March 2010
IMF Country Report No. 10/84

Mongolia: Fourth Review under the Stand-By Arrangement and Request for Modification of Performance Criteria

In the context of the fourth review under the 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 Fourth Review under the Stand-By Arrangement and Request for Modification of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on February 10, 2010, with the officials of Mongolia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 3, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Press Release summarizing the views of the Executive Board as expressed during its March 19, 2010 discussion of the staff report that completed the request and/or review.

- A statement by the Executive Director for Mongolia.

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

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

Fourth 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 Dewitt David Marston

March 3, 2010

Stand-by Arrangement. An 18-month Stand-By Arrangement in the amount of SDR 153.3 million (300 percent of quota) was approved by the Board on April 1, 2009. The third review was approved by the Board on December 22, 2009. All end-December performance criteria for the fourth review were met.

Summary. The economic outlook is favorable, thanks in large part to the authorities' strong policy implementation. The economy has started to recover, and growth is expected to rebound sharply this year boosted by investment in a large mining project. Inflation, after falling rapidly into negative territory for the past few months, has swung upwards and could reach 8 percent this year. The flexible exchange rate regime continues to work well and the central bank has intervened sparingly in recent months. The key macro-management priorities in the period ahead will be to contain inflation and maintain fiscal discipline.

On the structural reform agenda, significant progress has been made. A new banking law was recently passed, and the fiscal responsibility and social transfer reform laws have been submitted to parliament. The authorities are committed to securing passage of these laws when the parliament reconvenes in the spring. Progress is also being made on a comprehensive bank restructuring strategy that will be presented to parliament in early April. Adoption and implementation of this strategy will be essential to secure a healthy banking system, and will need to be complemented by efforts to strengthen bank supervision.

Discussions. A staff team visited Ulaanbaatar, February 3–10, 2010 consisting of S. Barnett (Head), J. Bersch (APD), J. Hartley (SPR), J. Gottschalk (FAD), I.W. Song (MCM), and P. Ramlogan (Resident Representative). The team held discussions with the prime minister, first deputy prime minister, speaker of parliament, finance minister, governor of the central bank, minister of mineral resources, minister of social welfare, other officials, and commercial banks. The mission liaised closely with the World Bank and Asian Development Bank, and benefited from an overlapping MCM mission on bank restructuring.

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I. BACKGROUND

1. **Context.** The economy has bottomed out and is set to recover strongly in 2010 (Figure 1). The main driver will be the investment in the Oyu Tolgoi mine, which is projected to amount to nearly 20 percent of GDP this year. Even though much of that investment will be met through imports, there will be substantial positive spillovers to the domestic economy. Copper prices have also been strong. The severe winter, however, is creating hardship for the Mongolian herdsmen and is driving up meat prices. As a result, inflation could reach 8 percent by year-end.

2. **Program performance.** All end-December performance criteria have been met and the indicative limit on the fiscal deficit was met with a comfortable margin. The fiscal responsibility law was submitted to parliament on January 12 (an end-December structural benchmark). The social transfer law was submitted to parliament in January, but parliament began its winter recess before discussing the law so passage will be delayed (December 1, 2009 structural benchmark). The authorities aim to secure passage of this legislation in the spring session of parliament.

II. POLICY DISCUSSIONS

A. Fiscal policy

3. **Fiscal stance.** The fiscal deficit in 2009 was 1 percent of GDP less than projected, driven largely by spending restraint. A similar overperformance is likely for 2010 on the back of an improved outlook for copper prices. The government reaffirmed its commitment to save any revenue overperformance or, if necessary, to lower spending to offset any revenue shortfalls and ensure that the program deficit target is met.

4. **2011 budget.** In 2011, fiscal adjustment on the order of 5 percent of GDP will be needed to offset the revenue loss from the planned elimination of a distortionary mining tax. In addition, the increase in universal transfers adopted as part of the 2010 budget (through the creation of the Human Development Fund with earmarked mineral revenues) will further reduce fiscal flexibility. The authorities are exploring options for high-quality measures that will lead to a durable improvement in public finances while also enhancing economic efficiency. They intend to strengthen tax administration of the largest taxpayers and to modernize the mineral taxation regime so as to boost revenue and facilitate development of the mining sector. Staff noted that additional options would include partly reversing previous cuts in the VAT and social security contribution rates and reducing untargeted transfers. No decision has yet been made, however, among these various options.

Mongolia: Fiscal Indicators
(In percent of nonmineral GDP)

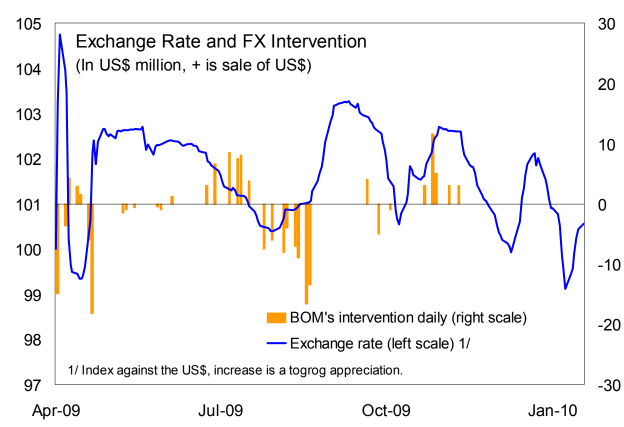
	2006	2007	2008	Projected 2009	2010	2011	2012	2013	2014
Overall balance (in percent of GDP)	8.2	2.8	-4.9	-5.4	-4.0	-4.5	-2.3	-1.3	2.0
Structural balance (in percent of GDP) 1/	4.8	-2.2	-6.9	-3.4	-4.2	-5.0	-3.1	-1.9	1.9
Nonmineral balance	-3.2	-14.9	-19.4	-16.5	-15.6	-9.4	-7.1	-11.4	-10.9
Nonmineral revenue	37.3	38.7	33.2	32.7	33.7	34.7	34.8	34.8	34.7
Total expenditure	40.5	53.6	52.6	49.2	49.3	44.0	41.9	46.3	45.6
Fiscal effort (change in cyclically adjusted) 2/	-1.0	-12.7	-6.6	7.0	-0.7	5.4	2.4	-3.6	0.5
Real expenditure growth	25.8	48.5	9.6	-9.0	8.1	-4.4	1.0	15.8	4.4
Memorandum items:									
Real nonmineral GDP (growth in percent)	9.2	12.2	11.9	-2.8	7.9	7.1	6.1	4.9	6.1
Output gap of nonmineral GDP	-2.0	0.3	4.3	-3.7	-0.6	1.2	1.0	-0.8	-0.6

Sources: Mongolian authorities; and IMF staff calculations.
1/ Staff estimate of the structural balance as defined in the current draft of the Fiscal Responsibility Law.
2/ In percent of potential nonmineral GDP. The elasticity assumptions are 1 for revenue and 0 for spending.

5. **Structural fiscal reform.** The authorities submitted the fiscal responsibility and social transfer laws to parliament and intend to pass both laws during the upcoming spring session (June 15 structural benchmarks). The social transfer reform law would phase-in a targeted poverty benefit, which, when fully operational, could cost around 1 percent of GDP per year. The World Bank and Asian Development Bank are helping the authorities in building the capacity for the needed means-testing. The introduction of a targeted benefit would also ensure that transfers to the very poorest are prioritized in the budget process. Passage of the fiscal responsibility law, meanwhile, will help entrench fiscal discipline and reduce procyclicality (see Box 5 of the previous staff report for a description of the draft law). The authorities recognized that strictly adhering to the law's provisions in the 2011 budget will be critical for building the law's credibility. The authorities indicated that the complementary organic budget law may take more time to finalize largely because some complex fiscal federalism issues will need to be resolved.

B. Monetary and exchange rate policies

6. **Monetary policy.** Though the recovery is in its early stages, the authorities recognized that monetary policy typically takes 6–12 months to affect prices. As a result, the central bank will need to be forward-looking and proactive in tackling signs of rising inflation. Monetary policy, therefore, has moved to a neutral bias and it is likely interest rates will need to be increased during the course of this year. The authorities fully shared staff concerns on the inflation risks, and were watching closely for signs of a broader inflationary dynamic evolving from recent increases in meat prices.

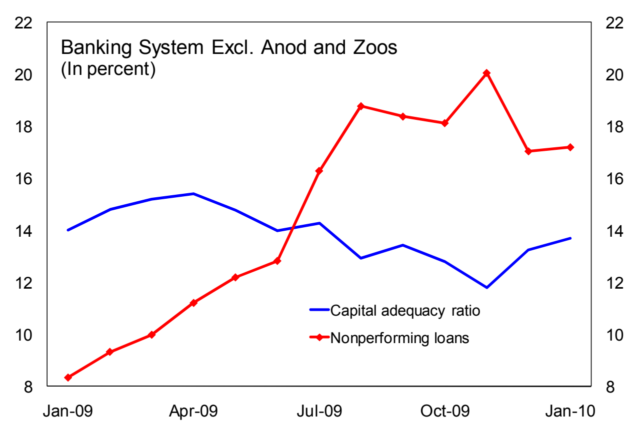


7. **Exchange rate policy.** The flexible exchange rate regime is working well and

the authorities remain committed to allowing the exchange rate to move in line with evolving market conditions. The central bank has intervened sparingly in the past several months and intends to continue to limit intervention to smoothing excess volatility and opportunistically building reserves. Meanwhile, the screen-based system for interbank foreign exchange transactions is now being piloted and is expected to be rolled out by the second quarter.

C. Banking system

8. **Bank restructuring strategy.** The authorities, with the assistance of MCM and World Bank technical assistance, are in the process of preparing a comprehensive bank restructuring plan. The intention is to submit that plan to parliament when it reconvenes in early April. There was consensus on the main principles of the strategy: (i) existing owners must bear losses before they receive any public money; (ii) there should be uniform treatment for all banks and a credible commitment to take necessary actions up to and including government intervention in the bank; (iii) public money should be made sufficiently unattractive to provide incentives to use private funds to recapitalize the banks; and (iv) the budget, not the central bank, should bear the costs of bank restructuring. Staff highlighted that the upfront recapitalization costs may be high—although there was significant uncertainty surrounding the underlying health of individual banks (see below)—but the ultimate costs would be lower since the government should be able to recover some of its investment over time. Nonetheless, there was agreement that the cost of delay or inaction would be even greater.



9. **Bank-by-bank plans.** System-wide, nonperforming loan and capital adequacy ratios have improved. Nonetheless, this masks significant variations across banks. Therefore, a detailed and comprehensive bank-by-bank plan will be needed to restore health to the banking system. Supervisory data and the findings of external audits that are currently underway will be key inputs to designing the strategy for each bank. The government will categorize banks into unviable nonsystemic banks that need to be intervened; unviable but systemic banks that will be nationalized; and undercapitalized banks that will be required to submit a restructuring plan that includes a timetable for meeting regulatory capital standards. To ensure that banks are treated uniformly, staff and the authorities agreed that any decision to approve the pending merger between two weak, mid-sized banks should be delayed until the comprehensive strategy has been formulated and clear information on the financial condition of both banks is available.

10. **Supervision.** Strengthening supervision will be critical in supporting bank restructuring and preventing the re-emergence of problems in the banking system. The central bank will formulate time-bound plans to unwind existing forbearance, especially as regard

single-borrower limits, connected party loans, and provisioning requirements. The central bank will also improve the loan classification system for restructured loans and strengthen the monitoring of banks that offer deposit rates that are well above market rates. The new banking law passed in January 2010 introduces consolidated supervision, strengthens the fit and proper test of prospective shareholders, more clearly defines connected parties, and improves the resolution framework. Staff noted, however, that the legal protections for bank supervisors are still insufficient and suggested the authorities find a way to redress this shortcoming in due course.

D. Other

11. **External financing.** The authorities have cleared their bilateral official arrears to Russia and signed a rescheduling agreement with Finland. The authorities agreed that they should be cautious in undertaking new nonconcessional external borrowing, and the government plans to keep in place the current prohibition on government guarantees.

12. **Safeguard assessment.** The authorities provided external auditors access to the vaults, a key recommendation of the safeguards assessment, to pave the way for completion of the 2009 audit of the central bank. They intend to have the audit finalized by end-April and share it with staff at that time.

III. Staff Appraisal

13. **Overview.** The macroeconomic outlook is encouraging, a remarkable turnaround relative to the dire economic situation of a year ago. This success is due first and foremost to the authorities' strong policy implementation, but timely financial support from the international community and the recovery in copper prices have also played important roles. All performance criteria were met for the review and there has been progress on structural reforms, with passage of a new banking law and submission of two key fiscal laws to parliament. However, the passage of the social transfer reform has been delayed by the parliamentary recess. The program's quantitative targets have been recalibrated to reflect recent data. Specifically, the net international reserve floors were raised to partly lock-in recent overperformance; the targets on net domestic assets were adjusted to incorporate MCM advice to exclude foreign currency time deposits from reserve money; and the fiscal targets were realigned to be consistent with the seasonal spending pattern in the approved budget.

14. **Fiscal policy.** The authorities' spending restraint meant the deficit was kept well below the program target last year. It is likely that the fiscal position will outperform program targets again this year. The key challenge now will be to achieve the sizeable fiscal adjustment needed in 2011. This would best be achieved through measures that structurally strengthen public finances, such as reducing universal transfers while safeguarding the poor through introduction of a targeted poverty benefit, strengthening tax administration of the largest taxpayers, and unwinding reductions in VAT and social security contributions

implemented during the boom. Passage of the fiscal responsibility law will be critical for institutionalizing fiscal discipline and avoiding the boom-bust policies of the past. Passage of the social transfer reform, moreover, will be an important step in fighting poverty and will increase fiscal flexibility going forward.

15. **Exchange rate policy.** The flexible exchange rate is working well and the central bank has intervened sparingly in the past few months. The authorities' continued commitment to allowing the exchange rate to move in line with evolving market conditions is commendable. Maintaining such flexibility will facilitate the adjustment that will be needed to the expansion of the mining sector and allow real appreciation pressures to feed through the nominal exchange rate rather than inflation.

16. **Monetary policy.** With the recovery underway and inflation returning to positive territory, the authorities have appropriately switched to a neutral bias for monetary policy. Indeed, there could well be a need to tighten monetary policy in the near future if inflation pressures continue to build or if the spike in meat prices starts to feed through to wages or other prices. More broadly, it would be helpful going forward to build a stronger public consensus around the need for the central bank to focus first and foremost on fighting inflation, which would facilitate an eventual movement toward inflation targeting and guard against political pressures to lower interest rates to boost short-term growth.

17. **Banking system.** Bank restructuring needs to proceed expeditiously to ensure that businesses, herders, and households have access to credit at reasonable rates. Inaction or delay will only increase the ultimate costs of restructuring and delay the economic recovery. Nonetheless, adopting and then implementing the government's restructuring plan will require substantial political commitment. This, in particular, means a willingness to take enforcement actions against banks when necessary, including intervening banks, changing management, or limiting bank operations. International experience shows that a good restructuring plan strengthens the banking system and safeguards taxpayer resources. Going forward, it will be critical to further strengthen supervision, including by unwinding existing forbearance.

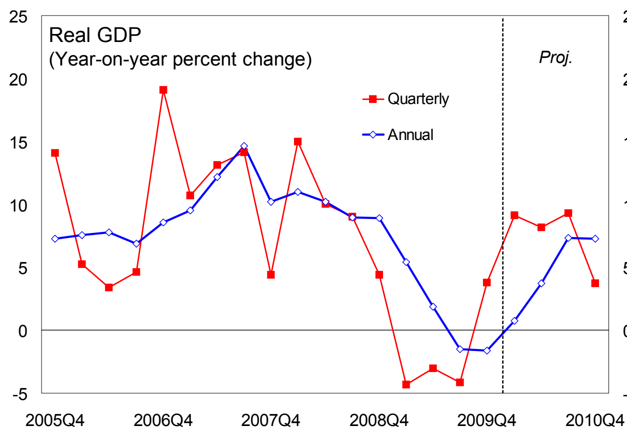
18. **Risks.** Thanks to the authorities' strong policy implementation, the economy is now set for a strong recovery. The main remaining risks to the program relate to the need to secure parliamentary passage of key parts of the structural reform agenda and moving ahead with bank restructuring. Both will require significant political commitment. However, these reforms will be central to strengthening the institutional framework in Mongolia and lay a strong foundation for sustainable growth. The fiscal responsibility and social transfer laws may face potential hurdles in parliament, but the authorities are committed to securing parliamentary passage of these laws during the spring session.

19. The authorities' performance under the program has been exemplary and staff recommends completion of the fourth review.

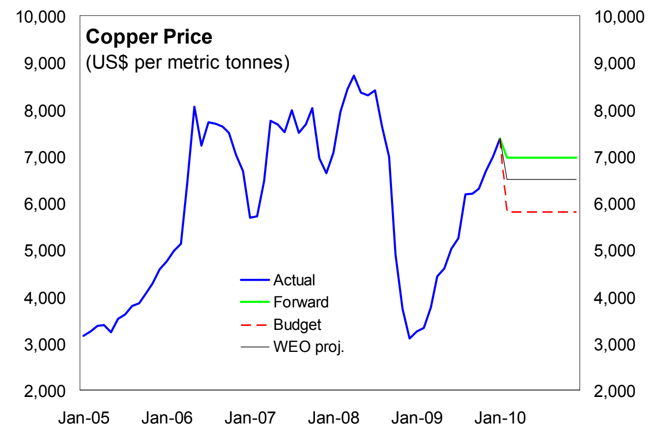
Figure 1. Macroeconomic Developments

Main Message: The economy has bottomed out and is set to rebound strongly in 2010.

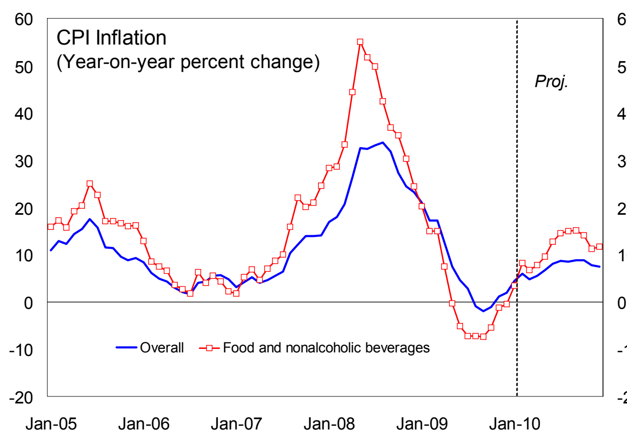
Real GDP growth is bottoming out and is expected to recover strongly this year, spurred by Oyu Tolgoi related investment.



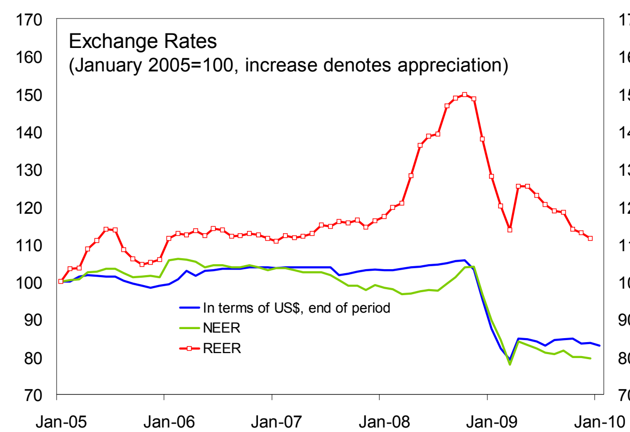
Copper prices have recovered and are projected to remain strong.



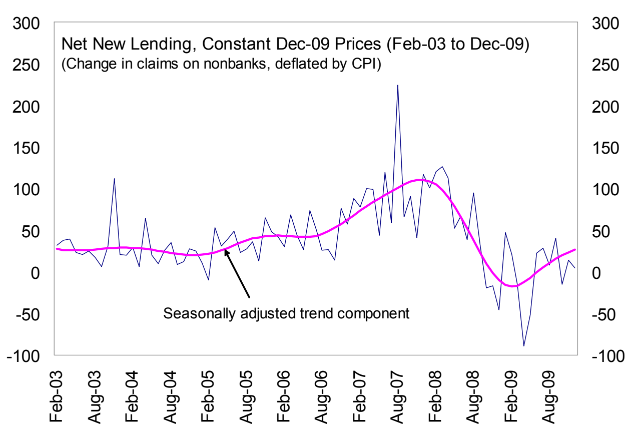
Inflation, which had fallen rapidly, is expected to rise to around 8 percent, driven in part by higher meat prices.



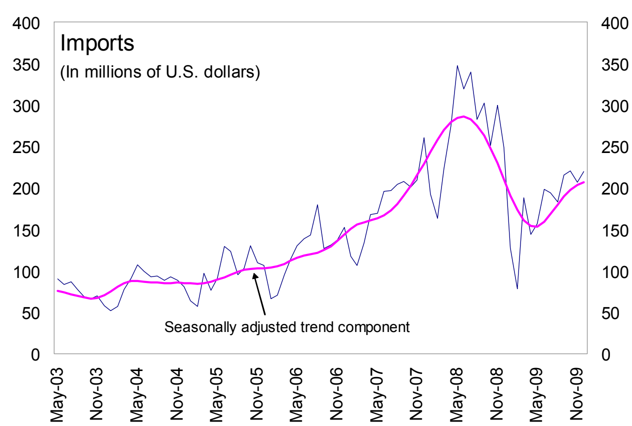
Real exchange rate appreciation has been largely unwound by the togrog depreciation and low inflation.



Bank lending to the private sector is recovering…



…as are imports, underscoring the recovery in demand.

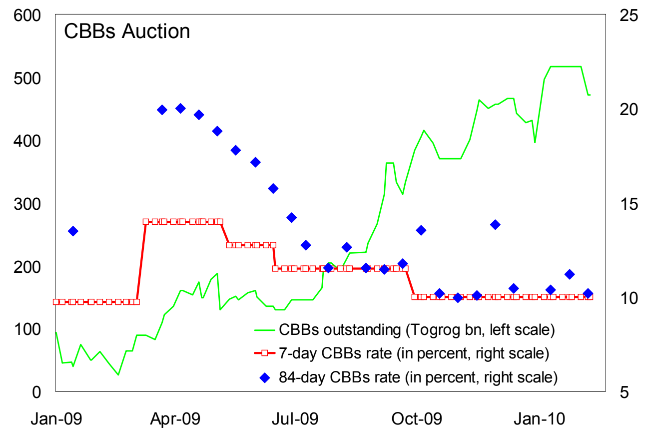


Sources: Mongolian authorities; and IMF staff estimates.

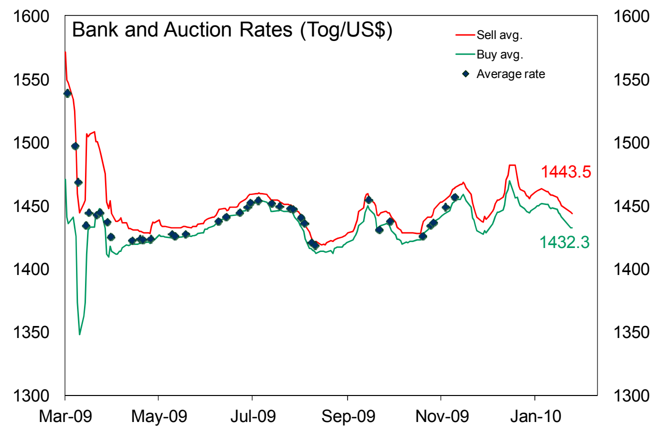
Figure 2. Policy Developments

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

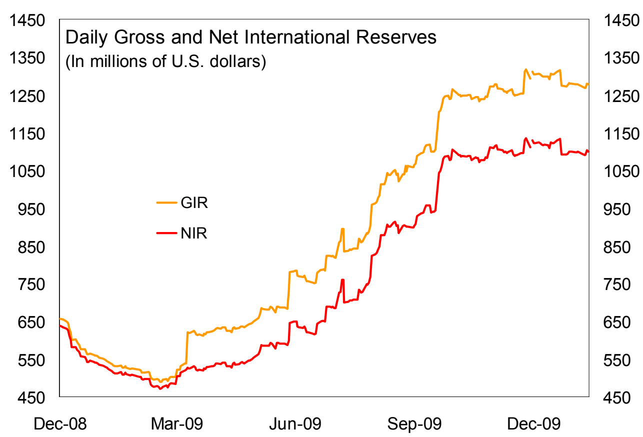
As market conditions stabilized, the central bank appropriately began to unwind the earlier hike in interest rates.



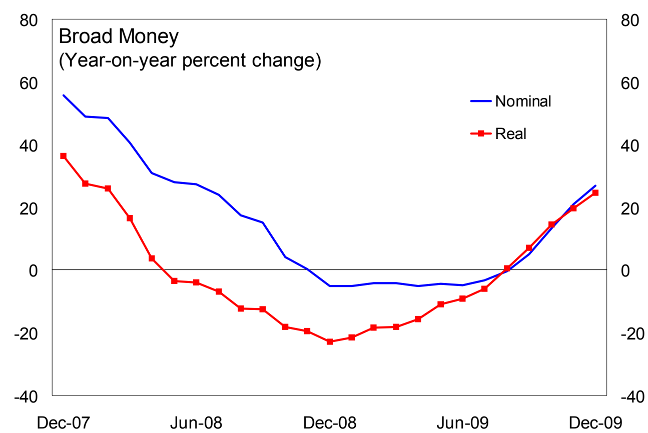
Meanwhile, the exchange rate has been fairly stable….



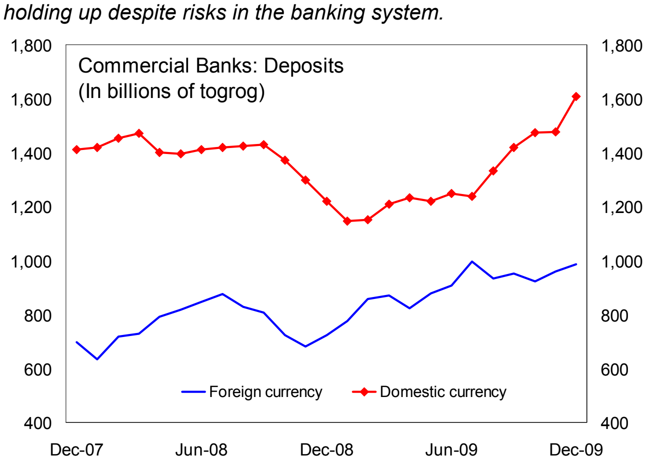
…and international reserves have been rebuilt.



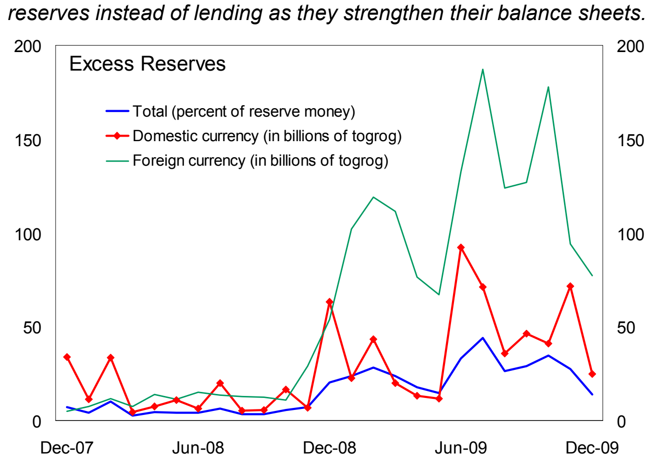
Broad money growth is recovering as the economy remonetizes and confidence returns…



…with deposits starting to come back to the banking system and holding up despite risks in the banking system.



Banks are prudently directing deposits toward building excess reserves instead of lending as they strengthen their balance sheets.



Sources: Mongolian authorities; and IMF staff estimates.

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

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

		Prel.	Proj.		3rd review		
	2008	2009	2010	2011	2009	2010	2011
	(Percent change)						
Real sector							
Real GDP growth	8.9	-1.6	7.3	7.1	-1.0	8.6	6.5
Mineral	-2.9	3.7	4.7	7.1	0.3	6.0	6.6
Nonmineral	11.9	-2.8	7.9	7.1	-1.2	9.2	6.4
Consumer prices (period average)	26.8	6.3	7.1	5.5	6.3	4.9	6.0
Consumer prices (end-period)	23.2	1.9	7.5	5.5	2.0	6.0	6.0
GDP deflator	20.2	2.2	11.2	4.2	7.5	6.0	5.6
Gross national savings (in percent of GDP)	29.6	34.0	36.5	39.9	34.3	33.7	35.5
Gross national investment (in percent of GDP)	40.3	36.8	44.7	58.4	35.1	47.1	54.2
	(In percent of GDP)						
General government budget							
Revenue and grants	36.1	32.9	34.5	30.6	30.7	33.0	29.5
Expenditure and net lending	41.0	38.3	38.5	35.0	37.2	38.0	32.2
Current balance	6.5	2.9	2.8	2.7	1.4	2.3	4.5
Primary balance	-4.6	-4.9	-2.7	-3.2	-6.0	-3.6	-1.2
Overall balance (including grants)	-4.9	-5.4	-4.0	-4.5	-6.5	-5.0	-2.7
Nonmineral overall balance	-15.1	-12.9	-12.2	-7.5	-12.7	-12.2	-5.2
	(Percent change)						
Money and credit 4/							
Broad money	-5.1	26.9	19.9	17.2	20.0	25.4	18.3
Net foreign assets (contribution to BM growth)	-27.8	43.0	1.0	6.0	28.7	6.4	1.1
Net domestic assets (contribution to BM growth)	22.7	-16.1	18.9	11.1	-8.6	18.9	17.2
Claims on non-banks, adjusted for bank restructuring	n.a.	1.2	13.8	13.3	2.9	7.5	…
Broad money velocity (GDP/BM)	n.a.	2.1	2.1	2.0	2.4	2.2	2.1
Interest rate on 7-day central bank bills, end-period (percent)	9.8	10.0	…	…	…	…	…
	(In millions of US$)						
Balance of payments							
Current account balance (including official transfers)	-722	-235	-566	-1,302	-167	-772	-1,176
(In percent of GDP)	-14.0	-5.6	-11.0	-21.0	-3.8	-16.1	-21.2
Trade balance	-613	-158	-456	-1,341	-91	-841	-1,401
Exports	2,534	1,902	2,233	2,431	1,833	1,995	2,183
Imports	-3,147	-2,060	-2,689	-3,772	-1,924	-2,836	-3,584
Foreign direct investment	836	426	422	849	305	609	768
Gross official international reserves (end-period)	658	1,327	1,492	1,646	1,050	1,252	1,368
(In months of next year's imports of goods and services)	3.0	4.9	4.0	4.4	3.9	3.8	4.2
Trade prices							
Export prices (US$, percent change)	-4.7	-23.0	18.6	5.4	-16.0	4.0	5.5
Import prices (US$, percent change)	16.9	-19.5	10.9	3.9	-19.5	9.3	3.1
Terms of trade (percent change)	-18.5	-4.3	7.0	1.5	4.3	-4.9	2.3
	(In percent of GDP)						
Public and publicly guaranteed debt							
Total public debt	33.8	53.4	66.2	70.8	51.6	70.8	69.0
Domestic debt 5/	0.0	6.3	22.7	30.4	6.3	26.6	32.7
External debt 6/	33.7	47.1	43.5	40.4	45.3	44.2	36.3
(In millions of US$)	1,602	1,977	2,176	2,252	1,937	2,082	2,120
Exchange rate							
Togrogs per US$ (end-period)	1,268	1,443	...	...	...	...	...
Togrogs per US$ (period average)	1,169	1,441	...	...	...	...	...
Nominal effective exchange rate (end-period; percent change)	-2.5	-17.6	...	...	...	...	...
Real effective exchange rate (end-period; percent change)	18.7	-19.2	...	...	...	...	...
Nominal GDP (In billions of togrogs)	6,020	6,056	7,221	8,055	6,407	7,373	8,291

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/ 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.
6/ Includes prospective Fund credit under the SBA. Projections for 2010-2011 are valued at the program exchange rate.

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

		Prel.	Proj.		3rd review		
	2008	2009	2010	2011	2009	2010	2011
			(In billions of togrogs)				
Total revenue and grants	2,170	1,993	2,493	2,461	1,967	2,432	2,444
Total expenditure and net lending	2,467	2,322	2,784	2,820	2,383	2,802	2,667
Overall balance (incl. grants)	-296	-329	-291	-359	-416	-370	-223
Nonmineral overall balance	-911	-778	-882	-600	-815	-898	-433
Financing	296	329	291	359	416	370	223
Foreign (net)	39	300	20	68	324	17	57
Domestic (net)	258	29	271	290	91	353	166
Privatization receipts (valuation adj.)	9	26	19	19	33	33	33
Domestic bank financing (net)	249	76	182	142	98	243	-16
Domestic nonbank financing (net)	0	-73	70	130	-40	77	149
			(In percent of GDP)				
Total revenue and grants	36.1	32.9	34.5	30.6	30.7	33.0	29.5
Current revenue	35.7	32.5	33.7	30.1	29.8	32.6	29.1
Tax revenue and social security contributions	31.4	26.7	29.0	25.9	24.5	28.8	25.3
Income taxes	12.5	8.6	10.8	6.4	7.5	9.9	5.8
Social security contributions	3.8	4.2	4.0	4.6	4.1	3.9	3.9
Sales tax and VAT	6.1	5.4	6.4	6.9	5.3	6.9	7.5
Excise taxes	3.0	2.8	2.5	2.5	2.6	2.5	2.6
Customs duties and export taxes	2.3	1.9	1.9	2.2	1.8	2.3	2.6
Other taxes	3.6	3.8	3.4	3.3	3.2	3.3	2.7
Nontax revenue	4.3	5.8	4.7	4.2	5.3	3.9	3.9
Capital revenue and grants	0.3	0.5	0.9	0.4	0.9	0.4	0.4
Total expenditure and net lending	41.0	38.3	38.5	35.0	37.2	38.0	32.2
Current expenditure	29.3	29.6	30.8	27.5	28.5	30.3	24.6
Wages and salaries	9.0	9.6	8.3	7.5	9.1	8.1	7.7
Purchase of goods and services	8.5	6.5	6.3	6.0	5.6	6.3	6.0
Subsidies to public enterprises	1.2	0.6	1.1	0.6	0.8	0.9	0.4
Transfers 1/	10.2	12.5	13.8	12.2	12.5	13.5	9.1
Interest payments	0.3	0.5	1.3	1.3	0.5	1.4	1.5
Capital expenditure and net lending	11.7	8.7	7.7	7.5	8.7	7.7	7.5
Capital expenditure	10.4	7.6	6.9	6.0	7.1	6.7	6.0
Net lending	1.3	1.2	0.8	1.5	1.7	1.0	1.5
Overall balance (incl. grants)	-4.9	-5.4	-4.0	-4.5	-6.5	-5.0	-2.7
Nonmineral overall balance (incl. grants)	-15.1	-12.9	-12.2	-7.5	-12.7	-12.2	-5.2
Financing	4.9	5.4	4.0	4.5	6.5	5.0	2.7
Foreign (net)	0.6	4.9	0.3	0.9	5.1	0.2	0.7
Disbursements	1.4	6.4	1.3	1.8	6.6	1.3	1.8
Project loans	1.4	1.5	1.7	1.8	1.7	1.8	1.8
Program loans	0.0	3.3	0.8	0.0	3.3	0.8	0.0
Gold financing loan	0.0	1.6	-1.3	0.0	1.5	-1.4	0.0
Amortization	0.8	1.5	1.0	1.0	1.5	1.1	1.1
Domestic (net)	4.3	0.5	3.7	3.6	1.4	4.8	2.0
Banking system (net)	4.1	1.3	2.5	1.8	1.5	3.3	-0.2
Nonbank	0.1	-0.8	1.2	1.8	-0.1	1.5	2.2
Of which: Oyu Tolgoi tax-prepayment	0.0	2.4	1.0	1.6	2.3	1.0	1.8
Memorandum items:							
Overall balance incl. banking sector restructuring costs (percent of GDP) 2/	-4.9	-5.4	-11.2	-4.5	-9.3	-9.6	…
Mineral revenue (percent of GDP)	10.2	7.4	8.2	3.0	6.2	7.2	2.5
Nonmineral revenue (percent of GDP)	25.5	25.0	25.5	27.2	23.6	25.5	26.6
Nominal GDP (in billions of togrogs)	6,020	6,056	7,221	8,055	6,407	7,373	8,291
Copper price (US$ per ton)	6,963	5,100	6,500	7,000	5,000	5,800	6,000

Sources: Ministry of Finance; and IMF staff projections.

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

2/ Includes the estimated fiscalization cost of bank restructuring.

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

		Prel.	Proj.		3rd review	
	2008	2009	2010	2011	2009	2010
	(In billions of togrog; end of period)					
Monetary survey						
Broad Money	2,270	2,880	3,454	4,046	2,725	3,417
Currency	329	285	345	405	395	466
Deposits	1,941	2,595	3,108	3,642	2,330	2,951
Net foreign assets	683	1,659	1,688	1,896	1,334	1,510
Net domestic assets	1,587	1,221	1,765	2,150	1,391	1,907
Domestic credit	2,118	1,958	2,873	3,400	2,102	2,879
Net credit to government	-574	-746	-16	126	-479	104
Claims on nonbanks	2,692	2,704	2,889	3,274	2,581	2,774
Other items, net	-532	-736	-1,107	-1,250	-711	-971
Monetary authorities						
Reserve money	580	741	879	1,017	730	865
Net foreign assets	805	1,665	1,694	1,903	1,272	1,445
BOM defined reserves 2/	808	1,783	1,807	2,016	1,394	1,567
Net international reserves (NIR) 3/	627	1,439	1,489	1,698	1,245	1,419
Other BOM defined reserves	181	343	318	318	148	148
Other assets, net	-3	-118	-113	-113	-122	-122
Net domestic assets	-225	-923	-815	-886	-542	-580
Net credit to government	-183	-287	74	217	-132	-49
Claims on deposit money banks	243	198	22	22	120	120
Minus: Central bank bills (net)	120	393	470	540	350	460
Other items, net	-165	-442	-442	-585	-179	-191
Memorandum items:	(In percent; unless otherwise indicated)					
Annual broad money growth	-5.1	26.9	19.9	17.2	20.0	25.4
Annual growth of claims to nonbanks	28.7	0.4	6.8	13.3	-4.1	7.5
Adjusted for bank restructuring	…	…	13.8	13.3	2.9	7.5
Annual reserve money growth	8.4	27.9	18.6	15.7	15.2	18.5
Velocity	2.7	2.1	2.1	2.0	2.4	2.2
Broad money/reserve money	3.9	3.9	3.9	4.0	3.7	3.9
Total loans/deposits	138.7	104.2	92.9	89.9	110.8	94.0
BOM defined reserves (in millions of US$) 2/	638	1,143	1,252	1,397	893	1,004
Net international reserves (NIR, in millions of US$) 3/	495	923	1,032	1,177	798	909
Monetary Survey NCG	-574	-746	-16	126	-479	104
Monetary Survey NCG, excluding bank restructuring costs	-574	-746	-535	-393	-658	-415
Net credit to government program definition 4/	-574	-590	-307	-21	-515	-196

Sources: Mongolian authorities; and IMF staff projections.

1/ Valued at the program exchange rate and gold price. The definition of reserve money was changed to exclude foreign currency time deposits of commercial banks and the presentation consistently applies this new definition, except for the columns of the 3rd review. In addition, the projections are based on the new program exchange rate. Due to these changes, the projections are not directly comparable with the 3rd review columns.

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, the expected cost associated with bank restructuring, and the Oyu Tolgoi tax-prepayment.

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

(In millions of US$, unless indicated otherwise)

		Proj.			3rd review		
	2008	2009	2010	2011	2009	2010	2011
Current account balance (including official grants)	-722	-235	-566	-1,302	-167	-772	-1,176
Trade balance	-613	-158	-456	-1,341	-91	-841	-1,401
Exports	2,534	1,902	2,233	2,431	1,833	1,995	2,183
Copper concentrate	836	502	667	749	600	667	734
Gold	600	336	353	365	381	382	398
Other	1,099	1,064	1,213	1,317	852	946	1,050
Imports	-3,147	-2,060	-2,689	-3,772	-1,924	-2,836	-3,584
Oil imports	-891	-525	-680	-856	-457	-620	-717
Food imports	-436	-314	-370	-430	-325	-360	-400
Oyu Tolgoi-related imports	-190	-143	-576	-1,326	-143	-791	-1,326
Other	-1,630	-1,077	-1,063	-1,159	-999	-1,066	-1,141
Services, net	-191	-128	-154	-114	-199	-102	11
Income, net	-130	-128	-126	-12	-115	-81	-29
Current transfers	212	179	169	165	237	251	244
General government 1/	87	40	29	24	144	147	120
Other sectors	125	140	140	141	93	104	123
Of which: workers remittances	94	120	120	121	63	73	92
Capital and financial account	546	745	662	1,446	402	907	1,296
Capital account	…	164	118	96	…	…	…
Financial account	546	581	544	1,350	402	907	1,296
Direct investment	836	426	422	849	305	609	768
Portfolio investment	-18	-93	-107	0	-34	-107	0
Trade credits, net	72	-25	-19	-22	-25	-18	-20
Currency and deposits, net	120	-45	-38	-31	-144	-38	-31
Loans, net	189	119	1,025	1,566	258	709	1,067
Other, net	-654	200	-738	-1,011	42	-247	-487
SDR allocations	0	75	0	0	75	0	0
Errors and omissions	-161	0	0	0	0	0	0
Overall balance	-337	510	96	145	235	135	120
Financing	337	-510	-96	-145	-235	-135	-120
Gross official reserves (- increase)	342	-670	-165	-141	-393	-202	-117
Use of IMF credit (+)	-5	160	68	-4	158	67	-4
Financing need (- overfinancing)	0	0	0	0	0	0	0
Memoranda items:							
Current account balance (in percent of GDP)							
Including official grants	-14.0	-5.6	-11.0	-21.0	-3.8	-16.1	-21.2
Excluding Oyu Tolgoi	-10.3	-2.2	0.2	0.4	-0.5	0.4	2.7
Excluding official grants	-15.7	-6.5	-11.6	-21.4	-7.0	-19.1	-23.3
Gross official reserves (end-period)	658	1,327	1,492	1,646	1,050	1,252	1,368
(In months of imports of goods and services)	3.0	4.9	4.0	4.4	3.9	3.8	4.2
Copper price (in US$ per ton)	6,963	5,100	6,500	7,000	5,000	5,500	6,000
Oil price (in US$ per barrel)	97	62	76	82	62	77	80
Gold price (in US$ per troy oz.)	872	973	1,136	1,150	933	955	975

Sources: Mongolian authorities; and IMF staff projections.

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

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

	2010	2011	2012	2013	2014	2015
Fund obligations based on existing credit (in millions of SDRs)						
Principal	2.4	2.4	22.7	55.3	32.6	0.0
Charges and interest	1.0	1.3	1.3	0.9	0.2	0.0
Fund obligations based on existing and prospective credit (in millions of SDRs)						
Principal	2.4	2.4	22.7	66.8	55.6	11.5
Charges and interest	1.5	1.9	1.9	1.4	0.6	0.1
Total obligations based on existing and prospective credit						
In millions of SDRs	3.9	4.4	24.6	68.2	56.2	11.6
In millions of US$	6.2	6.9	39.2	108.6	89.1	18.4
In percent of gross international reserves	0.4	0.4	2.6	6.1	4.1	0.7
In percent of exports of goods and services	0.2	0.2	1.3	2.2	1.5	0.3
In percent of debt service 2/	4.1	8.3	31.8	61.0	48.7	13.6
In percent of GDP 3/	0.1	0.1	0.6	1.4	1.0	0.2
Outstanding Fund credit						
In millions of SDRs	159.0	156.6	139.0	79.8	19.2	0.0
In millions of US$	253.2	249.3	221.4	127.2	30.4	0.0
In percent of gross international reserves	17.0	15.1	14.7	7.1	1.4	0.0
In percent of exports of goods and services	9.6	8.3	7.1	2.6	0.5	0.0
In percent of debt service 2/	167.7	298.0	179.5	71.4	16.6	0.0
In percent of GDP 3/	5.1	4.5	3.7	1.6	0.3	0.0
In percent of quota	311.2	306.4	271.9	156.2	37.5	0.0
Net use of Fund credit (in millions of SDRs)	43.6	-2.4	-22.7	-66.8	-55.6	-11.5
Disbursements 4/	46.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	2.4	2.4	22.7	66.8	55.6	11.5
Memorandum items:						
Exports of goods and services (in millions of US$)	2,645	2,988	3,130	4,870	6,070	6,346
Gross international reserves (in millions of US$)	1,492	1,646	1,501	1,791	2,150	2,688
Debt service (in millions of US$) 2/	151	84	123	178	183	135
Quota (millions of SDRs)	51.1	51.1	51.1	51.1	51.1	51.1

Sources: Fund staff estimates and projections.

1/ Includes prospective SBA purchase of SDR 153.3 million (300 percent of quota).

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

3/ Nominal GDP valued at program exchange rate.

4/ The purchases are assumed to take place on the first day of the following month after each review.

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 19, 2010	30	15,330,000	Completion of the fourth review and observance of end-December 2009 performance criteria.
June 15, 2010	30	15,330,000	Completion of the fifth review and observance of end-March 2010 performance criteria.
September 15, 2010	30	15,330,000	Completion of the sixth review and observance of end-June 2010 performance criteria.
Total	300	153,300,000	

ATTACHMENT 1. LETTER OF INTENT

February 24, 2010

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

Dear Mr. Strauss-Kahn:

Our macroeconomic policies, supported by the Stand-By Arrangement with the International Monetary Fund, have successfully stabilized market conditions, boosted international reserves, and lowered inflation. The outlook for this year is favorable and growth, boosted by the investment in the Oyu Tolgoi mine, is expected to rebound.

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, improving public finances, maintaining a flexible exchange rate, and alleviating poverty. The attached Memorandum of Economic Policies (MEP) describes our macroeconomic policies for the remainder of 2010.

Given the success to date of the program, and our observance of all end-December 2009 performance criteria, we request the completion of the fourth review. Quantitative targets and structural policies of our program are outlined in Tables 1 and 2. The fifth review is scheduled to take place on or after June 15, 2010 and the sixth review is scheduled to take place on or after September 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. Bayartsogt
Minister of Finance

/s/
L. Purevdorj
Governor of Bank of Mongolia

Attachments
Memorandum of Economic Policies
Revised Technical Memorandum of Understanding

ATTACHMENT 2. MEMORANDUM OF ECONOMIC POLICIES

1. **Growth and inflation.** We expect the economy to rebound this year and to grow around 7 percent, spurred by investments that will accompany the development of the Oyu Tolgoi mine. Inflation was 4½ percent in January and is projected to pick up this year, due in part to rising meat prices, and stabilize at around 6 percent for 2011.

Fiscal Policy

2. **Fiscal stance**. We remain committed to restoring health to public finances and made significant progress toward this goal last year. For this year, we are committed to limiting the 2010 budget deficit to less than 5 percent of GDP and will fully offset any revenue shortfall with a reduction in spending to ensure that the 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.

3. **Maintaining fiscal responsibility**. We will pass by June 15 a Fiscal Responsibility Law. 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. The law will limit the structural budget deficit to 4 percent of GDP in 2011, falling to 2 percent of GDP by 2013. We will achieve this adjustment by adopting high-quality measures that will help ensure a durable improvement in public finances while also enhancing economic efficiency. Specifically, we intend to strengthen tax administration by significantly expanding the large taxpayer office and doubling the audit staff devoted to large taxpayers (by end-July). In addition, we are planning to modernize the mineral taxation regime so as to boost revenue and facilitate development of the mining sector. Finally, an organic budget law, complementary to the Fiscal Responsibility Law, is under preparation and expected to be passed later this year.

4. **Protecting the poor**. A social transfer reform law has been submitted to parliament and will be passed by June 15. The law aims to better assist Mongolia’s most vulnerable citizens by increasing the benefits to low income households. We will phase-in implementation 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.

Monetary and Exchange Rate Policies

5. **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 28 day period, our net sales in the foreign exchange auctions exceed US$30 million.

6. **Monetary policy.** Our primary objective for monetary policy continues to be oriented toward achieving and maintaining low inflation and macroeconomic stability. Inflation, which had decelerated sharply and turned negative last year, has started to pick-up in line with our expectations. Monetary policy, therefore, has switched to a neutral stance and the central bank will continue to closely monitor the inflation outlook and the strength of the economic recovery to assess whether to adjust interest rates.

Banking System Reforms

7. **Banks.** We are taking decisive action to bolster confidence in the banking system and ensure financial stability. We have started external audits at several banks and will complete ten of these audits by end-March of this year. With the audit results as input, we will develop plans to ensure that all banks have strong capital bases and viable business plans, and will submit a comprehensive bank restructuring strategy to Parliament in early April. As part of this strategy, public funds may well be needed. 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.

8. **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, Parliament recently passed a revised Banking Law that reinforces prudential requirements, more clearly defines connected parties, and strengthens the resolution framework. We also will (i) improve the loan classification system for restructured loans, including by clarifying the definition, tightening the rules for upgrading, and requiring monthly reporting; (ii) establish a separate unit within the central bank to handle on-site examination; (iii) strengthen the monitoring and supervision of banks offering deposit rates above the market rate; and (iv) more strictly enforce prudential rules on single-borrower limits, connected party loans, and provisioning requirements.

Other policies

9. **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.

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

	12/31/2008	12/31/2009			3/31/2010			6/30/2010		
					3rd review			3rd review		
	Actual	Prog.	Adjusted	Outcome	Prog.	Adjusted	Rev. Prog.	Prog.	Adjusted	Rev. Prog.
Performance criteria 1/										
Net international reserves (NIR) of the Bank of Mongolia (BOM) (floor, eop stock, in million US$) 2/	495	798	766	923	853	761	809	788	746	776
Net domestic asset (NDA) of the BOM (ceiling, eop stock, in billion togrog) 3/	-171	-542	-492	-728	-618	-485	-645	-491	-431	-477
Net credit to government (NCG) (ceiling, cumulative from the beginning of the fiscal year, in billion togrog) 3/	130	58	108	-17	100	114	220	242	228	270
New nonconcessional external debt maturing in one year or more, contracted or guaranteed by the government or the BOM (ceiling, eop stock since April 2009, in million US$).	0	200	200	100	200	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$).	0	0	0	0	0	0	0	0	0	0
Accumulation of new external payment arrears (ceiling, eop, in million US$).	…	0	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	0
Indicative targets										
General government fiscal deficit (ceiling, cumulative since the beginning of fiscal year, in billion togrog).	296	416	416	329	136	136	220	216	216	270
Memorandum items:										
Support from bilateral and multilateral donors excluding IMF (cumulative since April 2009, in million US$), program level.	0	174	142	142	194	152	152	234	192	192
Disbursed new nonconcessional external debt (eop stock, in million US$), program level.	…	75	75	75	75	75	75	0	0	0
Disbursed Oyu Tolgoi tax prepayment loans (eop stock, in million US$), program level.	…	100	100	100	150	100	100	150	150	150

1/ Evaluated at the program exchange rate.

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

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

Table 2. Mongolia: Structural Benchmarks

Actions	Date	Status
Revising relevant laws to require Erdenet to pay taxes in togrog.	6/30/2009	Completed on July 9.
Announcement of a resolution plan for Anod bank based on the diagnostic assessment of the external auditor.	6/30/2009	Completed. Anod bank was put into receivership on November 30, 2009.
A comprehensive review of transfer programs resulting in a revision of the relevant laws to streamline transfer programs and safeguard the social safety.	6/30/2009	Completed late June, reform plan approved by Cabinet-level Working Group.
Submission to the parliament of a revised banking law and other pertinent laws and legislations that include: (i) strengthened prompt corrective action clauses including an increase in penalties for noncompliance; (ii) requiring consolidated supervision; (iii) an improved bank resolution framework that more clearly defines the roles of the conservator and liquidator; (iv) legal protection for bank and nonbank supervisors; (v) a more clear definition of "group of connected parties;" and (vi) reinforced prudential supervision requirements.	6/30/2009	Completed on July 24.
Pass a 2010 budget consistent with the IMF supported Stand-By Arrangement.	12/1/2009	Completed November 27.
The submission to parliament of Fiscal Responsibility Law consistent with recommendations of Fund technical assistance.	12/31/2009	Completed, submitted to Parliament on January 12.
Pass a comprehensive social transfer reform that saves money and protects the poor through better targeting.	12/1/2009	Delayed. Reset below.
Passage of a comprehensive social transfer reform.	6/15/2010	
Parliamentary passage of Fiscal Responsibility Law consistent with recommendations of Fund technical assistance.	6/15/2010	

ATTACHMENT 3. TECHNICAL MEMORANDUM OF UNDERSTANDING

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

1. Performance criteria for end-March 2010 and end June-2010 have been established with respect to:

- floors on the level of net international reserves of the 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;
- ceilings 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-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 1,443 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$1.56. Monetary gold will be valued at US$1,096 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 (excluding foreign currency denominated time deposits).

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 bank restructuring costs approved by Parliament.

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 bank restructuring approved by Parliament are excluded from expenditure and net lending, but the corresponding interest payments are included.

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 public sector with nonresidents with original maturities of one year or more. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector. The public sector comprises the central government and the Bank of Mongolia.

21. 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.

22. 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 31, 2009 (Decision No. 14416-(09/91)) (see Annex I).

23. Excluded from the ceiling are (i) the use of Fund resources; (ii) lending from the World Bank Group, 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.

24. For program purposes, the guarantee of a debt arises from any explicit legal obligation of the public sector 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 public sector to finance partially or in full any shortfall incurred by the loan recipient.

25. 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 present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV 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 PV 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

26. A ceiling applies to the contracting and guaranteeing by the public sector 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.

27. For program purposes, the definition of debt is set out in Executive Board Decision No. 12274, Point 9, as revised on August 31, 2009 (Decision No. 14416-(09/91)) (see Annex I).

28. 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

29. 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

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

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

A. Monetary Data (BOM)

- The monetary survey, the balance sheet of the BOM, and the consolidated balance sheet of the commercial banks. Data will be provided on a monthly basis, with the exception of the balance sheet of the BOM, which will be provided on a weekly basis within five working days of the end of the respective week.
- Net international reserves and interventions of the BOM in the foreign exchange market on daily basis.
- Interest rates and volume on standing facilities and market operations on a weekly basis within five working days of the end of the respective week.
- A detailed breakdown of net credit to government from the BOM and the commercial banks.
- Stock of monetary gold in both thousands of fine troy ounces and U.S. dollars. If the BOM engages in monetary gold transactions or employs any other accounting rate, directly or implicitly, for valuing gold assets, this information will be reported to the Fund. Any increase in monetary gold through purchases from domestic sources and refining of nonmonetary gold held or purchased by the BOM will also be reported

(both prices and volumes). Any liabilities that are guaranteed or otherwise backed by gold will be reported to the Fund.

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

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

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

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

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

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

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

- Classified transactions of all social insurance funds.

- Domestic payment arrears of the general government.

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

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

C. External Sector Data (BOM and MOF)

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

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

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

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

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

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

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

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

ANNEX 1. GUIDELINES ON PERFORMANCE CRITERIA WITH RESPECT TO FOREIGN DEBT

Excerpt from Executive Board Decision No. 12274, as revised on August 31, 2009 (Decision No. 14416-(09/91)).

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 EXTERNAL RELATIONS DEPARTMENT

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March 19, 2010

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth Review Under Stand-By Arrangement with Mongolia and Approves US$23.4 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the fourth 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$23.4 million), bringing total disbursements under the arrangement to an amount equivalent to SDR 122.64 million (about US$187.4 million). The Board also approved the request for the 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$234.3 million) or 300 percent of Mongolia's quota.

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

"Mongolia's macroeconomic outlook has improved markedly. Growth is expected to rebound sharply boosted by investment in a large mining project and the authorities' strong policy implementation. At the same time, inflation has recently picked up in part because of higher food prices due to the severe winter.

"The authorities have made substantial progress in strengthening public finances. Expenditure restraint and an increase in revenues emanating from higher world copper prices have resulted in an improvement in the structural balance by 3½ percentage points, about 1 percentage point more than anticipated. This large fiscal adjustment was achieved while fully protecting social welfare expenditures.

"Passage of a comprehensive social transfer reform law with a targeted poverty benefit will be an important step in fighting poverty and increasing fiscal flexibility. The planned passage of a fiscal responsibility law will be critical for institutionalizing fiscal discipline and avoiding the boom-bust policies of the past.

“The flexible exchange rate regime is working well, helping to contain inflationary pressures and safeguarding international reserves. The current neutral stance of monetary policy is appropriate but will need to be reviewed if inflationary pressures persist. Maintaining low and stable inflation will be a prerequisite to continued improvement in poverty indicators and high and sustained growth.

“A comprehensive bank restructuring plan is needed to ensure that banks have strong balance sheets that can support sustained growth in lending to the private sector. Moreover, a further strengthening of bank supervision will help support the bank restructuring effort and prevent the re-emergence of problems in the banking system,” Mr. Shinohara stated.

Statement by Hi-Su Lee, Executive Director for Mongolia
and Suk Kwon Na, Advisor to the Executive Director
March 19, 2010

1. The Mongolian authorities are very thankful to the Fund and its staff for their insightful policy advice and productive cooperation in coping with the economic crisis faced by the authorities. Staff's recommendations and timely guidance are in accord with their keen interest in the Mongolian economy. Concerning the economic stabilization achieved so far and the broad policy consensus between the authorities and staff, the authorities continue to make concerted efforts in implementing the Fund's full-fledged advice toward economic stability and sustained development.

Macroeconomic Atmosphere and Program Performance

2. With the constructive helps from donors and the Fund, the Mongolian economy has bottomed out from the negative territory (– 1.6 percent) in 2009 and stands ready to rebound strongly this year, with real growth projected at around 7.3 percent. Major international agreement for the development of the Oyu Tolgoi (OT) mine in October 2009 has provided significant momentum for this turnaround, and recovered copper prices, a major export, will play a role in this recovery path. On the other hand, the current development in the mining sector and the recently-rising meat prices could pose some risk to inflation, which is projected to rise around 7.1 percent by end-2010 and stabilize at around 5.5 percent for 2011.

3. Given the authorities' policy objective for achieving strong, sustainable, and equitable growth together with low inflation and healthy public finances, the authorities are committed to doing their best in sustaining the economic development on the one hand and maintaining low and stable inflation on the other. The past experiences of boom-bust cycle and current global crisis would function as good alarm for all the relevant authorities not to lose good timing for appropriate policy implementation as well as vigilant monitoring.

4. As well noted by staff, all performance criteria (PC) for the fourth review were successfully met, with the indicative target of fiscal deficit showing comfortable margin. Staff readjusted quantitative targets to reflect favorably-changed environment. Out of structural benchmarks, the authorities have not met the target date for passing the social transfer law, because of late submission to Parliament and timing issue arising from Parliament's winter recess. Given the importance of this law in fiscal area, the authorities are committed to securing passage of this legislation in the forthcoming spring session, which starts in early April.

Fiscal Policy

5. The authorities fully recognize staff's recommendation that fiscal restraint is warranted for several years to come in order to bring government finance into a sustainable

path. Indicative of the authorities' keen interest in this agenda is the encouraging fiscal outcome of 2009, which shows that the fiscal deficit in 2009 (-5.4 percent of GDP) was well preserved below the program target of -6.5 percent, mainly due to spending restraint.

6. Although we welcome staff's expectation that this good performance is likely to happen again this year, mainly aided by rising copper prices, the authorities could face another challenging period in terms of fiscal prudence, given the planned elimination of the windfall profit tax and mining tax in 2011. The increase in universal transfers introduced in the 2010 budget, which originated from political motive, will limit the authorities' capacity for fiscal flexibility. With these in mind, the authorities strive to find various options to contribute to significant enhancement in public finances, including strengthening tax administration, modernizing the mineral taxation regime, and reducing untargeted transfers. The recent request letter for TA in tax policy and budget reform (including fiscal relations between central and local government) to the Fund is crystal evidence of the authorities' strong desire for future fiscal consolidation, and encourages us to urge the Fund to provide additional TA in a timely manner.

7. In the area of structural fiscal reform, the authorities clearly expressed their commitment to the passage of two pending laws in Parliament, the fiscal responsibility (FRL) and social transfer laws, by the target date of June 15. In particular, the FRL will, if approved, crucially promote fiscal discipline by enhancing transparency and establishing numerical rules. The authorities have an ambitious timeframe in achieving structural budget deficit of 4 percent of GDP in 2011 and 2 percent by 2013 through the FRL framework. An organic budget law as complementary legislation to the FRL, which deals with fiscal federalism issues, is under preparation and expected to be passed later this year. In parallel, another big goal of better assisting the poor and creating fiscal saving by better targeting will be achieved with the passage of social transfer law, with timely technical assistance from the World Bank and the Asian Development Bank, focusing on means-testing.

Monetary and Exchange Rate Policies

8. At this moment, key objectives for monetary policy remain unchanged at maintaining low inflation and contributing to macroeconomic stability. While supporting staff's concern on the recently-evolving inflation risks, the authorities continue to take vigilant stance in monitoring the inflation outlook, focusing on recent increases in meat prices. In addition, they are committed to investing sufficient caution in assessing whether to adjust interest rate, taking into balanced consideration the strength of the economic recovery and extent of inflation pressures. Toward the medium-term goal of an inflation targeting framework, the central bank will continue to lay the technical foundation as necessary, including by improving inflation forecasting and advancing monetary transmission channel.

9. The authorities are strongly committed to a flexible exchange rate, as they are fully cognizant of the positive advantage of flexible rates in relieving terms of trade volatility and

preventing higher inflation mainly arising from OT mining income in 2013. In the same vein, their intervention will be limited to smoothing excess volatility caused by temporary imbalances, with more focus placed on rebuilding international reserves and aligning the exchange rate with evolving market conditions.

Banking System

10. The authorities' proactive and comprehensive efforts need to be continuously invested in the banking sector, which still stays, at this juncture, as the Achilles' heel of the Mongolian economy. Among the many progress achieved recently, the most welcome item is that a new banking law was passed on January 2010 and is now in effect. We are also pleased to note the authorities' undeniable eagerness for bolstering the integrity of and confidence in the banking system.

11. For the purpose of bank restructuring reform, the authorities have already initiated external audits of several banks, as a first step, and will complete ten of these audits by end-March 2010. Secondly, they will develop a comprehensive bank restructuring plan, which is scheduled to be submitted to Parliament no later than its April session. As well alluded to in the staff paper, this plan will include the main principles in maneuvering such restructuring process ahead, including the use of public funds tied to recipient banks' governance reform. Thirdly, the authorities plan to establish bank-by-bank plans, fully utilizing available supervisory data and the findings of external audits. Sufficiently-deliberated and well-categorized plans suited to individual banks' situation will likely provide clear guidelines in due course. More importantly, through the whole process, the authorities will not spare any effort to proactively respond to newly-burgeoning problems in individuals banks on the one hand, and to strengthen the stability of and public confidence in the banking system as a whole on the other.

12. In terms of banking supervision, the newly-passed banking law will function as the main foundation for prudential requirements, consolidated supervision, and improved resolution framework. In addition, the authorities, primarily the Bank of Mongolia and the Financial Regulation Committee, are committed to redoubling their efforts in strengthening financial supervision, as well described in the attached Memorandum of Economic Policies.

Other Issues

13. With regard to external financing, the authorities are taking a firm stance to keep the non-concessional debt within program ceiling through prudent management and to maintain the current prohibition on government guarantees.

14. The authorities have shown good progress in the area of official arrears, including, reaching rescheduling agreement with Finland, as well as paying off 18.0 million USD for Russian debt.

Conclusion

15. Recently-emerging good signs, spurred by strong policy implementation and the recovery in copper prices, could loosen the authorities' steadfast determination for robust fiscal consolidation and concerted banking restructuring efforts. Accordingly, not being complacent with not-so-small achievement thus far, the authorities will continue to press ahead with comprehensive reform policies in the lead up to economic prosperity. With the first priority placed in passing two pending important laws, the authorities will try to entrench sound macroeconomic policies to allow them to consolidate achievements made so far and create a more enabling environment for growth.

16. Finally, my Mongolian authorities wish to express their utmost appreciation to the Fund and its staff for their comprehensive and appropriate policy advice in crucial times like this. They also extend their deepest gratitude to the Fund's mission chief, Mr. Steven Barnett, and his team for their devoted work and invaluable advice in developing Mongolia's economic reform program.