Program U.S. dollar per SDR	1.521		1.509		1.509	1.509	1.509
Program monetary gold price (U.S. dollar/ounce)	872		880		880	880	880

1/ Evaluated at the programmed exchange rate.

2/ The NIR does not include commercial bank foreign currency deposits and foreign currency current accounts held at the Bank of Mongolia. The floor on NIR will be adjusted upward (downward) by the amount of support from bilateral and multilateral donors (excluding IMF) in excess (short) of the programmed level. The floor will also be adjusted upward by the amount of nonconcessional borrowing disbursed during the program period.

3/ The ceiling on NDA and NBCGG, respectively, will be adjusted downward (upward) by the amount of support from bilateral and multilateral donors (excluding IMF) in excess (short) of the programmed level. The ceilings will also be adjusted downward by the amount of nonconcessional debt disbursed during the program period.

4/ Incorporates revisions of fiscal and monetary data for end-2008, reclassification of government deposits as of December 2008, and changes in NIR presentation consistent with the recommendation of the IMF Safeguard Assessment.

Table 2. Mongolia: Structural Benchmarks

Actions	Date IMF CR//09/130
Revising relevant laws to require Erdenet to pay taxes in togrog.	6/30/2009
Establishment of screen-based system for inter-bank foreign exchange transactions.	6/30/2009
Announcement of a resolution plan for Anod Bank based on the diagnostic assessment of the external auditor.	6/30/2009
A comprehensive review of transfer programs resulting in a revision of the relevant laws to streamline transfer programs and safeguard the social safety.	6/30/2009
Submission to the parliament of a revised banking law and other pertinent laws and legislations that include: (i) strengthened prompt corrective action clauses including an increase in penalties for noncompliance; (ii) requiring consolidated supervision; (iii) an improved bank resolution framework that more clearly defines the roles of the conservator and liquidator; (iv) legal protection for bank and nonbank supervisors; (v) a more clear definition of "group of connected parties;" and (vi) reinforced prudential supervision requirements.	6/30/2009
The submission to parliament of Fiscal Responsibility Law consistent with recommendations of Fund technical assistance.	12/31/2009

MONGOLIA—TECHNICAL MEMORANDUM OF UNDERSTANDING

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

1. Performance criteria for end-April 2009, end-June 2009, end-September 2009, end-December 2009, end-March 2010, and end June-2010 have been established with respect to:

- floors on the level of net international reserves of the Bank of Mongolia (BOM);
- ceilings on the level of net domestic assets of the BOM;
- ceilings on the level of net bank credit to general government;
- ceilings on the contracting and guaranteeing by the central government or the BOM of new medium- and long-term external debt;
- ceilings on the contracting or guaranteeing by the central government or the BOM of new short-term external debt.
- ceiling on accumulation of domestic payment arrears of the central government.

2. Performance criteria that are applicable on a continuous basis have been established with respect to:

- ceilings on accumulation of new external payment arrears of the central government and the BOM.

3. Indicative targets for end-April 2009, end-June 2009, end-September 2009, end-December 2009, end-March 2010, and end-June 2010 have been established with respect to:

- ceilings on the general government fiscal deficit.

II. INSTITUTIONAL DEFINITIONS

4. The general government includes all units of budgetary central government, social security funds, extrabudgetary funds, and local governments.

5. The domestic banking system is defined as the BOM, the existing and newly licensed commercial banks incorporated in Mongolia and their branches.

III. MONETARY AGGREGATES

6. **Valuation**. Foreign currency-denominated accounts will be valued in togrogs at the program exchange rate between the togrog and the U.S. dollar, Tog 1,560 per U.S. dollar. Foreign currency accounts denominated in currencies other than the U.S. dollar, excluding

SDRs, will first be valued in U.S. dollars at actual end-of-period exchange rates used by the BOM to calculate the official exchange rates. SDR-denominated accounts will be valued at the program exchange rate of SDR 1=US$1.509. Monetary gold will be valued at US$880 per ounce.

A. Reserve Money

7. Reserve money consists of currency issued by the BOM (excluding BOM holdings of currency) and commercial banks' deposits held with the BOM.

B. Net International Reserves of the BOM

8. A floor applies to the level of net international reserves (NIR) of the BOM. The floor on NIR will be adjusted upward (downward) by the amount of support from bilateral and multilateral donors (excluding IMF) in excess (short) of the programmed level. The floor on NIR will also be adjusted upward by the amount of nonconcessional borrowing disbursed during the program period.

9. NIR will be calculated as gross international reserves less international reserve liabilities. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the BOM shall be valued at program exchange rates and gold price as described on paragraph 6 above.

10. **Gross international reserves** of the BOM are defined as the sum of

- monetary gold holdings of the BOM;
- holdings of SDRs;
- Mongolia's reserve position in the IMF; and
- foreign currency assets in convertible currencies held abroad that are under the direct and effective control of the BOM and readily available for intervention in the foreign exchange market, or the direct financing of balance of payments imbalances and are of investment grade or held with an investment-grade institution.

Excluded from the definition of gross reserves are commercial bank foreign currency deposits held at the Bank of Mongolia, commercial bank foreign currency current accounts held at the Bank of Mongolia, any foreign currency claims on residents, capital subscriptions in international institutions, assets in nonconvertible currencies, and gross reserves that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities.

11. **International reserve liabilities** of the BOM are defined as the sum of

- all outstanding liabilities of Mongolia to the IMF; and

- any foreign convertible currency liabilities of the BOM to nonresidents with an original maturity of up to and including one year.

C. Net Domestic Assets of the BOM

12. A ceiling applies to the level of net domestic assets (NDA) of the BOM. The ceiling on NDA will be adjusted downward (upward) by the amount of support from bilateral and multilateral donors (excluding IMF) in excess (short) of the programmed level. The ceiling on NDA will be adjusted downward by the amount of nonconcessional debt disbursed during the program period.

13. NDA will be calculated as the difference between reserve money and the sum of NIR and other net foreign assets (ONFA) of the BOM.

14. ONFA is defined as the sum of (i) BOM's monetary gold pledged as collateral for external loans to domestic private companies and (ii) other net foreign assets of the BOM, including the difference between accrued interest receivables on gross international reserves of the BOM and accrued interest payables on international reserve liabilities of the BOM and deposits of international financial institutions.

D. Net Bank Credit to the General Government

15. A ceiling applies to the net bank credit flows to the general government (NBCGG) measured cumulatively from the beginning of the year. The ceiling on NBCGG will be adjusted downward (upward) by the amount of support from bilateral and multilateral donors (excluding IMF) in excess (short) of the programmed level. The ceiling will also be adjusted downward by the amount of nonconcessional debt disbursed during the program period.

16. **NBCGG** is defined as the sum of (i) net borrowing from the BOM (ways and means advances, loans, holdings of restructuring bonds, holdings of treasury bills and other government bonds, and the government liabilities to the IMF minus deposits) and (ii) net borrowing from commercial banks (loans, advances, holdings of restructuring bonds, and holdings of treasury bills and other government bonds minus deposits).

IV. Fiscal Aggregates

A. Fiscal Deficit

17. An indicative ceiling target applies to the general government fiscal deficit measured cumulatively from the beginning of the year.

18. Fiscal deficit is defined as total general government revenue and grants minus total general government expenditure and net lending.

V. DOMESTIC PAYMENT ARREARS

19. Domestic payment arrears for the purpose of the program are measured on the basis of the stock of government payables and liabilities that exceed its due-for-payment date by more than 60 days. If this stock is equal or smaller than Tog 3.5 billion, the program considers domestic arrear accumulation to be zero. If this stock exceeds Tog 3.5 billion, the difference is considered to constitute domestic arrear accumulation. The program aims for zero domestic arrear accumulation under this definition. Overdue claims that are arrears under the definition of the performance criteria subject to litigation shall be excluded from the application of the performance criteria.

VI. EXTERNAL DEBT

A. Medium- and Long-Term External Debt

20. A ceiling applies to the contracting and guaranteeing by the central government, the BOM, or other agencies on behalf of the central government of new debt with nonresidents with original maturities one year or more. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. However, with respect to swap arrangements with People's Bank of China, only amounts actually drawn under such arrangement would count toward the ceiling.

21. The definition of debt, for the purposes of the program, is set out in Executive Board Decision No. 12274, Point 9, as revised on August 24, 2000 (see Annex I).

22. Excluded from the ceiling are (i) the use of Fund resources; (ii) lending from the World Bank, the Asian Development Bank, and the International Fund for Agricultural Development; (iii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt; (iv) concessional debts; (vi) any togrog-denominated treasury bill and government bond holdings by nonresidents.

23. For program purposes, the guarantee of a debt arises from any explicit legal obligation of the central government, the BOM, or other agencies on behalf of the central government to service a loan in the event of nonpayment by the recipient (involving payments in cash or in kind), or indirectly through any other obligation of the central government, the BOM, or other agencies on behalf of the central government to finance a shortfall incurred by the loan recipient.

24. For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The NPV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs),

published by the Organization for Economic Cooperation Development (OECD). For debt with a maturity of at least 15 years, the ten-year-average CIRR will be used to calculate the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. To both the ten-year and six-month averages, the same margins for differing repayment periods as those used by the OECD would continue to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more). Loans provided by a private entity will not be considered concessional unless accompanied by a grant or grant element provided by a foreign official entity, such as both components constitute an integrated financing package with a combined grant element equal to at least 35 percent.

B. Short-Term External Debt

25. A ceiling applies to the contracting and guaranteeing by the central government, the BOM, or other agencies on behalf of the central government of new debt with nonresidents with original maturities of less than one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received.

26. For program purposes, the definition of debt is set out in Executive Board Decision No. 12274, Point 9, as revised on August 24, 2000 (see Annex I).

27. Excluded from the ceiling are (i) debts classified as international reserve liabilities of the BOM; (ii) debts to restructure, refinance, or prepay existing debts; (iii) togrog-denominated treasury bills, government bonds, and BOM bills held by nonresidents; and (iv) normal import financing. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

VII. External Payment Arrears

28. A continuous performance criterion applies to the nonaccumulation of external payments arrears on external debt contracted or guaranteed by the general government or the BOM. External payments arrears consist of external debt-service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreements. However, overdue debt and debt service obligations that are in dispute will not be considered as external payments arrears for the purposes of program monitoring.

VIII. Performance Criterion of The Modification of Multiple Currency Practices

29. The performance criterion on the introduction or modification of MCP will exclude any modifications as part of the introduction of the foreign exchange auction system, in line with staff advice, that may give rise to a MCP.

IX. Data Provision

30. The authorities have committed to using the best available data, so that any subsequent data revisions will not lead to a breach of a performance criterion. All revisions to data will be promptly reported to the Fund's Resident Representative. The likelihood of significant data changes, including definitional changes, will be communicated to Fund staff as soon as the risk becomes apparent to the authorities.

31. Data required to monitor performance under the program, including those related to performance criteria and indicative targets will be provided electronically or in hard copy to the Fund's Resident Representative by the 20th day of each month, unless otherwise indicated. The data to be reported are listed below, and the reporting responsibilities are indicated in parentheses.

A. Monetary Data (BOM)

- The monetary survey, the balance sheet of the BOM, and the consolidated balance sheet of the commercial banks. Data will be provided on a monthly basis, with the exception of the balance sheet of the BOM, which will be provided on a weekly basis within five working days of the end of the respective week.

- Net international reserves and interventions of the BOM in the foreign exchange market on daily basis.

- Interest rates and volume on standing facilities and market operations on a weekly basis within five working days of the end of the respective week.

- A detailed breakdown of net credit to government from the BOM and the commercial banks.

- Stock of monetary gold in both thousands of fine troy ounces and U.S. dollars. If the BOM engages in monetary gold transactions or employs any other accounting rate, directly or implicitly, for valuing gold assets, this information will be reported to the Fund. Any increase in monetary gold through purchases from domestic sources and refining of nonmonetary gold held or purchased by the BOM will also be reported (both prices and volumes). Any liabilities that are guaranteed or otherwise backed by gold will be reported to the Fund.

- A detailed breakdown of "other items net" for both the BOM and the commercial banks, including, inter alia, all valuation changes in net international reserves and net other foreign assets arising from exchange rate changes and/or revaluation of gold.

- Outstanding balances of all deposit accounts of the general government in commercial banks, including those of the extrabudgetary funds.

- Outstanding balances of any new deposit accounts of the general government opened in addition to the existing ones for grants and loans received from multilateral or bilateral donors, including associated counterpart funds.

- A bank-by-bank list of required reserves and actual reserves.

- Results of each central bank bills auction within five working days of each auction, including amount of bills offered, amount demanded, amount sold to each bank, announced rates, and cut-off rates.

B. Fiscal Data (Ministry of Finance (MOF))

- Consolidated accounts of the central, local, and general government, including detailed data on tax, nontax, and capital revenues, current and capital expenditures, net lending, and financing. Financing components should be separated into foreign sources (cash, project, and program loans) and domestic sources (bank and nonbank).

- Classified transactions of all social insurance funds.

- Domestic payment arrears of the general government.

- Noninterest outstanding payables by each subsector of the general government, including the social security funds, with a detailed breakdown by major categories and remaining maturity.

- Results of each treasury bills auction within five working days of each auction, including amount of bills offered, amount demanded, amount sold to each bank and nonbanks, and the average yield in percent per month.

C. External Sector Data (BOM and MOF)

- Complete list of new contracts for the execution of public investment projects, which have been signed or are under negotiation with foreign or domestic entities, including details on the amounts, terms, and conditions of current or future debt or nondebt obligations arising from these contracts.

- Outstanding stock, disbursements, amortization, and interest payments of short-term external debt contracted or guaranteed by the government or the BOM by creditor in original currency and U.S. dollars.

- Outstanding, disbursements, amortization, and interest payments of medium- and long-term external debt contracted or guaranteed by the government or the BOM by creditor in original currency and U.S. dollars.

- Daily midpoint exchange rates of the togrog against the U.S. dollar, including the official, interbank, and parallel market exchange rates (BOM).

- Arrears on the external debt contracted or guaranteed by the government or the BOM by creditor in original currency and U.S. dollars.

D. Other Data (National Statistical Office (NSO))

- The monthly consumer price index and a detailed breakdown by major categories of goods and services included in the consumer basket.

- The NSO’s monthly statistical bulletin, including monthly export and import data.

Annex 1. Guidelines on Performance Criteria with Respect to Foreign Debt

Excerpt from Executive Board Decision No. 12274, as revised on August 24, 2000

9. (a) For the purpose of this guideline, the term “debt” will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers’ credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

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June 24, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review Under Stand-By Arrangement with Mongolia and Approves US$39.4 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) completed on June 23, 2009 the first review of Mongolia's economic performance under a program supported by an 18-month Stand-By Arrangement (SBA). The completion of the review enables the immediate disbursement of an amount equivalent to SDR 25.55 million (about US$39.4 million), bringing total disbursements under the arrangement to an amount equivalent to SDR 76.65 million (about US$118.2 million).

The SBA was approved on April 1, 2009 (see Press Release No. 09/110) for an amount equivalent to SDR 153.3 million (about US$236.4 million) or 300 percent of Mongolia's quota.

Following the Executive Board's discussion on Mongolia, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, stated:

"The Mongolian authorities' strong policy implementation, supported by an exceptional access Stand By Arrangement with the Fund, is effectively stabilizing the economy in the face of the global crisis. The authorities are to be commended for their success in implementing the program to date. At the same time, there are still important challenges ahead, and efforts should focus on continued implementation of the reforms outlined in the ambitious economic program.

"The introduction of foreign exchange auctions, the continued commitment to a flexible exchange rate, and the skilled calibration of monetary policy have been instrumental in stabilizing market conditions. As inflation has come down and international reserve buffers have been built, the authorities' recent monetary easing is appropriate. Moreover, private sector credit conditions remain tight, and there is probably space for a further gradual and cautious easing of monetary conditions in the coming months, including by providing liquidity to the financial system.

"The authorities' success in containing the fiscal deficit is commendable, demonstrating the government's commitment to rein in spending. Continued spending restraint will be needed to ensure that this year's deficit target of 6 percent of GDP is achieved. In addition, to achieve the government's fiscal goals for the year it will be important that lending to gold mining operations be repaid during the course of the year. The government should also proceed expeditiously on a comprehensive reform of the social transfer system to safeguard the poor through better targeting while lessening the fiscal burden of such programs.

“Strengthening the banking system remains a key priority. This includes pressing ahead with the reforms underway to strengthen supervision and the institutional framework that are critical for securing the health of the banking system over time.

“The authorities should be prudent in undertaking any new nonconcessional external borrowing, and carefully consider the costs, risks, and broader debt sustainability implications of such loans. This is especially true given that the prospects for donor support are good and should provide sufficient fiscal financing during the course of this year. To avoid contingent fiscal liabilities, the government should continue to refrain from guaranteeing external loans,” Mr. Kato stated.

Statement by Hi-Su Lee, Executive Director for Mongolia, and
Suk Kwon Na, Advisor to the Executive Director
June 23, 2009

Introduction

1. The Mongolian authorities wish to express their utmost appreciation to the Fund and its staff for the long-standing and wholehearted cooperation in addressing the economic crisis facing the authorities. We must mention that staff's recommendations and timely guidance are indicative of their keen interest in the Mongolian economy.

2. The economy is projected to slow this year, spurred by the sharp decline in copper prices, so that the first-quarter growth in 2009 is somewhat lower-than-expected. However, it is clear that the authorities have benefited considerably from the Stand-By Arrangement (SBA) with the Fund. In this light, market conditions have stabilized; inflation is falling from the peak of around 34 percent in August 2008 to single digits in May 2009 with the assistance of the authorities' tightening measures and global price declines; the exchange rate has appreciated somewhat as market conditions have stabilized; the Bank of Mongolia (BOM) has continued foreign exchange auctions and has built buffers in gross international reserves from $625 million at end-April to $658 million in early June. On the other hand, the authorities are fully aware of the challenges and risks in the period ahead, in particular in the areas of fiscal consolidation and the banking system, and thus they will press ahead with strong implementation of the Fund program.

Program Performance and Objectives

3. All performance criteria (PCs) for the first review (end-April target) were successfully met with a comfortable margin. Although the definition of the domestic payment arrears has caused some confusion, this will be resolved with a minor revision in the Technical Memorandum of Understanding, which was submitted along with the new Letter of Intent (LOI) by the authorities.

4. As the next targets are set at end-June 2009, immediately after the Board discussion on the first review, the staff and the authorities closely discussed whether these coming targets would be achievable from the forward-looking perspective. They broadly agreed that the following targets would be smoothly observed if the authorities continue to pursue the program objectives with close monitoring of market developments.

5. The authorities have reaffirmed their strong commitment to the policy objectives, as expressed in the LOI. They strive to restore health to the public finances and put the emphasis on ensuring a fiscal deficit of under 6 percent of GDP this year and 4 percent in the following year. Given the increasing risks in the banking system, they continue to reform the financial supervisory and regulatory framework as part of ongoing efforts to monitor and support financial system stability. In addition, protecting the poor and the vulnerable during the crisis period will be continuously pursued.

Fiscal Policy

6. The authorities effectively restrained expenditure through end-April and successfully contained the fiscal deficit in line with the Fund program in the face of weak revenue. During the mission, staff repeatedly emphasized the significance of achieving 6 percent fiscal deficit of GDP this year, in terms of program objectives as well as the implication to international support, and this point has been sufficiently taken by the authorities. With this in mind, the authorities promised to adhere to the 6 percent target. In the same vein, they are also committed to achieving 4 percent deficit target next year.

7. In addition, staff underscored the importance of contingency measures to prepare for a possible revenue shortfall. The authorities fully agreed to staff's advice on this issue, while promising to make a full use of their current fiscal forecast system.

8. Protecting the poor is another main task. The authorities made it clear that, as the resources are limited in the face of growing needs for social transfer, the authorities are focusing on the prioritization of resources or retargeting of the subject groups. Two already-established working groups are doing analyzing work very intensively. Staff emphasized that social transfer reform should be comprehensive and designed to lower costs while safeguarding the poor through better targeting, and thus urged the authorities to fully work with the World Bank and the Asian Development Bank. In this regard, the authorities are working hard to prepare a comprehensive reform plan for social transfer to be announced in end-June, and will expedite the implementation process thereafter.

9. On the establishment of the Fiscal Responsibility Law, end-December Structural Benchmarks (SB), the authorities plan to start the discussion with the relevant parties in July, with a goal of preventing the boom-bust policies experienced in the past. In the meantime, the TA team from the Fiscal Affair Division will soon visit Mongolia to provide guidance on this topic.

Monetary and Exchange Rate Policies

10. On March 10, the authorities increased the policy rate from 9.75 percent to 14 percent to prevent reserve loss and provide support to the exchange rate. Although these monetary measures have contributed well to stabilizing market conditions, private sector credit has been somewhat squeezed due to the slowing economy and concerns about the creditworthiness of borrowers, in addition to the policy rate hike. Tight credit conditions are adversely impacting some industries, such as the construction and manufacturing sectors. There is some room for monetary easing, and the BOM is in the process of cautiously easing monetary policy. The policy rate as of early-May was lowered to 12.75 percent and, on June 11, the BOM lowered the policy rate again to 11.50 percent. Staff agreed with the authorities that a further monetary easing is helpful, including through injecting liquidity. The BOM is committed to carefully monitoring the market situation and assessing the various impacts to the economic entities of their decision before making a monetary decision going forward.

11. The inception of a foreign currency auction mechanism in April has worked well in improving price discovery and the transparency of foreign currency sales, so that interbank spreads have narrowed and the exchange rates have been stabilized at a somewhat appreciated level. In addition, exchange restrictions were removed on June 1, thereby allowing the exchange rate to adjust to a level consistent with economic fundamentals. The authorities reaffirmed that they will continue to maintain a flexible exchange rate to facilitate the needed adjustment, while safeguarding their international reserves.

12. Given the importance of developing the foreign exchange market as part of floating exchange rate regime, there has been meaningful progress in establishing screen-based system for inter-bank foreign exchange transactions (end-June SB). Ten banks have installed the terminals and banks' quotes are now displayed in the public website. However, the system is not yet fully active, and the BOM is working to put in place a master agreement and a code of conduct. Thus, the authorities indicated that the official launch of such system will be postponed to sometime in the third quarter of the year.

13. Staff reiterated that greater coordination between monetary operations and foreign exchange activity would help strengthen the BOM's policy framework. Toward this end, the authorities already initiated coordination work by organizing a single unit which has the comprehensive oversight on monetary and exchange markets. They expected this unit to function well in coordinating the Central Bank Bill issuance and foreign exchange auctions in line with policy objectives.

Banking Sector

14. With the slowing economy and decreasing demand, the strain in the banking sector has been deepening. The ratio of non-performing loans is in a rising trend from 7.1 percent at end-2008 to 11 percent on April 2009. In particular, the construction and manufacturing sectors have been hit hard by the ongoing financial crisis. Thus, the BOM stands ready to undertake a vigilant and close monitoring of the banking sector and to act decisively to address banking vulnerabilities by preparing a bank consolidation plan. The authorities have had extensive discussions with IFIs on the possible recapitalization and treatment of troubled assets of systemically important banks. In addition, the BOM plans to discuss with the Ministry of Finance the considerable fiscal burden which a banking restructuring framework entails.

15. Announcement of a resolution plan for Anod bank, the fourth largest bank in Mongolia in terms of outstanding loans, is an end-June SB. USAID funded experts identified three options: (i) liquidation, (ii) good bank-bad bank scheme and (iii) recapitalization, and recommended liquidation through purchase and assumption as the preferred option. Given the timeline of end-June, staff urged the authorities consider fully the fiscal consequences and their potential impact on the entire banking system. The authorities' decision will be made in due course after comprehensive and balanced considerations.

16. In terms of bolstering the legal framework for the banking system, the government, the BOM and the Financial Regulatory Commission are in the process of preparing the submission of a revised Banking Law and other related legislation to the parliament by end-June 2009. The authorities are committed to maintaining vigilant monitoring of the banking system and to further take prompt and decisive measures against banks that are non-compliant with prudential regulations, if necessary.

Other Issues

17. The authorities are facing drastic seasonality owing to very long and cold winter season. This seasonality peculiar to Mongolia tends to create a fiscal burden in the first half and cause fiscal imbalance. The slowing economy and shrinking domestic demand within a short window for investment before the start of winter call for fiscal stimulus in a timely manner. In this regard, the authorities are cautiously checking the possibility of financing for such stimulus, while being wary of the deterioration of the fiscal deficit. They bear in mind staff's view that such financing should be approached with great caution. In pursuit of Fund program for fiscal tightening, the authorities adhere to the fiscal deficit target and contemplate on the wise solution for financing such stimulus along with staff's advice.

18. The US$ 100 million one-year loan with a foreign commercial bank to finance lending to gold mining companies is being carefully monitored. Fully appreciating staff's advice that such loan is within the performance criterion on non-concessional borrowing, the authorities confirmed that the 6 percent target of GDP deficit will be ensured, with the banks paying back the loan within the end of year.

19. A swap arrangement with China is currently being negotiated and staff emphasized its possible Article VIII implications, as well as its relation to the ceiling of the non-concessional external borrowing. The authorities stance is very clear and straightforward. As they view as first priority the restoration of the economy with the help of the Fund program, they are committed not to signing any such agreement until Fund staff ensure its consistency with Article VIII obligation. The authorities also fully recognize the non-concessonality of such agreement and would limit disbursements under the swap arrangement to the program ceiling.

20. Since the authorities have started contact on external arrears with Paris Club creditors early this year, there has been sizable progress in resolving the arrears with creditors. Depending on the creditors' situation, the authorities are currently waiting for the creditors' response respectively and, in some cases, will arrange bilateral meeting with the responsible officials. In case of Spain, the arrears have been settled. The authorities reiterated their commitment to their good faith effort to finalize the arrears in due course with the relevant creditors.

21. Presidential elections were held on May 24 and the whole process was smooth and free of disruptions that occurred in the past. More importantly, the result of the election has caused little change on the current policy framework. During the first review mission, many top-ranking officials confirmed the president-elect's strong and sustained

support for the Fund program. This point was also confirmed by the Speaker of the parliament, who commended the mission team for their timely and dedicated assistance in stabilizing the economy and further promised their continued cooperation in implementing the policies consistent with the Fund program.

Conclusion

22. Given the success of the program to date and the observance of the end-April program targets, the authorities request the completion of the first review. While not being complacent with the short-term economic stabilization achieved thus far, the authorities are committed to maintaining a close policy dialogue with the Fund. As this is just the starting stage for the long road to recovery, they stand ready to take additional measures, if needed, to accomplish the government's social and economic objectives under the SBA. They believe that the frequent and close consultation with the Fund on the important policy measures is very crucial in leading to a quick recovery. The authorities will try to entrench sound macroeconomic policies to allow them to consolidate achievements made so far and create a more enabling environment for growth.

23. Finally, my Mongolian authorities wish to express their special appreciation to the Fund and its staff for their timely and appropriate policy advices in unraveling the economic crisis facing the authorities. They also extend their deepest gratitude to the Fund's mission chief, Mr. Steven Barnett, and his team for their hard work and precious guidance in developing Mongolia's economic reform program.