September 2010
IMF Country Report No. 10/294

Mongolia: Fifth and Sixth Reviews under the Stand-By Arrangement and Rephasing of Purchases

In the context of the fifth and sixth reviews under the stand-by arrangement and rephasing of purchases, the following documents have been released and are included in this package:

- The staff report for the Fifth and Sixth Reviews under the Stand-By Arrangement and Rephasing of Purchases, prepared by a staff team of the IMF, following discussions that ended on May 19, 2010, 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 August 23, 2010. 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 September 8, 2010 discussion of the staff report that completed the request and/or review.

- A statement by the Executive Director for Mongolia.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Mongolia*
Memorandum of Economic Policies by the authorities of Mongolia*

*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

Fifth and Sixth Reviews Under the Stand-By Arrangement and Rephasing of Purchases

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

Approved by Nigel Chalk and Thomas Dorsey

August 23, 2010

Stand-By Arrangement. An 18-month Stand-By Arrangement in the amount of SDR 153.3 million (300 percent of quota) was approved by the Board on April 1, 2009. The fourth review was approved by the Board on March 19, 2010. All the relevant performance criteria for the fifth and sixth reviews were met.

Summary. The economy has made a remarkable turnaround fueled by investment in the mining sector and a rebound in copper prices. Private demand has picked-up and the challenge now is to avoid overheating. Inflation, driven by a supply shock to food and demand pressures, rose to 12½ percent in June. Since then the food price shock appears to be dissipating and inflation has fallen to 9 percent. The central bank has appropriately tightened monetary policy and stands ready to take further steps as needed. Given the strong performance of revenue and increased availability of budget financing, the government has put in place plans to increase spending for the remainder of this year. At the same time, a fiscal framework has been approved for 2011 that should ensure continued macroeconomic stability. The authorities are pressing ahead with structural reforms and have adopted a comprehensive fiscal responsibility law; submitted a comprehensive bank restructuring program to parliament; and strengthened the regulatory framework for bank supervision.

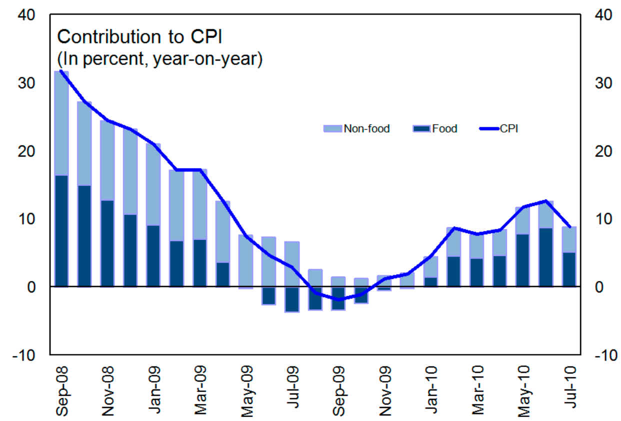
Discussions. A staff team visited Ulaanbaatar, May 13–19, 2010 consisting of S. Barnett (Head), J. Bersch (APD), J. Hartley (SPR), J. Gottschalk (FAD), I.W. Song (MCM), and P. Ramlogan (Resident Representative). Mr. Barnett returned to Ulaanbaatar on June 17–18 for follow-up discussions. The mission met with the prime minister, speaker of parliament, finance minister, central bank governor, minister of mineral resources, minister of social welfare, members of parliament, academics, and various other officials and private sector representatives. The mission liaised closely with the Asian Development Bank and World Bank, and benefited from an overlapping MCM mission on bank restructuring.

Contents

Page

I. BACKGROUND

1. **Context.** The economy is undergoing a brisk recovery, fueled by investment in the mineral sector, a recovery in copper prices, and surging coal exports. Growth is projected to exceed 8 percent this year, and risks are tilted toward the upside. Despite the negative impact of the severe winter on agriculture, other indicators are pointing to a strong recovery (Figure 1). However, this economic rebound and the shock to agriculture have combined to drive up inflation. While the food price shock appears to be unwinding, higher inflation is still expected to resume an upward trajectory in the latter part of this year as higher government wages and pensions feed through to inflation. Inflation is then projected to decline to around 7–8 percent by end 2011.



2. **External developments.** Exports are growing rapidly, fueled by the rebound in copper prices and a rapid growth in coal exports. Nonetheless, the strong recovery in demand and construction associated with the Oyu Tolgoi mine is boosting imports, and the current account deficit is expected to widen this year and next relative to what was projected at the last review. However, inflows associated with the Oyu Tolgoi investment have helped boost net international reserves to US$ 1.1 billion, an all time high for Mongolia and well above the US$ 0.4 billion at the time of program approval.

3. **Program issues.** All end-June and continuous performance criteria have been met. The structural benchmark on parliamentary passage of the fiscal responsibility law was met with a small delay although the structural benchmark to pass a social transfer reform law is still pending (see below). Rephasing of purchases by combining the fifth and sixth reviews is requested due to the delay in completing the fifth review, and the earlier than planned Board discussion of the sixth review. The authorities requested delay of the fifth review in order to have more time to build a political consensus needed on fiscal policy and to advance structural reforms before parliament went on recess in mid-July. The sixth review is the final review.

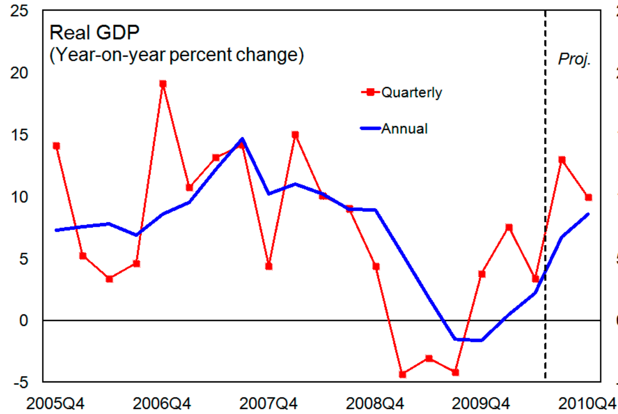
II. POLICY DISCUSSIONS

4. **Budget amendment.** There has been substantial political pressure to increase spending this year. Staff has consistently advised the authorities to save any revenue over-performance arising from increases in global commodity prices in order to: contain the inflationary consequences of higher fiscal spending; meet the debt amortization needs in the years ahead; build fiscal buffers; and transition to a more counter-cyclical approach to fiscal policy. The authorities agreed with this advice but noted there was significant political

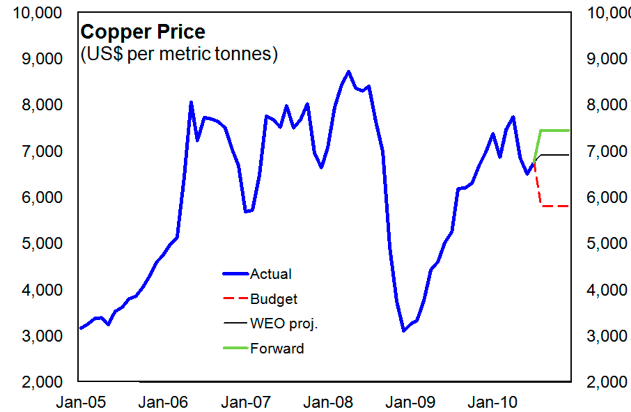
Figure 1. Macroeconomic Developments

Main Message: The economy is rebounding strongly and overheating is now a risk.

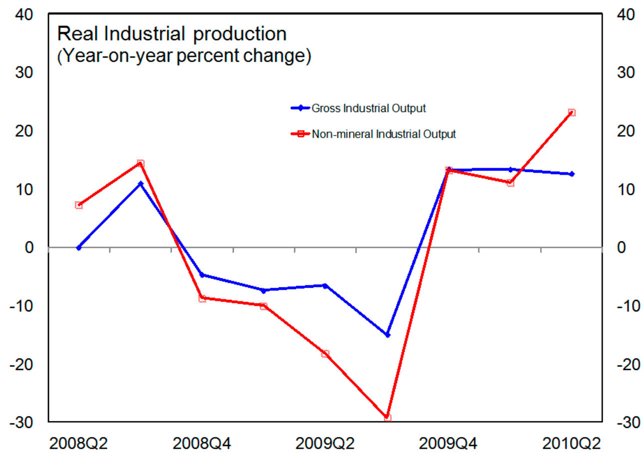
The economy is recovering briskly and real GDP growth could surpass 8 percent this year.



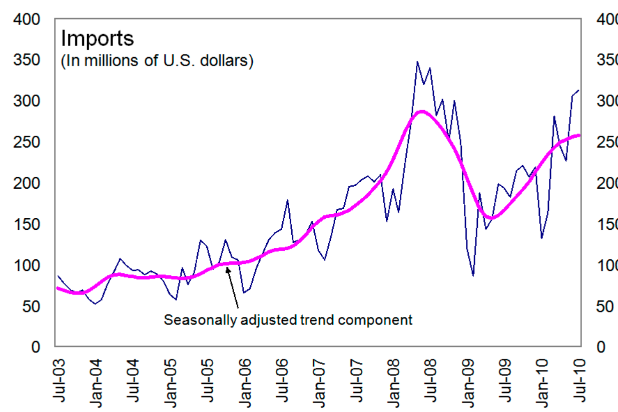
Copper prices have recovered and are projected to remain strong.



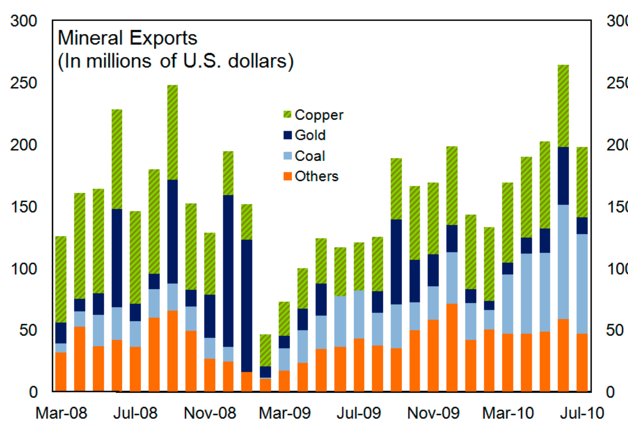
High frequency indicators are consistent with the brisk economic recovery: industrial production is rebounding strongly,…



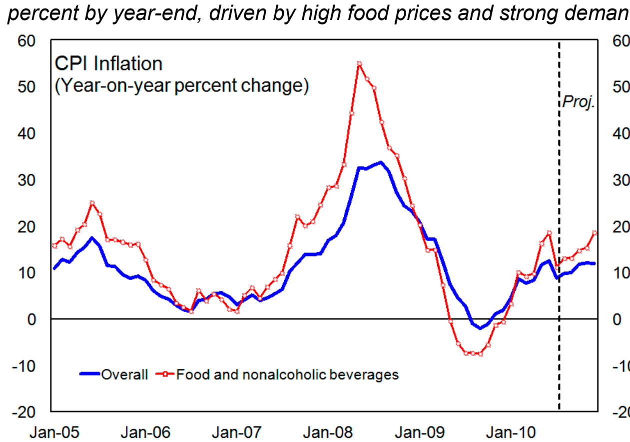
…as are imports, underscoring the recovery in demand.



The boom in mineral exports is driven not only by copper, but increasingly by coal and other minerals.



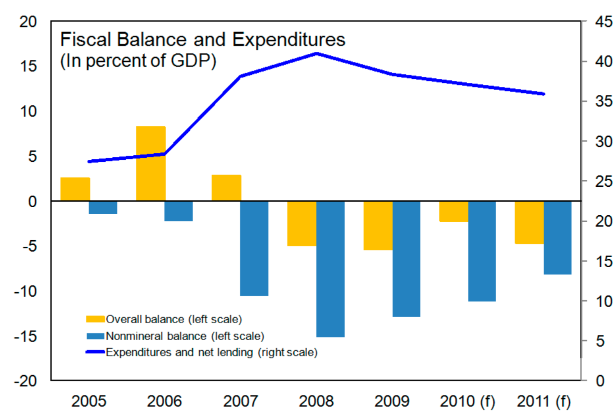
Inflation, after falling rapidly, has picked up and could exceed 12 percent by year-end, driven by high food prices and strong demand.



Sources: Mongolian authorities; and IMF staff estimates.

pressure to show tangible improvements from the recent signing of the Oyu Tolgoi investment agreement. At the same time, the lingering effects of the crisis, economic hardship caused by this year's severe winter, and the fact that pensions and civil service wages had not been increased in over two years have further fueled public pressure for more spending. This was all against a background of a surge in fiscal revenues (due to strong copper prices and the economic recovery) and large cash payments received by the budget as part of the Oyu Tolgoi investment agreement. The authorities recognized that an increase in spending at this stage of the business cycle poses a risk to macroeconomic stability, increases the burden on monetary policy to contain inflation, crowds-out the private sector, and makes the budget more vulnerable to a decline in copper prices. However, the government has balanced the economic and political considerations and decided to increase spending by 2 percent of GDP above the original 2010 budget. Parliament has passed an amendment to increase spending by 3 percent of GDP (mostly for an already-announced 30 percent increase in pensions and civil service wages, formalizing existing investment expenditures that were previously off-budget, and increasing spending on energy as a result of higher electricity tariffs). At the same time, the government has committed to under-execute the 2010 budget spending plan by 1 percent of GDP (in line with the experience of the past few years). Despite the higher spending, the fiscal deficit for this year is expected to be 2 percent of GDP, well below the program target of 5 percent of GDP, as a result of very strong mineral revenues.

5. **2011 budget and beyond.** The authorities are committed to avoiding the boom-bust policies of the past and have secured passage of a comprehensive fiscal responsibility law. It is an organic law and thus requires two-thirds majority to be changed, underscoring the government's success in forging the needed political consensus to secure lasting fiscal discipline. The key features of the law (as elaborated in previous staff reports) remained intact and the law has taken effect immediately. However, the numerical rule for the fiscal deficit will begin to apply only starting in 2013. Nevertheless, to safeguard fiscal discipline in 2011, parliament has adopted a prudent medium-term fiscal framework—which will be legally binding for the 2011 budget—that continues to reduce both spending and the non-mineral deficit. The authorities indicated that they were fully committed to strictly adhering to the fiscal responsibility law to enhance fiscal credibility and, at the same time, ensure fiscal policy is geared toward promoting macroeconomic stability.



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

	2006	2007	2008	2009	Projected 2010	2011	2012	2013	2014
Overall balance (in percent of GDP)	8.2	2.8	-4.9	-5.4	-2.2	-4.8	-2.4	-0.4	3.8
Structural balance (in percent of GDP)	0.2	-8.1	-11.0	-7.6	-5.6	-6.0	-4.0	-2.0	2.9
Nonmineral balance	-3.2	-14.9	-19.4	-16.5	-14.8	-10.4	-7.9	-11.1	-9.5
Nonmineral revenue	37.3	38.7	33.2	32.7	34.1	35.1	35.7	36.5	36.5
Total expenditure	40.5	53.6	52.6	49.2	48.9	45.5	43.6	47.6	46.0
Fiscal effort (change in cyclically adjusted) 2/	-1.0	-12.7	-6.6	7.0	0.5	3.5	2.6	-2.5	1.5
Real expenditure growth	25.8	48.5	9.6	-9.0	6.4	0.0	1.6	14.6	2.5
Memorandum items:									
Real nonmineral GDP (growth in percent)	9.2	12.2	11.9	-2.8	7.4	7.0	6.1	4.9	6.1
Output gap of nonmineral GDP	-2.0	0.3	4.3	-3.7	-1.0	0.8	0.6	-1.1	-0.9

Sources: Mongolian authorities; and IMF staff calculations.
1/ Staff forecasts based on application of the numerical rules in the Fiscal Responsibility Law.
2/ In percent of potential nonmineral GDP. The elasticity assumptions are 1 for revenue and 0 for spending.

6. **Structural fiscal reforms**. The authorities intend to pass the social transfer reform law in the fall session of parliament which begins in early October. The reform, which is being designed with assistance from the Asian Development Bank and World Bank, will introduce a targeted poverty benefit that will substantially strengthen the social safety net. The busy parliamentary calendar had made it difficult to address this legislation in the spring session, which adjourned in mid-July. In addition, the authorities indicated that additional outreach was needed to secure the political consensus needed to pass the law. Separately, the authorities are also considering options for:

- *Reforming the mineral taxation regime*. The windfall profits tax will expire at the end of this year and reform of the mineral tax regime will be necessary to recover some of the lost revenue. The authorities' goal is to establish a more modern and less distortionary mineral tax regime that balances the government's revenue needs with the goal of promoting development of the mineral sector

- *Revising the organic budget law*. A draft law has been prepared.

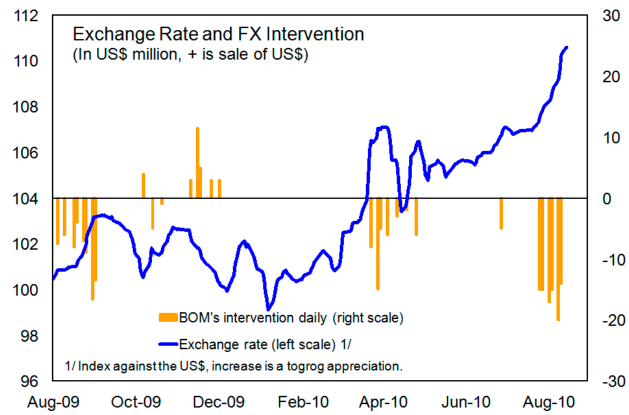
- *Improving tax administration*. Tax administration efforts focus on improving the large taxpayer office (LTO), including creating an extractive industries group within the LTO, increasing LTO staffing, and enhancing training of LTO audit staff and senior management.

FAD is providing technical assistance in each of these areas.

7. **Monetary policy**. After declining sharply last year and dipping into negative territory, inflation picked up in the first half of this year. The hike is driven by the impact of the severe winter on food prices as well as the strong rebound in economic activity. The central bank has appropriately tightened monetary conditions increasing the policy interest rate by 100 basis points and allowing for a nominal appreciation of some 7 percent since March. At the same time, a new auction system for 7-day central bank bills was introduced to

strengthen liquidity management. This change in monetary operations has tightened liquidity conditions and increased the 12-week interest rate by more than 300 basis points (Figure 2). Nonetheless, inflation pressures are likely to resurface in the coming months especially once the increase of pensions and civil service wages is put in place in October. Staff argued that, looking forward, the balance of risks pointed to a further preemptive hike in interest rates. The authorities, however, argued that headline inflation should decline as the shock to food prices dissipates. They, therefore, favored taking a wait-and-see approach while maintaining a tightening bias (Box 1).

8. **Exchange rate policy.** The flexible exchange rate regime continues to work well and the central bank has intervened sparingly. Starting in late-July, the central bank began purchasing foreign currency to smooth a seasonal imbalance in the foreign exchange market (they had followed a similar approach in August-September last year). The authorities, nevertheless, remain committed to allowing the exchange rate to move in line with market conditions while smoothing excess volatility during periods of temporary imbalances. Staff emphasized that pressures for a real appreciation were likely as the mineral sector develops; ensuring nominal exchange rate flexibility would, therefore, help contain inflation.



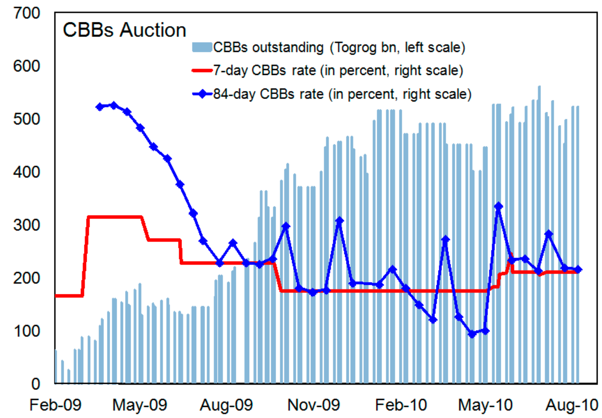
9. **Bank restructuring**. The authorities have submitted to parliament the Empowering the Banking Sector and Capital Support Program. This program, prepared in consultation with the World Bank and Fund staff, provides a comprehensive restructuring framework that is fair to both the banks and taxpayers (Box 2). In parallel, the authorities are also advancing in the preparation of bank-by-bank plans—with MCM technical assistance—that would be implemented once parliament approves the Empowering the Banking Sector and Capital Support Program. Staff encouraged the authorities to ensure that all bank restructuring costs are borne by the budget and that the central bank is promptly reimbursed for its expenses.[1]

[1] As in previous staff reports, the macroeconomic and public debt projections incorporate the staff assumption of some 6½ percent of GDP in bank restructuring costs in 2010.

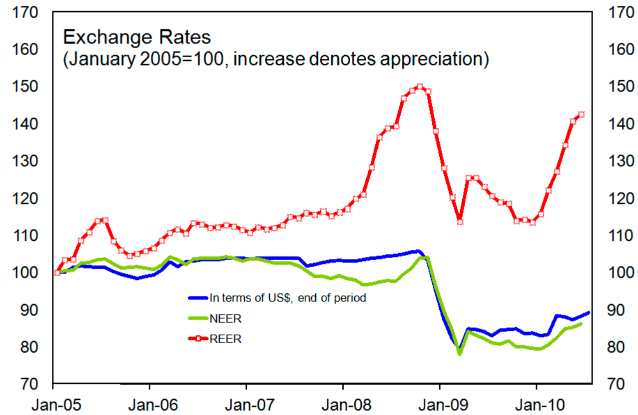
Figure 2. Policy Developments

Main Message: The economy stabilized quickly thanks to the authorities' strong policy implementation.

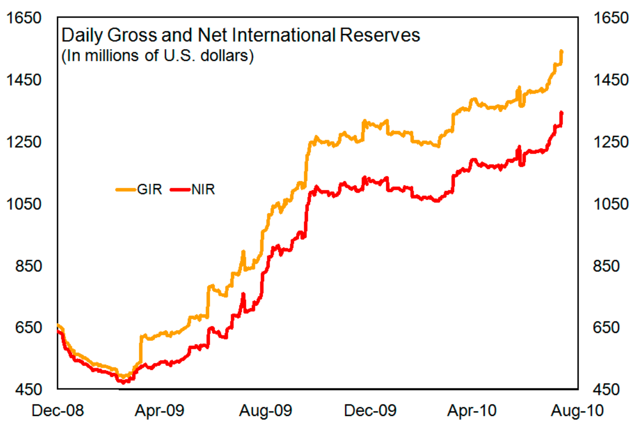
With inflation picking up, the central bank appropriately started to tighten monetary conditions by increasing interest rates.



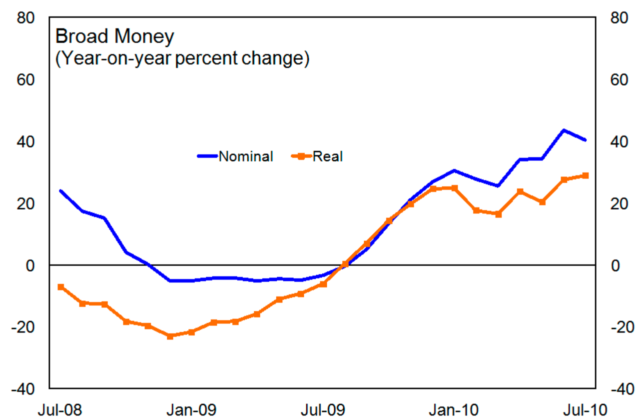
Recently, the Togrog has appreciated and contributed, together with the increase in inflation, to a real appreciation.



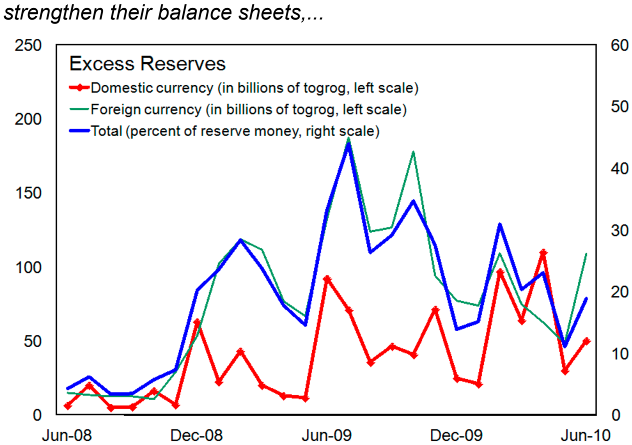
International reserves have been rebuilt,…



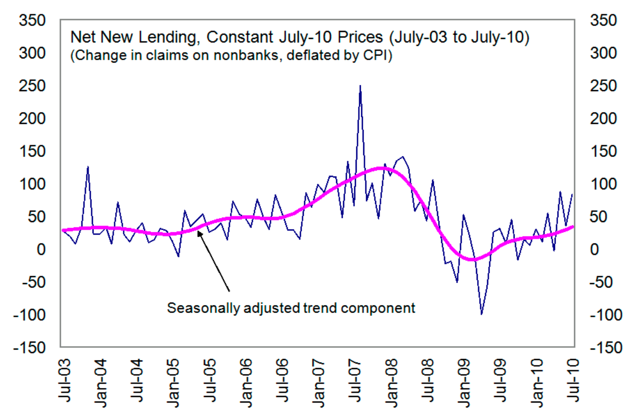
…the economy is remonetizing,…



…and banks have built excess reserves instead of lending as they strengthen their balance sheets,…



…so private sector credit has been more sluggish.



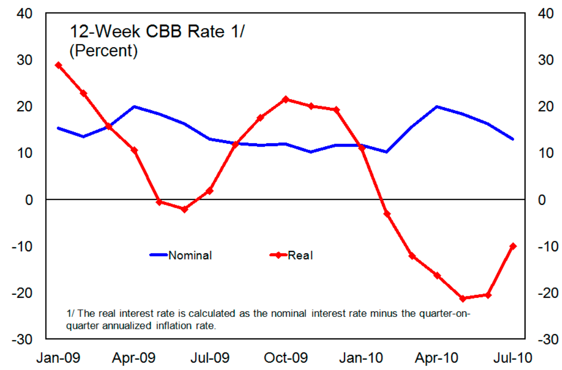
Sources: Mongolian authorities; and IMF staff estimates.

Box 1. Should the Policy Interest Rate Be Hiked Further?

Background. Inflation had risen sharply during the first half of this year. Monetary policy was tightened in May, with a 100 basis point hike in the 7-day policy rate accompanied by a reform to the central bank bill auction system, which in effect led to a more than 300 basis point increase in interest rates (as seen in the 12-week central bank bill rate).

Staff argued for a further increase in policy rates based upon:

- The economy is recovering sharply and there are signs of excess demand. Staff analysis, moreover, suggests that the output gap has already closed.



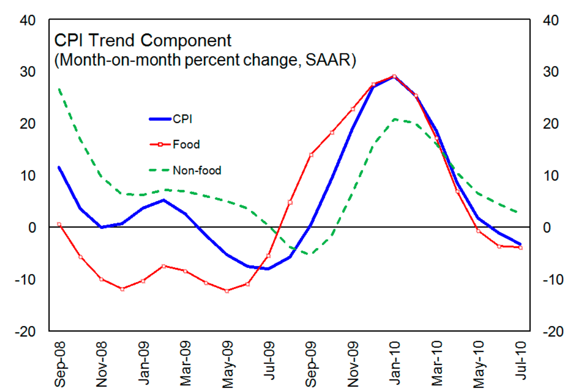
- Ex-post real central bank bill interest rates have declined sharply, a by-product of the large increase in inflation over the past six months.

- Price pressures are broad-based, as non-food inflation has also increased significantly and is running at 7 percent. Moreover, food price inflation itself also, in part, reflects demand pressure.

- The continued strength of the economic rebound and the pending 30 percent hike in pensions and civil service wages will exacerbate price pressures. Given that monetary policy takes 6 months or more to work, rates should go up preemptively.

However, it is a complicated judgment with several mitigating factors:

- The biggest driver of inflation over the past several months comes from the impact of a supply shock (the severe winter) on food prices; this effect appears to be winding down.



- Sequential inflation has been easing, with seasonally adjusted, month-on-month inflation falling.

- The past monetary tightening is still working its way through the system and will counter inflationary pressures in the months ahead.

- Though many high-frequency indicators are growing rapidly, this partly reflects base effects. In level terms, the economy is only now returning to the pre-crisis peak reached in 2008. Moreover, some indicators, like private sector credit, are still sluggish.

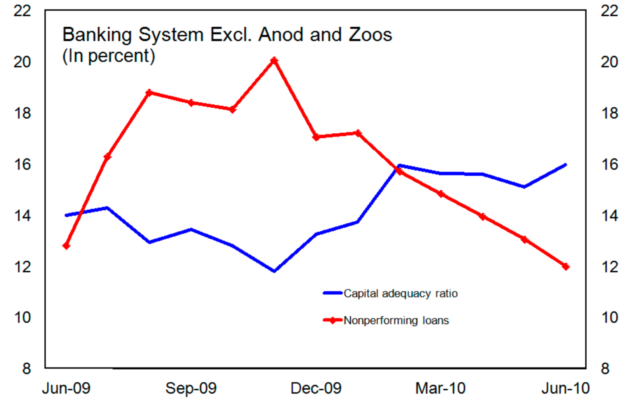
- The central bank projects that inflation will rise into the double digits in the next several months, but will then fall comfortably to the single digits by end-2011, even in the absence of a further increase in policy rates.

Box 2. Bank Restructuring Plan

The authorities' Empowering the Banking Sector and Capital Support Program is founded on the principles of (i) private ownership with fit and proper owners and managers; (ii) government capital support being used as a last resort; (iii) minimizing the costs to the taxpayers; and (iv) transparency, with fair and equitable treatment of banks.

Key aspects of the plan include:

- Banks that do not meet prudential requirements have 45 days to agree with the central bank on time-bound rehabilitation plan.
- Banks that do not meet the 12 percent CAR must increase their capital to this level with fresh funds.
- If a bank cannot raise private capital, eligible banks can receive temporary government capital support, with eligibility requirements including compliance with all non-CAR prudential regulations, agreement on a time-bound rehabilitation plan, and having a CAR above 2.4 percent and a market share of at least 1.5 percent. The recommended CAR after the recapitalization is 14 percent to provide a sufficient margin for potential loan provisions. Eligible banks could complete a rigorous application process for:
    - **Tier 1 capital.** The government would match private capital raised by a bank to get from a CAR of at least 2.4 percent up to 7 percent. The injection would come with safeguards including a commitment from the majority shareholders to cover any government losses from buying shares, not sell any shares before the government disposed of all its shares, and surrender voting rights to the government. Existing shareholders will have the right of first refusal for 30 months to buy back the shares bought by the government.
    - **Tier 2 capital.** Banks with a Tier 1 CAR over 7 percent could apply to sell convertible subordinated debt (seven-year maturity at the policy rate plus 500 basis points) to the government to bring the CAR up to 14 percent.
- Banks that are unable to reach the statutory CAR requirements would be intervened.



10. **Banking system risks**. The authorities issued new regulations in August that increased provisioning for restructured loans and tightened the treatment of related-party loans. Indicators of banking system health had been improving this year but the application of these new regulations will both lower capital ratios and raise non-performing loans. Indeed, for some systemic banks, capital adequacy is likely to fall below regulatory requirements. This makes the passage of a framework for restructuring and recapitalizing the banking system an essential piece of legislation. To further strengthen the banking system, staff argued that banks should be required to record loans to a company as non-performing if that company has non-performing loans at any bank; consolidated supervision should be put in place; and penalties should be increased for loans to single parties in excess of prudential limits. The authorities are carefully considering these proposals. They have also tightened the coverage of the blanket deposit guarantee in order to reduce moral hazard (including by no longer covering interbank deposits, interest earned on deposits in excess of the policy interest rate, and by netting guaranteed deposits against the depositor's liabilities to the bank).

III. Staff Appraisal

11. **Overview.** The IMF-supported Stand-By Arrangement with Mongolia has been successful in stabilizing the economy. International reserves have been rebuilt, the fiscal position has strengthened (helped by a rebound in copper prices), and spending on the poor has been protected (as indicated by a steady rise in social transfers as a share of GDP). The introduction of a targeted poverty benefit, which has been unfortunately delayed, would significantly strengthen the social safety net while increasing the flexibility and efficiency of the budget. With a brisk recovery underway the challenge ahead will be to avoid a return to the boom-bust policies of the past.

12. **Fiscal policy.** There has been significant political pressure on the government to increase spending at a time when the immediate fiscal financing constraints have been alleviated by high world copper prices and substantial prepayments from Oyu Tolgoi. The authorities' budget amendment for this year aims to balance this pressure with the need to preserve macroeconomic stability. The increase in spending, however, will increase inflation (especially the wage and pension increase) and place a heavier burden on monetary policy to contain inflation. Higher spending will also make the budget more vulnerable to a downturn in copper prices. Therefore, it is critical that the authorities continue to under-execute the budget, as in previous years, notwithstanding the high revenues. Going forward, holding nominal spending in the 2011 budget to the commitment enshrined in the medium-term fiscal framework will help avoid procyclical fiscal policy, bring inflation down to more comfortable levels, and foster private sector development.

13. **Monetary policy.** The central bank has appropriately tightened monetary policy to deal with rising inflation pressures. Moreover, the introduction of a new auction system for 7-day central bank bills was an important step forward in money market development and has also contributed to the tightening of monetary conditions. The balance of risks—underscored by the strength of the economy, the broad-based price pressures, and the pending hike in pensions and civil service wages—favors a further hike in interest rates, which would also bolster the central bank's inflation fighting credentials and help anchor inflation expectations going forward.

14. **Exchange rate policy.** The flexible exchange rate regime is working well. Foreign currency intervention should continue to be used sparingly and geared toward smoothing volatility in the exchange rate. Allowing for a stronger currency would help ensure that the real appreciation of the currency, which is likely as the mineral sector develops further, takes place through the nominal exchange rate instead of inflation.

15. **Banking system.** Pressing ahead with bank restructuring is critical for reducing macroeconomic vulnerabilities. The restructuring program submitted to parliament strikes the right balance between the prudent use of public resources to recapitalize the banks and more stringent supervision and enforcement. This restructuring strategy should be passed and implemented as soon as possible, complemented by strict enforcement of the new banking regulations and the establishment of bank-by-bank restructuring plans.

16. **Risks.** The authorities' strong policy implementation has facilitated a rapid and brisk economic recovery. The main risks to the program, therefore, are a loss of momentum for structural reforms and a return to the boom-bust policies of the past. Monetary policy can only do so much to control inflation and prudent fiscal policy will be critical for safeguarding macroeconomic stability. Passage of the fiscal responsibility law has helped secure the needed fiscal discipline going forward; adherence to this law is essential. Meanwhile, pressing ahead with reforms to strengthen the banking system will be critical for financial stability and to ensure that the private sector has sufficient access to credit. Finally, introduction of a targeted poverty benefit is needed to strengthen the social safety net. Taken together, these policies will put Mongolia firmly on a path of strong, sustainable, and equitable growth with low inflation.

17. Staff recommends completion of the fifth and sixth reviews. Discussions on the first review under post program monitoring are expected to be initiated during the next Article IV consultation discussions.[2] A financial stability module FSAP is scheduled for later this year.

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[2] The approval of Mongolia's Multiple Currency Practice was recently extended until June 22, 2011 or the conclusion of the next Article IV (Decision No. 14669-(10/63, June 23, 2010)).

Table 1. Mongolia: Selected Economic and Financial Indicators, 2008–11

Nominal GDP (2009): US$4,203 million 1/
Population, end-year (2009): 2.74 million
Per capita GDP (2009): US$1,551 2/
Poverty incidence (2007/08): 35.2 percent 3/
Quota: SDR 51.1 million

			Proj.		4th review		
	2008	2009	2010	2011	2009	2010	2011
			(Percent change)				
Real sector							
Real GDP growth	8.9	-1.6	8.5	7.0	-1.6	7.3	7.1
Mineral	-2.9	3.7	13.4	7.0	3.7	4.7	7.1
Nonmineral	11.9	-2.8	7.4	7.0	-2.8	7.9	7.1
Consumer prices (period average)	26.8	6.3	10.5	8.9	6.3	7.1	5.5
Consumer prices (end-period)	23.2	1.9	12.0	7.4	1.9	7.5	5.5
GDP deflator	20.2	2.2	20.3	8.2	2.2	11.2	4.2
			(In percent of GDP)				
General government budget							
Revenue and grants	36.1	32.9	34.9	31.1	32.9	34.5	30.6
Expenditure and net lending	41.0	38.3	37.1	35.9	38.3	38.5	35.0
Current balance	6.5	2.9	4.3	4.4	2.9	2.8	2.7
Primary balance	-4.6	-4.9	-1.5	-4.1	-4.9	-2.7	-3.2
Overall balance (including grants)	-4.9	-5.4	-2.2	-4.8	-5.4	-4.0	-4.5
Nonmineral overall balance	-15.1	-12.9	-11.2	-8.2	-12.9	-12.2	-7.5
			(Percent change)				
Money and credit 4/							
Broad money	-5.1	26.9	31.0	18.3	26.9	19.9	17.2
Net foreign assets (contribution to BM growth)	-27.8	42.9	15.3	1.6	43.0	1.0	6.0
Net domestic assets (contribution to BM growth)	22.7	-16.1	15.7	16.7	-16.1	18.9	11.1
Claims on nonbanks, adjusted for bank restructuring	…	1.2	18.1	17.5	1.2	13.8	13.3
Broad money velocity (GDP/BM)	2.7	2.1	2.1	2.1	2.1	2.1	2.0
Interest rate on 7-day central bank bills, end-period (percent)	9.8	10.0	…	…	10.0	…	…
			(In millions of US$)				
Balance of payments							
Current account balance (including official transfers)	-722	-411	-805	-1,651	-235	-566	-1,302
(In percent of GDP)	-14.0	-9.8	-13.9	-22.9	-5.6	-11.0	-21.0
Trade balance	-613	-195	-639	-1,680	-158	-456	-1341
Exports	2,534	1,875	2,446	2,567	1,902	2,233	2,431
Imports	-3,147	-2,070	-3,085	-4,247	-2,060	-2,689	-3,772
Foreign direct investment	836	496	422	849	426	422	849
Gross official international reserves (end-period)	658	1,328	1,599	1,631	1,327	1,492	1,646
(In months of next year's imports of goods and services)	3.0	4.3	3.9	4.0	4.9	4.0	4.4
Trade prices							
Export prices (US$, percent change)	-4.3	-23.2	32.6	2.2	-23.0	18.6	5.4
Import prices (US$, percent change)	15.9	-18.1	10.3	1.6	-19.5	10.9	3.9
Terms of trade (percent change)	-17.4	-6.2	20.2	0.6	-4.3	7.0	1.5
			(In percent of GDP)				
Public and publicly guaranteed debt							
Total public debt	33.8	50.8	58.3	61.0	53.4	66.2	70.8
Domestic debt 5/	0.0	3.7	19.3	25.8	6.3	22.7	30.4
External debt 6/	33.7	47.1	39.0	35.1	47.1	43.5	40.4
(In millions of US$)	1,602	1,977	2,141	2,231	1,977	2,176	2,252
Exchange rate							
Togrogs per US$ (end-period)	1,268	1,443	...	...	1,443	...	...
Togrogs per US$ (period average)	1,169	1,441	...	...	1,441	...	...
Nominal effective exchange rate (end-period; percent change)	-2.5	-17.6	...	...	-17.6	...	...
Real effective exchange rate (end-period; percent change)	18.7	-17.7	...	...	-19.2	...	...
Nominal GDP (In billions of togrogs)	6,020	6,056	7,911	9,162	6,056	7,221	8,055

Sources: Mongolian authorities; and IMF 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/ For 2009-11, valued at the program exchange rate and gold price.
5/ Domestic debt in 2009 includes the Oyu Tolgoi tax-prepayment while the projections for 2010-11 additionally include the estimated fiscalization cost of bank restructuring and the financing of the government's equity share in Oyu Tolgoi.
6/ Includes prospective Fund credit under the SBA. Projections for 2010-11 are valued at the program exchange rate.

Table 2. Mongolia: Summary Operations of the General Government, 2008–11

	2008	2009	Proj. 2010	Proj. 2011	4th review 2010	4th review 2011
			(In billions of togrogs)			
Total revenue and grants	2,170	1,993	2,762	2,850	2,493	2,461
Total expenditure and net lending	2,467	2,322	2,938	3,287	2,784	2,820
Overall balance (incl. grants)	-296	-329	-176	-436	-291	-359
Nonmineral overall balance	-911	-778	-887	-751	-882	-600
Financing	296	329	176	436	291	359
Foreign (net)	39	300	19	114	20	68
Domestic (net)	258	29	157	322	271	290
Privatization receipts (valuation adj.)	9	26	6	6	19	19
Domestic bank financing (net)	249	76	115	189	182	142
Domestic nonbank financing (net)	0	-73	36	127	70	130
			(In percent of GDP)			
Total revenue and grants	36.1	32.9	34.9	31.1	34.5	30.6
Current revenue	35.7	32.5	33.9	30.7	33.7	30.1
Tax revenue and social security contributions	31.4	26.7	29.9	26.9	29.0	25.9
Income taxes	12.5	8.6	11.2	6.4	10.8	6.4
Social security contributions	3.8	4.2	3.9	4.8	4.0	4.6
Sales tax and VAT	6.1	5.4	6.4	6.8	6.4	6.9
Excise taxes	3.0	2.8	2.7	2.7	2.5	2.5
Customs duties and export taxes	2.3	1.9	2.0	2.2	1.9	2.2
Other taxes	3.6	3.8	3.7	4.1	3.4	3.3
Nontax revenue	4.3	5.8	4.0	3.8	4.7	4.2
Capital revenue and grants	0.3	0.5	1.0	0.4	0.9	0.4
Total expenditure and net lending	41.0	38.3	37.1	35.9	38.5	35.0
Current expenditure	29.3	29.6	29.6	26.3	30.8	27.5
Wages and salaries	9.0	9.6	8.2	8.5	8.3	7.5
Purchase of goods and services	8.5	6.5	6.5	5.7	6.3	6.0
Subsidies to public enterprises	1.2	0.6	1.1	0.5	1.1	0.6
Transfers 1/	10.2	12.5	13.1	11.0	13.8	12.2
Interest payments	0.3	0.5	0.7	0.6	1.3	1.3
Capital expenditure and net lending	11.7	8.7	7.5	9.6	7.7	7.5
Capital expenditure	10.4	7.6	6.7	7.8	6.9	6.0
Net lending	1.3	1.2	0.8	1.7	0.8	1.5
Overall balance (incl. grants)	-4.9	-5.4	-2.2	-4.8	-4.0	-4.5
Nonmineral overall balance (incl. grants)	-15.1	-12.9	-11.2	-8.2	-12.2	-7.5
Structural balance	-11.0	-7.6	-5.6	-6.0	-4.2	-5.0
Financing	4.9	5.4	2.2	4.8	4.0	4.5
Foreign (net)	0.6	4.9	0.2	1.2	0.3	0.9
Disbursements	1.4	6.4	1.1	2.1	1.3	1.8
Project loans	1.4	1.5	1.5	2.1	1.7	1.8
Program loans	0.0	3.3	0.7	0.0	0.8	0.0
Gold financing loan	0.0	1.6	-1.1	0.0	-1.3	0.0
Amortization	0.8	1.5	0.9	0.8	1.0	1.0
Domestic (net)	4.3	0.5	2.0	3.5	3.7	3.6
Banking system (net)	4.1	1.3	1.5	2.1	2.5	1.8
Nonbank	0.1	-0.8	0.5	1.5	1.2	1.8
Of which : Oyu Tolgoi tax-prepayment	0.0	2.4	0.9	1.4	1.0	1.6
Memorandum items:						
Overall balance incl. banking sector restructuring costs (percent of GDP) 2/	-4.9	-5.4	-8.8	-4.8	-11.2	-4.5
Mineral revenue (percent of GDP)	10.2	7.4	9.0	3.4	8.2	3.0
Nonmineral revenue (percent of GDP)	25.5	25.0	24.9	27.2	25.5	27.2
Nominal GDP (in billions of togrogs)	6,020	6,056	7,911	9,162	7,221	8,055
Copper price (US$ per ton)	6,963	5,165	6,911	7,200	6,500	7,000

Sources: Ministry of Finance; and IMF staff projections.

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

Table 3. Mongolia: Monetary Aggregates, 2008−11 1/

			Proj.		4th review	
	2008	2009	2010	2011	2010	2011
	(In billions of togrog; end of period)					
Monetary survey						
Broad money	2,270	2,880	3,772	4,463	3,454	4,046
Currency	329	285	377	446	345	405
Deposits	1,941	2,595	3,395	4,017	3,108	3,642
Net foreign assets	683	1,658	2,099	2,159	1,688	1,896
Net domestic assets	1,587	1,222	1,673	2,304	1,765	2,150
Domestic credit	2,118	1,958	2,881	3,588	2,873	3,400
Net credit to government	-574	-746	-116	68	-16	126
Claims on nonbanks	2,692	2,704	2,997	3,520	2,889	3,274
Other items, net	-532	-736	-1,208	-1,284	-1,107	-1,250
Monetary authorities						
Reserve money	580	741	903	1,068	879	1,017
Net foreign assets	805	1,664	1,851	1,903	1,694	1,903
BOM defined reserves 2/	808	1,783	1,964	2,016	1,807	2,016
Net international reserves (NIR) 3/	627	1,439	1,646	1,698	1,489	1,698
Other BOM defined reserves	181	343	318	318	318	318
Other assets, net	-3	-119	-113	-113	-113	-113
Net domestic assets	-225	-923	-949	-835	-815	-886
Net credit to government	-183	-287	-174	10	74	217
Claims on deposit money banks	243	198	-18	-18	22	22
Minus: Central bank bills (net)	120	393	496	499	470	540
Other items, net	-165	-442	-260	-327	-442	-585
Memorandum items:	(In percent; unless otherwise indicated)					
Annual broad money growth	-5.1	26.9	31.0	18.3	19.9	17.2
Annual growth of claims to nonbanks	28.7	0.4	10.8	17.5	6.8	13.3
Adjusted for bank restructuring	…	…	18.1	17.5	13.8	13.3
Annual reserve money growth	8.4	27.9	21.8	18.3	18.6	15.7
Velocity	2.7	2.1	2.1	2.1	2.1	2.0
Broad money/reserve money	3.9	3.9	4.2	4.2	3.9	4.0
Total loans/deposits	138.7	104.2	88.3	87.6	92.9	89.9
BOM defined reserves (in millions of US$) 2/	638	1,143	1,361	1,397	1,252	1,397
Net international reserves (NIR, in millions of US$) 3/	495	923	1,141	1,177	1,032	1,177
Monetary Survey NCG	-574	-746	-116	68	-16	126
Monetary Survey NCG, excluding bank restructuring costs	-574	-746	-635	-451	-535	-393
Net credit to government program definition 4/	-574	-590	-407	-79	-307	-21

Sources: Mongolian authorities; and IMF staff projections.

1/ Valued at the program exchange rate and gold price. The definition of reserve money was changed to exclude foreign currency time deposits of commercial banks. The projections are based on the new program exchange rate.

2/ Previously referred to as net international reserves.

3/ Previously referred to as net international reserves under program definition. The definition of NIR has been revised in line with the recommendation of the IMF Safeguard Assessment, and does not include commercial bank foreign currency deposits and foreign currency current accounts held at the Bank of Mongolia. The outturn for 2009 and the projections for 2010-11 include the Oyu Tolgoi tax-prepayment.

4/ Net credit to government excluding government deposits in Anod bank, the expected cost associated with bank restructuring, and the Oyu Tolgoi tax-prepayment.

Table 4. Mongolia: Balance of Payments, 2008–11

(In millions of US$, unless indicated otherwise)

			Proj.		4th review	
	2008	2009	2010	2011	2010	2011
Current account balance (including official grants)	-722	-411	-805	-1,651	-566	-1,302
Trade balance	-613	-195	-639	-1,680	-456	-1,341
Exports	2,534	1,875	2,446	2,567	2,233	2,431
Copper concentrate	836	502	705	764	667	749
Gold	600	308	300	316	353	365
Other	1,099	1,065	1,440	1,487	1,213	1,317
Imports	-3,147	-2,070	-3,085	-4,247	-2,689	-3,772
Oil imports	-891	-528	-722	-873	-680	-856
Food imports	-436	-311	-385	-444	-370	-430
Oyu Tolgoi-related imports	-190	-143	-576	-1,326	-576	-1,326
Other	-1,630	-1,088	-1,402	-1,603	-1,063	-1,159
Services, net	-191	-164	-157	-12	-154	-114
Income, net	-130	-190	-160	-106	-126	-12
Current transfers	212	138	151	147	169	165
General government 1/	87	-1	29	24	29	24
Other sectors	125	140	122	123	140	141
Of which: workers remittances	94	120	102	103	120	121
Capital and financial account	545	737	1,007	1,683	662	1,446
Capital account	…	208	118	96	118	96
Financial account	545	529	889	1,587	544	1,350
Direct investment	836	496	422	849	422	849
Portfolio investment	-18	-93	-107	0	-107	0
Trade credits, net	72	13	-19	-24	-19	-22
Currency and deposits, net	120	-45	-38	-31	-38	-31
Loans, net	189	274	1,023	1,571	1,025	1,566
Other, net	-654	-115	-392	-777	-738	-1,011
SDR allocations	0	75	0	0	0	0
Errors and omissions	-161	187	0	0	0	0
Overall balance	-337	514	202	32	96	145
Financing	337	-514	-202	-32	-96	-145
Gross official reserves (- increase)	342	-670	-271	-32	-165	-141
Use of IMF credit (+)	-5	156	69	0	68	-4
Financing need (- overfinancing)	0	0	0	0	0	0
Memoranda items:						
Current account balance (in percent of GDP)						
Including official grants	-14.0	-9.8	-13.9	-22.9	-11.0	-21.0
Excluding Oyu Tolgoi	-10.3	-6.4	-3.9	-4.5	0.2	0.4
Excluding official grants	-15.7	-9.7	-14.4	-23.2	-11.6	-21.4
Gross official reserves (end-period)	658	1,328	1,599	1,631	1,492	1,646
(In months of imports of goods and services)	3.0	4.3	3.9	4.0	4.0	4.4
Copper price (in US$ per ton)	6,963	5,165	6,911	7,200	6,500	7,000
Oil price (in US$ per barrel)	97	62	77	80	76	82
Gold price (in US$ per troy oz.)	872	973	1,183	1,221	1,136	1,150

Sources: Mongolian authorities; and IMF staff projections.

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

Table 5. Mongolia: Indicators of Capacity to Repay the Fund, 2010–15 1/

	Projections					
	2010	2011	2012	2013	2014	2015
Fund obligations based on existing drawings (in millions of SDRs)						
Principal	1.2	2.4	22.7	61.0	40.2	1.9
Charges and interest	0.4	1.6	1.6	1.1	0.3	0.0
Fund obligations based on prospective drawings (in millions of SDRs)						
Principal	0.0	0.0	0.0	3.8	15.3	11.5
Charges and interest	0.2	0.4	0.4	0.4	0.3	0.1
Total obligations based on existing and prospective drawings						
In millions of SDRs	1.8	4.5	24.7	66.4	56.2	13.5
In millions of US$	2.7	6.7	37.0	99.5	84.3	20.3
In percent of gross international reserves	0.2	0.4	2.3	5.6	3.9	0.8
In percent of exports of goods and services	0.1	0.2	1.2	2.0	1.4	0.3
In percent of debt service 2/	1.8	8.0	30.6	57.6	46.8	14.9
In percent of GDP 3/	0.1	0.1	0.5	1.1	0.8	0.2
In percent of quota	3.6	8.7	48.3	129.8	110.0	26.5
Outstanding Fund credit based on existing and prospective drawings						
In millions of SDRs	159.0	156.6	133.9	67.1	11.5	0.0
In millions of US$	237.5	234.1	200.4	100.5	17.3	0.0
In percent of gross international reserves	14.9	14.4	12.7	5.7	0.8	0.0
In percent of exports of goods and services	8.2	7.4	6.3	2.0	0.3	0.0
In percent of debt service 2/	157.9	282.1	165.7	58.2	9.6	0.0
In percent of GDP 3/	4.3	3.7	2.9	1.1	0.2	0.0
In percent of quota	311.2	306.4	261.9	131.3	22.5	0.0
Net use of Fund credit (in millions of SDRs) based on existing an	44.8	-2.4	-22.7	-64.9	-55.6	-13.4
Disbursements	46.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	1.2	2.4	22.7	64.9	55.6	13.4
Memorandum items:						
Exports of goods and services (in millions of US$)	2,889	3,179	3,196	4,927	6,192	6,221
Gross international reserves (in millions of US$)	1,599	1,631	1,576	1,764	2,137	2,688
Debt service (in millions of US$) 2/	150	83	121	173	180	136
Quota (millions of SDRs)	51.1	51.1	51.1	51.1	51.1	51.1

Sources: IMF staff estimates, and projections.

1/ Exclude GRA surcharges. Projected Payments based on existing drawings calculated at current concessional PRGF/ESF rate of 0.5%.

2/ Total PPG debt service, including IMF repurchases and repayments.

3/ Nominal GDP valued at program exchange rate.

Table 6. Mongolia: Reviews and Disbursements under the 18-Month Stand-By Arrangement

Date	Amount of Purchase		Condition
	In percent of quota	In SDRs	
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 21, 2009	30	15,330,000	Completion of the second review and observance of end-June 2009 performance criteria.
December 22, 2009	30	15,330,000	Completion of the third review and observance of end-September 2009 performance criteria.
March 19, 2010	30	15,330,000	Completion of the fourth review and observance of end-December 2009 performance criteria.
September 8, 2010	60	30,660,000	Completion of the fifth and sixth review and observance of end-June 2010 performance criteria.
Total	300	153,300,000	

ATTACHMENT 1. LETTER OF INTENT

August 12, 2010

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

Dear Mr. Strauss-Kahn:

Our macroeconomic policies, supported by the Stand-By Arrangement with the International Monetary Fund, have helped Mongolia through a difficult but necessary period of economic adjustment. Our efforts have been successful and the economy is rebounding strongly, aided by investments in the mining sector and a recovery in global copper prices.

Our economy stands to benefit greatly over the medium-term from its vast mineral deposits and we are committed to using this mineral wealth to secure strong, sustainable, and equitable growth with low inflation. In the near-term, this means pressing ahead with key structural reforms and avoiding a repeat of the boom-bust policies of the past. The attached Memorandum of Economic Policies (MEP) provides an update of our macroeconomic policies for the remainder of 2010, supplementing the policies described in our last MEP.

Given the success to date of the program, and our observance of all end-June 2010 performance criteria, we request completion of the fifth and sixth reviews and that the arrangement be rephased to allow us to make the remaining purchases under the arrangement on September 8, 2010.

During the period of the arrangement, the Mongolian government will maintain the usual close policy dialogue with the Fund and consult with the IMF before modifying measures contained in this letter or adopting new measures. We will continue to provide the IMF with the necessary information for program monitoring and we authorize the IMF to publish this letter and the attached MEP.

Sincerely yours,

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

Attachment
Memorandum of Economic Policies

Attachment 2. Memorandum of Economic Policies

1. **Outlook.** The economy is recovering briskly and growth, boosted by investments in the mineral sector, is expected to be at least 7½ percent this year. Inflation accelerated this year, due to rising meat prices as a result of the severe winter and a recovery in demand. We will continue to adjust policies as necessary to contain the increase in inflation and achieve inflation in the single digits by end-2011.

2. **Monetary and exchange rate policies.** Our primary objective for monetary policy continues to be oriented toward achieving and maintaining low inflation and macroeconomic stability. The central bank raised the policy interest rate by 100 basis points in May. Nevertheless, we remain concerned that inflation is already high and upward price pressures will be increased by the planned increase in spending. Therefore, the central bank will maintain its tightening bias and is prepared to act forcefully if inflation rises further. We also remain fully committed to allowing the exchange rate to move in line with market conditions while smoothing excess volatility due to temporary imbalances.

3. **Fiscal stance**. We remain committed to restoring health to public finances. Revenue is set to exceed initial expectations by a wide margin this year, due in large part to the recovery in copper prices. Given the social needs in our economy, we amended our budget to allow for 3 percent of GDP in higher spending, including an increase in pensions and civil service wages which have been frozen for more than two years. We are, however, committed to avoiding a repeat of the boom-bust policymaking of the past and will restrain spending to a level that is consistent with macroeconomic stability. This year, therefore, we will ensure that actual spending is no more than 2 percent of GDP above the original budget approved in December. Parliament has also adopted a prudent medium-term fiscal framework, and in line with this, the 2011 budget will limit spending to togrog 3,250 billion.

4. **Structural fiscal reforms**. We recently passed a fiscal responsibility law. The fiscal responsibility law will help secure a lasting fiscal discipline and, as an organic law, has higher legal standing than the budget and requires a two-thirds majority of parliament to be amended. The law provides for comprehensive coverage of all fiscal spending and numerical rules to enforce fiscal discipline. The social transfer reform law, which strengthens the social safety net through introduction of a targeted poverty benefit, has been submitted to parliament. The law is expected to be approved by November 2010 and the related budget impact has been reflected in the medium-term fiscal framework.

5. **Bank restructuring.** The Empowering the Banking Sector and Capital Support Program was submitted to parliament in August. This program outlines a comprehensive strategy to strengthen our banking system and we intend to ensure its prompt approval. To complement this effort, the central bank will continue to improve supervision and tighten enforcement of prudential regulations. We amended the supervision regulations in August to strengthen loan classification rules for restructured loans and specify tougher penalties for non-compliance with prudential regulations.

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

	12/31/2008	12/31/2009			3/31/2010		6/30/2010		
	Actual	Prog.	Adjusted	Outcome	Prog.	Outcome	Prog.	Adjusted	Outcome
Performance criteria 1/									
Net international reserves (NIR) of the Bank of Mongolia (BOM) (floor, eop stock, in million US$) 2/	495	798	766	923	809	957	776	736	983
Net domestic asset (NDA) of the BOM (ceiling, eop stock, in billion togrog) 3/	-171	-542	-492	-728	-645	-793	-477	-419	-796
Net credit to government (NCG) (ceiling, cumulative from the beginning of the fiscal year, in billion togrog) 3/	130	58	108	-17	220	16	270	328	130
New nonconcessional external debt maturing in one year or more, contracted or guaranteed by the government or the BOM (ceiling, eop stock since April 2009, in million US$).	0	200	200	100	200	100	200	200	100
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$).	0	0	0	0	0	0	0	0	0
Accumulation of new external payment arrears (ceiling, eop, in million US$).	…	0	0	0	0	0	0	0	0
Accumulation of domestic payment arrears (ceiling, eop, in billion togrog).	0	0	0	0	0	0	0	0	0
Indicative targets									
General government fiscal deficit (ceiling, cumulative since the beginning of fiscal year, in billion togrog).	296	416	416	329	220	9	270	270	68
Memorandum items:									
Support from bilateral and multilateral donors excluding IMF (cumulative since April 2009, in million US$), program level.	0	174	142	142	152	152	192	192	152
Disbursed new nonconcessional external debt (eop stock, in million US$), program level.	…	75	75	75	75	75	0	0	0
Disbursed Oyu Tolgoi tax prepayment loans (eop stock, in million US$), program level.	…	100	100	100	100	100	150	150	150

1/ Evaluated at the program exchange rate.

2/ NIR does not include commercial bank foreign currency deposits and foreign currency current accounts held at the Bank of Mongolia. The adjustors are specified in the Technical Memorandum of Understanding (TMU) which remains unchanged from the last review, and include: 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 program level cumulative since April 2009; the floor will be adjusted upward by the amount of nonconcessional borrowing disbursed in excess of the program level; the floor on NIR will be adjusted upward by the amount of the cumulative additional SDR allocations up to the test date.

3/ The adjustors are specified in the TMU, and include: the ceilings on NDA and NCG, respectively, will be adjusted downward (upward) by the amount of support from bilateral and multilateral donors (excluding IMF) in excess (short) of the program level; the ceilings will be adjusted downward by the amount of nonconcessional debt disbursed in excess of the program level.

Table 2. Mongolia: Structural Benchmarks

Actions	Date	Status
Revising relevant laws to require Erdenet to pay taxes in togrog.	6/30/2009	Completed on July 9.
Announcement of a resolution plan for Anod bank based on the diagnostic assessment of the external auditor.	6/30/2009	Completed. Anod bank was put into receivership on November 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	Completed late June, reform plan approved by Cabinet-level Working Group.
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	Completed on July 24.
Pass a 2010 budget consistent with the IMF supported Stand-By Arrangement.	12/1/2009	Completed November 27.
The submission to parliament of Fiscal Responsibility Law consistent with recommendations of Fund technical assistance.	12/31/2009	Completed, submitted to Parliament on January 12.
Pass a comprehensive social transfer reform that saves money and protects the poor through better targeting.	12/1/2009	Delayed. Reset below.
Passage of a comprehensive social transfer reform.	6/15/2010	Delayed to November.
Parliamentary passage of Fiscal Responsibility Law consistent with recommendations of Fund technical assistance.	6/15/2010	Completed June 24.

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes the Final Two Reviews Under Stand-By Arrangement with Mongolia

The Executive Board of the International Monetary Fund (IMF) has completed the fifth and the sixth reviews of Mongolia's economic performance under a program supported by an 18-month Stand-By Arrangement (SBA). The Board also approved the Mongolian authorities' request for rephasing the final disbursement. While the completion of the final two reviews under Mongolia's SBA enables the disbursement of an amount equivalent to SDR 30.66 million (about US$46.4 million), the Mongolian authorities do not intend to draw this amount. Total disbursements under the arrangement remain an equivalent to SDR 122.64 million (about US$185.4 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$231.8 million) or 300 percent of Mongolia's quota.

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

"The Mongolian economy is undergoing a brisk recovery. International reserves are at historic highs, the fiscal position has strengthened, and pro-poor spending has been protected. These developments are a testament to the authorities' unwavering commitment and policy performance under the Fund-supported program. Close engagement with the Fund, together with technical support and outreach efforts, has contributed to the program's success in stabilizing the economy and the financial market.

"The government has built a strong institutional foundation for fiscal policy. The recently adopted fiscal responsibility law—a landmark in public financial management—will help secure fiscal discipline. The nominal spending limit for 2011 enshrined in the medium-term fiscal framework will promote macroeconomic stability and bolster fiscal policy credibility. Strict adherence to the targets in the medium-term fiscal framework and fiscal responsibility law will be essential.

“Spending on social transfers has steadily increased. The social transfer reform legislation, expected to be adopted by parliament in the coming months, will introduce a targeted poverty benefit, which will both strengthen the social safety net and enhance budget flexibility.

“Monetary policy continues to focus on maintaining low inflation, contributing to strong, sustainable, and equitable growth. The recent tightening of monetary policy, alongside a nominal appreciation of the currency, has helped contain the upswing in inflation. The flexible exchange rate regime continues to work well and foreign currency intervention is being used appropriately to build reserves and smooth out short-term fluctuations in currency markets.

“Significant progress has been made in reforming the banking system. The Empowering the Banking Sector and Capital Support Program, a comprehensive bank restructuring and recapitalizing framework, has been submitted to parliament. Its implementation will help ensure prudent, transparent use of public resources. The recently issued banking regulations are an important step toward strengthening banking supervision, critical to preventing a re-emergence of vulnerabilities,” Mr. Shinohara stated.

Statement by Hi-Su Lee, Executive Director for Mongolia
and Suk Kwon Na, Senior Advisor to the Executive Director
September 8, 2010

1. The Mongolian authorities are grateful to the Fund and its staff for their productive cooperation thus far and their timely and insightful policy advice in addressing the economic crisis. With staff's intuitive recommendation based on their keen interest in the Mongolian economy, the economy has successfully landed in a new era for strong, sustainable and equitable growth. The authorities' concerted efforts for economic stability and sustainable growth will be continued, backed by close policy dialogue with the Fund, in their economic maneuvering in the years ahead. They will also continue to provide the Fund with the necessary information for the purpose of post-program monitoring.

Macroeconomic Development and Program Performance

2. Spurred by constructive help from donors and the Fund, the Mongolian economy has been put back on a brisk recovery path in a short period, marking a momentous turnaround. The authorities' growth forecast is expected to be at least 7.5 percent this year (staff's projection at 8.5 percent) and will clearly bottom out from last year's negative area (-1.6 percent), with investment in the mining sector and a rebound in copper prices playing a role. Exports are growing rapidly due to the boom in mineral exports, including copper, coal and other minerals, and thus Gross International Reserves have much improved at around 1.6 billion dollars as of end-August from 0.65 billion dollars at end-2008.

3. The main policy challenge now is the risk of overheating and the possible recurrence of the boom-and-bust cycle which happened in the past. This point has been repeatedly discussed and well recognized within the authorities. All the variables which could have an impact on price level, including food prices and higher government wages as well as pensions later this year, will be closely monitored and entail the authorities' prompt intervention, if deemed necessary.

4. As well noted by staff, all end-June and continuous performance criteria (PC) have been successfully met, with the indicative target of fiscal deficit also met in comfortable margin. One of the important structural benchmark, fiscal responsibility law (FRL), was approved at the parliament with a slight delay, consistent with the recommendation of Fund technical assistance. Another benchmark, the passage of a comprehensive social transfer reform, has not yet been met, but is waiting for approval in the upcoming fall session of parliament, which starts in early October. Despite some delay, the authorities will strive to get parliamentary approval within this session, in pursuit of both a targeted poverty benefit and fiscal saving.

Fiscal Policy

5. The authorities fully recognize staff's recommendation that fiscal restraint is warranted for several years ahead to bring government finance into a sustainable path. It is thus encouraging that the authorities' projection runs a deficit comfortably below the target in the originally approved budget, as a result of very strong mineral revenues.

6. In fact, the fiscal situation has much improved, mainly due to a surge in fiscal revenues, helped by strong copper prices and the economic recovery, as well as large cash payments in the budget arising from the Oyu Tolgoi investment agreement. However, on the other hand, such fiscal enhancement has produced considerable political and public pressure for higher spending, which has been viewed as a threat to macroeconomic stability at this juncture. With abundant efforts and compromise to balance both economic and political considerations, the 2010 budget has been amended to allow for an increase in spending of 3 percent of GDP. Being well aware of the detrimental impact of repeated boom-bust policies of the past and threatening vulnerability to a downturn in copper price in the future, the authorities are very eager to pursue fiscal prudence and restrain spending to a level that is consistent with macroeconomic stability. Thus, they committed to under-execute the 2010 budget spending to limit actual spending to no more than 2 percent of GDP, following the precedent of the past few years.

7. In the area of structural fiscal reform, a comprehensive fiscal responsibility Law (FRL) has been successfully passed, with a one-week delay compared to the target date of June 15. This is a clear evidence of the authorities' fiscal prudence commitment in the period ahead, as this legislation can make long-awaiting fiscal discipline be pursued in systemic and legal way. With this law's comprehensive coverage of all fiscal spending and numerical rules (which start to apply from 2013), the authorities are fully committed to enhancing fiscal credibility and ultimately contributing to macroeconomic stability. The authorities' effort to modernize the mineral taxation regime and improve tax administration continues to be pursued as standing policy goals.

8. In parallel, another big goal of better assisting the poor and creating fiscal saving by better targeting will be achieved by the passage of social transfer law, which is still pending in Parliament, waiting for approval in the October session. To finalize this reform, the authorities will do their best to secure as much political support as needed to pass the law by hosting more outreach.

Monetary and Exchange Rate Policies

9. The key objective for monetary policy remains unchanged at maintaining low and stable inflation and finally contributing to macroeconomic stability. While being partly sympathetic to staff's call for preemptive rate hike, the authorities strive to see both the evolving inflation risks and burgeoning mitigating factors. They stand vigilant to monitor the inflation pressures and committed to continue to do so, focusing on the possibility of food price-inducing supply shocks. In addition, they are being cautious in

assessing whether to adjust interest rates, taking into consideration the strength of both the economic recovery and severity of inflation pressures. Toward the medium-term goal of an inflation targeting framework, the central bank will continue to lay the technical foundation as necessary, including by improving inflation forecasting and advancing monetary transmission channel.

10. The authorities stand fully committed to a flexible exchange rate, given the positive advantage of flexible rates in relieving terms of trade volatility and preventing higher inflation, mainly arising from OT mining income. Their intervention will be limited to smoothing excess volatility caused by temporary imbalances, such as the late-July through August purchase of foreign currency to smooth a seasonal imbalance in foreign exchange market.

Banking System

11. The authorities' proactive effort needs to be continuously invested in the banking sector, where we see some room for further improvement. It is crystal clear that the authorities remain eager to bolster the integrity of and confidence in the banking system.

12. In terms of banking supervision, a revised banking law passed in January 2010 has worked as the main foundation for prudential requirements, consolidated supervision, and improved resolution framework. Based on this, the authorities have submitted to parliament the Empowering the Banking Sector and Capital Support Program, which is expected to function as a comprehensive restructuring framework. As well explained in box 2 in the staff paper, this program clearly deliberates the main principles and entailing procedural mechanism in maneuvering such restructuring process ahead, including the use of public funds tied to recipient banks' capital situation. As a complementary step, the authorities are also accelerating the process of setting up bank-by-bank plans, which need to be implemented as soon as the above-mentioned program is passed. In this regard, the authorities will not spare any effort to pass and implement this program, as soon as possible, and finalize bank-by-bank plans in a timely manner.

13. With regard to banking systemic risks, the authorities issued new regulations in August, which aim to increase provisioning standard and tighten the rule of related-party loans. Staff's further recommendation in banking regulation will be fully considered and adopted, tailored to its circumstances. More importantly, through the whole process, the authorities will do their best to proactively respond to newly-burgeoning problems in individuals banks on one hand, and to strengthen the stability of and public confidence in the banking system as a whole on the other.

Conclusion

14. Given the clear policy objective for achieving strong, sustainable, and equitable growth together with low inflation and healthy public finances, the authorities are firmly committed to doing their best in sustaining the economic development as well as maintaining low and stable inflation. The past experiences of boom-bust cycle and current global crisis would function as invaluable alarm for all the relevant authorities

not to lose good and timely insight for appropriate policy implementation as well as vigilant monitoring. While being wary of complacency with achievement thus far, the authorities will continue to press ahead with comprehensive reform policy and try to create a more enabling environment in the lead up to economic prosperity.

15. Finally, the Mongolian authorities wish to express their sincere appreciation to the Fund and its staff for their comprehensive and insightful policy advices, which have helped overcome the current crisis and expedited the pending economic reform necessary to achieve their strong, sustainable and equitable growth in the future. Things start with a crisis, but with staff's help, they finally end with another big leap for a better future. In this regard, the authorities also extend their deepest gratitude to the Fund's mission chief, Mr. Steven Barnett, and his team, for their devoted work and invaluable advices in sophisticating Mongolia's economic reform program.