February 2010
IMF Country Report No. 10/52

Mongolia: 2009 Article IV Consultation, Third Review Under Stand-by Arrangement, and Request for Modification of Performance Criteria—Staff Report; Staff Supplement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Mongolia.

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2009 Article IV consultation with Mongolia, Third Review Under Stand-by Arrangement, and Request for Modification of Performance Criteria, the following documents have been released and are included in this package:

- The staff report for the combined 2009 Article IV consultation, Third Review Under Stand-by Arrangement, and Request for Modification of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on November 10, 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 December 7, 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 staff supplement of December 8, 2009 on debt sustainability Analysis
- A Public Information Notice and a Press Release, summarizing the views of the Executive Board as expressed during its December 22, 2009, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- 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 and Financial Policies 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

Staff Report for the 2009 Article IV Consultation, Third Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria

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

Approved by Nigel Chalk and Dhaneshwar Ghura

December 7, 2009

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 second review was approved by the Board on September 21, 2009. All end-September performance criteria for the third review were met.

Executive Summary. The global economic crisis and collapse in copper prices last year hit the Mongolian economy hard. The loose macro-policies pursued during the preceding boom years had made the economy particularly vulnerable and the situation deteriorated markedly earlier this year. International reserves were being depleted, there were insufficient funds to finance the 2009 budget, and the fourth largest bank had to be intervened. Since then, the authorities' strong policy implementation under the Fund-supported program has helped to quickly stabilize the economy. Though growth is likely to be slightly negative this year, the outlook for 2010 is favorable as the economy is projected to rebound sharply driven by development of the mineral sector. Looking forward, Mongolia stands to benefit enormously from its vast mineral deposits. Maximizing these benefits will require a continued commitment to fiscal discipline, a flexible exchange rate, and a sound banking system. Staying the course with such policies will help ensure that Mongolia's considerable mineral wealth is transformed into lower poverty, rising household income, and a steadily improving standard of living for all of Mongolia's citizens.

Past Advice. The 2008 Article IV Consultation was concluded on June 4, 2008. Executive Directors recommended tightening monetary and fiscal policies to address the risk of economic overheating and developing a medium-term fiscal framework to limit pro-cyclicality and ensure debt sustainability.

Discussions. A staff team visited Ulaanbaatar, October 28–November 10, 2009 consisting of S. Barnett (Head), J. Bersch, T. Feridhanusetyawan (APD), J. Hartley (SPR), J. Gottschalk (FAD), I. W. Song (MCM), and P. Ramlogan (Resident Representative). Mr. Na (OED) participated in the discussions.

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I. Recent Developments

1. **Context**. Mongolia was hit hard by the global financial crisis and the collapse in copper prices last year. The pro-cyclical macro-policies pursued during the preceding boom years made the economy particularly vulnerable. Indeed, other copper producers faired better in many respects (Box 1). By early 2009, the balance of payments position had become critical, and the authorities devised an ambitious adjustment program, supported by Fund resources. Since then, the economy has stabilized, a product of the authorities' strong policy implementation and a rebound in international copper prices.

2. **Growth and inflation**. Real growth averaged 9 percent during 2004–08, but is expected to be slightly negative this year as a result of the global crisis and the necessary tightening of policies. Nevertheless, the economy is now bottoming out and, driven by investment in the newly signed Oyu Tolgoi mining project, should recover strongly next year (Figure 1). Inflation peaked at over 30 percent last year but has declined sharply in recent months and should settle at around 6 percent by end-2010.

3. **Politics.** Presidential elections this summer proceeded smoothly and Mr. Tsakhia Elbegdorj of the Democratic Party, the junior member of the governing coalition, defeated the incumbent. In late October, Prime Minister Bayar submitted his resignation due to ill health and Mr. S. Batbold was elected Prime Minister. The coalition government that has ruled since 2008 is widely credited with creating the political consensus necessary to bring the protracted negotiations on the Oyu Tolgoi mine project to a conclusion. Parliamentary elections are scheduled for 2012.

4. **Macro-policies**. Prior to this year, a pro-cyclical fiscal policy, tightly managed exchange rate, and passive monetary policy led to overheating, inflation, a credit boom, and, ultimately, significant balance of payments pressures earlier this year (Box 2). The legacy of these policies is still being felt. On the fiscal front, many of the initiatives of the past few years—including a cut in the VAT rate, lowering of social security contributions, the introduction of untargeted universal transfers, and civil service wage increases—permanently increased the deficit. In the financial sector, the rapid credit growth during 2006–08 has led to a worsening of credit quality leaving the banking system undercapitalized and with weak balance sheets.

5. **External sector**. The trade balance has been volatile, reflecting significant terms of trade shocks. The current account improved significantly this year, primarily through a slowdown in imports, but is set to worsen next year as a result of a surge in imports associated with the development of the Oyu Tolgoi mine. In the coming years, the current account deficits will be largely financed by FDI inflows and private loans. Large current account surpluses are expected after production at Oyu Tolgoi starts in 2013.

Box 1. Comparison of Selected Copper Producing Countries[1]

Macro-economic management in resource-dependent economies is challenging. Export earnings and fiscal revenue are subject to large fluctuations driven by swings in global resource prices. For Mongolia, copper is a key export and the collapse in its price last year was the trigger for Mongolia's economic troubles. However, not all copper producers were hit equally hard by the global economic downturn.

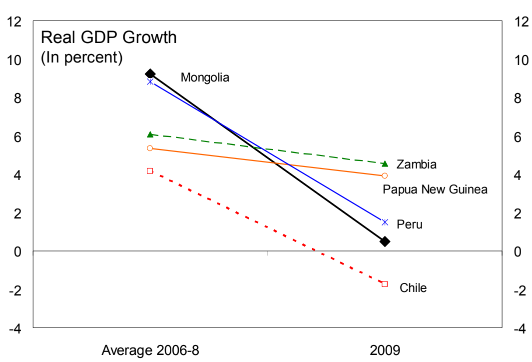
	Mongolia	Chile	Zambia	Papua New Guinea	Peru
Apr-2007 to Apr-2008 (in percent)					
REER (+ is appreciation)	14.4	14.0	17.2	4.2	7.7
NEER (+ is appreciation)	-5.6	9.5	16.2	-0.9	6.9
Inflation differential	20.0	4.5	1.0	…	0.7
Inflation, CPI	24.7	8.3	10.1	…	5.5
Implicit partner country inflation	4.7	3.8	9.1	…	4.8
Memorandum item:					
Appreciation against US$	0.0	12.9	16.4	9.2	11.7

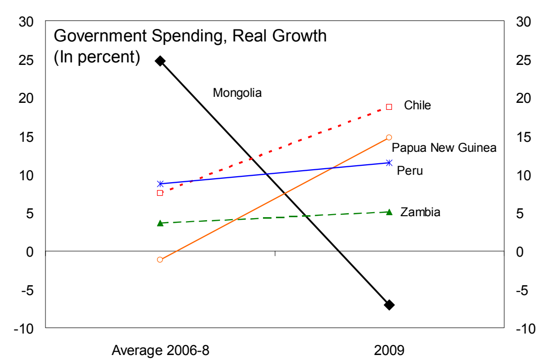
Sources: WEO; and IMF staff calculations.

All the copper producers experienced real currency appreciation as copper prices peaked in mid-2008. However, Mongolia's appreciation was entirely realized through higher inflation. In other economies, some of the appreciation pressure was absorbed by the nominal exchange rate instead of inflation. For example, the real appreciation in Mongolia and Chile was virtually the same, but inflation in Chile was much lower. This highlights the importance of exchange rate flexibility in such resource-dependent economies that face volatile international prices.

After copper prices fell, the contraction in Mongolia was much larger than in other economies. Real GDP growth, which had been among the highest in Mongolia, fell precipitously. Only Peru had a similar decline.

Part of the reason that output volatility in Mongolia was so large is related to the highly procyclical government spending in Mongolia. For other copper producers, real government spending picked up following the decline in copper prices, providing counter-cyclical support for the economy. In direct contrast, Mongolia was forced to contract spending sharply to reduce its fiscal deficit to a level that was consistent with available financing. Given the rapid expansion of spending in 2007–08, this subsequent fiscal contraction was unavoidable but contributed to the sharper slowdown in growth experienced in 2008 and during the course of this year.



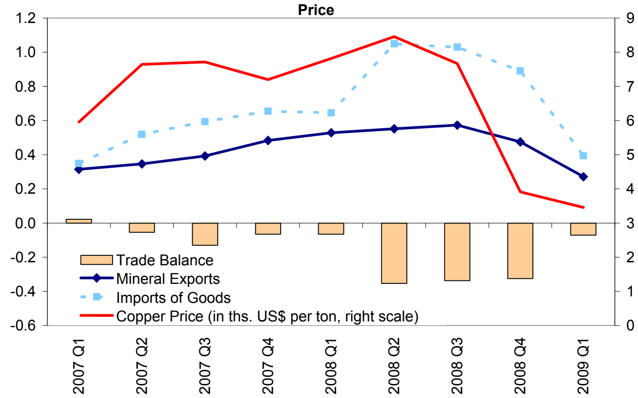


[1]Comparable economies include Chile, Zambia, Papua New Guinea, and Peru.

Box 2. The Recent Boom-Bust Cycle From a Macro-Policy Perspective

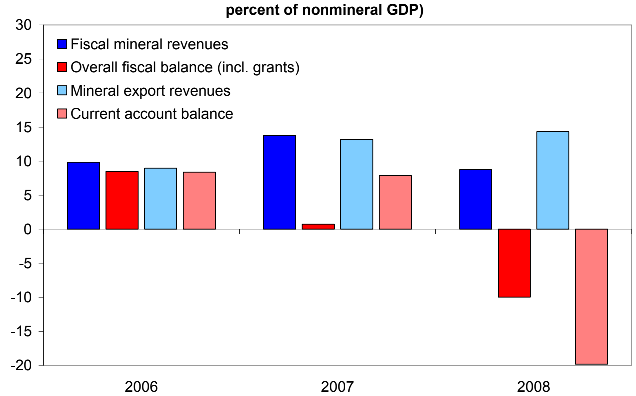
The spend-and-absorb approach provides a useful analytical framework for assessing Mongolia's macroeconomic policies during the recent copper price boom-bust cycle.[1] This approach looks at how monetary and fiscal policies determine the extent that additional mineral revenue inflows are absorbed through an increase in the nonmineral current account deficit. Formally, this is done using a dynamic stochastic general equilibrium model with nominal rigidities.[2] The analysis shows that for the 2006–08, copper price cycle fiscal policy spent all of the mineral revenue inflows while monetary policy allowed for full absorption. However, policies differed over time, with a strong ramping up of expenditures in 2008 just before the collapse in copper prices. This set the stage for the fiscal and balance of payment's pressures that emerged in late 2008 and early 2009.

Mineral Exports, Imports, Trade Balance (in billion US$), and Copper Price



Initially, the surge in mineral revenue led only to a gradual increase in spending and absorption. In 2006, very little of these resources were spent, bringing about sizeable improvements in the fiscal and current account balances relative to 2005. In 2007, fiscal policy fully spent the additional resources and the fiscal balance returned to its 2005 level. This set the stage for a large economic boom. While initially monetary policy was relatively tight, monetary conditions loosened considerably in the latter half of the year as evidenced by fast money and credit growth. This led to a sharp rise in inflation, real exchange rate appreciation, and a rapid increase in imports.

Spending and Absorption 2006-08 (changes relative to 2005, as percent of nonmineral GDP)



The boom ended abruptly in late 2008 when copper prices slumped, reducing exports, government revenues, and foreign exchange inflows. Despite the drop in revenues, government spending remained high, leading to a drawdown of government deposits. In the absence of a monetary tightening, this contributed to a high level of imports and a large deterioration in the current account. The resulting drain on the central bank's international reserves made the tightly managed exchange rate unsustainable and led to a sharp depreciation in late 2008. Fiscal policy also became unsustainable as the deficit rose. However, the authorities then implemented an ambitious Fund-supported adjustment program that succeeded in restoring macroeconomic stability by mid-2009.

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[1]The "spend-and-absorb" framework was initially developed for an analysis of scaling up of aid, see IMF Occasional Paper No. 253.

[2]The following synopsis is based on staff analysis of the recent boom-bust cycle in Mongolia that retraces fiscal and monetary policy decisions through 2006 to 2009 within a dynamic stochastic general equilibrium model. J. Bersch and J. Gottschalk, "Boom-Bust Cycle in Mongolia from a Macro-Policy Perspective," IMF Working Paper (forthcoming).

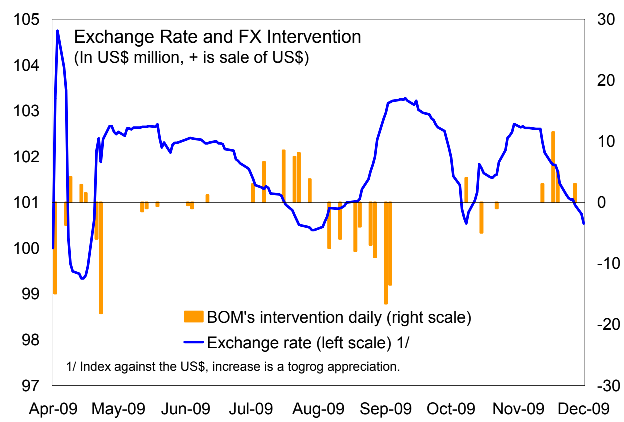
6. **Program performance**. All performance criteria for the third review were met. The indicative limit on the budget deficit was breached by a small margin due to higher-than-expected capital spending, but the annual deficit target should be met since mineral revenues are projected to pick up in the fourth quarter. The structural benchmark to place Anod Bank into receivership was met with some delay and the authorities are committed to passing a social transfer reform law by February 1, 2010.

II. Policy Discussions

7. **Outlook.** There was broad agreement on the growth and inflation outlook although the authorities felt that growth this year could be slightly higher than the staff's forecast. There is some uncertainty as to the extent that growth in the fourth quarter could be dampened by closures related to a H1N1 flu outbreak. Growth should recover strongly next year given the substantial investment in the Oyu Tolgoi mine. The medium-term prospects are favorable with growth accelerating sharply as Oyu Tolgoi production starts in 2013 (Box 3). Staff and the authorities agreed that the deflation of recent months was due to temporary factors and inflation would likely bounce back next year to around 6–8 percent.

A. Monetary and Exchange Rate Policy

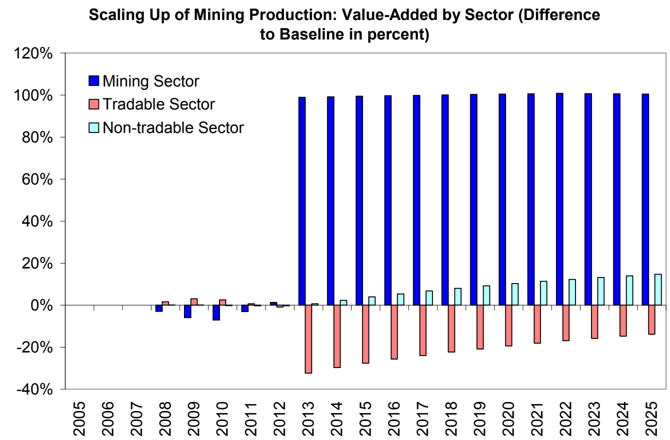
8. **Exchange rate**. The authorities remain committed to a flexible exchange rate and have intervened on both sides of the market to smooth volatility and opportunistically build international reserves. The central bank anticipates that, as the interbank market deepens, they will move away from their twice weekly foreign currency auctions and, instead, begin intervening through the interbank market. There was agreement that a flexible exchange rate would be indispensable in the coming years to ensure that the expected real appreciation pressures do not manifest themselves as higher inflation. Determining the real equilibrium exchange rate is difficult in a resource dependent economy like Mongolia. Nonetheless, staff estimates suggest that the current level of the real exchange rate is broadly in line with fundamentals (Box 4).



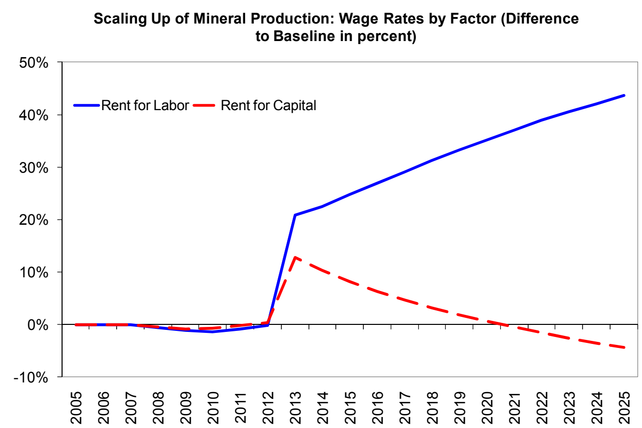
9. **Monetary policy**. The hike in policy rates earlier this year was instrumental in stabilizing market conditions. Since then, the central bank has appropriately lowered interest rates in line with evolving market conditions. The authorities indicated that, going forward, monetary policy would continue to be geared to achieving low inflation and safeguarding international reserves. The authorities were also cautious on the prospects for further easing, given that inflation is expected to rebound to around 6–8 percent next year. The central bank

Box 3. The Long-Run Effect of Scaling Up Mining Production[1]

The Oyu Tolgoi mine will be a key driver of long-term economic growth. In October 2009, the Government of Mongolia and Ivanhoe Mines Mongolia signed the Oyu Tolgoi Investment Agreement, thereby, advancing to the next stage of exploring Mongolia's vast mineral wealth. The construction and exploration of the Oyu Tolgoi copper and gold mine are expected to lead to significant structural changes in the economy.



A multisectoral computable general equilibrium model was used to analyze long-term implications of the surge in mining production. The scaling up of mining will increase mineral GDP and also have a significant impact on other sectors through a reallocation of resources and changes in relative prices. For example, the large increase in mineral exports will put pressure on the real exchange rate to appreciate. This would make nonmineral exports less competitive and lead to a decline in the relative role of the nonmineral tradable sector. The increase in government revenue will create space for increased government spending, but higher wages and nontradable prices mean that the increase in real terms will be smaller. The simulations show that the government will compete for labor with other nontradable sectors, resulting in strong upward pressures on wages. In fact, these wage pressures were evident during the recent copper-induced boom-bust cycle.



The increase in the relative role of the mining sector could make the economy more vulnerable to commodity price shocks. The simulations highlight the benefits, especially in terms of lower inflation, of maintaining a flexible exchange rate. Likewise, adoption of the planned Fiscal Responsibility Law would make an important contribution to insulating fiscal policy from price shocks and smoothing the economy's adjustment to higher mineral output, which will facilitate development of the nonmineral economy.

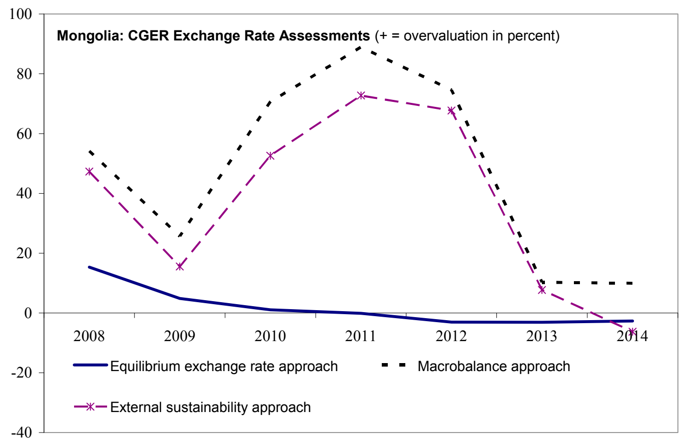
[1] Staff analyzes the long-term implications of the surge in mining production within a multisectoral computable general equilibrium model in J. Bersch, J. Gottschalk, and H. Lofgren, "Long-run Effect of Scaling Up Mining Production in a CGE Perspective," IMF Working Paper (forthcoming).

Box 4. Exchange Rate Assessment

A large mining project drives the economic outlook over the medium-term and complicates any assessment of the equilibrium real exchange rate. Nevertheless, the available information does not indicate the current level of the real exchange rate is out of line with medium-term fundamentals.

Traditional indicators. The current account balance is expected to be quite volatile over the next several years. Imports related to the development of the Oyu Tolgoi mine are sizeable and will result in significant current account deficits in the next few years. Then, the current account will rapidly swing to surplus once production from the mine starts. Finally, like other commodity producers, the current account outlook is highly sensitive to expected commodity prices. These substantial structural changes will imply large swings in the equilibrium exchange rate over the next decade.

Quantitative assessments. The real effective exchange rate has depreciated by some 20 percent from the peak in October 2008, and the current level appears broadly in line with medium-term fundamentals as indicated by the Equilibrium Exchange Rate approach, which is a more reliable indicator for a mineral dependent economy. The Macrobalance and External Sustainability approaches produce volatile estimates that follow the large swing in the current account driven by Oyu Tolgoi related flows and, therefore, are less reliable.



Implications. The structural changes the Mongolian economy will experience in the coming years are expected to lead to substantial shifts in the real exchange rate. A flexible exchange rate, therefore, will be indispensable in helping to facilitate adjustment through the nominal exchange rate rather than prices. Moreover, a flexible exchange rate would also help the economy absorb the large terms-of-trade shocks that are likely as a result of Mongolia's increased reliance on commodity exports.

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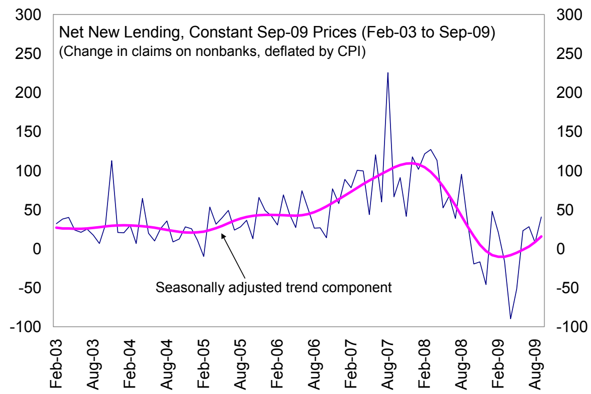
[1] The assessment is based on standard CGER Methodology using the Exchange Rate Assessment Toolkit.



indicated that, in any case, a further lowering of policy rates would likely do little to spur credit growth and stimulate the economy given the weakness of bank balance sheets caused by the overhang of lending from the 2007–08 credit boom. Nevertheless, the authorities believed that credit growth should pick up as the economy recovers, and that there were already signs that the contraction in credit was bottoming out.

10. **Inflation targeting**. Over the long-run, inflation targeting, coupled with a flexible exchange rate, should provide an appropriate monetary framework for Mongolia. However, the introduction of such a regime is still some years away as the central bank needs to build capacity in inflation forecasting, amend the legal framework to make inflation the central bank's main policy goal, and develop a better understanding of how the monetary transmission mechanism works. The authorities have a tentative timetable to introduce inflation targeting starting in 2012.

B. Fiscal Policy

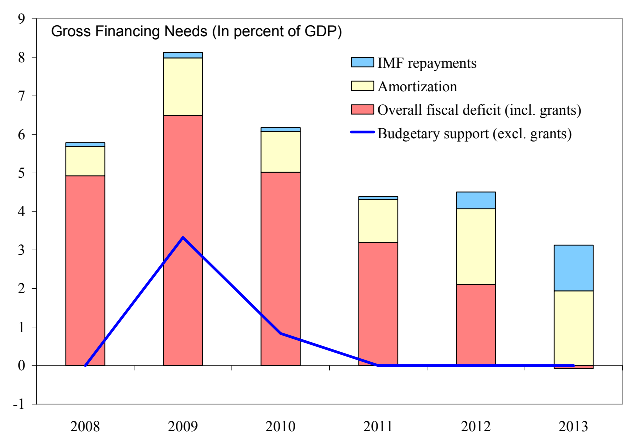
11. **Fiscal stance.** The authorities remain committed to restoring health to public finances and are targeting a budget deficit of 6½ percent of GDP for 2009 and 5 percent of GDP in 2010. Strong copper prices, however, may well provide some room to increase spending this year. Staff advised that revenues in excess of budget forecasts should be saved, particularly given the substantial fiscal financing needs over the next three years. The authorities, however, indicated they were contemplating the introduction of a new program aimed at boosting the construction sector by providing subsidized mortgages to civil servants, funded by higher mineral-related revenues. In November, Parliament authorized Tog 80 billion in financing for this program, but the authorities are planning that any spending on this program would fit within the deficit target. Staff expressed significant reservations as to whether this was the best use of fiscal resources, particularly given the still-high level of poverty in the country (more than one-third of all Mongolians live below the poverty line).

12. **2010 budget**. In late November, Parliament passed a 2010 budget targeting a 5 percent of GDP deficit. However, the government's proposal to increase social security contributions, which would have boosted revenue some 1 percent of GDP per year and also reduced imbalances in the pension system, was rejected. In addition, the underlying assumption for copper prices was increased, increasing mineral revenues by around 1½ percent of GDP above the government's submitted budget draft. These revenues were then earmarked to financing a significant increase in universal social transfers, delivering on a campaign promise that was made by both major parties. Staff expressed reservations about the amendments made to the budget. The 2010 budget now implies only minimal adjustment in the nonmineral balance indicating a weakening fiscal effort. In addition, the creation of a

new entitlement program will further limit fiscal flexibility going forward. Both of these factors will make it more difficult to achieve the needed fiscal adjustment in 2011 and beyond. The transfers also run counter to the program goal of replacing universal transfers with higher benefits that are specifically targeted to the poor. While the authorities recognized the approved budget was now somewhat less conservative, they noted that the copper price assumption was still well below both spot and forward prices. Moreover, the authorities indicated they were fully committed to the deficit target and would adjust spending, if needed, to offset any revenue shortfalls. They will also ensure that any revenue over-performance would be saved to help meet future financing needs and limit the pro-cyclicality of spending.

13. **Structural fiscal reforms.** The authorities intend to submit their Fiscal Responsibility Law to Parliament by end-December alongside a complementary integrated budget law. The government plans to have both laws passed by February 1, 2010. These laws will be critical for providing an institutional framework to promote fiscal discipline and to contain pro-cyclicality (Box 5). The authorities also plan to soon submit a new social transfer reform law to Parliament to increase benefits to the very poorest and generate fiscal savings through better targeting. Passage of this law was delayed over concerns that early implementation could worsen poverty since the government still lacks an effective mechanism to target benefits. To ensure that the poor are fully protected, the means-testing of benefits will be phased in over the course of next year as the authorities develop their institutional capacity to identify the poor. The World Bank and Asian Development Bank will continue to provide assistance in this area.

14. **Medium-term outlook**. Staff argued that there was an ongoing need for fiscal adjustment in the coming years. In 2011, the windfall profits tax will be eliminated which significantly lowers revenues (by around 2 percent of GDP). At the same time, donor budget financing is set to be phased out. Staff forecasts indicated that an adjustment of nearly 10 percent of nonmineral GDP will be needed over the next three years to keep the deficit at a level that can be comfortably financed. The authorities recognized the need for fiscal discipline but also indicated that there were good prospects to sign an agreement to develop a large coal mine (Tavan Tolgoi) which would provide substantial additional revenues in the coming years. As such, the need for a significant further adjustment in budget spending may be less pressing than indicated by staff's forecasts. While prospects may be improved by future development of mineral resources, staff advised prudence in undertaking new spending commitments until a sustainable flow of mineral



Box 5. Fiscal Responsibility Law

Mongolia's mineral wealth is an economic blessing that, if well managed, will lead to lasting economic prosperity. But prosperity is not guaranteed. Indeed, international experience shows this blessing often becomes a resource curse.[1] The challenge, therefore, is to ensure that the substantial mineral deposits are exploited to promote strong, sustainable, and equitable growth with low inflation.

The government plans to adopt a Fiscal Responsibility Law to promote the needed budget discipline by constraining policymakers' discretion. The law would put in place three complementary rules that would function as a fiscal "circuit breaker" and would work together to ensure fiscal discipline:

- *A ceiling on the "structural" deficit*. The structural deficit adjusts the deficit for swings in copper prices. Specifically, revenue projections would be based on a "normal" or smoothed copper price instead of the actual copper price. This helps insulate the budget from copper price volatility, and prevents fiscal policy from transmitting copper price shocks to the rest of the economy. This is the main rule to prevent a repeat of boom-bust policies. A similar such rule has worked well in Chile. The plan is to target structural budget balance, albeit with a transition period before that target is achieved.
- *A debt ceiling*. This rule would prevent excessive borrowing against future wealth—a common mistake among resource economies. High public debt makes the economy vulnerable to commodity price changes, other shocks, or financing constraints. A debt ceiling also reinforces the government's commitment to fiscal sustainability. The authorities plan to set the ceiling at 40 percent of GDP.
- *A ceiling on expenditure growth*. Rapid spending growth is bad for the economy (leading to overheating and inflation) and, from a fiscal perspective, is difficult to manage without reducing quality and efficiency. This rule is a safeguard that would apply when structural revenue is rising fast, such as when the Oyu Tolgoi mine comes on line. In more normal times, it would generally be non-binding.

In addition to the numerical rules, the Fiscal Responsibility Law will also incorporate procedural and transparency reforms to strengthen budget discipline. This includes, for example, strengthening the role of the medium-term framework in setting aggregate ceilings for the budget process and requiring mandatory cost estimates for program proposals to ensure consistency with the fiscal framework. The government also plans to adopt an organic budget law that will complement the Fiscal Responsibility Law in promoting sound budgeting.

At the end of the day, the Fiscal Responsibility Law will only work if policymakers adhere to it. The fiscal rules and the annual budget must become a binding constraint on policy. This means that all new policy initiatives with fiscal consequences would have to be made consistent with the fiscal policy framework before being adopted. Policies that boost spending, for example, would have to be paid for through spending cuts elsewhere or new revenue measures. Policymakers are in effect agreeing to "tie their own hands" to safeguard fiscal discipline. This fiscal discipline will, in turn, yield huge benefits in helping to convert Mongolia's substantial mineral wealth into economic prosperity.

[1] Specifically, resource dependent economies often grow slower than other economies—see, for example, Ricardo Hausmann and Roberto Rigobon, 2003, "An Alternative Interpretation of the "Resource Curse": Theory and Policy Implications," in *Fiscal Policy Formulation and Implementation in Oil-Producing Countries*, ed. by Davis, Ossowski, and Fedelino (Washington, International Monetary Fund).

revenues were established (which may not be until 2015). Until then, the deficit should be constrained by the availability of noninflationary fiscal financing. Moreover, public debt was already high, although it should fall rapidly in the coming years, particularly as repayments to the Fund come due (see Debt Sustainability Analysis).

Mongolia: Fiscal Indicators
(In percent of nonmineral GDP)

				Projected					
	2006	2007	2008	2009	2010	2011	2012	2013	2014
Overall balance (in percent of GDP)	8.2	2.8	-4.9	-6.5	-5.0	-2.7	-1.7	0.1	3.2
Nonmineral balance	-3.2	-14.9	-19.4	-16.2	-15.6	-6.6	-5.7	-7.2	-6.2
Nonmineral revenue	37.3	38.7	33.2	31.2	33.1	34.2	33.6	32.7	32.6
Total expenditure	40.5	53.6	52.6	47.4	48.7	40.9	39.3	39.9	38.8
Fiscal effort (change in cyclically adjusted) 1/	-1.1	-12.6	-6.1	7.1	-0.9	8.4	1.0	-0.5	0.9
Real expenditure growth	25.8	48.5	9.6	-10.9	12.1	-10.6	1.7	5.1	3.3
Memorandum items:									
Real nonmineral GDP (growth in percent)	9.2	12.2	11.9	-1.2	9.2	6.4	5.7	3.4	6.2
Output gap of nonmineral GDP	-1.7	0.4	3.4	-4.4	-1.2	0.0	-0.2	-2.6	-2.4

Sources: Mongolian authorities; and IMF staff calculations.
1/ In percent of potential nonmineral GDP. The elasticity assumptions are 1 for revenue and 0 for spending.

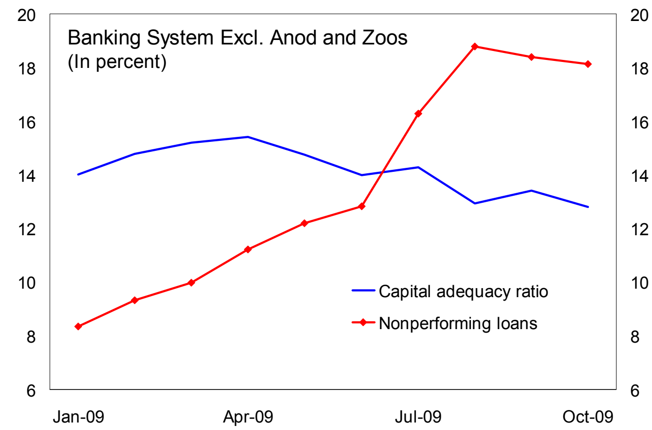
C. Banking System

15. **Anod Bank**. The rapid expansion of credit in past years is now leading to a steady increase in nonperforming loans and which has precipitated sequential bank failures. Anod Bank was taken into conservatorship in December 2008 and the authorities have recently appointed a receiver to liquidate the bank. Potential lawsuits by minority shareholders are, however, presenting a legal constraint to liquidating the bank and the authorities have decided to preemptively offer to settle with these shareholders, costing the budget around Tog 5 billion. While the authorities shared staff concerns of the precedent this would set, their legal advisors have indicated that, in the absence of such a step, the central bank would remain unable to liquidate the bank until minority shareholders claims were determined by the courts. This would be a very lengthy process that could take several years to resolve.

16. **Zoos Bank**. The authorities have also appointed a receiver at Zoos Bank, the only other publicly listed bank, following a significant loss of the bank's deposits and the discovery that the bank was insolvent, in part a result of significant accounting irregularities. An external audit of the bank is underway and losses could be considerable (perhaps up to 2 percent of GDP). The authorities plan to use a "good bank, bad bank" model to resolve Zoos and have already moved the performing assets from the bank into a new, government-owned bank.

17. **Banking system.** The remainder of the banking system remains under stress as highlighted by an increase in nonperforming assets and falling capital adequacy ratios (even after excluding Anod and Zoos Banks). The three largest banks, which make up 70 percent of the system, still report capital adequacy ratios that are 2–3 percentage points above the regulatory minimum. However, some mid- and small-sized banks have weaker balance sheets and it is unclear whether the current system of loan provisioning fully reflects expected losses. The mission, in conjunction with an overlapping MCM technical assistance

mission, has discussed contingency plans with the authorities that could be implemented quickly should another bank face distress. The authorities have indicated they are committed to acting promptly and decisively, as problems arise, and that their main goal is to promote public confidence in the banking system as a whole. They also highlighted that an emergency facility for liquidity support and a blanket deposit guarantee were already in place which provides a strong basis for maintaining financial stability.



18. **Banking system strategy**. The authorities intend, as a first step, to assess the strength of the banking system by undertaking external audits of all the banks, supported by World Bank financing. Bank-by-bank plans will then be developed to recapitalize the system, with the support of MCM technical assistance. The public debt projections assume that bank restructuring will cost around 5 percent of GDP in addition to the 3 percent of GDP already deployed to cover the cost of Anod Bank. Stringent conditions would be placed on the use of public resources and existing shareholders would be required to either inject new capital or be the first to bear losses. The authorities also intend to implement legal reforms to strengthen the central bank's powers to intervene and resolve individual institutions, including the power to write down existing shareholder capital, to transfer assets and liabilities to a healthy bank, to quickly license a new bank, and to effect mergers. Staff advice was to proceed expeditiously with bank restructuring. However, there is a strong possibility that some restructuring of corporate entities may also need to be undertaken in the coming months, particularly for those sectors that were hit hard by the economic downturn or where banks are significantly exposed to individual corporations.

19. **Supervision**. The authorities intend to further strengthen bank supervision. The central bank has already completed on-site inspection of all the banks and appointed a comptroller in one mid-sized bank where there are concerns about the health of the bank's balance sheet. The authorities are also committed to improving the loan classification system for restructured loans and to closely monitor such loans. Staff encouraged the authorities to promptly pass the Banking Law (submitted to Parliament in October) which includes provisions that will strengthen prudential requirements, increase the legal protection for bank supervisors, and more clearly define connected parties.

D. Other

20. **External financing**. It was agreed that the authorities should be cautious in undertaking new nonconcessional external borrowing. The government should also keep in place the current prohibition on government guarantees. Earlier this year, the government borrowed US$75 million for on-lending to gold mining operations and the authorities remain

committed to having these loans repaid to the budget by the end of the year. As part of the Oyu Tolgoi agreement, the government will receive advance payment loans of US$250 million (of which US$100 million has already been disbursed) as well as loans to finance the government's 34 percent equity stake in the mine. For program purposes, both of these loans are considered domestic financing since the lender is technically a resident company (despite being majority owned by an international mining conglomerate). The advance payment loans will be repaid from the general budget while the government's equity share borrowing will be repaid from accrued dividends (the government will not be liable for the loan in the unlikely event that dividends are insufficient).

21. **Program issues.** The authorities continue to work to reach agreement on their remaining arrears to bilateral creditors. The mission again discussed with the authorities the options for a successor concessional arrangement but the authorities have chosen to reserve judgment on that possibility until a later date.

22. **Data.** Data provision to the Fund is adequate for surveillance. As flagged by the Safeguards Assessment, staff reiterated that external auditors need to be given access to central bank's vaults by end-2009 to provide assurances on the reliability of monetary data aggregates and to resolve the qualified audit opinion that arose in 2008.

23. **Extractive Industry Transparency Initiative (EITI)**. Mongolia has made progress in their goal of becoming EITI compliant by next year. The EITI audit report covering the company payments and government receipts for the fiscal year 2006 has been published and the 2007 report is being verified by the EITI National Council. The EITI validation is expected to be completed by March 2010.

24. **Trade and investment policies.** The authorities remain committed to maintaining a free trade and investment regimes. Such policies will strengthen Mongolia's competitiveness and facilitate the structural changes in the economy associated with the development of the Oyu Tolgoi project.

III. Staff Appraisal

25. **Macro-outlook**. Growth this year is likely to be around -1 percent, reflecting the impact of the global crisis and the necessary tightening of policies. The economy, however, is bottoming out and real GDP growth is projected to pick up substantially next year to around 8 percent, boosted by capital expenditure related to the ongoing construction of the Oyu Tolgoi mine. Inflation has fallen sharply this year reflecting global price movements and the success of the authorities' stabilization program. Over the medium term, real growth is expected to be high, driven first by investment in the mining sector and, subsequently, by a rapid expansion in mineral output. However, prudent macroeconomic management will be required to ensure that Mongolia's substantial mineral wealth translates into prosperity for all of its citizens.

26. **Fiscal stance**. Fiscal policy was loosened substantially in 2007–08 and the nonmineral fiscal deficit increased by 13 percent of GDP. This extraordinary loosening will

now need to be unwound in order to return the budget deficit to a level that can be comfortably financed without generating inflation or crowding out lending to the private sector. The ambitious consolidation undertaken this year was a major down payment on the needed adjustment. However, fiscal restraint will be necessary for several more years to fully restore health to government finances. For 2010, the overall balance should be limited to 5 percent of GDP, in line with the budget passed by Parliament, and the deficit should continue to fall in the coming years. The 2010 target implies only a modest consolidation in the nonmineral balance. While this should support the economic recovery, it will be important that any revenue over-performance is saved to prevent a return to the pro-cyclical policies of the past. Continued adjustment will be needed in 2011, in part to offset the considerable revenue loss emanating from the planned elimination of the windfall profits tax. Such consolidation could be achieved through expenditure rationalization, including reductions in subsidies, universal transfers, and investment spending. The decline in the deficit will need to continue until the revenue from Oyu Tolgoi starts to enter the budget (in around 2015). A larger fiscal deficit simply cannot be reasonably financed without either crowding out the private sector or overly relying on costly foreign borrowing. Indeed, the financing situation will become increasingly difficult after 2010 since donor budgetary support will decline. Therefore, the advance payments associated with the Oyu Tolgoi project will need to be saved in order to meet the expected financing needs in 2011 and beyond.

27. **Structural fiscal reforms**. The prompt adoption of a Fiscal Responsibility Law will help institutionalize a lasting commitment to fiscal discipline. For that fiscal framework to be successful, it will be critical that the law is comprehensive in nature, covering all aspects of government revenue and spending. The costs of all spending initiatives will need to be explicitly determined and will need to be consistent with the Fiscal Responsibility Law's numerical targets. Reform of the social transfer regime is another critical priority. The new social transfer system will need to be designed to ensure better protection for the poor and vulnerable groups by moving away from universal transfers toward more targeted benefits. The recent increase in universal transfers, therefore, is a step in the wrong direction that will reduce fiscal flexibility and increase fiscal risks going forward.

28. **Exchange rate policy**. The reforms to exchange rate management are working well, allowing the Bank of Mongolia to rebuild international reserves. Looking ahead, a flexible exchange rate will be crucial for macroeconomic stability. It will help insulate the economy from external shocks, facilitate the continued rebuilding of international reserves, and reduce inflation. As production from Oyu Tolgoi takes off and Mongolia becomes wealthier, the real exchange rate will naturally begin to appreciate. A flexible exchange rate would allow this to occur through a stronger nominal exchange rate rather than through higher inflation. In addition, allowing for greater flexibility will give the central bank greater autonomy in pursuing an independent monetary policy that is calibrated to Mongolia's own circumstances and geared toward maintaining low inflation and robust growth. Returning to the tightly managed exchange rate of the past would run the risk that movements in the real exchange rate will again show up in higher inflation. This would have a significant and negative impact

on the very poorest and most vulnerable in society, raising both poverty and income inequality.

29. **Monetary policy framework**. The Bank of Mongolia should consider moving, over time, to an inflation targeting framework, which would provide a nominal anchor consistent with a flexible exchange rate. While such a move is some years away, much can be done in the interim to lay the technical groundwork for the adoption of inflation targeting. This includes enhancing inflation forecasting and improving the monetary policy transmission channel by promoting financial market deepening and strengthening the banking system. In the meantime, monetary policy should continue to be geared toward achieving stable and low inflation, safeguarding international reserves, and containing exchange rate volatility by targeting monetary aggregates.

30. **Near-term monetary policy**. Earlier this year, the central bank raised interest rates, which helped to quickly stabilize market conditions. Since then, markets have remained calm and inflation has decelerated sharply allowing the central bank to gradually and appropriately lower the policy interest rate. Going forward, the central bank should continue to adjust interest rates prudently and in line with evolving market conditions and the inflation outlook. Inflation is expected to rise from the current very low levels and stabilize at around 6 percent. A cautious approach, therefore, will help enhance the credibility of the central bank's commitment to low inflation while also safeguarding international reserves. Moreover, at the present juncture, efforts to further loosen monetary policy are unlikely to jumpstart credit growth or provide substantial demand impetus since banks already hold excess liquidity and are constrained by weak balance sheets.

31. **Banking system**. The rapid expansion of credit during the boom years is now taking its toll on the banking system. Nonperforming loans have increased sharply and capital adequacy ratios have fallen. The central bank has responded proactively and vigorously to handle problems in individual banks, as they arise, and to maintain the integrity of and confidence in the Mongolian banking system. They should continue with this approach. Further public money may well be needed to restructure the banking system. If so, the injection of public funds should be intimately tied to governance and structural reforms at the recipient bank. Such reforms would include changes in management; a dilution of shareholders' ownership; ensuring transparent, fit, and proper bank ownership and management; improving risk management systems; and strengthening lending practices. In addition, continued progress in strengthening supervision is needed to prevent a recurrence of banking system instability and secure a sound and stable banking system.

32. **The need to avoid a repeat of boom-bust cycles**. What would happen if there was a return to the policy mix of 2007–08? For example, if the Oyu Tolgoi advance payments were spent today, the fiscal adjustment process were halted, and the exchange rate again became tightly managed, the government would run a significant risk of running out of financing resources in the next one–two years. Even with relatively high copper prices this could lead to a repeat of the near-crisis experienced earlier this year. The end result would be high and rising inflation, large current account deficits, and a depletion of international reserves. The

difficult measures undertaken by the government in the context of the current policy program will have all been in vain.

33. **Program performance**. The authorities have had strong policy implementation, exemplified by the fact that all the principal performance criteria—for this and all previous reviews—have been met. The indicative limit on the fiscal deficit was slightly missed for end-September, but the end-December fiscal target should be comfortably met as revenues are expected to pick up in the fourth quarter. Some of the structural benchmarks will be completed with a modest delay. However, the authorities are committed to them and have made demonstrable progress toward fulfilling them.

34. **Risks**. Despite the success of the program to date, there remain considerable risks. Weaknesses in the banking system have now become the primary risk facing the government. It is likely that difficult decisions will be needed in the near future to restructure some banks, including writing down the equity stake of some existing owners. There is also a possibility that the recent deposit outflow at Zoos Bank could be repeated at other banks, leading to capital outflows and pressure on the currency. This would require a prompt and decisive response from the authorities. Fiscal policy also represents a source of risk. There already are significant political pressures to immediately spend the large advance payments received as part of the Oyu Tolgoi agreement and any mineral revenue over-performance. The government will have to show strong political will to resist such pressures and avoid complacency.

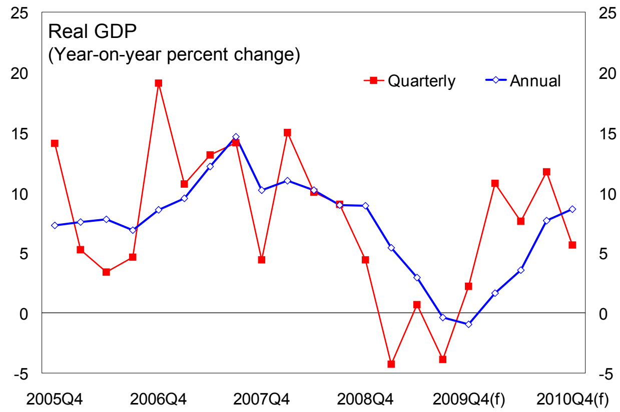
35. **Summary**. The economy has now weathered the worse of the crisis and is set to rebound strongly starting in 2010. Looking forward, Mongolia stands to benefit enormously from its vast mineral deposits. Maximizing these benefits will require a continued commitment to fiscal discipline, a flexible exchange rate, and a sound banking system. Staying the course with such policies will help ensure that Mongolia’s considerable mineral wealth is transformed into falling poverty, rising household income, and a steadily improving standard of living for all of Mongolia’s citizens.

36. Staff recommends completion of the third review and that the next Article IV consultation takes place on the 24-month cycle since Mongolia is currently under a Fund arrangement.

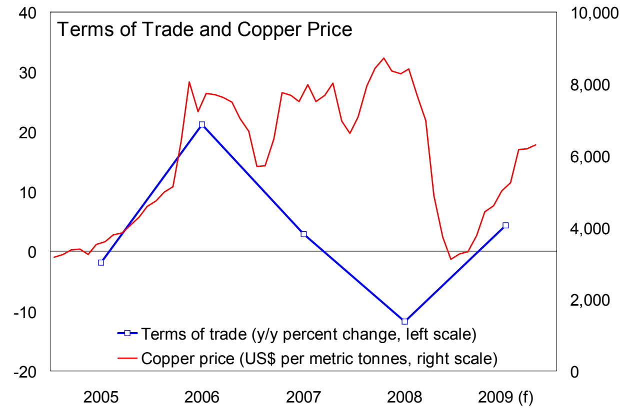
Figure 1. Macroeconomic Developments

Main Message: The economy was hit hard by the global economic crisis but has now stabilized and is expected to rebound strongly next year.

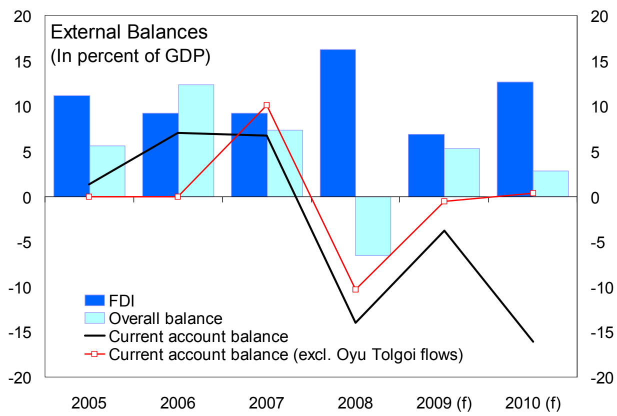
Real GDP growth is bottoming out and is expected to recover strongly next year, spurred by Oyu Tolgoi related investment.



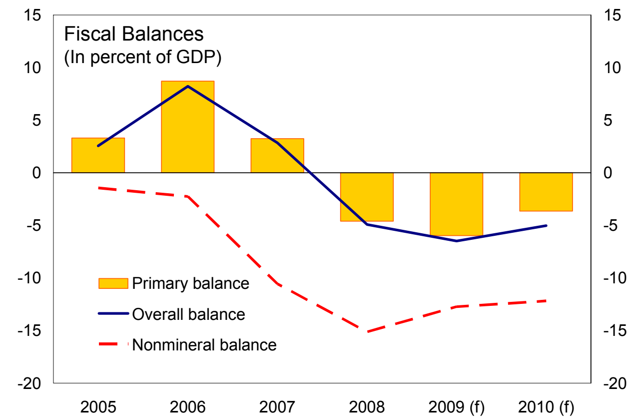
A recovery in copper prices is also helping the economy, including by boosting export earnings and fiscal revenue.



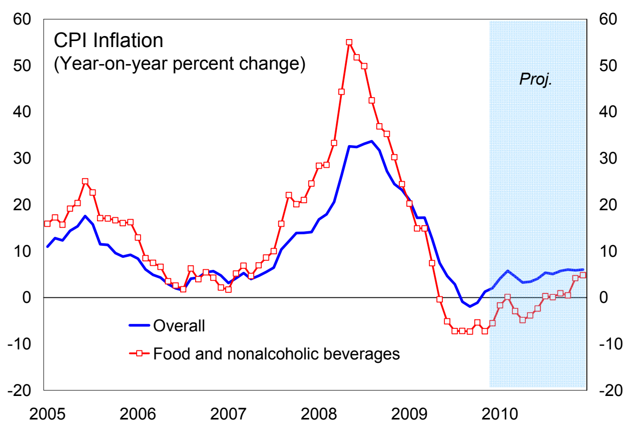
The current account, which worsened considerably in 2008, is now broadly in balance (excluding Oyu Tolgoi flows).



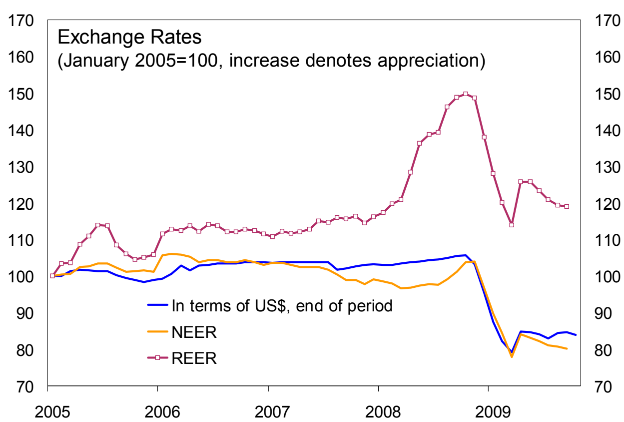
The authorities' fiscal adjustment effort is reducing the nonmineral fiscal deficit, which had grown rapidly in 2007-08.



Inflation has fallen rapidly and is expected to remain low.



Real exchange rate appreciation has been largely unwound by togrog depreciation and low inflation.

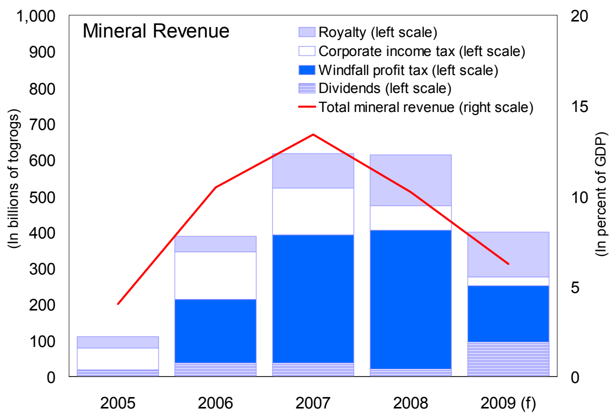


Sources: Mongolian authorities; and IMF staff estimates.

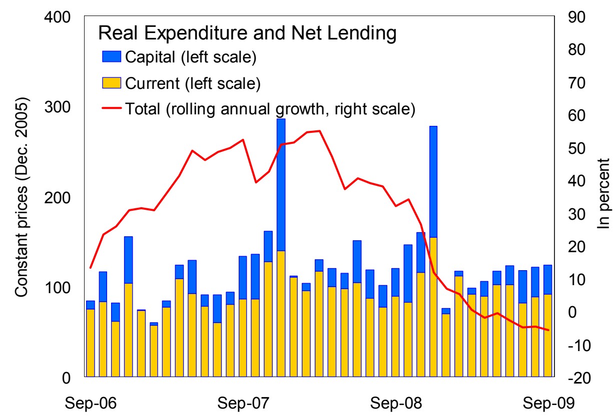
Figure 2. Policy Developments

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

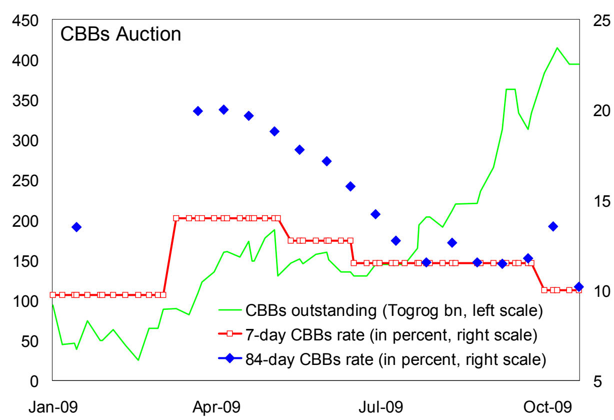
Mineral revenue fell sharply in 2008-09, exposing the extent that fiscal policy had been loosened during the boom years...



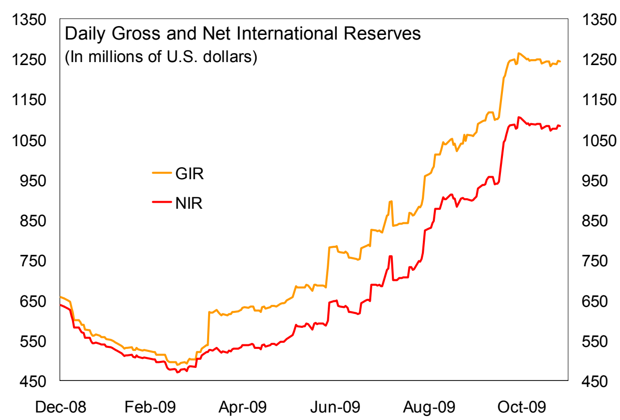
..and necessitating a considerable adjustment in real government spending to bring the deficit to a level that could be financed.



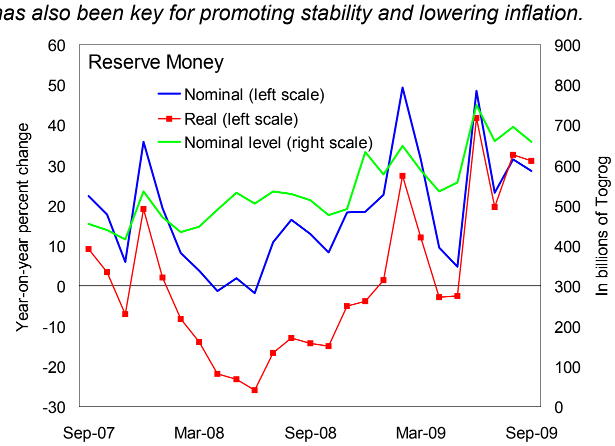
As market conditions stabilized, the central bank appropriately began to unwind the earlier hike in interest rates, a hike…



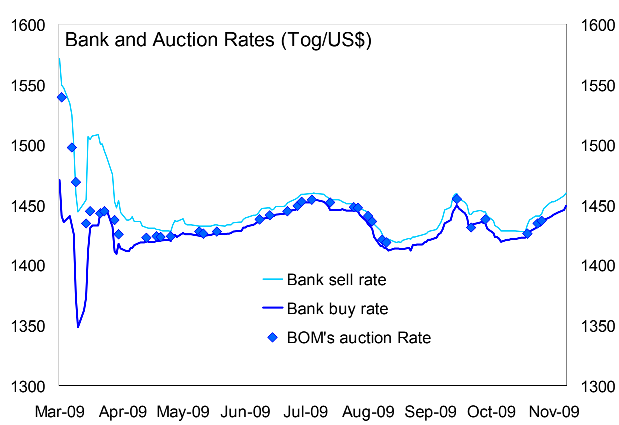
…instrumental in stabilizing the foreign exchange market and allowing the authorities to rebuild international reserves.



Reserve money has been kept in line with program targets, which has also been key for promoting stability and lowering inflation.



These policies have also helped to stabilize the exchange rate.

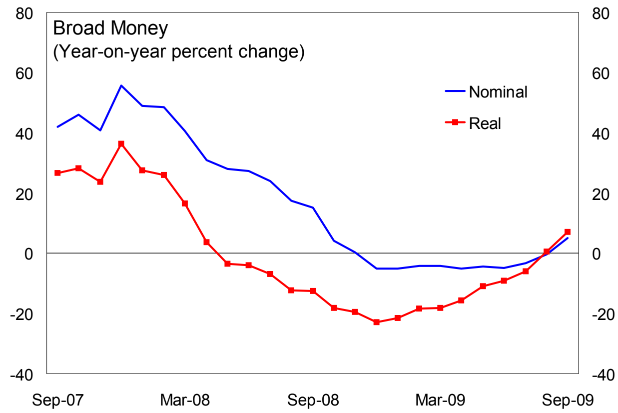


Sources: Mongolian authorities; and IMF staff estimates.

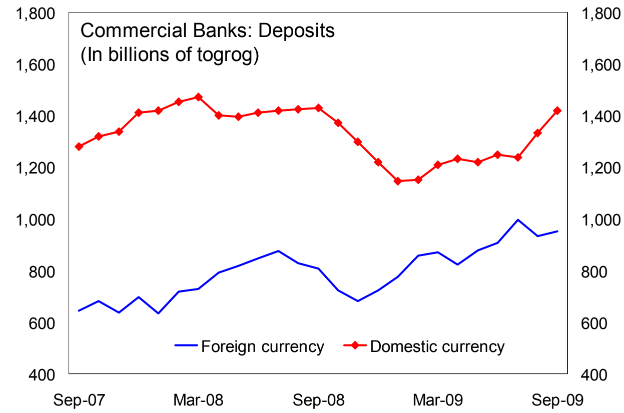
Figure 3. Banking Developments

Main Message: The economic downturn has taken its toll on banks, and though there are some signs that confidence is returning, there are still risks to the banking sector as highlighted by the worsening of the system-wide balance sheet.

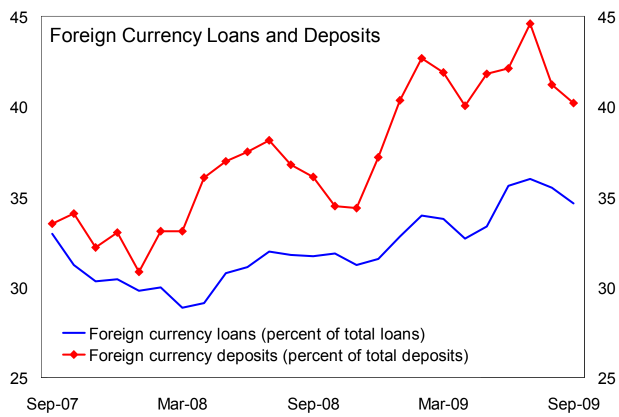
Broad money growth is recovering as the economy remonetizes and confidence returns…



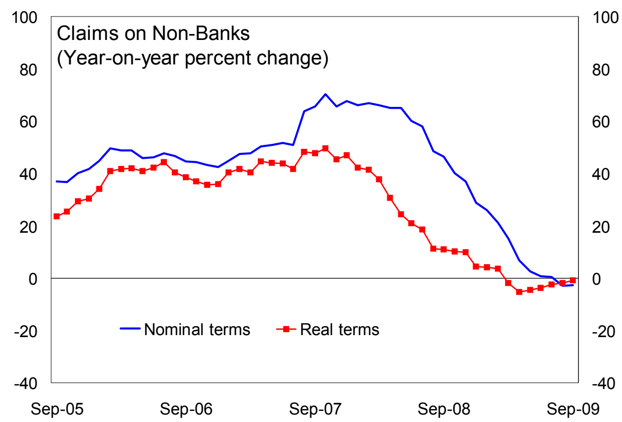
…with deposits starting to come back to the banking system…



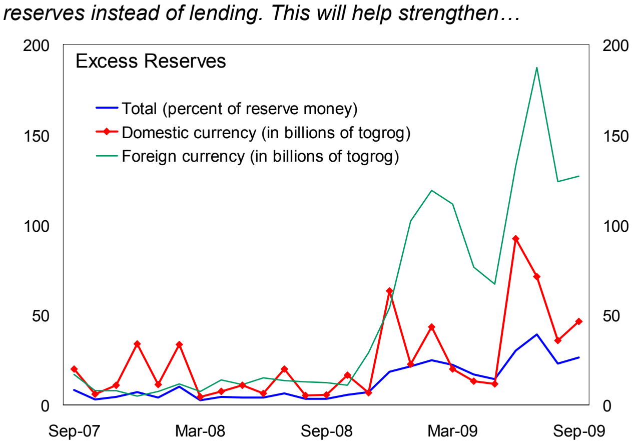
…and signs that the increase in dollarization has moderated.



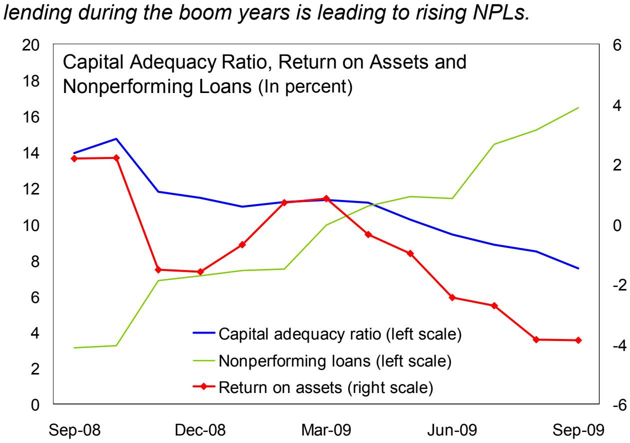
The decline in credit growth rates is bottoming out; however, it remains sluggish due to the weak economy and…



…banks' prudent decision to direct deposits toward building excess reserves instead of lending. This will help strengthen…



…banks' balance sheets, which have weakened as the imprudent lending during the boom years is leading to rising NPLs.



Sources: Mongolian authorities; and IMF staff estimates.

Table 1. Mongolia: Selected Economic and Financial Indicators, 2007–10

Nominal GDP (2008): US$5,243 million 1/
Population, end-year (2008): 2.68 million
Per capita GDP (2008): US$1,972 2/
Poverty incidence (2007/08): 35.2 percent 3/
Quota: SDR 51.1 million

		Rev.	Proj.		2nd review	
	2007	2008	2009	2010	2009	2010
			(Percent change)			
Real sector						
Real GDP growth	10.2	8.9	-1.0	8.6	0.5	3.0
Mineral	2.9	-2.9	0.3	6.0	0.0	1.0
Nonmineral	12.2	11.9	-1.2	9.2	0.6	3.5
Consumer prices (period average)	8.2	26.8	6.3	4.9	8.5	7.9
Consumer prices (end-period)	14.1	23.2	2.0	6.0	8.5	6.0
GDP deflator	12.3	20.2	7.5	6.0	0.8	8.3
Gross national savings (in percent of GDP)	45.2	29.6	34.3	33.7	…	…
Gross national investment (in percent of GDP)	35.4	40.3	35.1	47.1	…	…
			(In percent of GDP)			
General government budget						
Revenue and grants	40.9	36.1	30.7	33.0	30.8	30.1
Expenditure and net lending	38.0	41.0	37.2	38.0	37.3	35.0
Current balance	14.1	6.5	1.4	2.3	0.7	2.5
Primary balance	3.2	-4.6	-6.0	-3.6	-6.0	-4.1
Overall balance (including grants)	2.8	-4.9	-6.5	-5.0	-6.5	-5.0
Nonmineral overall balance	-10.6	-15.1	-12.7	-12.2	-12.1	-9.0
			(Percent change)			
Money and credit 4/						
Broad money	55.6	-5.1	20.0	25.4	15.0	23.0
Net foreign assets (contribution to BM growth)	14.1	-27.8	28.7	6.4	14.5	4.1
Net domestic assets (contribution to BM growth)	41.5	22.7	-8.6	18.9	0.5	18.9
Claims on non-banks, adjusted for bank restructuring	67.7	28.7	2.9	7.5	1.6	6.9
Broad money velocity (GDP/BM)	1.9	2.7	2.4	2.2	2.4	2.2
Interest rate on central bank bills, end-period (percent) 5/	8.4	9.8	…	…	…	…
			(In millions of US$)			
Balance of payments						
Current account balance (including official transfers)	265	-722	-167	-772	-291	-449
(In percent of GDP)	6.7	-14.0	-3.8	-16.1	-6.9	-10.3
Trade balance	-54	-613	-91	-841	-183	-411
Exports	1,949	2,534	1,833	1,995	1,830	2,117
Imports	-2,003	-3,147	-1,924	-2,836	-2,013	-2,528
Foreign direct investment	360	836	305	609	517	930
Gross official international reserves (end-period)	1,001	657	1,050	1,252	919	1,068
(In months of next year's imports of goods and services)	3.2	3.3	3.9	3.8	3.7	3.9
Trade prices						
Export prices (US$, percent change)	14.2	3.3	-16.0	4.0	-23.5	4.5
Import prices (US$, percent change)	11.0	17.0	-19.5	9.3	-19.8	6.1
Terms of trade (percent change)	2.9	-11.7	4.3	-4.9	-4.6	-1.5
			(In percent of GDP)			
Public and publicly guaranteed debt						
Total public debt	39.4	33.9	51.6	70.8	49.1	52.1
Domestic debt 6/	0.5	0.0	6.3	26.6	2.6	5.2
External debt 7/	38.9	33.9	45.3	44.2	46.5	46.9
(In millions of US$)	1,529	1,610	1,937	2,082	1,860	2,002
Exchange rate						
Togrogs per US$ (end-period)	1,170	1,268	...	...	...	...
Togrogs per US$ (period average)	1,170	1,169	...	...	...	...
Nominal effective exchange rate (end-period; percent change)	-4.0	-2.5	...	...	...	...
Real effective exchange rate (end-period; percent change)	4.1	18.7	...	...	...	...
Nominal GDP (In billions of togrogs)	4,600	6,020	6,407	7,373	6,209	6,931

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 2009-10, valued at the program exchange rate and gold price.
5/ Yield of 14-day bills until 2006 and of 7-day bills from 2007 onward.
6/ The projections for 2009 and 2010 include the estimated fiscalization cost of bank restructuring, the financing of the government's equity share in Oyu Tolgoi and the Oyu Tolgoi tax-prepayment.
7/ Includes prospective Fund credit under the SBA.

Table 2. Mongolia: Summary Operations of the General Government, 2007–10

			Proj.		2nd review	
	2007	2008	2009	2010	2009	2010
			(In billions of togrogs)			
Total revenue and grants	1,880	2,170	1,967	2,432	1,910	2,083
Total expenditure and net lending	1,750	2,467	2,383	2,802	2,315	2,428
Overall balance (incl. grants)	131	-296	-416	-370	-405	-345
Nonmineral overall balance	-486	-911	-815	-898	-753	-622
Financing	-131	296	416	370	405	345
Foreign (net)	47	39	324	17	303	18
Domestic (net)	-178	258	91	353	102	327
Privatization receipts (valuation adj.)	18	9	33	33	19	19
Domestic bank financing (net)	-176	249	98	243	82	307
Domestic nonbank financing (net)	-19	0	-40	77	0	0
			(In percent of GDP)			
Total revenue and grants	40.9	36.1	30.7	33.0	30.8	30.1
Current revenue	40.4	35.7	29.8	32.6	30.1	29.7
Tax revenue and social security contributions	32.7	31.4	24.5	28.8	24.5	25.6
Income taxes	14.1	12.5	7.5	9.9	6.9	7.5
Social security contributions	3.5	3.8	4.1	3.9	4.3	5.0
Sales tax and VAT	5.8	6.1	5.3	6.9	5.5	5.5
Excise taxes	2.9	3.0	2.6	2.5	2.7	2.7
Customs duties and export taxes	2.2	2.3	1.8	2.3	1.9	2.4
Other taxes	4.2	3.6	3.2	3.3	3.3	2.6
Nontax revenue	7.7	4.3	5.3	3.9	5.5	4.0
Capital revenue and grants	0.5	0.3	0.9	0.4	0.7	0.4
Total expenditure and net lending	38.0	41.0	37.2	38.0	37.3	35.0
Current expenditure	26.3	29.3	28.5	30.3	29.4	27.2
Wages and salaries	6.4	9.0	9.1	8.1	9.4	8.5
Purchase of goods and services	8.5	8.5	5.6	6.3	5.9	6.2
Subsidies to public enterprises	0.3	1.2	0.8	0.9	0.8	0.8
Transfers 1/	10.6	10.2	12.5	13.5	12.7	10.8
Interest payments	0.4	0.3	0.5	1.4	0.5	0.9
Capital expenditure and net lending	11.8	11.7	8.7	7.7	7.9	7.8
Capital expenditure	10.0	10.4	7.1	6.7	6.9	6.5
Net lending	1.7	1.3	1.7	1.0	0.9	1.3
Overall balance (incl. grants)	2.8	-4.9	-6.5	-5.0	-6.5	-5.0
Nonmineral overall balance (incl. grants)	-10.6	-15.1	-12.7	-12.2	-12.1	-9.0
Financing	-2.8	4.9	6.5	5.0	6.5	5.0
Foreign (net)	1.0	0.6	5.1	0.2	4.9	0.3
Disbursements	2.1	1.4	6.6	1.3	6.5	1.4
Project loans	2.1	1.4	1.7	1.8	1.8	2.0
Program loans	0.0	0.0	3.3	0.8	3.1	0.9
Gold financing loan	0.0	0.0	1.5	-1.4	1.6	-1.5
Amortization	1.1	0.8	1.5	1.1	1.6	1.2
Domestic (net)	-3.9	4.3	1.4	4.8	1.6	4.7
Banking system (net)	-3.8	4.1	1.5	3.3	1.3	4.4
Nonbank	0.0	0.1	-0.1	1.5	0.3	0.3
Of which : Oyu Tolgoi tax-prepayment	0.0	0.0	2.3	1.0	0.0	0.0
Memorandum items:						
Overall balance incl. banking sector restructuring costs (percent of GDP) 2/	2.8	-4.9	-9.3	-9.6	-9.4	-5.0
Nominal GDP (in billions of togrogs)	4,600	6,020	6,407	7,373	6,209	6,931
Copper price (US$ per ton)	7,132	6,963	5,000	5,800	4,000	4,100

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, 2007−10 1/

	2007	2008	Sept. 2009	Proj. 2009	Proj. 2010	2nd review 2009	2nd review 2010
			(In billions of togrog; end of period)				
Monetary survey							
Broad Money	2,391	2,270	2,743	2,725	3,417	2,610	3,211
Currency	283	329	282	395	466	378	438
Deposits	2,108	1,941	2,461	2,330	2,951	2,232	2,773
Net foreign assets	1,348	683	1,371	1,334	1,510	1,013	1,120
Net domestic assets	1,043	1,587	1,372	1,391	1,907	1,597	2,091
Domestic credit	1,389	2,119	2,041	2,102	2,879	2,227	2,710
Net credit to government	-703	-574	-724	-479	104	-330	-22
Claims on nonbanks	2,092	2,692	2,765	2,581	2,774	2,557	2,732
Other items, net	-346	-532	-669	-711	-971	-630	-619
Monetary authorities							
Reserve money	535	634	675	730	865	730	840
Net foreign assets	1,134	805	1,293	1,272	1,445	1,073	1,168
BOM defined reserves 2/	1,137	808	1,411	1,394	1,567	1,191	1,286
Net international reserves (NIR) 3/	…	628	1,190	1,245	1,419	1,043	1,138
Other BOM defined reserves	…	180	221	148	148	148	148
Other assets, net	-4	-3	-118	-122	-122	-118	-118
Net domestic assets	-599	-171	-618	-542	-580	-343	-328
Net credit to government	-573	-183	-208	-132	-49	64	114
Claims on deposit money banks	19	243	156	120	120	20	20
Minus: Central bank bills (net)	103	120	357	350	460	225	270
Other items, net	59	-112	-210	-179	-191	-202	-192
Memorandum items:			(In percent; unless otherwise indicated)				
Annual broad money growth	55.6	-5.1	8.6	20.0	25.4	15.0	23.0
Annual growth of claims to nonbanks	67.7	28.7	-2.6	-4.1	7.5	-5.0	6.9
Adjusted for bank restructuring	…	…	…	2.9	7.5	1.9	6.9
Annual reserve money growth	35.9	18.4	31.6	15.2	18.5	15.2	15.0
Velocity	1.9	2.7	2.7	2.4	2.2	2.4	2.2
Broad money/reserve money	4.5	3.6	4.1	3.7	3.9	3.6	3.8
Total loans/deposits	99.3	138.7	112.4	110.8	94.0	114.6	98.5
BOM defined reserves (in millions of US$) 2/	972	637	905	893	1,004	764	825
Net international reserves (NIR, in millions of US$) 3/	…	495	763	798	909	669	730
Monetary Survey NCG, excluding bank restructuring costs	…	-574	-724	-658	-415	…	…
Net credit to government program definition 4/	…	-574	-724	-515	-196	-509	-202

Sources: Mongolian authorities; and IMF staff projections.

1/ Valued at the program exchange rate and gold price.
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 projections for 2009-10 include the Oyu Tolgoi tax-prepayment.
4/ Net credit to government excluding government deposits in Anod bank and the expected cost associated with bank restructuring in 2009-10.

Table 4. Mongolia: Balance of Payments, 2007–10

(In millions of US$, unless indicated otherwise)

			Proj.		2nd review	
	2007	2008	2009	2010	2009	2010
Current account balance (including official grants)	265	-722	-167	-772	-291	-449
Trade balance	-54	-613	-91	-841	-183	-411
Exports	1,949	2,534	1,833	1,995	1,830	2,117
Copper concentrate	812	836	600	667	496	525
Gold	235	600	381	382	566	733
Other	903	1,099	852	946	768	859
Imports	-2,003	-3,147	-1,924	-2,836	-2,013	-2,528
Oil imports	-560	-891	-457	-620	-438	-545
Food imports	-266	-436	-325	-360	-328	-340
Oyu Tolgoi-related imports	-132	-190	-143	-791	…	…
Other	-1,046	-1,630	-999	-1,066	-1,247	-1,643
Services, net	161	-191	-199	-102	-207	-146
Income, net	-79	-130	-115	-81	-133	-134
Current transfers	237	212	237	251	232	242
General government	133	87	144	147	144	147
Other sectors	104	125	93	104	88	95
Of which: workers remittances	84	94	63	73	58	64
Capital and financial account	236	545	402	907	420	509
Direct investment	360	836	305	609	517	930
Portfolio investment	75	-18	-34	-107	67	-141
Trade credits, net	-13	72	-25	-18	-51	-37
Currency and deposits, net	-268	120	-144	-38	-259	-245
Loans, net	45	189	258	709	204	358
Other, net	37	-654	42	-247	-58	-356
SDR allocations	0	0	75	0	75	0
Errors and omissions	-212	-161	0	0	0	0
Overall balance	288	-338	235	135	129	60
Financing	-288	338	-235	-135	-129	-60
Gross official reserves (- increase)	-283	343	-393	-202	-263	-149
Use of IMF credit (+)	-5	-5	158	67	134	89
Financing need (- overfinancing)	0	0	0	0	0	0
Memoranda items:						
Current account balance (in percent of GDP)						
Including official grants	6.7	-14.0	-3.8	-16.1	-6.9	-10.3
Excluding Oyu Tolgoi	10.1	-10.3	-0.5	0.4	-1.2	3.5
Excluding official grants	3.3	-15.7	-7.0	-19.1	-10.3	-13.7
Gross official reserves (end-period)	1,001	657	1,050	1,252	920	1,068
(In months of imports of goods and services)	3.2	3.3	3.9	3.8	3.7	3.9
Copper price (in US$ per ton)	7,132	6,963	5,000	5,500	4,000	4,100
Oil price (in US$ per barrel)	71	97	62	77	58	70
Gold price (in US$ per troy oz.)	697	881	933	955	914	986

Sources: Mongolian authorities; and IMF staff projections.

Table 5. Mongolia: Selected Economic and Financial Indicators, 2007-16

			Proj.							
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
			(In percent of GDP; unless indicated otherwise)							
Real sector										
Nominal GDP (in billions of togrogs)	4,600	6,020	6,407	7,373	8,291	9,025	11,552	14,145	16,702	19,568
Per capita GDP (in US$) 1/	1,503	1,936	1,642	1,755	1,998	2,212	2,697	3,145	3,535	4,521
Real GDP growth (percent change)	10.2	8.9	-1.0	8.6	6.5	5.8	26.3	18.8	12.7	20.0
Mineral real GDP growth	2.9	-2.9	0.3	6.0	6.6	5.9	132.7	44.7	23.4	38.2
Nonmineral real GDP growth	12.2	11.9	-1.2	9.2	6.4	5.7	3.4	6.2	5.7	6.0
GDP deflator (percent change)	12.3	20.2	7.5	6.0	5.6	2.9	1.4	3.1	4.7	-2.3
Consumer prices (end-period; percent change)	14.1	23.2	2.0	6.0	6.0	5.0	5.0	5.0	5.0	5.0
Gross national savings	45.2	29.6	34.3	33.7	35.5	34.8	39.1	38.5	40.4	42.2
Gross national investment	35.4	40.3	35.1	47.1	54.2	50.1	32.7	33.0	34.7	34.1
General government accounts										
Total revenue and grants	40.9	36.1	30.7	33.0	29.5	29.6	24.8	23.8	23.6	26.7
Total expenditure and net lending	38.0	41.0	37.2	38.0	32.2	31.3	24.7	20.6	20.5	21.7
Primary balance	3.2	-4.6	-6.0	-3.6	-1.2	-0.4	2.9	5.9	5.1	6.4
Overall balance	2.8	-4.9	-6.5	-5.0	-2.7	-1.7	0.1	3.2	3.0	5.0
Nonmineral overall balance	-10.6	-15.1	-12.7	-12.2	-5.2	-4.6	-4.5	-3.3	-4.6	-6.4
			(In percent of nonmineral GDP)							
Total revenue and grants	57.6	46.2	39.1	42.2	37.5	37.1	40.1	44.8	48.6	60.2
Total expenditure and net lending	53.6	52.6	47.4	48.7	40.9	39.3	39.9	38.8	42.3	48.9
Primary balance	4.6	-5.9	-7.6	-4.7	-1.5	-0.4	4.7	11.1	10.5	14.5
Overall balance	4.0	-6.3	-8.3	-6.4	-3.4	-2.2	0.2	6.0	6.3	11.3
Nonmineral overall balance	-14.9	-19.4	-16.2	-15.6	-6.6	-5.7	-7.2	-6.2	-9.4	-14.5
Monetary sector										
Broad money (percent change)	55.6	-5.1	20.0	25.4	18.3	14.4	28.0	21.8	21.8	17.2
Velocity (GDP/M2)	1.9	2.7	2.4	2.2	2.1	2.0	2.0	2.0	1.9	1.9
Balance of payments										
Current account balance	6.7	-14.0	-3.8	-16.1	-21.2	-17.5	1.2	3.9	5.0	7.3
Excluding Oyu Tolgoi	10.1	-10.3	-0.5	0.4	2.7	0.8	-4.5	-3.4	-4.8	-6.6
Gross official reserves (in millions of US$)	1,001	657	1,050	1,252	1,368	1,369	1,787	2,149	2,688	3,367
(In months of next year's imports of goods and services)	3.2	3.3	3.9	3.8	4.2	4.9	5.8	6.2	6.3	6.8
Debt indicators										
Total public debt	39.4	33.9	51.6	70.8	69.0	67.1	54.0	45.6	37.7	25.7
Domestic public debt 2/	0.5	0.0	6.3	26.6	32.7	32.8	26.4	22.1	16.3	10.6
External public debt 3/	38.9	33.9	45.3	44.2	36.3	34.3	27.6	23.5	21.4	15.1
(In millions of US$)	1,529	1,610	1,937	2,082	2,120	2,105	2,098	2,113	2,194	2,340
Memorandum items:										
Copper prices (US$ per ton)	7,132	6,963	5,000	5,500	6,000	5,500	5,000	4,500	4,570	4,641
Gold prices (US$ per ounce)	697	881	933	955	975	1,000	1,025	1,050	1,066	1,083

Sources: Mongolian authorities; and IMF staff projections.

1/ Based on period average exchange rate.
2/ Includes the expected fiscalization cost of bank restructuring, the financing of the government's equity share in Oyu Tolgoi and the Oyu Tolgoi tax-prepayment.
3/ Includes prospective Fund credit under the SBA.

Table 6. 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 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 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 I

December 3, 2009

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 successfully stabilized market conditions, boosted international reserves, and lowered inflation. We have also signed a major international agreement to develop the Oyu Tolgoi mine which should sustain growth in Mongolia for years to come.

Our objective remains to achieve strong, sustainable, and equitable growth with low inflation and healthy public finances. In the coming months, we intend to press ahead with key reforms aimed at strengthening the banking system, restoring health to the budget, maintaining a flexible exchange rate, and shielding low income groups from the effects of the crisis. The attached Memorandum of Economic Policies (MEP) describes our macroeconomic policies for the remainder of 2009 and 2010.

Given the success to date of the program, and our observance of all end-September performance criteria, we request the completion of the third review. Quantitative targets and structural policies of our program are outlined in Tables 1 and 2. The fourth review is scheduled to take place on or after March 15, 2010 and the fifth review is scheduled to take place on or after June 15, 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 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

Attachments
Memorandum of Economic Policies
Revised Technical Memorandum of Understanding

MEMORANDUM OF ECONOMIC POLICIES

1. **Growth and inflation** We expect the economy to rebound from around zero growth this year to roughly 8 percent next year, spurred by investments that will accompany the development of the Oyu Tolgoi mine. The prospects for the medium term are favorable owing to the significant upswing in mineral exports once the Oyu Tolgoi project comes on stream in 2013. Inflation was -1.1 percent in October and is projected to reach 2 percent by December and below 8 percent at end-2010.

Fiscal Policy

2. **The 2009 fiscal targets**. Restoring heath to public finance remains our top priority. With the recovery in copper prices, we expect the 2009 deficit to be lower than the government's target of 6½ percent of GDP. We will, as planned, require the banks to repay the budget for the net lending to the gold mining sector that was undertaken earlier this year.

3. **The 2010 budget and beyond**. We are committed to limiting the 2010 budget deficit to 5 percent of GDP as in the budget passed by Parliament. If revenue comes in lower than projected in the budget, we will fully offset any shortfall with a reduction in spending to ensure that program deficit targets are achieved. On the other hand, if revenues exceed budget forecasts, we intend to save the additional revenues to help meet future financing needs and limit pro-cyclicality of spending. We intend to continue the process of fiscal adjustment after 2010 as we recognize the financing situation will become increasingly difficult in the coming years as donor budgetary support will be scaled down. In this regard, we will fully incorporate any advance payments we receive for the Oyu Tolgoi mining project in the budget as a financing item.

4. **Maintaining fiscal responsibility**. We will submit by end-December a Fiscal Responsibility Law to Parliament. The law will promote fiscal discipline by enhancing transparency, strengthening accountability, and establishing numerical rules that would limit the fiscal balance, government debt, and spending growth. A complementary organic budget law is under preparation. We plan to pass both laws by February 1, 2010.

5. **Protecting the poor**. A social transfer reform law will soon be submitted to Parliament that aims to better assist Mongolia's most vulnerable citizens by increasing the benefits to low income households. At the same time, modest fiscal savings will be generated through a significant improvement in the targeting of social transfers to ensure that resources go to the most needy groups. Implementation will be phased in over the coming year as we improve our capacity to carry out effective means-testing to target the poverty benefit. We appreciate the support of donors in preparing this reform, and will continue to work with the World Bank and Asian Development Bank on its implementation. We will pass this law by February 1, 2010.

Monetary and Exchange Rate Policies

6. **Exchange rate policy**. We remain fully committed to a flexible exchange rate to provide a shock absorber against terms of trade volatility and to safeguard international reserves. Our intervention strategy is guided by the goals of rebuilding international reserves and allowing the exchange rate to move in line with market conditions while smoothing excess volatility due to temporary imbalances. We will consult with Fund staff on the appropriate policy response if, during any 30 day period, our net sales in the foreign exchange auctions exceed US$30 million.

7. **Monetary policy.** Our primary objective for monetary policy continues to be oriented toward achieving and maintaining low inflation and macroeconomic stability. Inflation has decelerated sharply and we expect it to stay below 8 percent through 2010. This has created some scope for the central bank to lower policy interest rates in October and the central bank will continue to adjust interest rates prudently and in line with evolving market conditions and the inflation outlook.

Banking System Reforms

8. **Banks.** We are taking decisive action to bolster confidence in the banking system and ensure financial stability. We appointed a receiver to begin the process of liquidating Anod Bank. The government, by the end of this year, will fully reimburse the central bank for any resolution costs it has incurred. A receiver has also been appointed to Zoos Bank and an external audit has been initiated. External audits at other banks will start soon, and ten will be completed by end-January 2010. Public money may well be needed to restructure the banking system. If so, we will tie the injection of public funds to governance and structural reforms at the recipient bank. Such reforms would include changes in management; ensuring transparent, fit, and proper owner/managers of the bank; improving risk management systems; and strengthening lending practices. We are committed to responding proactively and vigorously to handle problems in individual banks, as they arise, and to maintain the stability of and confidence in the Mongolian banking system. In this regard, we will continue to enhance our supervision efforts and fully intend to enforce all existing regulatory requirements for all banks.

9. **Supervision.** A robust banking system is a top priority of the government, and enhancing supervision is an integral part of our strategy. Toward this end, we will improve the loan classification system for restructured loans, including by clarifying the definition, tightening the rules for upgrading, and requiring monthly reporting. The Banking Law was submitted to Parliament in October that aims to reinforce prudential requirements, strengthen legal protection of bank supervisors, and more clearly defines connected parties.

Other Policies

10. **External financing.** We are committed to prudently managing any further nonconcessional borrowing within program ceilings and we will maintain the current prohibition on government guarantees. We remain committed to resolving the remaining bilateral official arrears.

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

	12/31/2008	9/30/2009			12/31/2009		3/31/2010		6/30/2010	
	Actual	Prog.	Adjusted	Outcome	Prog.	Rev. Prog.	Prog.	Rev. Prog.	Prog.	Rev. Prog.
Performance criteria 1/										
Net international reserves (NIR) of the Bank of Mongolia (BOM) (floor, eop stock, in million US$) 2/	495	537	614	763	595	798	600	853	535	788
Net domestic asset (NDA) of the BOM (ceiling, eop stock, in billion togrog) 3/	-171	-302	-304	-618	-343	-542	-331	-618	-224	-491
Net credit to government (NCG) (ceiling, cumulative from the beginning of the fiscal year, in billion togrog) 3/	130	-69	-70	-150	64	58	87	100	227	242
New nonconcessional external debt maturing in one year or more, contracted or guaranteed by the government or the BOM (ceiling, eop stock since April 2009, in million US$).	0	200	…	100	200	200	200	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$).	0	0	…	0	0	0	0	0	0	0
Accumulation of new external payment arrears (ceiling, eop, in million US$).	…	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	315	…	333	405	416	125	136	200	216
Memorandum items:										
Support from bilateral and multilateral donors excluding IMF (cumulative since the beginning of the year, in million US$), program level.	0	112	…	113	147	174	20	20	40	40
Support from bilateral and multilateral donors excluding IMF (cumulative since April 2009, in million US$), program level.	0	112	…	113	147	174	167	194	207	234
Disbursed new nonconcessional external debt (eop stock, in million US$), program level.	…	75	…	75	75	75	75	75	0	0
Disbursed Oyu Tolgoi tax prepayment loans (eop stock, in million US$), program level.	…	…	…	0	…	100	…	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), 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 2nd review	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 comprehensive social transfer reform that saves money and protects the poor through better targeting.	12/1/2009	Delayed, passage expected by February 1, 2010.
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	In progress, FAD provided TA in July.

MONGOLIA—TECHNICAL MEMORANDUM OF UNDERSTANDING

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

1. Performance criteria for 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-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 cumulative since April 2009. The floor on NIR will be adjusted upward by the amount of nonconcessional borrowing disbursed in excess of the program level, with the exception of any amounts drawn under a swap arrangement with China. The NIR will also be adjusted upward (downward) by the amount of Oyu Tolgoi tax prepayment loans disbursed in excess (short) of the programmed level.

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;
- 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 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;
- any foreign convertible currency liabilities of the BOM to nonresidents with an original maturity of up to and including one year;
- commercial bank foreign currency deposits held at the BOM, commercial bank foreign currency current accounts held at the BOM, any foreign currency claims on residents.

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 cumulative since April 2009. The ceiling on NDA will be adjusted downward by the amount of nonconcessional debt disbursed during the program period, with the exception of any amounts drawn under a swap arrangement with China. The ceiling on NDA will also be adjusted downward (upward) by the amount of Oyu Tolgoi tax prepayment loans disbursed in excess (short) of the programmed level.

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 Domestic Credit to the General Government

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

16. **NCG** 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); (ii) net borrowing from commercial banks (loans, advances, holdings of restructuring bonds, and

holdings of treasury bills and other government bonds minus deposits); and (iii) net change in domestic government debt held by parties other than the BOM and commercial banks. NCG excludes government deposits lost or government debt (or other liabilities) issued to pay for the resolution of Anod Bank.

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. The principal costs of resolving Anod Bank are excluded from expenditure and net lending, but the corresponding interest payments are included. If gold mining loans on-lent to commercial banks are not fully repaid back to the government by end-2009, then the fiscal deficit indicative targets for (i) end-2009 will be adjusted upward by the amount of unpaid loans; and (ii) the end-June 2010 target will be adjusted downward by the amount of unpaid loans as of end-2009.

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 nonconcessional borrowing 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 and all such drawings, regardless of the duration, would be considered to have an original maturity of more than one year. Secondary market transactions of Oyu Tolgoi tax-prepayment loans with nonresidents are not considered external financing for the purpose of the program.

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; and (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 nonconcessional borrowing 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; (iv) normal import financing; and (v) amounts drawn under any swap arrangements with People's Bank of China. 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. Data Provision

29. 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.

30. 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.

INTERNATIONAL MONETARY FUND

MONGOLIA

Staff Report for the 2009 Article IV Consultation, Third Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria— Informational Annex

Prepared by the Asia and Pacific Department

December 7, 2009

Contents Page

ANNEX I. MONGOLIA—FUND RELATIONS

(As of October 31, 2009)

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

II.	**General Resources Account**:	**SDR Million**	**Percent Quota**
	Quota	51.10	100.0
	Fund Holdings of Currency	142.95	279.74
	Reserve Position in Fund	0.14	0.27

III.	**SDR Department**:	**SDR Million**	**Percent Allocation**
	Net cumulative allocation	48.76	100.00
	Holdings	49.09	100.67

IV.	**Outstanding Purchases and Loans**:	**SDR Million**	**Percent Quota**
	Stand-by Arrangements	91.98	180.00
	ESAF/PRGF Arrangements	8.73	17.09

V. **Latest Financial Arrangements**:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-by	04/01/2009	10/01/2010	153.30	91.98
PRGF	09/28/2001	07/31/2005	28.49	12.21
ESAF/PRGF	07/30/1997	07/29/2000	33.39	17.44
ESAF	06/25/1993	06/24/1996	40.81	29.68

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

	Forthcoming				
	2009	**2010**	**2011**	**2012**	**2013**
Principal		3.04	2.44	22.71	47.62
Charges/interest	0.29	1.22	1.20	1.16	0.71
Total	0.29	4.25	3.65	23.86	48.32

VII. **Safeguards Assessments**:

An update safeguards assessment of the Bank of Mongolia (BOM), conducted with respect to the Stand-by Arrangement approved in April 2009, was finalized on June 17, 2009. Previous safeguards assessments were completed in March 2002 and November 2003. The 2009 update assessment found that the BOM has continued to improve its safeguards framework since the 2003 assessment. The BOM's financial reporting and audit practices generally comply with international standards. However, some aspects of the oversight mechanism should be strengthened and certain external audit scope limitations removed.

VIII. **Exchange Arrangement**:

On May 27, 1993, Mongolia moved from a fixed exchange rate against the U.S. dollar to a floating exchange rate system. The *de jure* exchange rate arrangement is floating. BOM's official exchange rate is the midpoint of the previous days' average buying and selling rates of transactions in the interbank market and transactions between banks and their clients. The official rate is announced each weekday except for national public holidays, and the BOM reserves the right to intervene in the foreign exchange market. Effective February 2, 2009, the classification of the *de facto* exchange rate arrangement has been changed from a conventional pegged arrangement to a stabilized arrangement, retroactively to April 30, 2008, due to the revision of the classification methodology. This change reflects only a methodological modification and does not imply a judgment that there has been a substantive alteration in the country's exchange arrangement or other policies. Due to rapid currency depreciation between October 2008 and February 2009, the exchange rate arrangement was reclassified to "other managed arrangement" from a stabilized arrangement as of November 1, 2008. On March 24, 2009, the BOM instituted a foreign exchange auction allowing the determination of the exchange rate mainly by market forces and therefore, effective March 24, 2009, the de facto exchange rate arrangement has been reclassified to floating.

Mongolia accepted the obligations of Article VIII, Sections 2, 3, and 4 on February 1, 1996. Mongolia imposes two multiple currency practices (MCPs) subject to Fund jurisdiction. First, the modalities of the multi-price auction system give rise to an MCP 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. Second, 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 and infrastructure that ensure that the official rate does not deviate by more than 2 percent from the commercial rate also gives rise to an MCP (Country Report 09/254 08/14/2009). Further progress is needed to develop the screen-based system which enables the Bank of Mongolia to trade at spot exchange rates. The Bank of Mongolia intends to institute and introduce the screen-based system in the inter-bank market by March 31, 2010. The Executive Board approved the multi-price auction MCP until June 22, 2010 (Decision No. 14365 of June 23, 2009). Mongolia imposes exchange restrictions for security reasons in accordance with United Nations Security Council

Resolution No. 92/757 concerning certain transactions with the Federal Republic of Yugoslavia (Serbia and Montenegro) that have been notified to the Fund under Decision 144 (11/4/94).

IX. **Article IV Consultation**:

The 2008 Article IV consultation (IMF Country Report No. 08/200) was concluded by the Executive Board on June 4, 2008. Mongolia is on the 12–month cycle.

X. **ROSC Assessments**:

- Data Dissemination, May 2001 (www.imf.org)
- Fiscal Transparency Module, November 2001 (Country Report No. 01/218)
- Fiscal update, May 2005 (www.imf.org)
- Data Dissemination, April 2008 (www.imf.org)
- Monetary and Fiscal Policy Transparency, September 2008 (www.imf.org)
- Banking Supervision, September 2008 (www.imf.org)

XI. **Recent Financial Arrangements**:

An 18- month Stand-by Arrangement in an amount of equivalent to SDR 153.3 million (300 percent of quota) was approved on April 1, 2009. The first review was completed on June 23, 2009, and the second was completed on September 21, 2009.

A three-year arrangement under the Enhanced Structural Adjustment Facility (ESAF) in an amount equivalent to SDR 40.81 million (80 percent of quota), with a first annual arrangement in an amount of SDR 18.55 million (36.3 percent of quota), was approved on June 25, 1993. The second annual arrangement in an amount of SDR 11.13 million (21.8 percent of quota) was approved on November 23, 1994. The ESAF arrangement lapsed on June 24, 1996.

A three-year arrangement under the ESAF/PRGF in an amount equivalent to SDR 33.4 million (65.4 percent of quota), with a first annual arrangement in an amount of SDR 11.13 million (21.8 percent of quota), was approved by the Executive Board on July 30, 1997. The first year arrangement lapsed on July 30, 1998. The second annual arrangement of SDR 14.8 million (29 percent of quota) was approved on June 16, 1999. The first review under that arrangement was completed in January 2000 and the arrangement lapsed on June 15, 2000. The ESAF/PRGF arrangement lapsed on July 29, 2000.

A three-year arrangement under the PRGF in an amount equivalent to SDR 28.49 million (55.8 percent of quota), with the first year of the arrangement in an amount of SDR 12.21 million (23.9 percent of quota), was approved by the Executive Board on September 28, 2001. The first and second review under the PRGF was completed on September 12, 2003, and the Executive Board approved the extension of the PRGF through July 31, 2005. The arrangement expired on that date without the completion of the third and subsequent reviews.

XII. **FSAP Participation**:

Mongolia participates in the Financial Sector Assessment Program (FSAP). The first and second FSAP missions took place in May 2007 and September 2007 respectively, and the latest report (IMF Country Report No. 08/300) was published in September 2008.

XIII. **Technical Assistance**:

Missions:

- External Sector Statistics (STA), November 2009
- Banking Restructuring (MCM), October-November 2009
- Monetary and Financial Statistics (STA), September 2009
- Supervisory and Regulatory Capacity Building of the FRC (MCM), February, April, and September 2009
- Bank Restructuring (MCM), August 2009
- Budget Preparation and Budget Legal Reforms (FAD), January, June, and July 2009
- Foreign Exchange Market and Monetary Policy (MCM), May 2009
- Foreign Exchange Market (MCM), March 2009
- Fiscal Expenditure Review (FAD), January 2009
- Operational Framework of Monetary Policy (MCM), December 2008
- Supervisory and Regulatory Capacity Building of the FRC (MCM), September, November, and December 2008
- Banking Supervision and Accounting Framework (MCM), November 2008
- Budget and Legal Reforms (FAD), October 2008
- External Sector Statistics (STA), October 2008
- Real sector Statistics (STA), August 2008
- Monetary and Financial Statistics (STA), June 2008
- Budget Preparation (FAD), February–March 2008
- Budget Preparation (FAD), February 2008
- Bank Supervision (MCM), February 2008
- Enhancing Foreign Exchange Market (MCM), February 2008
- Monetary Operations (MCM), January 2008

- Real Sector Statistics (STA), November–December 2007
- Poverty and Social Impact Analysis (FAD), December 2007
- Measures to Combat Money Laundering and the Financing of Terrorism (LEG), December 2007
- ROSC Data Module (STA), October 2007
- Fiscal Affairs Department Scoping Mission (FAD), September 2007
- Real Sector Statistics (STA), June–July, 2007
- International Market Access (MCM), May 2007
- Bank Supervision and Reserves Management (MCM), April 2007
- Real Sector Statistics (STA), March–April 2007
- Government Finance Statistics (STA), March–April 2007
- Fiscal Regime for the Mining Sector and the Development Fund (FAD), January 2007
- Government Finance and Monetary and Financial Statistics (STA), September 2006
- Improving Banking Supervision and Reserve Management (MCM), September 2006
- Value Added Tax, Income Tax and Excise Tax Legislation (LEG), August 2006
- Cooperation between Mongolia's NSO and STA, May 2006
- Management Structure of the Bank of Mongolia (MFD), April 2006
- Monetary and Financial Statistics (STA), October 2005
- Banking Supervision and Payment Systems (MFD), June 2005
- Options for Expenditure Savings and Efficiency Improvements (FAD), January 2005
- Banking Supervision and Prudential Framework (MFD), October 2004
- Reforms of Tax Policies (FAD), October 2004
- Government Finance Statistics (STA), August 2004
- Balance of Payments Statistics (STA), July–August 2004
- Banking Supervision and Prudential Framework, (MFD), May–June 2004
- AML/CFT Action Plan and Legislative Awareness, May 2004
- Banking Supervision and Accounting (MFD), October 2003
- Government Finance Statistics (STA), August 2003
- AML/CFT (MFD), June 2003
- Banking Supervision and Accounting (MAE), November 2002
- Revenue Administration (FAD), September 2002
- Banking Supervision and Accounting (MAE), May 2002
- Review of Treasury and Intergovernmental Fiscal Reforms (FAD), August 2001
- Banking Supervision and Accounting (MAE), May–June 2001
- Money and Banking Statistics (STA), May 2001

- Government Finance Statistics (STA), March 2001
- Fiscal Transparency and ROSC (FAD), March 2001
- Intergovernmental Fiscal Relations and Budget Reform (FAD), January 2001
- Visits by MAE Peripatetic Experts on Banking Supervision, Payments System, Monetary Policy, and Accounting and Audit, November 2000
- Consumer Price Statistics (STA), September–October 2000
- ROSC Data Module (STA), May 2000
- Restructuring Bonds and Other Securities (MAE), March 2000
- National Accounts Statistics (STA), February 2000

Resident Advisors:

- Budget Planning (FAD), June 2009–June 2010
- National Accounts Statistics (STA), August 2001–September 2003
- Treasury Reform (FAD), June 1999–November 2003
- Balance of Payments (STA), March 1999–May 2001

Technical assistance for the period May 1995–October 1999 is reported in Annex II of the staff report for the 1999 Article IV consultation.

XIV. **Resident Representative**:

Mr. Parmeshwar Ramlogan has been the Fund's resident representative in Mongolia since August 2009.

ANNEX II. MONGOLIA—RELATIONS WITH THE WORLD BANK GROUP[1]

Mongolia became a member of the World Bank Group in February 1991. Bank lending to Mongolia, currently on IDA-only terms, represents about 11 percent of the country's overall official development assistance flows. Given the economic downturn, an Interim Strategy Note (ISN) was prepared and endorsed by the World Bank Board in May 2009. The ISN provides a bridging framework for assistance over an 18-month period. As conditions stabilize and there is a clearer planning horizon, it is anticipated that a four-year Country Partnership Strategy (CPS) will be prepared, supporting Mongolia's medium-term agenda.

The ISN positions the Bank to support the Government's immediate crisis response and ease the fiscal adjustment, but also to support renewed efforts to make reforms that will improve the medium-term management of the country's mineral-based economy. In particular, the ISN focuses the World Bank Group assistance program on three strategic areas:

- Improving macro and fiscal sustainability in a mineral-based economy;
- Protecting the poor and vulnerable; and
- Encouraging transparent and prudent mining investments and a more competitive and stable medium-term business investment climate.

In light of governance concerns, mechanisms to promote greater accountability and transparency, including a more informed and inclusive policy dialogue, will be promoted throughout the program. To provide this support, the Bank Group is adapting its program to respond to evolving needs. The ISN program has the following features:

- Ongoing IDA projects and technical assistance activities have been being refocused to build capacity in crisis management and support medium-term policy reforms as part of the donor-supported stabilization package. For instance, to assist with the fiscal reform agenda, an existing TA project is financing IMF-supervised consultants.

- The majority of new IDA resources have been shifted from previously planned investment projects to development policy credits (DPCs). Two DPCs totaling around SDR 40 million and representing two-thirds of the notional IDA-15 envelope (SDR 60 million), will support key policy reforms in the three strategic areas outlined above and provide budgetary support to help fill the fiscal financing shortfall. A first DPC of SDR 27 million was approved in late June 2009. The second DPC is planned for June 2009. Remaining IDA resources will support TA and investment operations determined to have a high impact on the above strategic priorities.

[1] Prepared by World Bank Staff.

- The Bank Group's analytical and advisory program is intensifying its emphasis on just-in-time policy advice and analytical products to respond to the crisis. Ongoing technical assistance is being re-aligned to emerging needs, particularly in the financial sector.

- The Bank currently administers approximately $32 million of grant trust funding supporting education reform, sustainable livelihoods, environmental improvements, public administration, and governance enhancement. To meet emerging priority needs, additional trust fund resources are being sought for high impact activities.

- Strong emphasis on joint work and close coordination with the IMF, AsDB, Japan, and other external partners.

With this broad framework, the World Bank's main sectoral activities include:

- *Public Sector Management and Governance*. The Bank, in partnership with the IMF, is working with the government to strengthen its public financial management framework through a combination of analytical advice and technical assistance projects including the ongoing Economic Capacity Building Technical Assistance and Governance Assistance projects.

- *Financial Sector*. The World Bank Group has actively supported capacity building and reforms in the financial sector with an emphasis on strengthening banking supervision and credit risk management capacity of commercial banks. The Bank, together with the IMF and other development partners, is now actively engaged with the Bank of Mongolia and the Government to address emerging problems in the financial sector. The IFC is also playing a significant role in the World Bank Group's investments and transactions in the Mongolian financial.

- *Mining Sector*. A Mining Technical Assistance project is providing support to the government in establishing key pieces of the policy, fiscal, legal, regulatory, and institutional framework for the mining sector, in cooperation with the IMF, AsDB, GTZ and EBRD.

- *Rural Sustainable Development*. The Bank Group is building on a long-term package of assistance for rural populations focused on scaling up and institutionalizing successful approaches from ongoing projects. These include projects to reduce vulnerability of herders, provide basic social infrastructure investment, enhance access to rural financial and ICT services, and improve environmental management.

- *Social Sectors*. The World Bank is active across a range of social sectors, including on pensions and on social welfare/transfer schemes (in partnership with the AsDB), education and labor markets. A new Poverty Assessment is also underway, based on new 2007/08 household survey data.

- Other sectors in which the Bank is engaged in Mongolia through investment lending, technical assistance or analytical work include private sector development, urban sustainable development, infrastructure and judicial and legal reforms.

The **International Finance Corporation** (IFC) will continue to address weaknesses in the financial and real sectors through investment and advisory service programs. This work includes: (i) strategies to assist investment clients with liquidity; (ii) developing the nonbank financial sector including leasing; and (iii) providing training to help banks through the crisis, such as best practices in NPL management and corporate governance. Where feasible, Mongolia will participate in IFC initiatives aimed at helping developing countries address private sector crisis-related problems, for example to support microfinance institutions, relieve liquidity stress, expand trade financing, and provide banks with skills to help them cope with the crisis.

The **Multilateral Investment Guarantee Agency** (MIGA) would be able to supplement the work of the Bank and the IFC by offering its guarantee products in support of private investment into the country.

ANNEX III. MONGOLIA—RELATIONS WITH THE ASIAN DEVELOPMENT BANK[2]

Mongolia became a member of the Asian Development Bank (AsDB) in February 1991. In line with AsDB's poverty reduction strategy, AsDB entered into a Poverty Partnership Agreement (PPA) with the Government of Mongolia in 2000. Within the framework of the PPA, in October 2005, AsDB formulated its Country Strategy and Program (CSP) for 2006−08.

AsDB has been a leading development partner in Mongolia, which is eligible for, and borrows from AsDB's concessional Asian Development Fund (ADF) resources. AsDB allocates its concessional special fund resources to eligible member countries, including Mongolia, based on an annual country performance assessment. The assessment focuses on indicators of sustainable economic growth, socially inclusive development, governance and public sector management, and portfolio performance.

AsDB has provided loans for 39 projects totaling $705.1 million in the agriculture, education, energy, financial, health, industry, telecommunications, transport, and urban development sectors as of August 31, 2009. AsDB has also approved and implemented 145 technical assistance projects for Mongolia totaling $71.4 million. Grants funded by Japanese special funds (Japan Fund for Poverty Reduction, and Japan Fund for Information, Communication and Technology total $28.6 million and have been increasing in recent years. Four JFPR projects, totaling $8 million, and two amounting to $4.0 million, were approved in 2008 and so far in 2009, respectively.

Mongolia became eligible for 100 percent ADF grant financing for the period 2007–08. Six grant projects and one grant program, totaling $105.2 million, were approved during this period. The total active loan and grant portfolio as of August 31, 2009 consists of 12 loans amounting to a net total of $219.5 million and seven grants totaling $105.2 million.

Since late 2008, AsDB has worked with the government to formulate a response to the global economic crisis, in close cooperation with other development partners. When the economic crisis struck, the new CPS 2009–13 was at an advanced stage of preparation. AsDB and the government agreed to postpone finalization of the CPS until the economy had stabilized and implementation of the government's medium-term plans resumed. For the meantime, the Country Operations Business Plan 2009–12 has been prepared, which is specifically designed to the challenges posed by Mongolia's deteriorating economic environment.

Mongolia's 2009–10 country ADF allocation was set at $91.1 million, of which half has been made available as grants. An additional $27.9 million was made available from the resources

[2] Prepared by Asian Development Bank staff.

identified to address the global financial crisis. Three regional projects have also been included in the program for a total amount of $56.0 million. For 2009, AsDB provided a $60 million Social Sector Support Program (SSSP). The Program is cofinanced by the Japan International Cooperation Agency, under a parallel cofinancing arrangement, for an amount of $50 million. The SSSP will assist the government to protect and improve the efficiency and effectiveness of social sector outlays geared to the needs of the poor, while providing a program loan and grant to supplement the assistance provided by the IMF and other development partners.

ANNEX IV. MONGOLIA—STATISTICAL ISSUES

Data provision to the Fund is adequate for surveillance, but further improvements are needed, especially on national accounts and government finance statistics. There is also a need for broadening the dissemination of macroeconomic data to the public. Mongolia participates in the General Data Dissemination System (GDDS). A data ROSC mission visited Mongolia in September 2007 to update the May 2000 assessment of the macroeconomic statistics against the GDDS, complemented by an assessment of data quality based on the IMF's Data Quality Assessment Framework.

The IMF Statistics Department has provided support to the National Statistics Office (NSO) in implementing its Program of Statistics Development for 2006–10. It aimed to strengthen the statistical capacity in conformity with the GDDS plans for improvement and to place Mongolia in a position to subscribe the Special Data Dissemination Standard.

On national accounts and price statistics, deficiencies persist in the annual and quarterly production accounts that detract from the accuracy of the data, including the estimation of capital formation and deflators to derive constant price estimates of GDP. While a proper methodological treatment of animal losses due to harsh winters has been finalized, efforts are needed to improve coverage of the informal sector and small-scale activity, especially in the services sector. Furthermore, the construction of expenditure-based national accounts in constant price terms would serve as a useful check for the production side estimates. Experimental estimates, requiring some further refinements, were produced in August 2008. The first real sector technical assistance mission following the September 2007 ROSC took place in November 2007, and the final mission in August 2008.

The consumer price index (CPI) was rebased in January 2008 with expenditure-derived weights from the 2005 Household Income and Expenditure Survey . The NSO has published a national CPI for Ulaanbaatar and 21 aimags (provinces) since January 2008, and a housing price index since October 2008. Progress is still needed on wages and earnings data. The August 2008 mission reviewed the CPI and provided the appropriate worksheets to address some issues. Development of the producer price index for mining, manufacturing, and electricity is complete. A retail price index and a construction index were under development in 2008.

The concepts and definitions used to compile fiscal statistics generally follow the guidelines of the *GFSM 1986*. No formal decision has yet been taken on adopting a migration path to the *GFSM 2001* methodology, although the new framework is planned to be used for compiling fiscal statistics. The classifications used for sub-annual and annual fiscal statistics follow broadly the classifications of the *GFSM 1986*, but with some differences for financing.

Monetary and financial statistics broadly conform to the concepts and definitions of the *MFSM* methodology. The Bank of Mongolia's (BOM's) monetary survey covers the central bank and 16 operating commercial banks, but excludes savings and credit unions, which increasingly compete with commercial banks in collecting deposits from households. The September 2006 STA mission recommended actions aimed at correcting misreporting of government deposit data by commercial banks. The June 2008 mission recommendations include extending the coverage of monetary statistics to include savings and credit unions as depository corporations and collecting supplementary data, such as repurchase agreements, accrued interest, and financial derivatives, from commercial banks. The September 2009 mission provided recommendations to reconcile the BOM and the Ministry of Finance data on government financing, and finalized the standardized report forms for the BOM and other depository corporations for the *International Financial Statistics* publication. The mission also recommended to include data on nonbank financial institutions (microfinance companies) in the compilation of financial corporations survey.

Regarding balance of payments statistics, the BOM follows the concepts and methods in the Balance of Payment Manual fifth edition. The BOM has started disseminating the balance of payments according to the IMF standard presentation table and the international investment position from the third quarter of 2009. The coverage has been widened by extending the International Transaction Reporting System (ITRS) to nonbank financial institutions and by increasing the number of direct reporting private enterprises as a result of the semi-annual external sector statistics seminar. Further improvement is needed in the analysis of balance of payments and the quarterly survey on direct investment of foreign investment enterprises.

As regards dissemination, the NSC publishes monthly and annual *Statistical Bulletins* in English and Mongolian. These publications include data on population, employment, national accounts, prices, household income and expenditure, central and local government revenue and expenditure, and external trade. The BOM publishes an *Annual Report* and a monthly *Statistical Bulletin*, which includes summary statistics for the central bank, consolidated balance sheet for commercial banks, and interest and exchange rate data.

Mongolia—Table of Common Indicators Required for Surveillance

As of October 31, 2009

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange rates	10/31/09	10/31/09	D	M	D
International reserve assets and reserve liabilities of the Monetary Authorities[1]	10/31/09	10/31//09	D	M	M
Reserve/base money	9/2009	10/20/09	M	M	M
Broad money	9/2009	10/20/09	M	M	M
Central bank balance sheet	9/2009	10/20/09	M	M	M
Consolidated balance sheet of the banking system	9/2009	10/20/09	M	M	M
Interest rates[2]	9/2009	10/20/09	M	M	M
Consumer price index	9/2009	10/20/09	M	M	M
Revenue, expenditure, balance and composition of financing[3] – general government[4]	9/2009	10/20/09	M	M	M
Revenue, expenditure, balance and composition of financing[3]– central government	9/2009	10/20/09	M	M	M
Stocks of central government and central government-guaranteed debt[5]	2008	2/2009	A	A	A
External current account balance	Q2 2009	8/2009	Q	Q	Q
Exports and imports of goods	9/2009	10/20/09	M	M	M
GDP/GNI	2008	1/2009	A	A	A
Gross external debt	2008	2/2009	A	A	A

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.

[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I), Not Available (NA).

Annex V. Mongolia—Millennium Development Goals

	1995	2000	2005	2008
Goal 1: Eradicate extreme poverty and hunger				
Employment to population ratio, 15+, total (percent)	53	51	52	52
Employment to population ratio, ages 15-24, total (percent)	42	39	36	35
GDP per person employed (annual percent growth)	2	-1	7	8
Income share held by lowest 20 percent	7.4	7.5	7.2	..
Malnutrition prevalence, weight for age (percent of children under 5)	...	11.6	5.3	...
Poverty gap at $1.25 a day (PPP) (percent)	5	4	6	...
Poverty headcount ratio at $1.25 a day (PPP) (percent of population)	19	15	22	...
Prevalence of undernourishment (percent of population)	40	..	29	...
Vulnerable employment, total (percent of total employment)	...	57	60	...
Goal 2: Achieve universal primary education				
Literacy rate, youth female (percent of females ages 15-24)	...	98	97	97
Literacy rate, youth male (percent of males ages 15-24)	...	97	94	94
Persistence to last grade of primary, total (percent of cohort)	...	89	84	84
Primary completion rate, total (percent of relevant age group)	71	87	93	110
Total enrollment, primary (percent net)	...	93	91	98
Goal 3: Promote gender equality and empower women				
Proportion of seats held by women in national parliaments (percent)	8	8	7	4
Ratio of female to male enrollments in tertiary education	...	179	162	156
Ratio of female to male primary enrollment	104	104	102	102
Ratio of female to male secondary enrollment	...	123	113	111
Share of women employed in the nonagricultural sector (percent of total nonagricultural employment)	47.9	50.4	53.1	...
Goal 4: Reduce child mortality				
Immunization, measles (percent of children ages 12-23 months)	85	92	97	98
Mortality rate, infant (per 1,000 live births)	61	49	39	35
Mortality rate, under-5 (per 1,000)	82	63	48	43
Goal 5: Improve maternal health				
Adolescent fertility rate (births per 1,000 women ages 15-19)	11	10	14	17
Births attended by skilled health staff (percent of total)	..	97	99	99
Contraceptive prevalence (percent of women ages 15-49)	65	67	66	66
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	..	46	...
Pregnant women receiving prenatal care (percent)	...	97	99	99
Unmet need for contraception (percent of married women ages 15-49)	...	...	14	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases				
Children with fever receiving antimalarial drugs (percent of children under age 5 with fever)	...	...	...	...
Incidence of tuberculosis (per 100,000 people)	205	205	205	205
Prevalence of HIV, total (percent of population ages 15-49)	...	...	0.1	0.1
Tuberculosis cases detected under DOTS (percent)	8	61	78	76
Goal 7: Ensure environmental sustainability				
CO_2 emissions (kg per PPP $ of GDP)	2.3	1.7	1.3	...
CO_2 emissions (metric tons per capita)	3.5	3.1	3.4	...
Forest area (percent of land area)	7	7	7	...
Improved sanitation facilities (percent of population with access)	47	48	50	50
Improved water source (percent of population with access)	65	68	72	72
Nationally protected areas (percent of total land area)	...	...	13.9	13.9
Goal 8: Develop a global partnership for development				
Aid per capita (current US$)	92	91	86	87
Debt service (PPG, percent of exports, excluding workers' remittances)	10	6	3	2
Internet users (per 100 people)	0	1	11	12
Mobile cellular subscriptions (per 100 people)	0	6	22	35
Telephone lines (per 100 people)	3	5	6	6

Source: World Bank, World Development Indicators database.

ANNEX VI. MONGOLIA—MAIN WEBSITES OF DATA

National Statistics Office (www.nso.mn)

- National Accounts
- Consumer Price Inflation
- Agricultural and Industrial Production
- Petroleum Imports
- Electricity Production and Consumption
- Coal Production
- Retail Prices
- Employment
- Exports and Imports

Bank of Mongolia (www.mongolbank.mn)

- Monetary Survey
- Consolidated Balance Sheet of Commercial Banks
- Distribution of Bank Credit to the Nongovernment Sector
- Net Credit to Government
- Interest Rates
- Balance of Payments
- Services and Income Accounts
- Official Reserves of the Bank of Mongolia
- Selected Indicators of Commercial Bank Foreign Exchange Operations
- Nominal and Real Exchange Rates
- Securities Market Data
- Government Budget Accounts

Ministry of Finance (www.mof.gov.mn)

- Government Budgetary Operations

INTERNATIONAL MONETARY FUND

MONGOLIA

Debt Sustainability Analysis under the Debt Sustainability Framework for Low-Income Countries[1]

Approved by Nigel Chalk and Dhaneshwar Ghura

December 7, 2009

Based on the external Debt Sustainability Analysis (DSA) Mongolia's risk of debt distress remains low.[2] Although the debt ratios will rise significantly over the next two years with the government receiving front-loaded foreign financing, the debt outlook is expected to recover and improve over the medium term. The public DSA suggests that in light of the signing of the Oyu Tolgoi mining agreement, domestic debt is expected to rise significantly in the medium term. However, risks are mitigated by the future associated mineral revenues starting in 2013 and do not lead to a different sustainability assessment than under the external DSA.

A. Background

1. **This update reflects new information regarding the recently signed Oyu Tolgoi mining agreement and its impact on the short-, medium-, and long-term outlook.** This update assumes that maintaining prudent macroeconomic and structural policies, including establishing a fiscal framework to avoid pro-cyclical policies, will be key for Mongolia to resume sustainable growth. Specifically, in light of tight financing conditions in the coming years, there is little choice but to continue fiscal adjustment until revenues from the Oyu Tolgoi mine, net of amortization, start to hit the budget (around 2016). Good macroeconomic policies will also help avoiding the "resource curse" which will represent a major challenge.

2. **The nonconcessional debt limit under the program is linked with the debt sustainability analysis.** The program includes a 35 percent minimum concessionality requirement but with added flexibility on nonconcessional external debt.[3] Under this ceiling

[1] This is a Fund staff update to the joint World Bank/IMF DSA presented in the report for the request for SBA (Country Report No. 09/130). The fiscal year for Mongolia is January-December.

[2] Mongolia is rated as a medium performer based on the 2008 World Bank's Country Performance and Institutional Assessment Index and the debt sustainability uses the indicative threshold indicators for countries in this category.

[3] Due mainly to the nonconcessional nature of the SBA, the average grant element of total new borrowing falls to 24–27 percent in 2009–10.

US$100 million have been used, of which $75 million have been disbursed for gold operation financing and which are expected to be fully repaid in 2010.

B. Developments in 2009

3. **This year was marked by the signing of the Oyu Tolgoi investment agreement.** Economic activity has slowed more than expected in 2009, but a sharp rebound is projected, driven largely by capital expenditures related to the Oyu Tolgoi mine. In addition, copper prices are rebounding, mainly driven by renewed Chinese demand, and are projected to be 20 percent higher on average over the medium term and 4 percent in the long-term than projected in the SBA request.

4. **Several other major mining projects are being explored which could further improve the outlook.** The Tavan Tolgoi deposit, close to the border with China, could transform Mongolia into a major world coal producer. Other investment projects are being considered to tap into Mongolia's vast mineral resources.

5. **Domestic debt will increase due to borrowing agreements signed with the mining conglomerate.** The government will borrow US$250 million for budget financing and around $540 million to finance its 34 percent equity share in the project. As both loans will be contracted from a resident company, their impact is reflected in the public DSA. The advance payments for the Oyu Tolgoi project will be saved in 2010 in order to meet the 2011 financing needs and beyond.[4]

6. **The banking system's financial position has been deteriorating.** Costs associated with the restructuring will be fiscalized through the issuance of government bonds in 2009–10 at an estimated 8 percent of GDP. The injection of public funds will be tied to governance and structural reforms.

C. Medium-Term Macro and DSA Assumptions

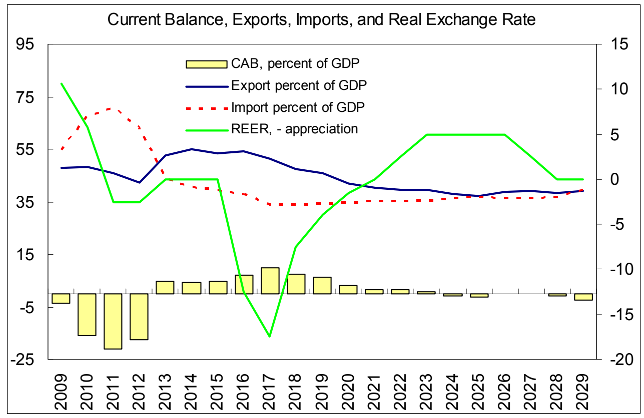
7. **Compared to the previous DSA, the macroeconomic outlook has improved, supported by Mongolia's strong policy implementation under the SBA-supported program.** Market conditions have improved and monetary policy has brought down inflation and rebuilt international reserves with comfortable margins compared to program objectives. In addition, copper prices have been buoyed by restocking in China. Short-term prospects depend on the speed of economic recovery in China, the main recipient of Mongolian exports, and in the rest of the world.

[4] These loans are expected to be repaid in 2014–17. The advance payment loans will be repaid from the general budget while government's equity share borrowing will be repaid from accrued dividends (the government will not be liable for the loan in the unlikely event that dividends are insufficient).

Mongolia—Macroeconomic Assumptions

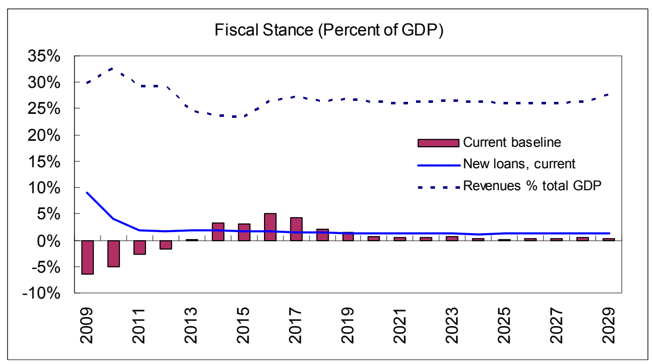
The baseline macroeconomic framework includes the 2009-10 fiscal consolidation and assumes that the economy will be underpinned by the Oyu Tolgoi project.

- **The real GDP growth** outlook is dominated by the Oyu Tolgoi mine. Real growth is expected to bottom-out in 2009 at -1 percent and to rebound to over 8 percent in 2010, boosted by Oyu Tolgoi-related capital expenditures. Once production from the Oyu Tolgoi mine starts in 2013, it will boost growth up to 25 percent. Real GDP growth is expected to average 11 percent over the medium term, taking into account the impact on the nonmineral economy.



- **The balance of payments** will go through large swings. The current account will remain in deficit until 2012 due to large imports of mining-related investment goods. As the project comes on stream, it will jump into a surplus in 2013 and, as the project tapers off, converge to a surplus of 1 percent of GDP by 2029.

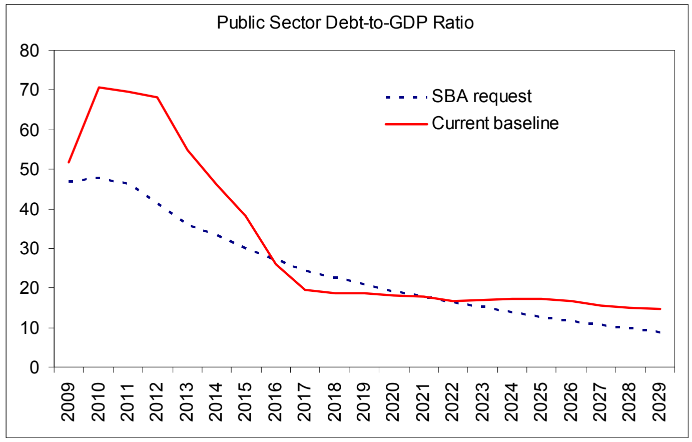
- After a period of consolidation **the overall fiscal deficit** is expected to converge to a new equilibrium. Fiscal revenues will be boosted by the project and are expected to reach 60 percent of nonmineral GDP in 2016. In the medium term, fiscal revenues are projected to gradually converge to 25 percent of overall GDP. The Fiscal Responsibility Law will reduce pro-cyclicality by restraining expenditure growth during periods of high mineral revenues and enable the authorities to save a substantial fraction of mineral revenues.



8. **The baseline assumes a strong institutional framework and macroeconomic policies to minimize Dutch disease effects.** Following the surge in mining production from the Oyu Tolgoi mine, Mongolia will likely experience a substantial real appreciation creating challenges to maintaining low inflation and developing the nonmineral economy. The baseline assumes a restrained fiscal policy, supported by the adoption of a Fiscal Responsibility Law, and a flexible exchange rate so that real exchange rate pressures feed though the nominal exchange rate. Finally, it assumes that structural fiscal reforms including pensions, civil service, and subsidy reforms will contribute to improve the business climate and the overall competitiveness of the economy. The authorities have made progress in becoming Extractive Transparency Industry Initiative (EITI) compliant by next year.

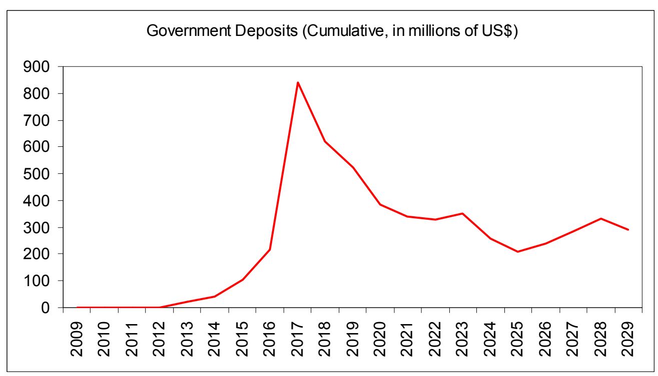
D. External and Public Debt Sustainability Analysis

9. **Mongolia's external risk of debt distress remains low (Figure. 1).** External debt ratios will remain broadly in line with the previous DSA over the medium term. Conversely, comparing the previous baseline debt ratios using the same respective PV of debt does not show a substantial difference. The one-off borrowing in 2009–10 will lead to a temporary but significant increase in the level of public debt but will fall rapidly in 2012–14. The debt service-to-exports and debt service-to-revenues ratios will peak in 2011–12 but will stay below the threshold. Pursuing fiscal adjustment in the period before the mining project comes into stream will be key.



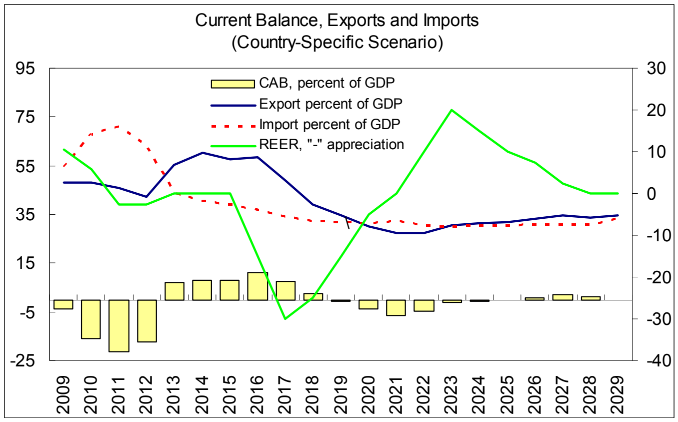
10. **Stress testing** shows that a one-time 30 percent exchange rate depreciation relative to the baseline in 2010 would breach the threshold over the 2010-12 period. However, with the Oyu Tolgoi mine starting production in 2013, the adverse effects of the depreciation would be gradually unwound. The exceptional access under the SBA and the broad program framework have bolstered international reserves and restored confidence in the currency making the probability of a depreciation of this magnitude relatively low.

11. **The risks for fiscal sustainability have increased over the medium term but remain low (Figure 2).** The baseline includes (i) fiscalization of the banking sector losses through domestic bond issuances, and (ii) loans to the government from the local mining company for acquiring the government's equity share and a pre-payment on future revenues. However, the government will receive dividends from its 34 percent equity share and government deposits are expected to increase providing a comfortable fiscal reserve cushion.



E. Country-Specific Alternative Scenario[5]

12. **The scenario assumes a more sizable real appreciation than the baseline.** When mineral revenues start materializing they will create macroeconomic challenges. This scenario assumes that fiscal policy is loose and mining revenues are fully spent over the medium to long term. Monetary policy can only counteract inflationary pressures resulting from the fiscal expansion by allowing the nominal exchange rate to adjust. Hence, the scenario assumes a significant real exchange rate appreciation and a deterioration in the current account balance over the long term. However, this country-specific alternative scenario does not result in indicators significantly breaching thresholds.

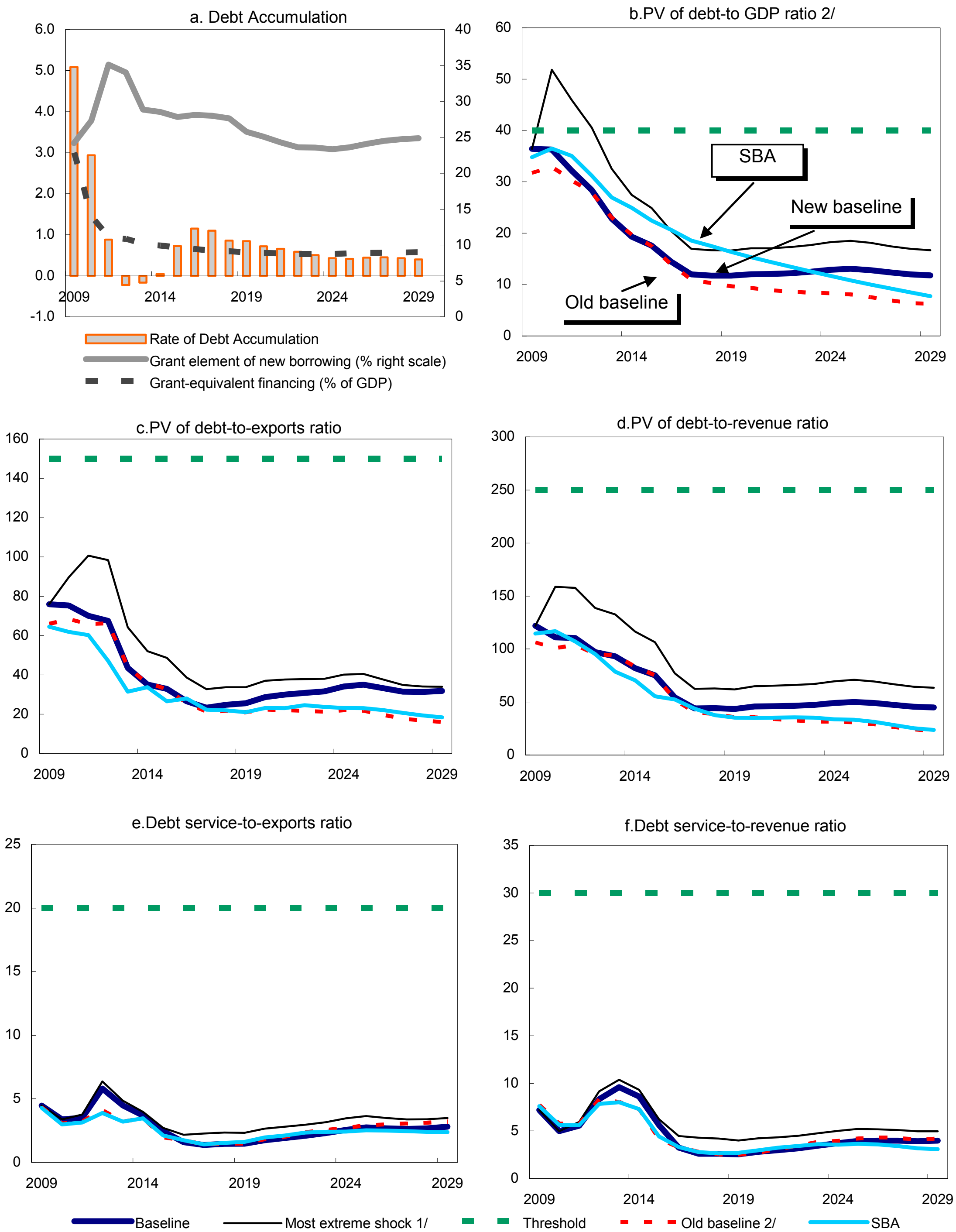


F. Conclusions

13. **The overall assessment has not changed with the last DSA and the external DSA indicates that Mongolia remains at low risk of external debt distress.** The short-term macroeconomic outlook has improved due to strong performance under the SBA and a more favorable global outlook than envisaged at the outset of the program. The increase in domestic debt, albeit from a low level, does not lead to a different sustainability assessment that under the external DSA.

[5] In the last joint Bank-Fund DSA (Country Report No. 09/130), a 20 percent lower copper price than in the baseline scenario (US$4,500/ton vs. US$5,100/ton in the current baseline) during 2010–15 showed that the economy remained vulnerable to changes in commodity prices despite the substantial increase in export volumes expected with the Oyu Tolgoi mining project.

Figure 1. Mongolia: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2009–2029 1/

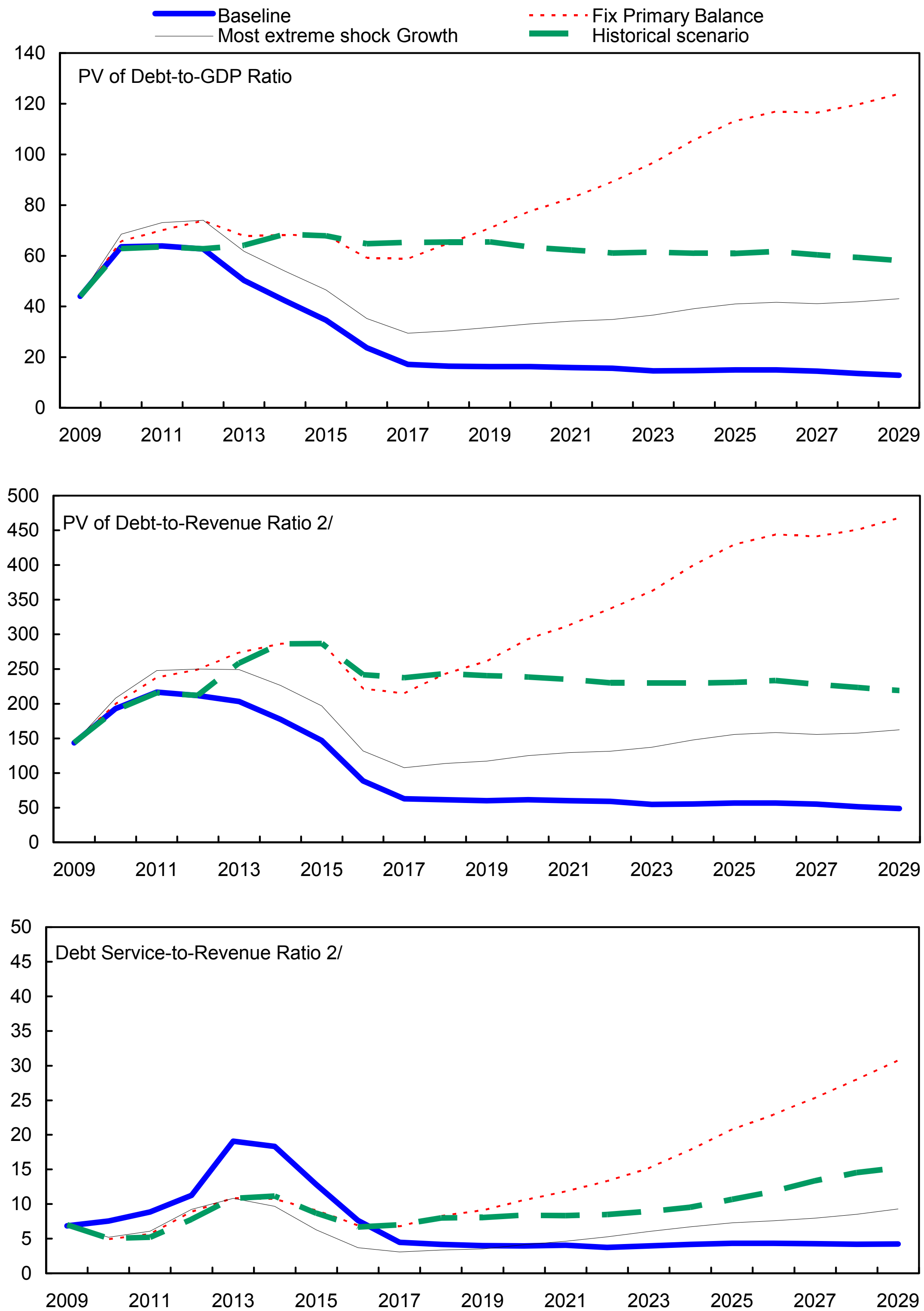


Source: IMF staff projections and simulations.

1/ The most extreme stress test is the test that yields the highest ratio in 2019. In figure b., it corresponds to a one-time depreciation shock; in c. to a exports shock; in d. to a one-time depreciation shock; in e. to a exports shock and in picture f. to a exports shock.

2/ Third review debt assumptions with SBA request macro assumptions.

Figure 2. Mongolia: Indicators of Public Debt Under Alternative Scenarios, 2009–2029 1/



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

1/ The most extreme stress test is the test that yields the highest ratio in 2019.
2/ Revenues are defined inclusive of grants.

Table 1. External Debt Sustainability Framework, Baseline Scenario, 2006–2029 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical	Standard 6/	Projections									
	2006	2007	2008	Average	Deviation	2009	2010	2011	2012	2013	2014	2009-2014 Average	2019	2029	2015-2029 Average
External debt (nominal) 1/	45.1	40.1	34.7			48.0	59.8	68.4	86.9	68.0	52.4		17.1	14.1	
Of which: public and publicly guaranteed (PPG)	44.3	38.9	33.9			45.3	44.2	36.3	34.3	27.6	23.5		14.0	13.8	
Change in external debt	-16.2	-5.0	-5.3			13.3	11.8	8.6	18.5	-18.9	-15.6		-1.1	-0.3	
Identified net debt-creating flows	-32.7	-24.8	-11.7			-2.7	-0.4	4.0	13.0	-24.0	-15.8		-7.7	0.9	
Non-interest current account deficit	-7.5	-7.1	13.7	2.3	7.5	3.2	15.6	20.7	17.0	-8.5	-7.6		-6.8	2.2	-3.1
Deficit in balance of goods and services	-4.8	-2.7	15.6			6.5	19.6	25.0	20.8	-8.6	-14.6		-11.7	0.4	
Exports	64.4	64.2	58.3			48.1	48.2	46.0	42.1	52.4	55.2		46.1	37.0	
Imports	59.6	61.5	73.9			54.6	67.8	71.0	62.9	43.8	40.6		34.3	37.5	
Net current transfers (negative = inflow)	-2.4	-2.1	-1.8	-3.4	2.5	-1.4	-1.5	-1.7	-1.7	-1.7	-1.7		-1.7	-1.6	-1.7
Of which: official	-3.5	-3.4	-1.7			-3.2	-3.1	-2.2	-2.7	-1.4	-0.8		-0.1	0.0	
Other current account flows (negative = net inflow)	-0.3	-2.3	-0.1			-1.9	-2.5	-2.7	-2.1	1.8	8.6		6.6	3.4	
Net FDI (negative = inflow)	-9.2	-9.2	-16.2	-7.9	4.0	-6.9	-12.7	-13.8	-1.0	-1.0	-1.0		-1.0	-1.0	-1.0
Endogenous debt dynamics 2/	-16.0	-8.5	-9.2			1.0	-3.3	-2.8	-3.0	-14.5	-7.2		0.1	-0.2	
Contribution from nominal interest rate	0.5	0.4	0.3			0.6	0.5	0.5	0.5	4.0	3.5		0.5	0.2	
Contribution from real GDP growth	-3.8	-3.7	-2.7			0.4	-3.8	-3.3	-3.5	-18.4	-10.8		-0.4	-0.4	
Contribution from price and exchange rate changes	-12.6	-5.2	-6.8			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	16.5	19.8	6.4			16.0	12.1	4.6	5.6	5.1	0.2		6.6	-1.2	
Of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	27.1			39.2	51.9	64.2	81.1	63.2	48.2		14.8	12.1	
In percent of exports	...	...	46.5			81.5	107.8	139.8	192.4	120.6	87.3		32.2	32.7	
PV of PPG external debt	...	...	26.3			36.5	36.3	32.2	28.4	22.8	19.3		11.7	11.8	
In percent of exports	...	...	45.1			75.9	75.3	70.0	67.5	43.5	35.0		25.5	31.8	
In percent of government revenues	...	...	73.4			122.1	111.1	110.3	97.1	93.2	81.9		43.6	44.9	
Debt service-to-exports ratio (in percent)	5.9	6.5	4.4			4.5	3.4	3.5	5.8	15.7	19.0		4.1	2.8	
PPG debt service-to-exports ratio (in percent)	5.4	4.3	3.6			4.5	3.4	3.5	5.8	4.5	3.7		1.5	2.8	
PPG debt service-to-revenue ratio (in percent)	9.5	6.8	5.9			7.2	5.0	5.5	8.3	9.6	8.6		2.5	4.0	
Total gross financing need (billions of U.S. dollars)	-0.4	-0.5	0.0			0.0	0.2	0.5	1.2	0.0	0.2		-1.1	0.8	
Non-interest current account deficit that stabilizes debt ratio	8.6	-2.1	19.1			-10.1	3.8	12.1	-1.5	10.4	8.0		-5.7	2.4	
Key macroeconomic assumptions															
Real GDP growth (in percent)	8.6	10.2	8.9	6.5	3.3	-1.0	8.6	6.5	5.8	26.3	18.8	10.8	2.3	3.1	5.7
GDP deflator in U.S. dollar terms (change in percent)	26.0	13.0	20.3	10.0	10.4	-13.2	-0.1	8.6	6.2	-2.0	-0.3	-0.1	4.9	2.2	2.8
Effective interest rate (percent) 5/	1.2	1.1	0.9	1.8	0.7	1.5	1.2	1.0	0.8	5.6	6.2	2.7	2.9	1.5	2.5
Growth of exports of G&S (U.S. dollar terms, in percent)	36.9	24.2	18.9	19.7	16.0	-29.0	8.8	10.3	3.0	54.1	24.5	11.9	4.1	1.6	6.0
Growth of imports of G&S (U.S. dollar terms, in percent)	19.5	28.5	57.4	19.8	16.1	-36.4	34.8	21.0	-0.4	-13.8	9.8	2.5	8.8	7.1	8.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	24.2	27.3	35.1	34.0	28.9	28.5	29.7	25.8	24.9	25.3
Government revenues (excluding grants, in percent of GDP)	36.5	40.4	35.8			29.9	32.7	29.2	29.3	24.5	23.6		26.9	26.2	26.2
Aid flows (in billions of U.S. dollars) 7/	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.1	
Of which: Grants	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.1	
Of which: Concessional loans	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			3.0	1.4	0.9	0.9	0.8	0.7		0.6	0.6	0.6
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			24.2	27.3	35.1	34.0	28.9	35.9		35.6	37.4	36.3
Memorandum items:															
Nominal GDP (billions of U.S. dollars)	3.2	3.9	5.1			4.4	4.8	5.6	6.2	7.7	9.1		20.6	30.7	
Nominal dollar GDP growth	36.8	24.5	31.0			-14.0	8.5	15.6	12.4	23.8	18.3	**10.8**	7.4	5.3	8.7
PV of PPG external debt (in billions of U.S. dollars)			1.4			1.6	1.7	1.8	1.8	1.8	1.8		2.4	3.6	
(PVt-PVt-1)/GDPt-1 (in percent)						**5.1**	2.9	0.9	-0.2	-0.2	0.0	1.4	0.8	0.4	0.6

Source: Staff simulations.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Mongolia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2005–2029

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2006	2007	2008	Average	Standard Deviation 5/	2009	2010	2011	2012	2013	2014	2009-14 Average	2019	2029	2015-29 Average
Public sector debt 1/	44.3	38.9	33.9			51.6	70.8	69.5	68.0	54.7	46.2		18.6	14.7	
Of which: foreign-currency denominated	44.3	38.9	33.9			45.3	44.2	36.3	34.3	27.6	23.5		14.0	13.8	
Change in public sector debt	-15.4	-5.5	-5.0			17.7	19.1	-1.2	-1.5	-13.3	-8.6		-0.2	-0.3	
Identified debt-creating flows	-25.7	-11.6	-2.0			12.6	3.2	-10.1	-4.0	-16.7	-15.0		-3.1	-1.2	
Primary deficit	-8.7	-3.2	4.6	1.3	5.0	6.0	3.6	1.2	0.4	-2.9	-5.9	0.4	-2.0	-0.5	-1.9
Revenue and grants	36.6	40.9	36.1			30.7	33.0	29.5	29.6	24.8	23.8		27.1	26.5	
Of which: grants	0.1	0.5	0.3			0.8	0.3	0.3	0.3	0.2	0.2		0.2	0.3	
Primary (noninterest) expenditure	27.9	37.6	40.6			36.7	36.6	30.7	30.0	21.9	17.9		25.1	25.9	
Automatic debt dynamics	-16.6	-8.0	-6.4			4.4	-4.6	-10.9	-4.0	-13.6	-8.9		-0.9	-0.6	
Contribution from interest rate/growth differential	-15.5	-8.4	-8.9			6.1	-3.9	-8.4	-6.2	-13.5	-8.9		-1.1	-0.6	
Of which: contribution from average real interest rate	-10.8	-4.2	-5.7			5.8	0.2	-4.1	-2.4	0.6	-0.2		-0.6	-0.1	
Of which: contribution from real GDP growth	-4.7	-4.1	-3.2			0.3	-4.1	-4.3	-3.8	-14.1	-8.6		-0.4	-0.4	
Contribution from real exchange rate depreciation	-1.0	0.4	2.5			-1.8	-0.7	-2.5	2.2	0.0	0.0		...	...	
Other identified debt-creating flows	-0.4	-0.4	-0.1			2.3	4.2	-0.4	-0.4	-0.3	-0.2		-0.1	-0.1	
Privatization receipts (negative)	-0.4	-0.4	-0.1			-0.5	-0.5	-0.4	-0.4	-0.3	-0.2		-0.1	-0.1	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Bank restructuring	0.0	0.0	0.0			2.8	4.6	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	10.3	6.2	-3.0			5.1	15.9	8.9	2.5	3.4	6.4		2.8	0.8	
Other Sustainability Indicators															
PV of public sector debt	0.0	0.0	28.5			44.1	63.6	63.8	62.6	50.3	42.3		16.3	12.8	
Of which: foreign-currency denominated	0.0	0.0	28.5			37.8	37.0	30.6	28.9	23.2	19.7		11.7	12.0	
Of which: external	...	...	28.5			37.8	37.0	30.6	28.9	23.2	19.7		11.7	12.0	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	-5.3	-0.5	6.8			8.1	6.1	3.8	3.7	1.8	-1.5		-0.9	0.6	
PV of public sector debt-to-revenue and grants ratio (in percent)	0.0	0.0	79.0			143.5	192.8	216.5	211.5	203.2	177.5		60.0	48.5	
PV of public sector debt-to-revenue ratio (in percent)	0.0	0.0	79.6			147.5	194.7	218.8	213.8	205.3	179.1		60.5	49.0	
Of which: external 3/	…	…	79.6			126.5	113.2	105.0	98.7	94.7	83.3		43.7	45.6	
Debt service-to-revenue and grants ratio (in percent) 4/	9.3	6.8	6.0			6.8	7.6	8.9	11.3	19.1	18.3		4.0	4.2	
Debt service-to-revenue ratio (in percent) 4/	9.4	6.9	6.1			7.0	7.6	8.9	11.4	19.3	18.5		4.0	4.3	
Primary deficit that stabilizes the debt-to-GDP ratio	6.7	2.2	9.6			-11.8	-15.5	2.4	1.9	10.4	2.7		-1.8	-0.2	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	8.6	10.2	8.9	6.5	3.3	-1.0	8.6	6.5	5.8	26.3	18.8	10.8	2.3	3.1	5.7
Average nominal interest rate on forex debt (in percent)	1.2	1.1	0.9	1.8	0.7	1.6	1.2	1.3	1.4	1.5	1.5	1.4	1.5	1.5	1.5
Real exchange rate depreciation (in percent, + indicates depreciation)	-2.3	1.0	8.4	0.8	3.3	-4.4	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	23.1	12.3	20.2	13.3	6.4	7.5	6.0	5.6	2.9	1.4	3.1	4.4	4.1	5.7	4.7
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	0.5	0.2	0.1	0.2	-0.1	0.1	-0.1	0.0	-0.1	0.0	0.0	0.1	0.0	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	24.2	27.3	35.1	34.0	28.9	28.5	29.7	25.8	24.9	...

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

1/ General government or nonfinancial public sector, gross debt.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 3. Mongolia: Sensitivity Analysis for Key Indicators of Public Debt 2009-2029

	Projections							
	2009	2010	2011	2012	2013	2014	2019	2029
PV of Debt-to-GDP Ratio								
Baseline	44	64	64	63	50	42	16	13
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	44	63	63	62	63	68	66	60
A2. Primary balance is unchanged from 2009	44	66	70	73	67	68	71	126
A3. Permanently lower GDP growth 1/	44	64	65	65	53	46	25	44
A4. Alternative Scenario :[Costumize, enter title]	45	69	72	69	67	67	52	32
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	44	68	73	74	62	54	32	43
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	44	66	70	69	56	47	20	11
B3. Combination of B1-B2 using one half standard deviation shocks	44	66	69	69	57	49	26	30
B4. One-time 30 percent real depreciation in 2010	44	79	77	75	61	51	21	15
B5. 10 percent of GDP increase in other debt-creating flows in 2010	44	73	72	70	57	48	20	12
PV of Debt-to-Revenue Ratio 2/								
Baseline	144	203	218	212	201	175	59	48
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	144	200	216	210	253	281	239	223
A2. Primary balance is unchanged from 2009	144	210	238	247	269	281	259	467
A3. Permanently lower GDP growth 1/	144	205	223	220	213	190	91	162
A4. Alternative Scenario :[Costumize, enter title]	147	260	274	260	250	252	198	123
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	144	218	249	250	246	223	116	161
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	144	211	240	233	223	195	71	41
B3. Combination of B1-B2 using one half standard deviation shocks	144	211	236	234	228	204	95	110
B4. One-time 30 percent real depreciation in 2010	144	254	263	255	243	212	75	57
B5. 10 percent of GDP increase in other debt-creating flows in 2010	144	232	245	238	228	199	74	43
Debt Service-to-Revenue Ratio 2/								
Baseline	7	8	9	11	19	18	4	4
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	7	5	5	8	11	11	8	15
A2. Primary balance is unchanged from 2009	7	5	6	9	11	10	9	30
A3. Permanently lower GDP growth 1/	7	5	6	8	9	8	3	8
A4. Alternative Scenario :[Costumize, enter title]	7	6	5	8	9	9	4	6
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	7	5	6	9	11	10	3	9
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	7	5	6	9	10	9	2	2
B3. Combination of B1-B2 using one half standard deviation shocks	7	5	6	9	10	9	3	6
B4. One-time 30 percent real depreciation in 2010	7	6	8	12	14	12	3	5
B5. 10 percent of GDP increase in other debt-creating flows in 2010	7	5	7	9	10	9	2	2

Sources: Country authorities; and IMF staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the length of the projection period.

2/ Revenues are defined inclusive of grants.

Table 4a.Mongolia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2009-2029
(In percent)

	Projections							
	2009	2010	2011	2012	2013	2014	**2019**	2029
PV of debt-to GDP ratio								
Baseline	36	36	32	28	23	19	**12**	12
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	36	28	17	0	2	3	**16**	-15
A2. New public sector loans on less favorable terms in 2009-2029 2	36	36	32	29	24	20	**12**	13
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	36	38	35	31	25	21	**13**	13
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	36	38	37	33	27	23	**13**	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	36	36	35	31	25	21	**13**	13
B4. Net nondebt creating flows at historical average minus one standard deviation in 2010-2011 4/	36	43	46	41	34	29	**16**	13
B5. Combination of B1-B4 using one-half standard deviation shocks	36	39	41	37	30	25	**14**	13
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	36	52	46	41	33	27	**17**	17
PV of debt-to-exports ratio								
Baseline	76	75	70	67	44	35	**25**	32
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	76	59	36	0	4	5	**34**	-39
A2. New public sector loans on less favorable terms in 2009-2029 2	76	75	70	69	45	37	**27**	34
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	76	75	70	67	43	35	**25**	31
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	76	83	90	87	57	46	**32**	36
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	76	75	70	67	43	35	**25**	31
B4. Net nondebt creating flows at historical average minus one standard deviation in 2010-2011 4/	76	90	101	98	64	52	**34**	34
B5. Combination of B1-B4 using one-half standard deviation shocks	76	80	83	81	52	42	**29**	32
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	76	75	70	67	43	35	**25**	31
PV of debt-to-revenue ratio								
Baseline	122	117	111	97	92	81	**43**	44
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	122	91	57	0	8	12	**58**	-55
A2. New public sector loans on less favorable terms in 2009-2029 2	122	117	112	99	95	85	**45**	48
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	122	123	121	106	100	87	**46**	48
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	122	122	128	113	108	94	**48**	45
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	122	117	122	106	101	88	**47**	48
B4. Net nondebt creating flows at historical average minus one standard deviation in 2010-2011 4/	122	139	160	142	136	120	**57**	47
B5. Combination of B1-B4 using one-half standard deviation shocks	122	127	143	126	120	106	**52**	48
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	122	167	159	139	131	115	**61**	63

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

Table 4b.Mongolia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2009-2029 (continued)
(In percent)

	Projections							
	2009	2010	2011	2012	2013	2014	**2019**	2029
Debt service-to-exports ratio								
Baseline	4	3	4	6	4	4	**1**	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	4	3	3	5	3	3	**0**	0
A2. New public sector loans on less favorable terms in 2009-2029 2	4	3	3	4	2	2	**1**	2
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	4	3	4	6	4	4	**1**	3
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	4	4	4	7	5	4	**2**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	4	3	4	6	4	4	**1**	3
B4. Net nondebt creating flows at historical average minus one standard deviation in 2010-2011 4/	4	3	4	6	5	4	**2**	4
B5. Combination of B1-B4 using one-half standard deviation shocks	4	3	4	6	4	4	**2**	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	4	3	4	6	4	4	**1**	3
Debt service-to-revenue ratio								
Baseline	7	5	6	8	9	8	**3**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	7	5	5	7	7	7	**0**	0
A2. New public sector loans on less favorable terms in 2009-2029 2	7	5	5	5	5	5	**2**	2
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	7	6	6	9	10	9	**3**	4
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	7	5	6	9	10	9	**3**	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	7	5	6	9	10	9	**3**	4
B4. Net nondebt creating flows at historical average minus one standard deviation in 2010-2011 4/	7	5	6	9	10	9	**4**	5
B5. Combination of B1-B4 using one-half standard deviation shocks	7	5	6	9	10	9	**3**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	7	7	8	12	14	12	**4**	6
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	26	26	26	26	26	26	**26**	26

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 10/
FOR IMMEDIATE RELEASE
February xx, 2010

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2009 Article IV Consultation with Mongolia

On December 22, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Mongolia.[1]

Background

The global economic crisis and collapse in copper prices in 2008 hit the Mongolian economy hard. The loose macro-policies and tightly managed exchange rate pursued during the preceding boom years had made the economy particularly vulnerable and the situation deteriorated markedly earlier in 2009. The authorities then adopted an ambitious adjustment program supported by an IMF Stand-By Arrangement that, thanks to their strong policy implementation, has helped to quickly stabilize the economy.

After averaging 9 percent during 2004–08, real growth is expected to be slightly negative in 2009 as a result of the global crisis and the necessary tightening of policies. Nevertheless, the economy is now bottoming out and is projected to recover strongly in 2010 driven by

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

investment in the Oyu Tolgoi mining project. Inflation, after peaking at over 30 percent in 2008, has declined sharply in recent months and is expected to settle at around 6 percent by end-2010. Medium-term prospects are favorable as Mongolia stands to benefit enormously from its vast mineral deposits and growth is expected to accelerate sharply around 2013 when production at the Oyu Tolgoi mine begins.

The authorities are making progress toward restoring health to public finances. An ambitious fiscal consolidation in 2009 is helping to unwind the considerable loosening of fiscal policy that took place during 2007–08. The budget deficit is projected to be 6½ percent of GDP for 2009 and 5 percent of GDP for 2010. Moreover, the authorities are committed to adjust spending, if needed, to offset any revenue shortfalls but to save any revenue over-performance. The government aims to adopt by early 2010 a Fiscal Responsibility Law to lock in fiscal discipline and a comprehensive social transfer reform to increase benefits to low-income households.

Exchange rate and monetary policies implemented earlier in 2009, especially the hike in interest rates, were instrumental in stabilizing market conditions. Since then, the authorities have appropriately lowered interest rates in line with the sharp decline in inflation and evolving market conditions. The authorities remain committed to a flexible exchange rate and a monetary policy geared toward low inflation and safeguarding international reserves.

The rapid expansion of credit during the boom years is now taking its toll on the banking system. The central bank is committed to strengthening the banking system and, as needed, acting promptly and decisively to bolster confidence. Two troubled banks were put into receivership in late November 2009 and the authorities are preparing a comprehensive bank restructuring plan with Fund staff assistance. The authorities already have in place an emergency facility for liquidity support and a blanket deposit guarantee which provide a strong basis for maintaining financial stability. Progress has also been made in strengthening supervision and a new Banking Law has been submitted to Parliament.

Executive Board Assessment

Executive Directors commended the Mongolian authorities' continued strong performance under the Stand-By Arrangement. The economy has weathered the worst of the global crisis and is projected to rebound strongly in 2010, driven by investment in the Oyu Tolgoi mining project. The medium-term prospects are also favorable given Mongolia's vast mineral wealth, although prudent macroeconomic management will be required to ensure that these resources translate into prosperity for all of its citizens.

Directors supported the authorities' policy priorities to restore health to public finances, rebuild international reserves while maintaining a flexible exchange rate, bolster confidence in the banking system, and protect the poor. They cautioned that a return to the procyclical policy mix of 2007–08, even with relatively high copper prices, could lead to a repeat of the fiscal and balance of payments pressures experienced earlier in 2009.

Directors saw the ambitious fiscal consolidation already undertaken as a good down payment on unwinding past fiscal loosening. They stressed that continued fiscal adjustment, in particular expenditure rationalization, will be essential to fully restore health to government finances.

In this regard, many Directors observed that the 2010 budget, as amended, implies only a modest adjustment. However, Directors were encouraged by the authorities' commitment to limit the 2010 fiscal deficit to 5 percent of GDP by adjusting spending, as needed, and to save any revenue over-performance. They welcomed the authorities' commitment to save the advance tax prepayment from Oyu Tolgoi mines to meet future financing needs. The authorities should be cautious in undertaking new nonconcessional external borrowing.

Directors underscored the importance of implementing structural fiscal reforms to strengthen the effectiveness of fiscal policy. They welcomed the authorities' plan to adopt a Fiscal Responsibility Law and an integrated budget law, which together will help institutionalize fiscal discipline, strengthen fiscal management, and enhance fiscal transparency. Directors expressed concerns about the increase in untargeted, universal social transfers in the 2010 budget, and urged the authorities to promptly pass a law to increase transfers to low-income households and improve the targeting of benefits.

Directors commended the authorities' success in managing the exchange rate and monetary policies. The authorities' continued commitment to the flexible exchange rate regime will be crucial to maintain macroeconomic stability, insulate the economy from external shocks, and help facilitate an adjustment of the real exchange rate to structural changes related to the development of the mineral sector. Directors considered that any further monetary easing should be undertaken cautiously, especially as inflation is expected to rebound in 2010. While the current targeting of monetary aggregates remains appropriate in the near term, the authorities could consider moving toward an inflation targeting framework over the medium term.

Directors underscored that strengthening the banking system should be a top priority. They urged the authorities to continue to take prompt and strong actions to address problems in individual banks, and supported the central bank's decision to put two problem banks into receivership. To bolster confidence, the authorities should develop comprehensive bank restructuring plans expeditiously, building on the results of the ongoing external audits, and continue to strengthen banking supervision. Directors also emphasized that any public financial support to banks should be tied to governance and structural reforms of the recipient banks, and that existing shareholders should be required to either inject new capital or be the first to bear losses.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2009 Article IV Consultation with Mongolia is also available.

Mongolia: Selected Economic and Financial Indicators, 2007–10

		Rev.	Proj.	
	2007	2008	2009	2010
		(Percent change)		
Real sector				
Real GDP growth	10.2	8.9	-1.0	8.6
Mineral	2.9	-2.9	0.3	6.0
Nonmineral	12.2	11.9	-1.2	9.2
Consumer prices (end-period)	14.1	23.2	2.0	6.0
GDP deflator	12.3	20.2	7.5	6.0
		(In percent of GDP)		
General government budget				
Revenue and grants	40.9	36.1	30.7	33.0
Expenditure and net lending	38.0	41.0	37.2	38.0
Overall balance (including grants)	2.8	-4.9	-6.5	-5.0
Nonmineral overall balance	-10.6	-15.1	-12.7	-12.2
		(Percent change)		
Money and credit 1/				
Broad money	55.6	-5.1	20.0	25.4
Claims on nonbanks, adjusted for bank restructuring	67.7	28.7	2.9	7.5
Interest rate on central bank bills, end-period (percent) 2/	8.4	9.8	…	…
		(In millions of US$)		
Balance of payments				
Current account balance (including official transfers)	265	-722	-167	-772
(In percent of GDP)	6.7	-14.0	-3.8	-16.1
Trade balance	-54	-613	-91	-841
Exports	1,949	2,534	1,833	1,995
Imports	-2,003	-3,147	-1,924	-2,836
Foreign direct investment	360	836	305	609
Gross official international reserves (end-period)	1,001	657	1,050	1,252
(In months of next year's imports of goods and services)	3.2	3.3	3.9	3.8
Terms of trade (percent change)	2.9	-11.7	4.3	-4.9
		(In percent of GDP)		
Public and publicly guaranteed debt				
Total public debt	39.4	33.9	51.6	70.8
Domestic debt 3/	0.5	0.0	6.3	26.6
External debt 4/	38.9	33.9	45.3	44.2
(In millions of US$)	1,529	1,610	1,937	2,082
Exchange rate				
Togrogs per US$ (end-period)	1,170	1,268	...	...
Togrogs per US$ (period average)	1,170	1,169	...	...
Nominal effective exchange rate (end-period; percent change)	-4.0	-2.5	...	...
Real effective exchange rate (end-period; percent change)	4.1	18.7	...	...
Nominal GDP (In billions of togrogs)	4,600	6,020	6,407	7,373

Sources: Mongolian authorities; and IMF staff projections.

1/ For 2009-10, valued at the program exchange rate and gold price.

2/ Yield of 14-day bills until 2006 and of 7-day bills from 2007 onward.

3/ The projections for 2009 and 2010 include the estimated fiscalization cost of bank restructuring, the financing of the government's equity share in Oyu Tolgoi, and the Oyu Tolgoi tax-prepayment.

4/ Includes prospective Fund credit under the SBA.

Press Release No. 09/475
FOR IMMEDIATE RELEASE
December 22, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third Review Under Stand-By Arrangement with Mongolia and Approves US$24.1 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the third 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 15.33 million (about US$24.1 million), bringing total disbursements under the arrangement to an amount equivalent to SDR 107.31 million (about US$168.6 million). The Board also approved the request for modification of performance criteria to reflect the revised macroeconomic data and framework.

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$ 240.9 million) or 300 percent of Mongolia's quota. The Mongolian economy was hit hard by the global economic crisis earlier the year, and the Fund's financial assistance via the SBA aims to support the country's economic stabilization efforts.

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

"The global economic crisis and collapse in copper prices last year hit the Mongolian economy hard. Since then, the authorities' strong policy implementation has helped to quickly stabilize market conditions. Growth is beginning to turn around and the outlook for next year and beyond is quite favorable, driven by development of the mineral sector.

"The authorities have made good progress in restoring health to public finances. Their commitment to strictly control the 2010 budget deficit is reassuring, especially their commitment to adjust spending to offset any revenue shortfalls while saving any revenue over-performance to help meet future financing needs and limit the pro-cyclicality of spending. Additional fiscal adjustment and expenditure rationalization will be needed in 2011 and beyond to ensure that the budget deficit can be comfortably financed. Adoption of a Fiscal Responsibility Law will help institutionalize fiscal discipline and prevent a repeat of the boom-bust fiscal policies of the past. Prompt passage of a comprehensive social transfer reform will be critical for fighting poverty by increasing support to low-income households and improving targeting.

"The combination of a flexible exchange rate and a monetary policy geared toward achieving low inflation and safeguarding international reserves is working well. In line with evolving market conditions, the central bank has appropriately lowered interest rates. Further monetary easing should be approached with caution as inflation is projected to rebound next year. In the years ahead, maintaining a flexible exchange rate will be critical for promoting macroeconomic stability, insulating the economy from external shocks, and facilitating the economy's adjustment to the substantial expansion of the mineral sector. Over the medium term, the adoption of formal inflation targeting would complement the flexible exchange rate regime and help secure low inflation by allowing pressures for a real appreciation of the currency to feed through the nominal exchange rate instead of inflation.

"Strengthening the banking system remains a top priority. The authorities will need to respond proactively and vigorously to problems in individual banks as they arise, and to bolster confidence in the banking system. A comprehensive bank restructuring plan should be developed that builds on the findings of the ongoing external audits. Public financial support should be tied to governance and structural reforms at the recipient banks, and existing owners should be required to either inject new capital or be the first to absorb losses.

"The authorities' success in implementing their economic program is commendable. The Mongolian economy stands to benefit considerably from the country's significant mineral deposits, and maximizing these benefits will require a continued commitment to fiscal discipline, a flexible exchange rate, and a sound banking system. Staying the course with such policies will help ensure that Mongolia's considerable mineral wealth translates into lower poverty, rising household income, and a steadily improving standard of living for all of Mongolia's citizens," Mr. Kato stated.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 10/31
FOR IMMEDIATE RELEASE
February 24, 2010

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

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Background

The global economic crisis and collapse in copper prices in 2008 hit the Mongolian economy hard. The loose macro-policies and tightly managed exchange rate pursued during the preceding boom years had made the economy particularly vulnerable and the situation deteriorated markedly earlier in 2009. The authorities then adopted an ambitious adjustment program supported by an IMF Stand-By Arrangement that, thanks to their strong policy implementation, has helped to quickly stabilize the economy.

After averaging 9 percent during 2004–08, real growth is expected to be slightly negative in 2009 as a result of the global crisis and the necessary tightening of policies. Nevertheless, the economy is now bottoming out and is projected to recover strongly in 2010 driven by investment in the Oyu Tolgoi mining project. Inflation, after peaking at over 30 percent in

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2008, has declined sharply in recent months and is expected to settle at around 6 percent by end-2010. Medium-term prospects are favorable as Mongolia stands to benefit enormously from its vast mineral deposits and growth is expected to accelerate sharply around 2013 when production at the Oyu Tolgoi mine begins.

The authorities are making progress toward restoring health to public finances. An ambitious fiscal consolidation in 2009 is helping to unwind the considerable loosening of fiscal policy that took place during 2007–08. The budget deficit is projected to be 6½ percent of GDP for 2009 and 5 percent of GDP for 2010. Moreover, the authorities are committed to adjust spending, if needed, to offset any revenue shortfalls but to save any revenue over-performance. The government aims to adopt by early 2010 a Fiscal Responsibility Law to lock in fiscal discipline and a comprehensive social transfer reform to increase benefits to low-income households.

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Directors supported the authorities' policy priorities to restore health to public finances, rebuild international reserves while maintaining a flexible exchange rate, bolster confidence in the banking system, and protect the poor. They cautioned that a return to the procyclical policy mix of 2007–08, even with relatively high copper prices, could lead to a repeat of the fiscal and balance of payments pressures experienced earlier in 2009.

Directors saw the ambitious fiscal consolidation already undertaken as a good down payment on unwinding past fiscal loosening. They stressed that continued fiscal adjustment, in particular expenditure rationalization, will be essential to fully restore health to government finances. In this regard, many Directors observed that the 2010 budget, as amended, implies only a modest adjustment. However, Directors were encouraged by the authorities' commitment to limit the 2010 fiscal deficit to 5 percent of GDP by adjusting spending, as needed, and to save any revenue over-performance. They welcomed the authorities' commitment to save the advance tax prepayment from Oyu Tolgoi mines to meet future financing needs. The authorities should be cautious in undertaking new nonconcessional external borrowing.

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Nonmineral	12.2	11.9	-1.2	9.2
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Revenue and grants	40.9	36.1	30.7	33.0
Expenditure and net lending	38.0	41.0	37.2	38.0
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Nonmineral overall balance	-10.6	-15.1	-12.7	-12.2
		(Percent change)		
Money and credit 1/				
Broad money	55.6	-5.1	20.0	25.4
Claims on nonbanks, adjusted for bank restructuring	67.7	28.7	2.9	7.5
Interest rate on central bank bills, end-period (percent) 2/	8.4	9.8	…	…
		(In millions of US$)		
Balance of payments				
Current account balance (including official transfers)	265	-722	-167	-772
(In percent of GDP)	6.7	-14.0	-3.8	-16.1
Trade balance	-54	-613	-91	-841
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Sources: Mongolian authorities; and IMF staff projections.

1/ For 2009-10, valued at the program exchange rate and gold price.

2/ Yield of 14-day bills until 2006 and of 7-day bills from 2007 onward.

3/ The projections for 2009 and 2010 include the estimated fiscalization cost of bank restructuring, the financing of the government's equity share in Oyu Tolgoi, and the Oyu Tolgoi tax-prepayment.

4/ Includes prospective Fund credit under the SBA.

Statement by Hi-Su Lee, Executive Director for Mongolia
and Suk-Kwon Na, Alternate Executive Director
December 22, 2009

The Mongolian authorities wish to express their utmost appreciation to the Fund and its staff for their constructive cooperation thus far in resolving the economic crisis facing the authorities. The recent signs of economic stabilization are a product of the authorities' strong policy implementation and the Fund's full-fledged advice through the recurring consultations and extensive technical assistance missions.

Macroeconomic Outlook

2. Compared to the average 9 percent real growth during 2004-08, this year's growth has shrunk due to the globally-evolving crisis and the sharp decline in the price of copper. Nonetheless, it is very encouraging that the authorities and staff have agreed that the Mongolian economy is bottoming out and stands ready to recover at a strong pace to above 8 percent next year. A major international agreement for the development of the Oyu Tolgoi (OT) mine in October 2009 has provided meaningful momentum for this recovery, concurrently stimulating significant structural changes in the economy. The role of the mining sector will likely increase with OT mining production starting in 2013, thus the medium-term macroeconomic outlook seems favorable. However, given the policy challenges in the period ahead, the authorities will strive to adopt prudent and premeditated macroeconomic management to maximize the contribution of their mineral wealth into economic success.

3. Double-digit high inflation rate in the recent boom-bust period has dropped sharply and will be stabilized at a stable low level of 2 percent at end-December and below 8 percent at end-2010, compared to staff's projection of 6 percent at end-2010. The current account balance has considerably improved from -14 percent of GDP last year to around -4 percent this year, owing to the big drop in imports and increasing copper price. Although there will be some deterioration in the current account balance in the near future in relation to OT-related investments and imports, the current account in the medium-term is expected to show large surpluses as OT mining starts production soon while, in the interim, expected short-term deficit could be financed by FDI inflows and private loans.

Program Performance and Objectives Forward

4. As well noted by staff, all performance criteria for the third review were successfully met. The scope of the breach in the indicative target of the government deficit for end-September is minimal enough to be addressed. Related to this, the authorities are confident that the end-December fiscal target will be comfortably observed, given the expected pick-up in mineral revenue in the fourth quarter. Even though there is a modest delay in some structural benchmarks, these are mostly technical matters and, accordingly, the authorities have displayed meaningful progress at the crucial points and are committed to achieving them in due course.

5. The authorities reaffirmed their strong commitment to the policy objectives forward, as well pointed out in their Letter of Intent. Aiming to achieve a strong, sustainable and equitable growth

coupled with low inflation and prudent public finances, they place a strong emphasis on crucial reform measures, targeting at strengthening the banking system, restoring health to the budget and maintaining a flexible exchange rate. Given the considerable risks in the years ahead, they will take prompt and decisive actions to cope with imminent problems on one hand, and take forward-looking and productivity-enhancing measures on the other hand.

Fiscal Policy

6. Despite the determined fiscal consolidation undertaken this year, the first priority still remains to make public finance healthier and sustainable. The authorities fully agree with staff that fiscal restraint will be warranted for several years ahead to bring government finance into a sustainable path. Thus, they are committed to sticking to the budget deficit of 6½ percent of GDP for 2009 and 5 percent in 2010. With regard to the gold mining-related loan that was carried out earlier this year, the authorities will try their best to encourage banks to repay their budget for the net lending to the gold mining sector.

7. It is pleasing to note that the authorities' debt distress level remains low and their debt outlook is expected to recover and improve over the medium term owing to foreseen mineral revenues starting in 2013, despite some increase in debt ratio over the next two years. Staff's various concerns with respect to the 2010 budget were fully delivered to the authorities, encouraging their cautious and deliberate implementation of the budget. Going forward, the fiscal situation in the near future will deteriorate with the elimination of the windfall profit tax in 2011, as well as the decrease in donor budgetary support. Staff's well-prepared briefing on the medium-term projection with regard to expected mineral revenues has helped the authorities to fully recognize the importance of fiscal prudence in a consistent manner. In this environment, the authorities reaffirm that any possible revenue shortfall lower than that projected in the budget will be fully compensated by a reduction in spending, while more revenue surplus than the budget forecast will be saved for future needs and for counter-cyclicality purposes. Mindful of staff's advice on the need for observing fiscal prudence until the time of sustainable mineral revenues, the authorities strongly commit to continue their efforts for fiscal adjustment in 2010 and onwards.

8. From the institutional viewpoint, the authorities will submit to Parliament by end-December a Fiscal Responsibility Law, as well as a complementary organic budget law, with the aim of obtaining approval for them by February 1, 2010. These laws would substantially contribute to promoting fiscal discipline by establishing numerical rules that would effectively control fiscal balance, government debt, and spending growth.

9. A social transfer is another big item for both better assisting the poor and the needy and creating fiscal saving by better targeting. Although there have been some setbacks in the upgrading system thus far, the authorities will soon submit the new social transfer reform law to Parliament in order to achieve the aforementioned goals, aiming at passing the law by February 1, 2010. Given that one major concern for the delay in this reform was institutional weakness in identifying the poor, the authorities will strive to improve their capacity for effective means-testing. In this light, the authorities appreciate the support of donors in preparing this reform, and will stand receptive to the advice from the World Bank and the Asian Development Bank.

Monetary and Exchange Rate Policies

10. The authorities have weathered the turbulent period with well-considered monetary policy – the hike in policy rate earlier this year and the timely and appropriate reduction consistent with market situations – following the Fund's advice. For the time being, their key objective for monetary policy will remain unchanged at maintaining low inflation and contributing to macroeconomic stability. While closely monitoring the inflation development, the Bank of Mongolia (BOM) will continue to take a vigilant and cautious stance in preserving international reserves and adjusting interest rates, which should be prudent and in line with evolving market conditions. Going forward, for the medium-term goal of introducing an inflation targeting framework, they will invest sufficient efforts to lay the technical foundation step by step, including by improving inflation forecasting and advancing the monetary transmission channel.

11. The authorities fully agree with staff that a flexible exchange rate would be an undisputable factor to relieve terms of trade volatility and prevent higher inflation which would mainly emanate from operation of OT mining in 2013. In light of this, their intervention will focus on smoothing excess volatility caused by temporary imbalances and thus make the exchange rate determined in line with market conditions. They welcome staff's estimation that the current level of the real exchange rate is broadly in line with fundamentals.

Banking System

12. The authorities are well cognizant that, despite the recent success in addressing the crisis by the help of the program, fragilities in the banking sector respectively and as a whole still remain as the Achilles' heel to the Mongolian economy, for the time being. The authorities highlight that bolstering the integrity of and confidence in the banking system are one of the key objectives to be achieved at current juncture, so that they are committed to responding proactively and vigorously to deal with problems in individual banks, as they arise.

13. The issue of Anod and Zoos banks has been timely addressed by the authorities' suitable measures depending on their own situations, such as appointing a receiver and accelerating the liquidating process. In particular, proactive measures are being considered in dealing with Zoos Bank, coupled with an external audit currently underway. On the other hand, the authorities are now striving to prevent the recent deposit outflow at Zoos Bank from happening at the other banks. The injection of public money, which is ensured to restructure the banking system, will be deliberately implemented in a way to improve governance and facilitate structural reforms at the recipient bank.

14. The authorities fully note that the banking system itself still faces challenges, like increasing non-performing assets and deteriorating capital adequacy ratios, along with some concern about the integrity of the current loan provisioning system. In dealing with the latter problem, the authorities intend to increase the effectiveness of such system by clarifying the definition and tightening the relevant rules, as well as by obligating regular reporting. They welcome the well-deliberated discussion with staff on contingency plans in case of additional bank distress, and also continue to strengthen their supervision efforts and to fully enforce all regulatory requirements on hand for all banks. In terms of legal framework, they will redouble their efforts in passing the pending revised Banking Law and continue to seek the options for a robust legal and regulatory system.

Other Issues

15. There has been some reshuffling in the cabinet in late-October after the presidential election in May 2009. The newly-elected Prime Minister clearly delivered his and his administration's firm political ownership of the Fund's program during the meeting with the mission team, while commending the Fund for its timely and insightful policy advice in getting out of the crisis. In detail, the authorities are committed to keeping the non-concessional debt within the program ceiling by prudent management and continue to maintain the current prohibition on government guarantees as a disciplinary measure. They also underscored their sustained commitment to resolve the remaining bilateral official arrears within the foreseeable future.

16. As a resource-abundant country, the authorities have made progress in becoming a member of the Extractive Industry Transparency Initiative (EITI). Increased transparency in the mining sector, along with fiscal consolidation efforts, would constitute a conduit for preventing recurrence of the past boom-bust cycle and ultimately contribute to sustainable and stable economy. The government's free trade and investment policies need to be pursued more rigorously in preparation for the after-crisis period.

Conclusion

17. Given that the authorities are not free from various policy challenges, they continue to maintain a cautious and proactive stance in managing their economic policies. Rather than being complacent with achievements made thus far, they intend to focus on possible threatening matters which they could face during the recovery period, while robustly contemplating on the possible optimal options. The authorities believe that the frequent and close consultations with the Fund on the important policy measures are essential in swiftly stabilizing economy. In this regard, staff deserve the credit for their timely and effective advice on fiscal and banking areas. Spurred by the assistance from the Fund and donors, the authorities stand ready to take additional measures, if necessary, to accomplish the government's social and economic objectives under the SBA.

18. In conclusion, my Mongolian authorities wish to express their exceptional appreciation to the Fund and its staff for their sustained and appropriate policy advice in resolving the current crisis and further instituting the fundamentals of a sustainable economy. They also extend their deepest gratitude to the Fund's mission chief, Mr. Steven Barnett, and his team for their hard work and precious advice in setting up Mongolia's economic reform program.