IMF Country Report No.12/320

# MONGOLIA

November 2012

## 2012 ARTICLE IV CONSULTATION AND THIRD POST-PROGRAM MONITORING

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2012 Article IV consultation with Mongolia, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV Consultation and Third Post-Program Monitoring, prepared by a staff team of the IMF, following discussions that ended on September 25, 2012, 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 November 1, 2012. 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.
- **Informational Annex** prepared by the IMF.
- **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its November 16, 2012 discussion of the staff report that concluded the Article IV consultation.

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

November 1, 2012

## STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION AND THIRD POST-PROGRAM MONITORING

## KEY ISSUES

**Context:** Mongolia has made impressive progress in developing its economy over the past ten years. Medium-term prospects are promising as mining output is projected to expand by more than 20 percent per annum, on average, over the next five years. However, the prospects for sustained, rapid and inclusive non-mineral growth depend on the implementation of the stability-oriented fiscal framework that has been adopted in the aftermath of the 2008/09 balance of payments (BOP) crisis. This framework was designed to dampen volatility, mitigate risks to economic and financial stability, and strengthen long-term natural resource management. The expansionary fiscal policy of the past year is causing double-digit inflation and BOP pressures. Public spending needs to be reined in, in order not to risk undermining stability and growth prospects, and in view of Mongolia's vulnerability to a downturn in commodities exports.

**Focus:** The discussions centered on the following:

- **Fiscal policy**: Expenditure restraint is critical to address overheating pressures. Unrealistic revenue projections in the 2012 Supplementary Budget and the draft 2013 Budget incorrectly suggest that there is ample room to expand spending while still observing the Fiscal Stability Law's (FSL) 2-percent-of-GDP structural deficit ceiling.
- **Fiscal policy framework**: Off-budget spending by the Development Bank of Mongolia (DBM) on public investment projects should be taken into account when determining the macro-economically sustainable level of government spending.
- **Monetary and exchange rate policy:** Inflation is considerably in excess of the Bank of Mongolia (BOM)'s stated target, notwithstanding the tightening of monetary policy effected over the past year. There is no room for monetary loosening at this stage and future policy should be contingent on inflationary pressures abating and prudent fiscal policy. The floating exchange rate regime should be maintained and intervention be limited to smoothing excessive exchange rate volatility.
- **Financial sector stability:** Efforts to strengthen the soundness and resilience of the financial sector should continue, building on the recommendations of the 2010/2011 FSAP. Development of a government bond market is a priority.

Approved By
**Markus Rodlauer and Masato Miyazaki**

Discussions were held in Ulaanbaatar during September 12–25, 2012. The staff team comprised Messrs. Almekinders (head) and Ojima (both APD), Min (FAD), and Shin (OAP). It was assisted by Mses. Ardak, Khulan, and Selenge in the local office. Mr. Lee (OED) participated in the meetings. The mission's concluding statement was published.

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# RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

## A. Introduction

1. **Mongolia has made impressive progress in developing its economy**. Spearheaded by the foreign direct investment (FDI)-financed development of the mining sector, growth averaged 8 percent per annum over the past 10 years, among the highest in the region. As a result, per capita GDP increased five-fold, to about US$3,000, and Mongolia gained market access and has become eligible for non-concessional borrowing from the World Bank and Asian Development Bank.

2. **But there is scope to improve the track record on poverty reduction and macrostability.** Inflation has been higher and more volatile than in regional peers. Despite strong growth and a substantial decline in poverty in 2011, about 30 percent of the population still lives in poverty, unemployment remains high, and inequality is rising (Figure 4).

3. **An 18-months Stand-By Arrangement (SBA) was completed in October 2010**. The program, which was supported by a SBA with access of 300 percent of quota (SDR 153.3 million), aimed to smooth adjustment to the large terms of trade shock triggered by the onset of the global financial crisis, restore health to the country's fiscal finances, allow for exchange rate flexibility in line with market conditions, address weaknesses in the banking system, and protect the most vulnerable from the burden of the needed adjustment. In addition, the program outlined a macroeconomic framework to provide the basis for the authorities to approach the broader international community for financial support.

4. **Since the end of the program, fiscal discipline has steadily eroded, jeopardizing the stability gains.** Government spending has been ramped up—similar to what was observed in the two years leading up to the SBA—contravening recommendations in the 2011 Article IV consultation and the authorities' own efforts to put in place a new fiscal framework. In line with staff advice, this framework was designed to address the key challenge of medium-term natural resource management, anchored by the 2010 Fiscal Stability Law (FSL), the 2011 Integrated Budget Law (IBL), and the 2012 Social Welfare Law (SWL).[1] The direction of the authorities' other macroeconomic policies during the past year has been broadly in line with staff advice. Monetary policy has been tightened markedly and the authorities have continued to operate a flexible exchange rate regime, albeit with intermittent interventions to limit the togrog's depreciation.

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[1] The design of Mongolia's new fiscal framework is discussed in more detail in Chapter III. D. of the recent Board Paper, *Macroeconomic Policy Frameworks for Resource-Rich Developing Countries, Background Paper I* (www.imf.org). The chapter highlights that Mongolia's fiscal policy framework is supported by a stabilization fund for mineral revenue which is envisaged to function as a savings account to build wealth for future generations. The chapter concludes that the Mongolian fiscal policy framework anchored by the Fiscal Stability Law constitutes a relevant example for other lower-income countries with large revenue from nonrenewable resources.

**5. The June Parliamentary elections led to a change in government**. The elections were won by the Democratic Party which had been a minority in the previous coalition government with the Mongolia People's Party until it broke away in January to focus on its campaign. The Democratic Party has formed a coalition government with three smaller parties. Local and presidential elections will be held in November 2012 and June 2013, respectively. A new Bank of Mongolia (BOM) governor was appointed in mid-September.

## B. Overheating Pressures Continue amid Decelerating Growth

**6. Growth is decelerating from the very rapid pace in 2011.** The expansion of the economy slowed to 10 percent during the first nine months of 2012 (y/y), down from 17 percent in 2011. Growth has been buoyed by expanding coal and copper production, the ongoing development of new large mining projects, a relatively mild winter boosting agriculture, and highly expansionary fiscal policy (Table 1, Figure 1).

**7. However, inflation remains high and the BOP is under pressure.** Inflation in other Asian countries has decelerated owing to slowing demand and moderating energy and food prices. By contrast, inflation in Mongolia is still around 15 percent, primarily due to rapidly rising government spending. Strong domestic demand is driving up imports of consumption goods, and the resulting BOP pressures are compounded by slowing FDI inflows and decelerating export growth. In recent months, coal exports to China slumped amid China's overall decelerating imports.

**8. Monetary policy has been tightened.** Over the past year, in response to inflation rising substantially above the official target of less than 10 percent, the central bank increased its policy rate—by 225 basis points, to 13.25 percent—and reserve requirements—by 700 basis points, to 12 percent. These tightening measures, which coincided with a deceleration of deposit inflows into the banking system, contributed to a marked slowdown in credit growth, from 72 percent in 2011 to 36 percent in September 2012 (year-on-year, Figure 2).

**9. But fiscal policy has remained excessively expansionary.**

- **The overall fiscal balance worsened by 5⅓ percentage points of GDP in 2011, to a deficit of 4¾ percent of GDP (Table 2).** Revenue surged, thanks to VAT and customs duties collected on imports of capital goods for mining sector development. But this was more than offset by a 62 percent increase in government spending.

- **Government spending continued to soar during the first half of 2012.** In the six months leading up to the end-June elections, government spending rose by 57 percent (year-on-year) as civil servants' wages were raised by more than 50 percent, cash handouts were stepped up, and capital expenditures were brought forward. As revenue collection fell short of the ambitious targets, a large domestic financing need arose which was met in part by borrowing about 1½ percent of GDP from the BOM.

**10. BOP pressures have mostly been reflected in a decline in Mongolia's Net International Reserves (NIR).** The BOM has intervened intermittently to limit the togrog's depreciation. Over the past year, the togrog/U.S. dollar exchange rate has depreciated by 7 percent while NIR have declined by a third (US$0.7 billion) to a two-year low of US$1.5 billion. The effect of the BOP pressures on *gross* international reserves (GIR) has been offset by BOM drawings on the swap line with the central bank of China (US$0.2 billion) and BOM deposit taking from the Development Bank of Mongolia (US$0.4 billion) and commercial banks (US$0.2 billion). Thus, while gross international reserves remains near an all-time high of US$2.6 billion (6.7 months of prospective non-mining imports), the share of borrowed reserves has risen to 43 percent, from 15 percent a year ago.

## C. Outlook and Risks

**11. The near-term outlook for growth is favorable, but inflation is projected to remain elevated:**

- **Notwithstanding a deceleration from last year, growth is projected to remain in double digits in 2012.** Rising coal production is expected to boost mineral GDP by 6.8 percent. Non-mineral GDP growth is projected at 12.8 percent, thanks to the ongoing development of the Oyu Tolgoi (OT) copper mine and Tavan Tolgoi (TT) coal mine (Box 1), alongside expansionary fiscal policy.

- **Growth is projected to accelerate in 2013.** Mining GDP is set to increase by over half as the massive Oyu Tolgoi copper mining project starts to produce and coal production from the Tavan Tolgoi mine expands further. Non-mining GDP growth is projected at 5½ percent in 2013, supported by government and DBM capital spending.

- **Inflation is projected to remain in double digits throughout 2013.** Meat prices, which have a large weight in Mongolia's CPI basket, are projected to moderate in the coming months. However, the continued strong growth of domestic demand is expected to prevent a rapid decline in inflation (Box 2).

**12. The external position is projected to remain under pressure in 2013.** Mongolia's coal export capacity will expand further in 2013, and the start of operations at the Oyu Tolgoi mine should boost copper exports. However, imports will also rise, owing to the DBM's public investment projects, and the net BOP effect of the start of Oyu Tolgoi operations will be limited in 2013 as the gross export proceeds will mostly be used for repayment of investment costs.

**13. Mongolia's medium-term prospects are promising.** The ramp-up of coal and copper production is projected to keep the growth of mineral GDP at over 20 percent per annum, on average, during 2013–17. Activity outside the mining sector is also projected to remain buoyant, although this would need to be supported by continued reforms to strengthen the business climate.

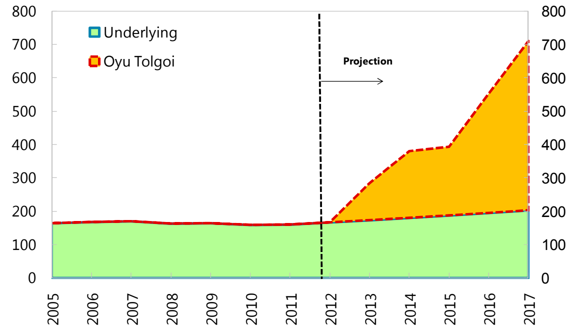
**14. However, a number of challenges need to be addressed as the new government embarks on implementing its Action Plan for 2012–16.** Importantly, policies need to be set against the continued uncertainties in the global economic outlook. While growth in China appears to have bottomed out, the near-term outlook for global growth offers only a very gradual pickup in activity amid considerable downside risks, in particular with regard to euro-area developments.

## Box 1. Mongolia: Two Large Mining Projects

**Exports of copper and coal are set to rise significantly over the medium term:**

- **The Oyu Tolgoi mine**, located in the south near the border with China, will be one of the largest copper and gold mines in the world. The government owns 34 percent of the mine, and the rest is owned by Turquoise Hills Resources (Canada), in which Rio Tinto (UK) has a 51 percent stake. Production is expected to start in early 2013.

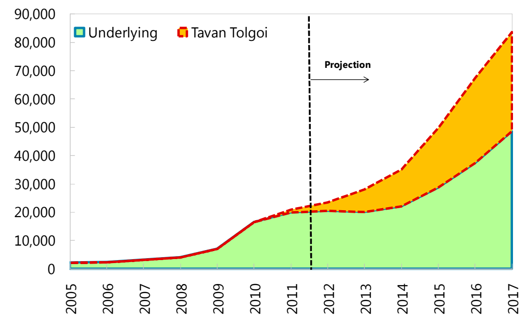
**Copper: Export Volume**
(In ths. tons, refined copper equivalent)




Sources: Mongolian authorities; and IMF staff estimates.

- **Tavan Tolgoi**, also located in southern Mongolia, is one of the world's largest untapped coal deposits with estimated reserves of about 6.4 billion tons. Erdenes Tavan Tolgoi LLC, a subsidiary of a 100 percent state-owned enterprise, has the mining license for what is called the eastern block (East Tsankhi) as well as the western block (West Tsankhi). An operating contract with foreign companies for the eastern block was concluded in October 2011. An initial public offering of 20 percent of Erdenes Tavan Tolgoi shares is expected to take place in the first half of 2013. The modalities for developing the western block are under discussion.

**Coal: Export Volume**
(In ths. tons)




Sources: Mongolian authorities; and IMF staff estimates.

**Export earnings and fiscal revenue will rise considerably thanks to exports from these mines.** Staff projects that export proceeds from these mines could total US$2 billion in 2013, rising to US$7 billion by 2020. Fiscal revenue is projected to grow in tandem, though with some delay, as much of the initial export proceeds from the Oyu Tolgoi mine will be used to repay advance tax payments and a loan used to finance the government's equity stake. However, by 2018 fiscal mineral revenue is projected to quintuple compared with 2011, and U.S. dollar GDP per capita could triple.

## Box 2. Inflation Dynamics in Mongolia 1/

Inflation in Mongolia is more volatile but less persistent than in other copper-producing countries. The higher volatility may be related to food price volatility and procyclicality in government spending. The relatively low persistence of inflation suggests that a tightening of macroeconomic policies may translate quickly in a deceleration of inflation.

- Food price volatility is a key driver of inflation volatility. Supply shocks to agriculture, such as the severe winter in 2010–11, can have an important effect on overall inflation. Food items represent about 30 percent of the CPI basket.

- Underlying inflation, which excludes food prices and administered prices, is more responsive to domestic demand conditions. For instance, there is clear evidence that government wage hikes push up underlying inflation. In addition to the direct impact from the increase in government employees' income, there is an indirect effect through higher private sector wage demands. Empirical evidence also confirms the role of the output gap, in line with a Phillips-curve relationship.

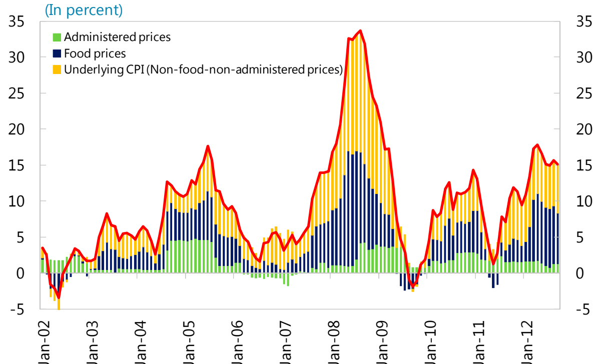
**Mongolia and other copper producers 1/**

| | Volatility 2/ | Persistence 3/ |
|---|---|---|
| Mongolia | **1.25** | **0.30** |
| Chile | 0.74 | 0.67 |
| Papua New Guinea | 1.07 | 0.23 |
| Peru | 0.86 | 0.78 |
| Zambia | 0.56 | 0.60 |

Source: IMF staff estimates.
1/ Quarter-on-quarter, seasonally adjusted inflation rate. Mongolia for 2001 to 2011, and other countries for 1995 to 2011.
2/ Volatility is measured with the coefficient of variation.
3/ Persistence is measured by the coefficient from a first order autoregressive process.

**Inflation: Contributions to Change**

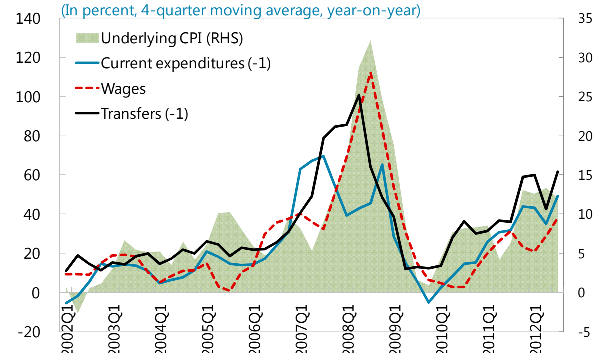
(In percent)




Sources: Mongolian authorities; and IMF staff estimates.

**Mongolia: Inflation and Fiscal Spending**

(In percent, 4-quarter moving average, year-on-year)




Sources: Mongolian authorities; and IMF staff estimates.

[1] Based on Steve Barnett, Julia Bersch and Yasuhisa Ojima, "Inflation Dynamics in Mongolia: Understanding the Roller Coaster," WP/12/192.

Potential spillovers are significant, affecting export volumes, commodity prices, and FDI inflows. A significant fall in non-oil commodity prices and volumes would have an important impact on the fiscal and external accounts (see the Risk Assessment Matrix). Other key risks refer to a continuation of the overly loose fiscal policy and the possibility of renewed problems in the banking sector, for instance triggered by declining real estate prices.

**15. Against this background, it is important to adopt policies that ensure macroeconomic and financial stability and that harness the country's long-term growth potential.** In particular:

- The laws that have been enacted in recent years to strengthen the fiscal policy framework—Fiscal Stability Law, Integrated Budget Law, and Social Welfare Law—now need to be implemented to ensure that Mongolia's resource wealth sustains the pace of economic development, and that this results in a generalized improvement in living standards and reduction in poverty.

- Achievement of the government's economic objectives will require: (i) an improvement in the efficiency of public investment, to ensure that Mongolia can fund its critical economic and social investments within the existing resource constraints; and (ii) the continued implementation of structural reforms aimed at improving the business climate and private sector productivity (see paragraph 47).

***Authorities' views***

**16. The authorities broadly agreed with the staff's assessment of the economic outlook.** However, they noted that the recently adopted Government Action Plan 2012–16 (see paragraph 50) aims to reduce inflation to single digits and contain the budget deficit to 2 percent of GDP. They were confident that a seasonal decline in meat prices would bring inflation to single digits going into next year. The authorities emphasized the need to increase investment in infrastructure. They viewed this as essential to facilitate exports, reduce the economy's reliance on the mining sector, and ease supply-side inflationary pressures, by improving the connections of traders and farmers to markets.

**17. The authorities also expressed concern about the elevated downside risks**. In view of the uncertain outlook for exports, a working group has recently been established to initiate contingency planning. The group includes senior officials from the Ministry of Finance (MOF), the Ministry of Economic Development (MOED), and the BOM.

# MACROECONOMIC POLICY DISCUSSIONS

**18. While the economy's prospects are promising as mining output is set to expand considerably over the next five years, macroeconomic policies need to be strengthened to mitigate risks to macroeconomic and financial stability**. Against this background, discussions centered on: (i) the need to tighten fiscal policy in the near-term to address pressures on the external position and put inflation on a sustained downward trajectory; and (ii) the agenda to upgrade the broader framework for managing macroeconomic policies, the financial system, and long-term natural resource management.

## A. Fiscal Policy

**19. On current policies, including spending by the DBM, the overall fiscal deficit in 2012 could exceed 9 percent of GDP, up from 4¾ percent of GDP in 2011:**

- The general government budget is projected to record a deficit of more than 5 percent of GDP. Steps announced in the context of the Supplementary 2012 Budget, including hikes in excises on diesel, alcohol and tobacco effected in September and a scaling down of capital spending, will not be enough to offset shortfalls in VAT and customs duties which were due to the 2012 Budget's extrapolation of favorable revenue trends in 2010 and 2011, which overlooked the deceleration in FDI-financed imports of capital goods in 2012.

- Off-budget spending by the DBM will add to demand pressures. The international bond issuance earlier in the year has put the bank in a position to spend up to 6 percent of GDP. Some two-thirds of this amount (US$400 million) is expected to be spent by end-2012, including on roads construction in Ulaanbaatar and other cities (US$150 million), railways construction (US$100 million), utility projects (heating, and power and water supplies, US$50 million), urban housing (US$60 million), and industrialization (US$30 million).

**20. Unrealistic revenue projections in the 2013 budget and off-budget DBM operations risk undermining stability and growth prospects (Box 3).** The 2013 budget sent to Parliament targets a general government deficit of 1.2 percent of GDP in 2013. This is consistent with the FSL's structural deficit ceiling of 2 percent of GDP. However, revenues are overestimated by as much as 6¾ percent of GDP. In addition, considerable capital spending will be channeled through the DBM. This spending is not included in the budget. It is also not covered by the FSL's limits on the structural deficit or expenditure growth.

**21. Revenue shortfalls will likely force the authorities to compress on-budget spending but off-budget DBM spending could still cause the overheating pressures to persist.** In the staff's baseline projections, revenue shortfalls and limited availability of domestic financing would in the end restrict the growth of on-budget spending to 13 percent in 2013. As a result, the FSL's structural deficit ceiling would be breached by about 1 percent of GDP. Moreover, overheating pressures could still persist depending on the magnitude of off-budget foreign financed capital spending by the DBM, which is currently projected at 4 percent of GDP. In any case, the integrity and meaningfulness of the FSL would be undermined.

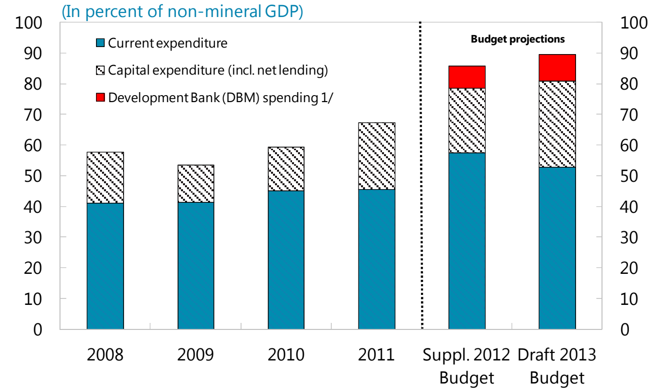
## Box 3. The 2012 and 2013 Budgets and Off-Budget Spending

**The 2012 and 2013 budgets include overly optimistic revenue projections**:

- *The Supplementary 2012 budget* was approved in mid-September. It did not take into account the full extent of the ongoing deceleration of revenue growth. The collection of VAT and customs duties has been particularly weak, in part owing to base effects related to the deceleration of capital goods imports for the OT mining project.
- *The draft 2013 budget* was sent to Parliament at end-September. While the budget is based on reasonable assumptions regarding economic growth, it took the unrealistic revenue projections from the Supplementary 2012 budget as a starting point, setting the stage for a potential revenue shortfall of 3 percent of GDP. Moreover, the budget counts on about 2½ percent of GDP in revenue that is predicated on the renegotiation of the 2009 OT investment agreement. The outcome and timing of this renegotiation, and hence the expected additional revenue, are highly uncertain.

**Mongolia: Fiscal Spending**

(In percent of non-mineral GDP)




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

**Overly optimistic revenue projections give the incorrect impression that there is ample room to expand government spending**, while still observing the FSL with its 2-percent-of-GDP structural deficit ceiling (see text chart).

**The staff's baseline projections assume that the bulk of the expected revenue shortfalls will be offset by compressing expenditure compared to the budget, particularly in 2013.** This is consistent with the government's intentions (see paragraph 29). The government is looking to borrow from the social security fund through the sale of treasury bonds in the last quarter of 2012 and the modalities for the issuance of treasury bonds in the open market are being finalized. However, financing from domestic treasury bonds will likely prove very expensive, making it likely that the government will instead opt for spending cuts.

**Nevertheless, the overall fiscal stance in 2013 could still be more expansionary than in recent years**, depending on the magnitude of off-budget foreign financed capital spending by the DBM, which is currently projected at 4 percent of GDP.

**Mongolia: Fiscal Indicators, 2008-13**

(In percent of non-mineral GDP, unless otherwise indicated)

| | 2008 | 2009 | 2010 | 2011 | 2012 | | 2013 | |
|---|---|---|---|---|---|---|---|---|
| | | | | | Suppl. budget | Staff proj. | Draft budget | Staff proj. |
| Overall balance (in percent of GDP) | -4.5 | -5.2 | 0.5 | -4.8 | -4.6 | -5.2 | -1.2 | -2.4 |
| Structural balance (FSL, in percent of GDP) | … | … | … | -6.9 | -5.3 | -6.0 | -2.0 | -3.1 |
| Non-mineral balance | -19.1 | -15.4 | -11.8 | -22.3 | -20.2 | -20.6 | -14.0 | -18.0 |
| Non-mineral revenue | 38.5 | 38.4 | 49.6 | 47.8 | 58.6 | 50.9 | 66.4 | 52.0 |
| Total expenditure | 57.6 | 53.8 | 61.4 | 70.1 | 78.7 | 71.5 | 80.4 | 70.0 |
| *Memorandum items:* | | | | | | | | |
| Real non-mineral GDP (growth in percent) | 10.3 | -1.8 | 6.0 | 19.9 | 13.3 | 12.8 | … | 5.4 |
| Government expenditure (in billions of togrog) | 2,467 | 2,337 | 3,081 | 4,997 | 6,312 | 5,735 | 7,449 | 6,489 |
| Government expenditure (growth in percent) | 41 | -5 | 32 | 62 | 26 | 15 | 30 | 13 |
| DBM spending (in percent of GDP) | … | … | … | … | … | 4 | … | 4 |

Sources: Mongolian authorities; and IMF staff calculations.

**22. Recently announced plans for DBM borrowing of up to US$5 billion (50 percent of GDP) over the next few years also raise efficiency concerns.** A recent World Bank report notes three key concerns. First, capacity constraints in the construction sector raise doubts about the extent to which the government's ambitious infrastructure plans can be realized without compromising project quality, appraisal and implementation. Second, because of supply bottlenecks, the price of building materials (e.g., cement) has been rising rapidly. Third, considering the size of the population and the contribution to economic growth, the capital and other growth centers have been receiving a disproportionately low share of infrastructure spending.

**23. A clear policy needs to be drawn up to ensure that the DBM can help meet the long-term infrastructure needs of Mongolia in a macro-economically sustainable manner.** It is imperative that the government clarify that: (i) there are limits on the aggregate lending of the DBM to ensure alignment with the principles of the FSL, in particular the expenditure growth limit; (ii) the DBM only funds revenue-generating projects; or (iii) if it were to fund social benefit projects, the amount of lending for such projects would be reflected in the state budget and thus be fully covered by the FSL. Experience in other countries shows that without a clear policy there is a risk that the DBM will be used as a non-transparent way to finance non-priority or non-viable infrastructure projects, or to bypass fiscal limits, which ultimately requires costly budget-funded bailouts.

**24. Also, the Law on the DBM should be amended to bring it in line with international best practice.** Accordingly, the law should clarify that the DBM can only finance viable projects that would generate revenue and achieve cost recovery. The independence and supervision of the DBM and its Board members should be strengthened and the MOF should have a more prominent role in the Board of the DBM. Finally, the DBM's authority to lend should be constricted by lowering the maximum loan-to-equity ratio to what is common internationally among the better performing development banks.

**25. In view of the uncertain external outlook there may be a need for additional measures to safeguard macroeconomic stability over the coming year.** Contingency planning could be facilitated by the preparation of a prioritized list of all capital expenditure items in the 2013 budget. The initiation and funding of lower-priority items could be deferred until later in the year, provided revenues are on track and external pressures have eased. The uncertain outlook makes it all the more important to strengthen policy coordination between the MOF and the newly created MOED.

**26. Implementation of the SWL should be a priority**. The SWL, which was adopted earlier this year, represents a significant step forward in efficiently fighting poverty. It introduces a means-tested benefit that would reach the poorest households and replace the existing costly universal cash transfers. Multilateral donors have provided considerable support to help set up the means-tested benefit system. The government should now move forward and roll out this system.

**27. The Debt Sustainability Analysis (DSA) suggests that Mongolia's risk of debt distress remains low.** To take into account the likely extent of external borrowing by the DBM, the staff's baseline macroeconomic projections assume the issuance of US$500 million in new government-guaranteed international bonds each year for the next five years (Appendix I). Because of the projected strong growth of the economy over this period the ratio of public and publicly guaranteed external debt to GDP would decline by 2 percent of GDP to 24 percent of GDP in 2017. However, the increased rate of debt accumulation would increase Mongolia's vulnerability to shocks. To limit vulnerability, recourse to non-concessional foreign financing should be limited to commercially viable projects.

**28. The establishment of a sovereign wealth fund (SWF) would be an important complement to the FSL's fiscal policy framework.** Staff welcomes the efforts underway to determine the modalities of a SWF that would best fit Mongolia.

***Authorities' views***

**29. The authorities indicated that they remained committed to the FSL while acknowledging that revenue targets were ambitious**. They noted that revenue shortfalls would be largely offset by lower-than-budgeted spending, particularly capital spending. They advised that government wages would not be raised in 2013 following the large increases in 2012. The authorities concurred with the need to prioritize on-budget public investment projects. In this regard, they noted that with the IBL now fully operational, the 2013 budget would only include public investment projects for which feasibility studies have been completed and which are aligned with national development priorities.

**30. The authorities confirmed that the main purpose of the DBM is to finance bankable projects**. However, the work to identify and develop efficient and bankable projects is mostly still ongoing. In the meantime, the authorities would like to proceed with disbursements for projects even if it is not assured that these will generate an adequate cash flow to service the debt. Over time, DBM funding for non-bankable social benefit projects would decrease.

**31. The authorities agreed that the progress made in setting up a system to identify the poorest household should not be lost**. At the same time, they indicated that a review would be undertaken of the existing multitude of social welfare programs as well as the Social Welfare Law itself. Subsequently, the government publicly announced the reintroduction of universal child allowances, effective October 20, 2012. The authorities noted that local governments would be responsible for administering social programs from January 1, 2013, using central government funding.

## B. Monetary and Exchange Rate Policy

**32. While monetary policy has been tightened, inflation remains high and the future course of monetary policy should be set depending on how inflation and fiscal policy evolve.** Inflation remains considerably in excess of the BOM's stated target for 2012 ("inflation in single digits"). Monetary policy has been tightened substantially over the past year, togrog liquidity remains tight, in part owing to ongoing sales of foreign exchange, and meat prices are expected to ease in the coming months. Going forward, there is no scope to loosen monetary policy unless fiscal policy adjusts to conform with the FSL and inflationary pressures abate. Conversely, the monetary authorities will have no choice but to tighten further in case fiscal policy remains expansionary.

**33. The BOM's intention to move to an inflation targeting framework is appropriate** (Box 4). In conjunction with a floating exchange rate regime (see below), this would complement and support the countercyclical fiscal policy implied by the FSL. The next steps to strengthen the monetary policy framework would involve the development of the government bond market and an interbank money market.

### Box 4. Strengthening the Monetary Policy Framework[1]

**The authorities' intention to move to an inflation-targeting regime is appropriate**. A cross-country study of commodity-exporting countries in the April 2012 WEO concluded that an inflation-targeting regime with a flexible exchange rate renders a countercyclical fiscal policy such as implied by Mongolia's FSL more effective. In such a framework, countercyclical fiscal policy would aim to dampen macroeconomic volatility arising from commodity price fluctuations and monetary policy would aim to reduce inflation volatility.

**Good progress has been made to facilitate the adoption of inflation targeting:**

- The BOM communicates to the public through its annual Monetary Policy Guideline that the aim of monetary policy is to achieve low and stable inflation. The 2012 Guideline states that inflation will be kept at a single-digit level in 2012 and below 8 percent in 2013–14. Since 2007, the BOM targets the policy rate of seven-day central bank bills (CBBs) which is set at monthly meetings of the monetary policy board whose policy decisions are announced to the public. The BOM has been making good use of IMF technical assistance to strengthen monetary policy operations. As a result, the seven-day CBB rate increasingly converges around the announced policy rate, improving the BOM's credibility. And the CBB rates are affecting short-term money market rates.
- A floating exchange rate regime was adopted in the context of the 2008/09 crisis to help absorb external shocks and safeguard international reserves.
- The FSL provides for a countercyclical fiscal policy. The recent adoption of the IBL and the SWL should serve to reinforce the fiscal policy framework.

**But important challenges remain:**

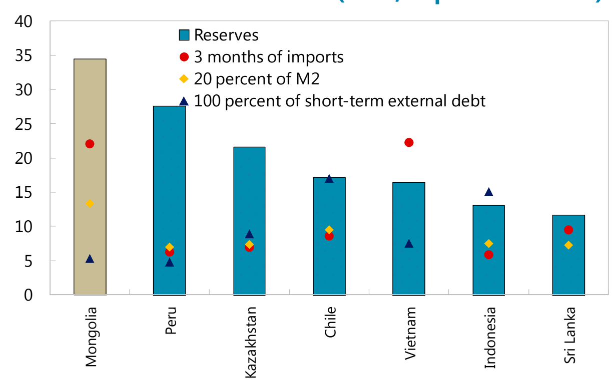
- Government spending in 2012 is set to nearly double from the level in 2010, pushing inflation above the BOM's target. Much depends on whether the FSL will be effectively adhered to once it becomes fully operational in 2013. For instance, non-revenue generating DBM operations should be fit within the FSL framework (see paragraph 23).
- The monetary transmission mechanism remains weak and unreliable, as in many other countries at an early stage of financial development (see e.g., WP/10/223 and WP/12/143). Policies and reforms conducive to financial deepening should remedy this over time, including the development of the government bond market (paragraph 46). Meanwhile, macro-prudential policies could be used in part to complement the weak transmission from policy rates to bank credit (paragraph 39).
- Dollarization, which undermines monetary policy autonomy, remains significant and should be actively discouraged (paragraphs 40–41).
- The foreign exchange market remains thin and needs to be developed further (paragraph 42). Appropriately tight macroeconomic policies and a deeper foreign exchange market would allow a larger share of the balance of payments pressures to be absorbed through adjustment of the exchange rate (paragraph 34).

[1]Prepared by Yasuhisa Ojima (APD) and Jongsoon Shin (OAP).

**34. The floating exchange rate regime and auction system should be maintained**. Intervention should be limited to smoothing excessive exchange rate volatility without changing the underlying trend in the exchange rate. In the staff's view, a disproportionate share of the balance of payments pressures over the past year has been absorbed through sales of official reserves. If external pressures continue, this may not be sustainable. To support the external position and exchange rate regime, it is critical to pursue appropriate fiscal and monetary policies, along the lines recommended above, while efforts to deepen the foreign exchange market should continue.

**35. International reserves are still adequate for precautionary purposes, even though they are on a downward trajectory.** Mongolia's reserves are adequate for the near term and its obligations to the IMF coming due in the next two years (about SDR 100 million in total or about 6 percent of gross reserves) should be manageable. However, the declining trend in net international reserves—taking into account the swap with China and the deposits taken by the central bank from the DBM and commercial banks—is not sustainable in the longer term, underscoring the need for appropriately tight policies. Mongolia's outstanding credit to the Fund is projected to fall below the threshold for post-program monitoring (200 percent of quota) by January 2013.

**Gross International Reserves (2011, in percent of GDP)**




Source: Assessing Reserve Adequacy (ARA) tool.

**36. The real exchange rate is broadly in line with macroeconomic fundamentals** (Box 5). However, the exchange rate assessment critically depends on FSL implementation. Mongolia's recent experience shows that looser fiscal policy would quickly lead to considerable overvaluation.

***Authorities' views***

**37. The authorities shared the staff's views regarding monetary policy and reaffirmed their commitment to the floating exchange rate regime.** They noted that Mongolia's foreign exchange market remains shallow and that smoothing operations, around the prevailing trend, are regularly required to prevent lumpy transactions from causing jumps in the exchange rate and disorderly market conditions. The authorities expressed broad satisfaction with the level of gross and net international reserves. They expected the DBM and a commercial bank, which recently raised funds abroad, to sell some of their foreign exchange to the BOM, which would raise the net international reserves (NIR).

## C. Financial Sector Issues

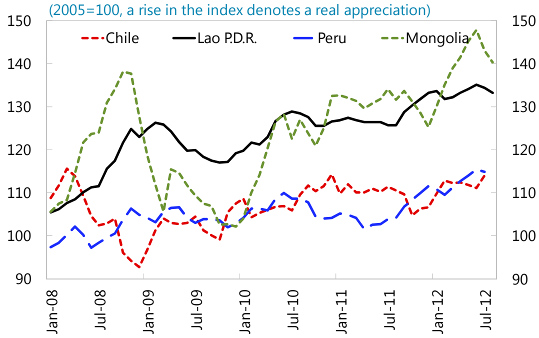
**38. The BOM has continued to take steps to improve banks' resilience, amid tightening liquidity (Table 7, Figure 3).** The liquidity ratio was raised from 18 to 25 percent, effective January 1, 2012. The five systemically important banks were required to raise their capital adequacy ratios to 14 percent from 12 percent (to be phased in by end-2013).

## Box 5. Exchange Rate Assessment[1]

**Mongolia's real exchange rate appreciation has outpaced that of its peers, but exports have risen considerably faster than on average in Asia.** Thanks to rising copper and coal prices and coal export volumes, exports nearly quadrupled from the early 2009 trough. The outlook for exports is favorable (see Box 1).

**Real Effective Exchange Rates**

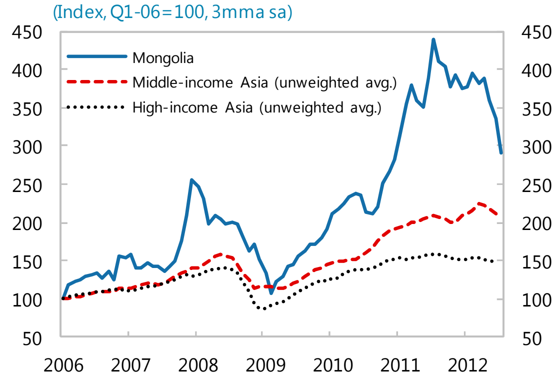
(2005=100, a rise in the index denotes a real appreciation)




Source: IMF INS.

**Export Performance in Asia**, March 2006–September 2012

(Index, Q1-06=100, 3mma sa)

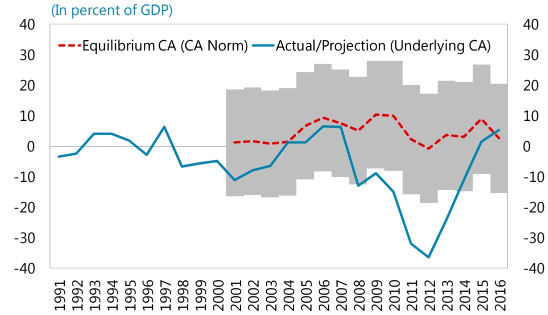



Source: IMF staff estimates.

**Current account (CA) outlook.** The CA balance is projected to swing back to a surplus over the medium-term. Imports of capital goods for the development of the Oyu Tolgoi mine pushed the CA in deficit, especially in 2011 and 2012. As the mine starts operations, copper and gold exports are projected to turn the CA around. The development of the Tavan Tolgoi mine will produce similar CA dynamics, with the magnitude of the improvement also depending on future mineral prices.

**Current Account Balance**

(In percent of GDP)



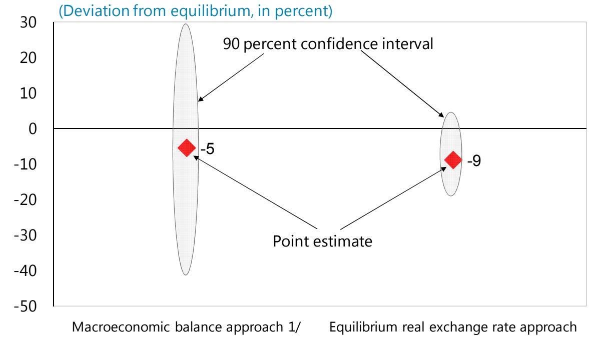

Source: IMF staff estimates.

Note: The shaded area represents the 90 percent confidence internal of the equilibrium.

**An updated CGER-like assessment suggests that the level of the real effective exchange rate (REER) is not out of line with medium-term macroeconomic fundamentals.** Over the medium term, the CA is projected to be broadly in line with the CA norm implied by the Macroeconomic Balance approach. The Equilibrium Exchange Rate approach indicates that the level of the REER is also broadly in line with longer-term fundamentals.[2]

**Real Exchange Rate Assessments**

(Deviation from equilibrium, in percent)




Sources: Mongolian authorities; and IMF staff estimates.

1/ A mineral export balance is used instead of the standard oil balance.

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[1] Prepared by Yasuhisa Ojima, based on standard CGER Methodology using the Exchange Rate Assessment Toolkit.

[2] Application of the external sustainability approach, which compares the projected CA balance with the CA balance needed to stabilize Mongolia's International Investment Position (IIP), does not appear to be meaningful at this juncture. As a result of large FDI-financed investments in the mining sector, Mongolia's IIP is currently highly negative and it seems unlikely that Mongolia would be looking to stabilize its IIP at the current level.

**39. Efforts to strengthen the soundness of the financial sector should continue.** IMF technical assistance advice has put forward options to better reflect banks' credit risk in their pricing and credit decisions. Accordingly, the BOM should consider the gradual introduction of dynamic provisioning by phasing in provisioning for standard assets.

**40. Lending dollarization represents a continuing risk**. The use of the togrog in domestic transactions is now firmly entrenched. However, more than one-third of bank loans and bank deposits are still denominated in U.S. dollars. Currency mismatches resulting from borrowers in U.S. dollars without U.S. dollar income increase the risk of default in case of a depreciation of the togrog vis-a-vis the U.S. dollar.

**41. Consideration should be given to prohibit foreign currency lending to unhedged borrowers.** This is consistent with an earlier FSAP recommendation and would help reduce banks' vulnerability to exchange rate fluctuations. This could be phased in gradually with assets and liabilities currently on banks' balance sheets initially grandfathered. In any case, the authorities should start to collect comprehensive data on foreign currency lending.

**42. A prohibition of foreign currency lending to unhedged borrowers would also contribute to strengthen the monetary transmission mechanism and develop the foreign exchange market.** If enforced consistently across all banks, a larger share of new loans would be denominated in domestic currency. Given the existing limits on banks' Net Open Foreign Currency Position, this would also encourage banks to compete more for domestic currency deposits. In turn, this would help deepen the foreign exchange market as banks would reduce interest rates on U.S. dollar deposits and would instead offer to buy the U.S. dollars from their depositors and sell them in the foreign exchange market. It would also strengthen the monetary transmission mechanism as increased competition among banks to provide loans and mobilize deposits in domestic currency would lead to narrower togrog interest rate spreads and would make interest rates more sensitive to changes in policy interest rates.

**43. Three years after the crisis, it is time to replace the blanket deposit guarantee scheme by a limited deposit insurance scheme**. Technical work on the legal and institutional underpinnings for such a limited scheme should be completed as a matter of priority. Meanwhile, as the expiration date for the existing scheme (November 2012) draws near, transitional arrangements should be communicated soonest to reduce uncertainty.

**44. The anti-money laundering/combating the financing of terrorism (AML/CFT) framework needs to be strengthened further**. Mongolia has taken steps toward an effective AML/CFT framework by enacting the AML law and establishing a Financial Intelligence Unit (FIU) in the BOM. However, the action plan agreed with the Financial Action Task Force (FATF) has only been partially implemented and key deficiencies remain. These deficiencies should be addressed as a matter of priority, including by properly criminalizing money laundering and terrorism financing, improving suspicious transaction reporting requirements, and putting in place effective confiscation and freezing measures. In this context, an October 2012 IMF technical assistance mission supported the authorities' efforts to enhance preventive measures, and to strengthen AML/CFT supervision.

***Authorities' views***

**45. The authorities first plan to take stock of the impact of changes in banking regulations effected over the past year.** While expressing broad agreement with the staff's recommendations at a conceptual level, they indicated that present conditions were not suitable to make major regulatory changes. The government was in the process of establishing its near-and medium-term policy priorities, taking into account the uncertain external outlook. Moreover, the BOM considered that banks and their customers had learned to manage prevailing risks in a broadly satisfactory manner.

**46. Developing the government bond market was seen as a key priority**. It would help establish a yield curve which was viewed as a necessary condition to establish reasonably priced hedging instruments. The BOM noted that it would not consider constricting foreign exchange lending until such hedging instruments are available. The authorities also noted that pushing back deposit dollarization could encourage capital flight which Mongolia could ill afford.

# STRUCTURAL REFORMS AND STATISTICS

**47. Efforts to improve the business climate and trade integration should be intensified**. Mongolia ranks relatively high in the World Bank's Doing Business Survey. However, there is ample scope to further streamline procedures and strengthen policy frameworks to boost private sector-led non-mineral growth. For instance, trading across borders, starting a business, and dealing with construction permits remain cumbersome.

**48. The government's ambitious plans to establish an industrial park to process mining products should avoid risks to medium-term macroeconomic and external stability**. Accordingly, the plans should involve reputable private sector companies which mobilize their own financing and bear a fair share of risk. The plans should be made consistent with Mongolia's absorptive and implementation capacity and they should not lead to an excessive accumulation of external debt.

**49. The new government should quickly clarify the foreign investment regime.** The efficient development of Mongolia's natural resources requires foreign financing and expertise. The perceived uncertainty regarding the foreign investment regime, particularly with regard to the mining sector, that has arisen in recent months and the debate about possible renegotiation of the OT contract should be resolved as soon as possible.

**50. Efforts to strengthen macroeconomic statistics should continue.** Technical assistance is being provided to improve national accounts statistics. There is also scope to upgrade balance of payments statistics.

***Authorities' views***

**51. The authorities concurred with the need to enhance the economy's productivity through structural reforms.** They noted that the recently adopted Government Action Plan 2012–

16 seeks greater transparency in the issuance of new mining licenses and increased value added of exports. The plan also aims to reduce the dependency on the mining sector and create a competitive and diversified economy. The economic diversification policy is focused on several key areas, including industrialization policy, and efforts to develop policies with regard to wool, cashmere, raw leather, livestock, tourism, business services, and information technology.

# STAFF APPRAISAL

**52. Mongolia continues to be one of the fastest growing economies in Asia.** Growth in 2011 and the first half of 2012 was buoyed by expanding coal and copper production, the ongoing development of new large mining projects, a relatively mild winter boosting agriculture, and highly expansionary fiscal policy. While poverty declined substantially in 2011, there is scope to make growth more inclusive.

**53. However, inflation remains stubbornly high and the rapid expansion of domestic demand is putting pressure on the BOP.** Monetary policy was tightened over the past year but fiscal policy has remained very expansionary. The resulting BOP pressures have been reflected in a decline in the BOM's NIR, even though the BOM's gross international reserves (GIR) remain near a record thanks to the BOM drawing on the swap line with the central bank of China and receiving deposits in foreign currency from commercial banks and the DBM.

**54. The outlook for growth is favorable but domestic demand pressures, unless reined in, risk undermining stability and growth prospects.** Fiscal policy needs to be tightened in order to put inflation on a downward path and address pressures on the external position. DBM-financed public investment projects are not included in the budget and they should be taken into account when setting the path of fiscal policy.

**55. The 2013 budget will be a critical tool to safeguard domestic and external stability and uphold the credibility of the government's efforts to observe the Fiscal Stability Law (FSL).** The FSL should be observed in the budget law as well as actual implementation of the budget. The persistent revenue shortfalls in 2012 underscore the importance of basing the 2013 budget on realistic revenue projections. However, the 2013 budget that was submitted to Parliament at end-September is again based on overly optimistic revenue projections, implying incorrectly that there is ample room to expand government spending while still observing the FSL's 2-percent-of-GDP structural deficit ceiling. In view of the expected revenue shortfall, government spending will have to be compressed to contain the deficit to honor the FSL and limit the government's domestic financing needs. In light of this, and in view of the uncertain external outlook, the initiation and funding of lower-priority capital expenditures should be deferred.

**56. A clear policy needs to be drawn up to ensure that the DBM can help meet the long-term infrastructure needs of Mongolia in a macro-economically sustainable manner.** As it stands, there is considerable risk that DBM operations will undermine the achievement of the goals of the FSL. Large-scale off-budget financing of non-revenue generating public infrastructure projects would exacerbate overheating pressures and undermine the integrity and meaningfulness of the FSL. The DSA suggests that Mongolia's risk of debt distress remains low.

**57. The reform of the fiscal policy framework should continue.** Implementation of the SWL should be a priority and the establishment of a sovereign wealth fund would be an important complement to the FSL's countercyclical fiscal policy framework.

**58. There is no room for monetary loosening, and the future course of monetary policy should be set depending on how inflation and fiscal policy evolve**. Monetary policy has been tightened substantially over the past year and togrog liquidity remains tight. However, inflation remains considerably in excess of the BOM's stated target for 2012 ("inflation in single digits"). Going forward, there is no scope to loosen monetary policy unless fiscal policy adjusts to conform with the FSL and inflationary pressures abate. Conversely, the monetary authorities will have no choice but to tighten further in case fiscal policy remains expansionary.

**59. The floating exchange rate regime and auction system should be maintained**. Interventions should be limited to smoothing excessive exchange rate volatility without targeting a particular exchange rate level. Net international reserves are on a downward trajectory that is not sustainable, even though gross reserves are still near a record high and adequate for precautionary purposes. The real exchange rate is broadly in line with macroeconomic fundamentals.

**60. Efforts to develop and strengthen the financial sector should continue**. Consideration should be given to the gradual introduction of dynamic provisioning, and foreign currency lending to unhedged borrowers should be prohibited. In addition to reducing banking sector risks, this would help deepen the foreign exchange market and strengthen the monetary transmission channel. The latter would also benefit from the development of a government bond market which would represent an important next step toward further financial deepening in Mongolia. Deficiencies in the AML/CFT framework need to be addressed as a matter of priority.

**61. Mongolia's medium-term prospects are promising**. Mineral GDP is projected to expand rapidly during the next five years thanks to large mining projects coming on stream. Activity outside the mining sector is also projected to remain buoyant, although this would need to be supported by appropriate macroeconomic policies and continued reforms to strengthen the business climate, as well as a clarification of the foreign investment regime. Efforts to strengthen macroeconomic statistics should continue.

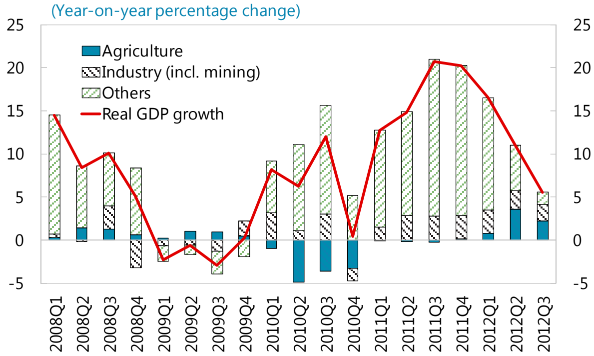
**62. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.**

## Figure 1. Mongolia: Macroeconomic Developments

**Main Message:** Overheating pressures continue amid decelerating growth.

*Growth is decelerating from the very rapid pace in 2011…*

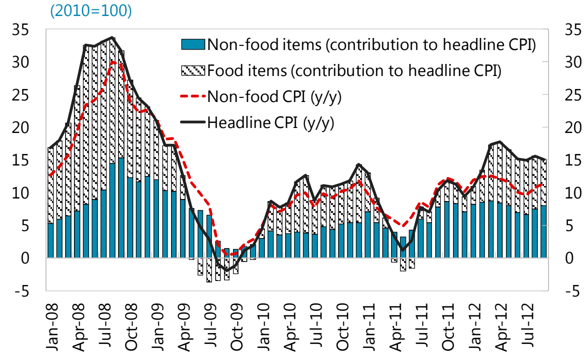
### Real GDP Growth
(Year-on-year percentage change)




Sources: Mongolian authorities; and IMF staff estimates.

*…but inflation remains stubbornly high.*

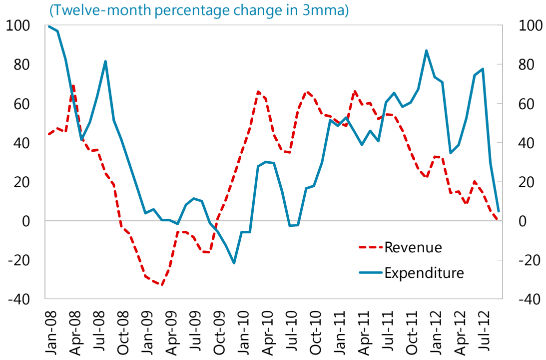
### Consumer Price Inflation
(2010=100)




Sources: Mongolian authorities; and IMF staff estimates.

*Surging government expenditure drove overheating pressures. Revenue shortfalls are now forcing a spending slowdown.*

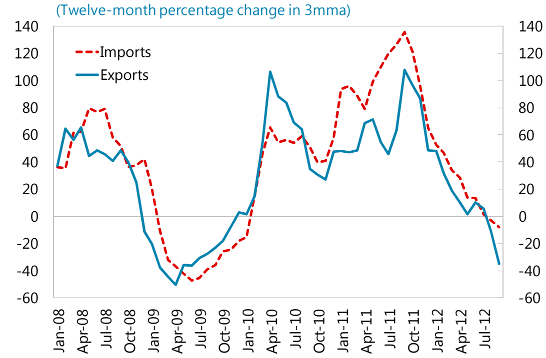
### Revenues and Expenditure
(Twelve-month percentage change in 3mma)




Sources: Mongolian authorities; and IMF staff estimates.

*Against the backdrop of decelerating FDI-related imports, export growth has decelerated, led by coal exports.*

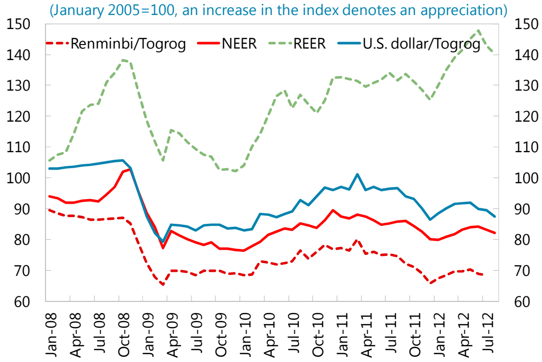
### Imports and Exports
(Twelve-month percentage change in 3mma)




Sources: Mongolian authorities; and IMF staff estimates.

*The BOM has met some of the resulting depreciation pressures by selling reserves…*

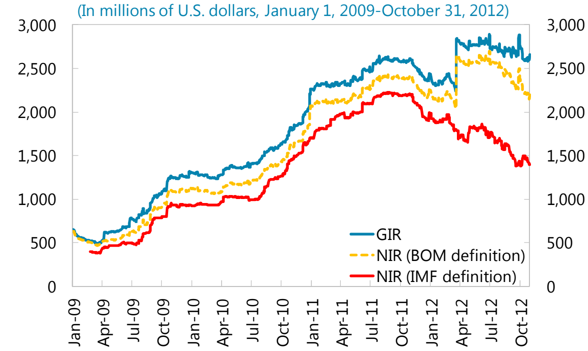
### Exchange Rates of the Togrog
(January 2005=100, an increase in the index denotes an appreciation)




Sources: Mongolian authorities; and IMF staff estimates.

*…putting underlying net international reserves ("IMF definition") on a declining path from the last quarter of 2011.*

### Gross and Net International Reserves
(In millions of U.S. dollars, January 1, 2009-October 31, 2012)



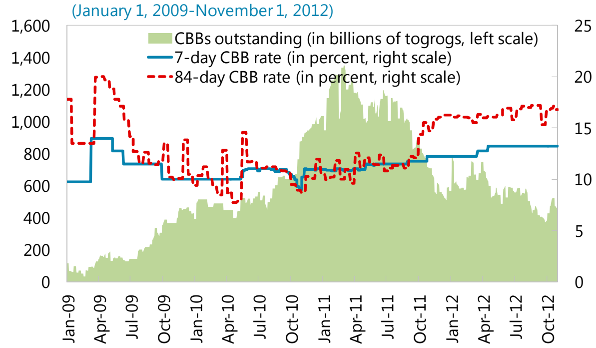

Sources: Mongolian authorities; and IMF staff estimates.

## Figure 2. Mongolia: Monetary Developments

**Main Message:** Credit has slowed in response to monetary policy tightening and slowing deposit growth.

*Interest rates on 7-day central bank bills (CBBs) have been raised. Yet the outstanding stock of CBBs has remained flat since Q4 2011.*

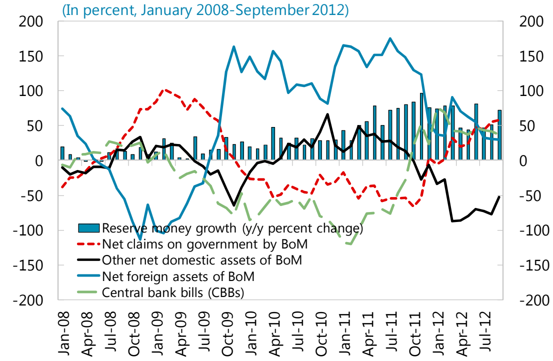
### Central Bank Bills (CBBs)
(January 1, 2009-November 1, 2012)




Sources: Mongolian authorities; and IMF staff estimates.

*Therefore, CBBs are making a positive contribution to reserve money growth from late-2011.*

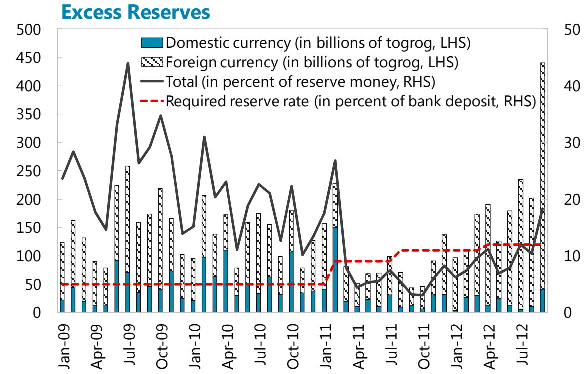
### Contribution to Reserve Money Growth
(In percent, January 2008-September 2012)




Sources: Mongolian authorities; and IMF staff estimates.

*The two reserve requirement increases have been partly absorbed by a decline in banks' holdings of excess reserves.*

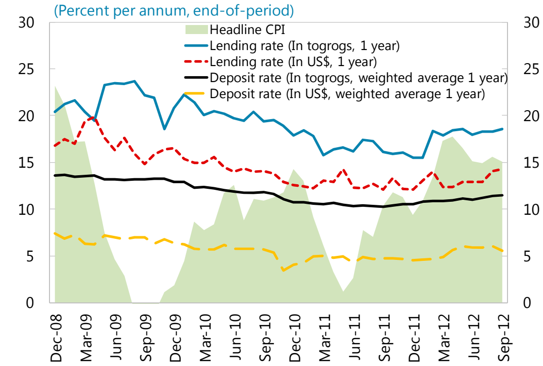
### Excess Reserves




Sources: Mongolian authorities; and IMF staff estimates.

*At the same time, banks raised their lending rates in response to the monetary tightening.*

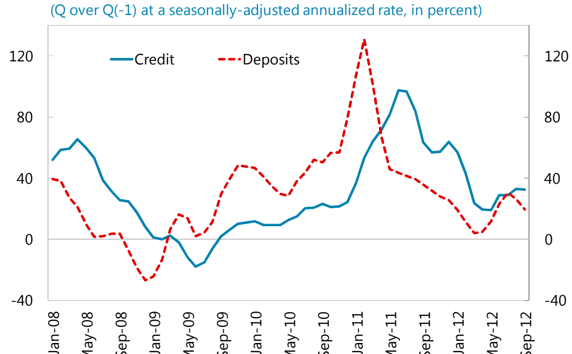
### Interest Rates
(Percent per annum, end-of-period)




Sources: Mongolian authorities; and IMF staff estimates.

*The drying up of banks' deposit funding ahead of the elections also seems to have played a role in the deceleration of credit growth.*

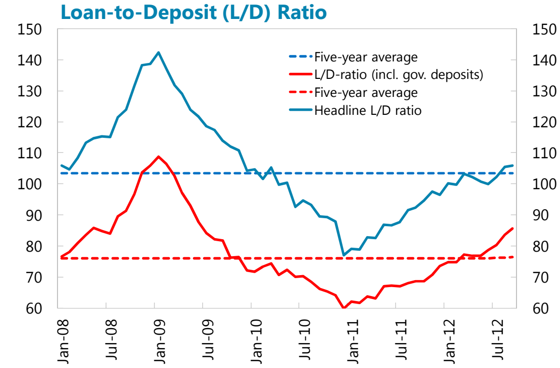
### Bank Credit and Deposits
(Q over Q(-1) at a seasonally-adjusted annualized rate, in percent)




Sources: Mongolian authorities; and IMF staff estimates.

*As deposit growth slowed, the rising loan to deposit ratio became banks' binding constraint to credit growth.*

### Loan-to-Deposit (L/D) Ratio



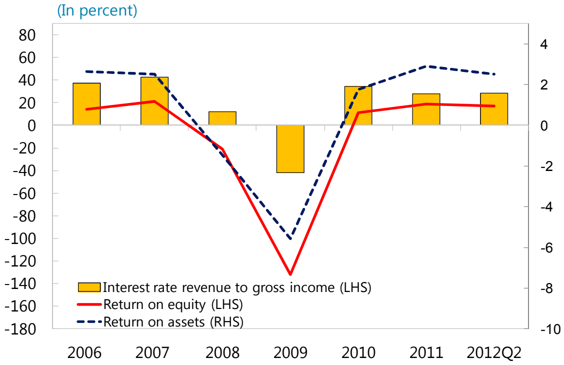

Sources: Mongolian authorities; and IMF staff estimates.

## Figure 3. Mongolia: Banking System Indicators

**Main Message:** Standard backward-looking financial soundness indicators have improved but risks may have built with the 2011 surge in bank credit.

*The banking system has returned to profitability…*

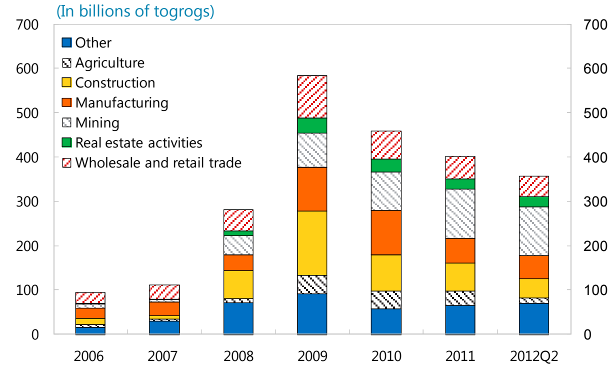
### Bank Profitability
(In percent)




Sources: Mongolian authorities; and IMF staff estimates.

*…and the stock of NPLs has fallen.*

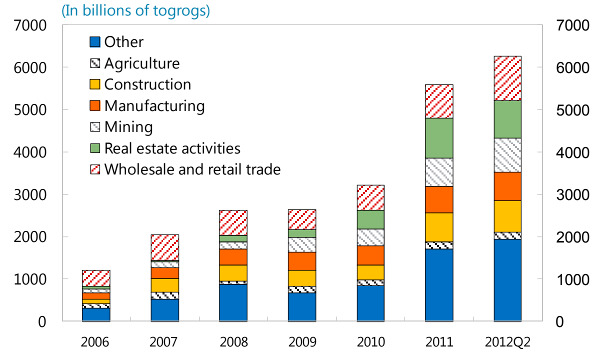
### Sectoral Distribution of NPLs
(In billions of togrogs)




Sources: Mongolian authorities; and IMF staff estimates.

*But credit has risen sharply, led by the real estate and mining sectors.*

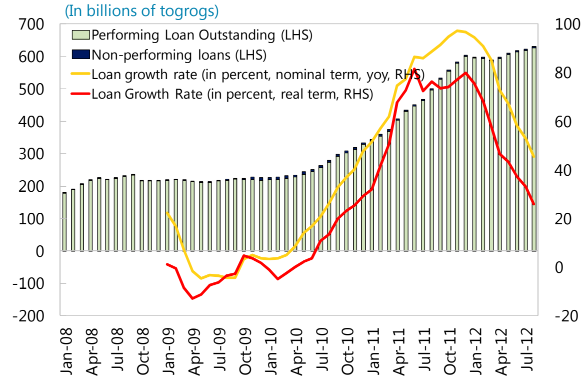
### Sectoral Distribution of Loans
(In billions of togrogs)




Sources: Mongolian authorities; and IMF staff estimates.

*Residential mortgages grew particularly fast in 2011 but have decelerated since.*

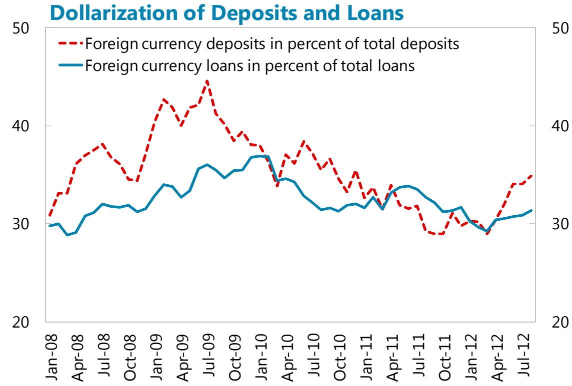
### Residential Mortgage Loan
(In billions of togrogs)




Sources: Mongolian authorities; and IMF staff estimates.

*Dollarization has remained in excess of 30 percent, exposing banks to risks since many borrowers in foreign currency lack forex income*

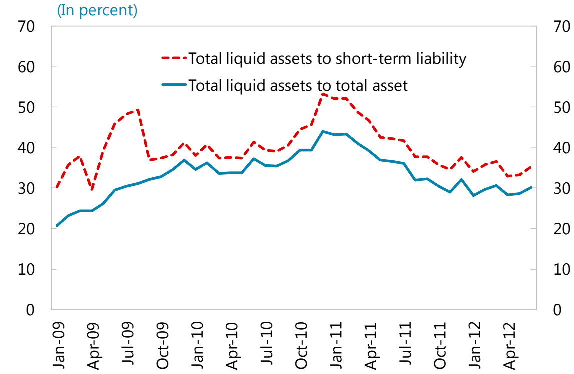
### Dollarization of Deposits and Loans




Sources: Mongolian authorities; and IMF staff estimates.

*Alongside the rising loan to deposit ratio, banks' liquidity position has been under pressures over the past year.*

### Banking System: Liquidity
(In percent)



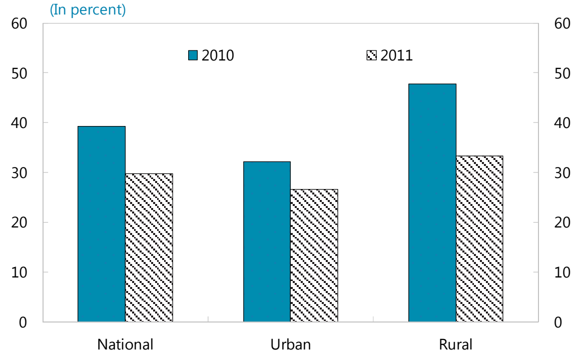

Sources: Mongolian authorities; and IMF staff estimates.

## Figure 4. Mongolia: Inclusive Growth Indicators

**Main Message:** Mongolia's track record in reducing poverty and achieving inclusive growth is mixed.

*Poverty declined markedly in 2011, on government cash handouts and a mild winter. Comparable pre-2010 data are not available.*

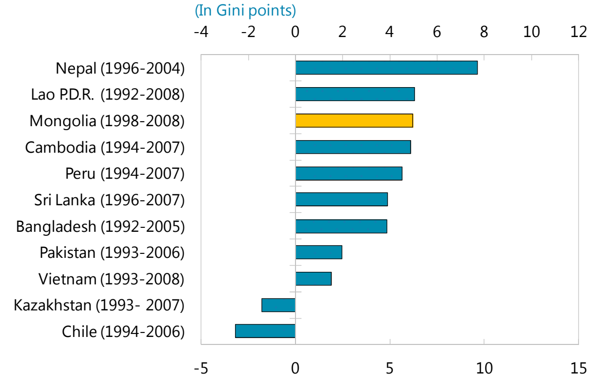
### Mongolia: Poverty Headcount
(In percent)




Sources: Mongolian authorities; and WB staff estimates.

*Inequality has worsened over the past decade, albeit less than in some of Mongolia's peers.*

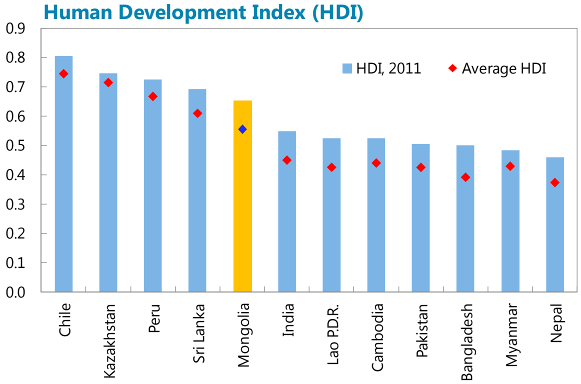
### Change in Gini Index
(In Gini points)




Source: World Bank.

*Mongolia has relatively high human capital....*

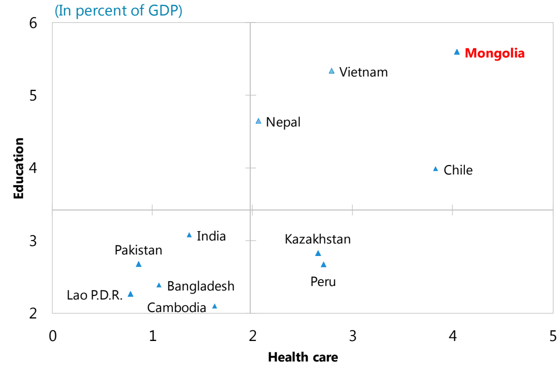
### Human Development Index (HDI)




Source: Human Development Report 2011 (UNDP).

*...in part owing to fiscal support to health care and education.*

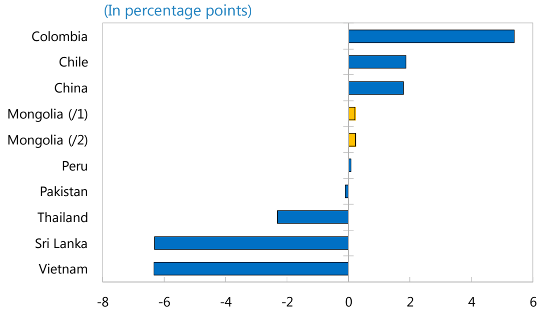
### Public Expenditure on Health Care and Education
(In percent of GDP)




Source: World Bank.

*Nevertheless, unemployment has remained stagnant, even with the very high rates of growth...*

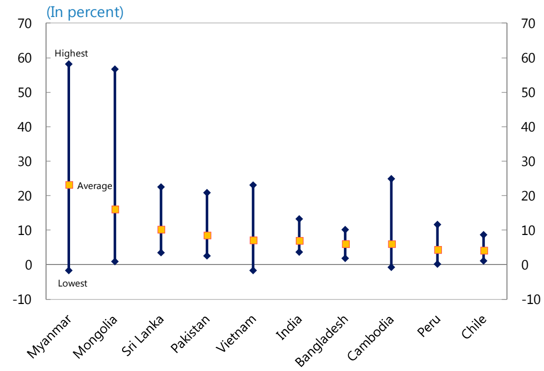
### Change in Unemployment Rate, 1990-2009
(In percentage points)




Source: IMF, WEO.
1/ Unemployment rate, 2006-2009.
2/ Registered unemployment rate, 1990-2009.

*...and inflation volatility, which especially hurts the poor, has been exceptionally high.*

### Inflation, 1995-2010
(In percent)




Source: IMF, WEO database.

## Table 1. Mongolia: Selected Economic and Financial Indicators, 2008–13

Nominal GDP (2011): US$8,709 million 1/
Population, end-year (2011): 2.81 million
Per capita GDP (2011): US$3,097 1/
Poverty incidence (2011): 29.8 percent 2/
Quota: SDR 51.1 million

| | 2008 | 2009 | 2010 | 2011 | Proj. 2012 | Proj. 2013 |
|---|---|---|---|---|---|---|
| | | | (Percent change) | | | |
| Real sector | | | | | | |
| Real GDP growth | 8.9 | -1.3 | 6.4 | 17.5 | 11.2 | 16.8 |
| Mineral | 5.2 | 0.2 | 7.4 | 11.2 | 6.8 | 50.6 |
| Non-mineral | 10.3 | -1.8 | 6.0 | 19.9 | 12.8 | 5.4 |
| Consumer prices (period average) | 26.8 | 6.3 | 10.2 | 7.7 | 14.1 | 10.9 |
| Consumer prices (end-period) | 23.2 | 1.9 | 14.3 | 9.4 | 12.9 | 10.2 |
| GDP deflator | 21.4 | 1.8 | 20.0 | 12.1 | 10.0 | 8.9 |
| | | | (In percent of GDP) | | | |
| General government budget | | | | | | |
| Revenue and grants | 33.1 | 30.3 | 37.1 | 40.3 | 37.1 | 35.2 |
| Expenditure and net lending | 37.6 | 35.5 | 36.6 | 45.1 | 42.3 | 37.6 |
| Current balance | 5.9 | 2.8 | 9.8 | 11.0 | 5.1 | 9.3 |
| Primary balance | -4.2 | -4.7 | 1.0 | -4.4 | -4.1 | -0.5 |
| Overall balance (including grants) | -4.5 | -5.2 | 0.5 | -4.8 | -5.2 | -2.4 |
| Non-mineral overall balance | -12.5 | -10.2 | -7.0 | -14.3 | -12.2 | -9.7 |
| Structural balance 3/ | … | … | … | -6.9 | -6.0 | -3.1 |
| | | | (Percent change) | | | |
| Money and credit | | | | | | |
| Broad money | -5.1 | 26.9 | 61.6 | 37.1 | 28.8 | 27.2 |
| Broad money velocity (GDP/BM) | 2.9 | 2.3 | 1.8 | 1.7 | 1.7 | 1.7 |
| Interest rate on 7-day central bank bills, end-period (percent) | 9.75 | 10.00 | 11.00 | 12.25 | … | … |
| | | | (In millions of US$) | | | |
| Balance of payments | | | | | | |
| Current account balance (including official transfers) | -722 | -410 | -931 | -2,774 | -3,605 | -2,839 |
| (In percent of GDP) | -12.9 | -9.0 | -14.9 | -31.8 | -36.3 | -24.1 |
| (In percent of GDP, excluding mining related imports) | -9.5 | -5.8 | -5.7 | -11.3 | -16.7 | -6.7 |
| Trade balance | -613 | -194 | -278 | -1,008 | -1,840 | -983 |
| Exports | 2,534 | 1,876 | 2,899 | 4,780 | 4,420 | 5,811 |
| Imports | -3,147 | -2,070 | -3,177 | -5,788 | -6,260 | -6,794 |
| Foreign direct investment | 836 | 496 | 1,574 | 4,620 | 2,789 | 1,907 |
| Gross official international reserves (end-period) | 658 | 1,328 | 2,288 | 2,447 | 2,319 | 2,273 |
| (In months of next year's imports of goods and services) | 3.0 | 4.0 | 3.6 | 3.6 | 3.2 | 3.2 |
| Trade prices | | | | | | |
| Export prices (US$, percent change) | 8.2 | -8.2 | 3.7 | 8.3 | -0.5 | -0.5 |
| Import prices (US$, percent change) | 14.1 | -14.1 | 8.8 | 13.1 | -0.7 | -1.5 |
| Terms of trade (percent change) | -5.2 | 6.9 | -4.7 | -4.3 | 0.2 | 1.0 |
| | | | (In percent of GDP) | | | |
| Public and publicly guaranteed debt | | | | | | |
| Total public debt | 31.0 | 46.6 | 45.3 | 51.7 | 56.7 | 54.2 |
| Domestic debt 4/ | 0.0 | 3.4 | 16.3 | 25.6 | 27.4 | 23.9 |
| External debt | 31.0 | 43.2 | 28.9 | 26.1 | 29.4 | 30.2 |
| (In millions of U.S. dollars) | 1,602 | 1,974 | 1,938 | 2,074 | 2,775 | 3,492 |
| Exchange rate | | | | | | |
| Togrogs per U.S. dollar (end of period) | 1,268 | 1,443 | 1,257 | 1,396 | … | … |
| Togrogs per U.S. dollar (period average) | 1,169 | 1,441 | 1,348 | 1,273 | … | … |
| Nominal effective exchange rate (end of period; percent change) | -2.7 | -15.8 | 3.4 | 3.1 | … | … |
| Real effective exchange rate (end of period; percent change) | 18.1 | -11.2 | 11.2 | 8.6 | … | … |
| Nominal GDP (in billions of togrogs) | 6,556 | 6,591 | 8,415 | 11,088 | 13,566 | 17,257 |

Sources: Mongolian authorities; and IMF staff projections.

1/ Estimate, based on period average exchange rate.
2/ Based on national poverty headcount index with the Household Socio-Economic Survey 2010-11.
3/ As defined in the Fiscal Stability Law, which uses smoothed instead of actual commodity prices to calculate revenue.
4/ Domestic debt in 2009-2011 includes the Oyu Tolgoi tax prepayment.

## Table 2. Mongolia: Summary Operations of the General Government, 2008–13

| | 2008 | 2009 | 2010 | 2011 | Proj. 2012 | Proj. 2013 |
|---|---|---|---|---|---|---|
| | | | (In billions of togrogs) | | | |
| Total revenue and grants | 2,170 | 1,994 | 3,122 | 4,468 | 5,029 | 6,079 |
| Current revenue | 2,151 | 1,973 | 3,078 | 4,455 | 5,013 | 6,059 |
| Tax revenue and social security contributions | 1,891 | 1,621 | 2,688 | 3,909 | 4,365 | 5,346 |
| Income taxes | 755 | 520 | 975 | 919 | 955 | 1,098 |
| Social security contributions | 229 | 264 | 331 | 473 | 688 | 709 |
| Sales tax and VAT | 368 | 326 | 579 | 1,114 | 1,273 | 1,467 |
| Excise taxes | 178 | 167 | 269 | 294 | 352 | 621 |
| Customs duties and export taxes | 141 | 116 | 193 | 337 | 340 | 396 |
| Other taxes | 219 | 228 | 341 | 772 | 757 | 1,055 |
| Non-tax revenue | 260 | 352 | 390 | 545 | 648 | 712 |
| Capital revenue and grants | 19 | 21 | 44 | 14 | 16 | 21 |
| Total expenditure and net lending | 2,467 | 2,337 | 3,081 | 4,997 | 5,735 | 6,489 |
| Current expenditure | 1,761 | 1,788 | 2,257 | 3,236 | 4,315 | 4,458 |
| Wages and salaries | 544 | 576 | 648 | 802 | 1,221 | 1,257 |
| Purchase of goods and services | 510 | 394 | 519 | 702 | 784 | 962 |
| Subsidies to public enterprises | 73 | 36 | 81 | 123 | 107 | 167 |
| Transfers | 614 | 753 | 967 | 1,572 | 2,054 | 1,754 |
| Interest payments | 20 | 30 | 42 | 37 | 149 | 317 |
| *Of which:* DBM | | | | | 24 | 72 |
| Capital expenditure and net lending | 706 | 548 | 824 | 1,761 | 1,420 | 2,031 |
| Capital expenditure | 624 | 461 | 591 | 1,281 | 1,458 | 1,914 |
| Domestically-financed | 604 | 434 | 577 | 1,229 | 1,296 | 1,485 |
| Foreign-financed | 20 | 27 | 13 | 51 | 161 | 429 |
| Net lending | 81 | 88 | 233 | 480 | -37 | 117 |
| Overall balance (including grants) | -296 | -343 | 42 | -529 | -706 | -410 |
| Non-mineral overall balance | -818 | -671 | -593 | -1,589 | -1,654 | -1,666 |
| Structural balance | … | … | … | -632 | -807 | -600 |
| Financing | 296 | 343 | -42 | 529 | 706 | 410 |
| Foreign (net) | 39 | 219 | 31 | 199 | 70 | 318 |
| Domestic (net) | 258 | 124 | -73 | 330 | 636 | 92 |
| Privatization receipts (valuation adj.) | 9 | -1 | 3 | 14 | 3 | 0 |
| Domestic bank financing (net) | 249 | 198 | -112 | 95 | 455 | 315 |
| Domestic non-bank financing (net) | 0 | -73 | 36 | 461 | 280 | -95 |
| Stabilization fund accumulation | 0 | 0 | 0 | -241 | -101 | -128 |
| | | | (In percent of GDP) | | | |
| Total revenue and grants | 33.1 | 30.3 | 37.1 | 40.3 | 37.1 | 35.2 |
| Current revenue | 32.8 | 29.9 | 36.6 | 40.2 | 36.9 | 35.1 |
| Tax revenue and social security contributions | 28.8 | 24.6 | 31.9 | 35.3 | 32.2 | 31.0 |
| Non-tax revenue | 4.0 | 5.3 | 4.6 | 4.9 | 4.8 | 4.1 |
| Capital revenue and grants | 0.3 | 0.3 | 0.5 | 0.1 | 0.1 | 0.1 |
| Total expenditure and net lending | 37.6 | 35.5 | 36.6 | 45.1 | 42.3 | 37.6 |
| Current expenditure | 26.9 | 27.1 | 26.8 | 29.2 | 31.8 | 25.8 |
| *Of which:* Wages and salaries | 8.3 | 8.7 | 7.7 | 7.2 | 9.0 | 7.3 |
| Capital expenditure and net lending | 10.8 | 8.3 | 9.8 | 15.9 | 10.5 | 11.8 |
| Overall balance (incl. grants) | -4.5 | -5.2 | 0.5 | -4.8 | -5.2 | -2.4 |
| Non-mineral overall balance (incl. grants) | -12.5 | -10.2 | -7.0 | -14.3 | -12.2 | -9.7 |
| Structural balance | … | … | … | -5.7 | -6.0 | -3.5 |
| Financing | 4.5 | 5.2 | -0.5 | 4.8 | 5.2 | 2.4 |
| Foreign (net) | 0.6 | 3.3 | 0.4 | 1.8 | 0.5 | 1.8 |
| Domestic (net) | 3.9 | 1.9 | -0.9 | 3.0 | 4.7 | 0.5 |
| Banking system (net) | 3.8 | 3.0 | -1.3 | 0.9 | 3.4 | 1.8 |
| Non-bank | 0.1 | -1.1 | 0.5 | 4.3 | 2.1 | -0.6 |
| Stabilization fund accumulation | 0.0 | 0.0 | 0.0 | -2.2 | -0.7 | -0.7 |
| Memorandum items: | | | | | | |
| Development Bank of Mongolia (DBM) expenditure | | | | | -4.0 | -4.2 |
| - Overall balance, including DBM expenditure | -4.5 | -5.2 | 0.5 | -4.8 | -9.2 | -6.6 |
| - Structural balance, including DBM expenditure | … | … | … | -5.7 | -10.0 | -7.7 |
| Mineral revenue | 8.0 | 5.0 | 7.5 | 9.6 | 7.0 | 7.3 |
| Non-mineral revenue (in percent of non-minderal GDP) | 38.5 | 38.4 | 49.6 | 47.8 | 50.9 | 52.0 |
| Total expenditure (in percent of non-mineral GDP) | 57.6 | 53.8 | 61.4 | 70.1 | 71.5 | 70.0 |
| Non-mineral overall balance (in percent of non-mineral GDP) | -19.1 | -15.4 | -11.8 | -22.3 | -20.6 | -18.0 |
| Nominal GDP (in billions of togrogs) | 6,556 | 6,591 | 8,415 | 11,088 | 13,566 | 17,257 |
| Copper price (Market, US$ per ton) | 6,963 | 5,165 | 7,538 | 8,823 | 7,770 | 7,424 |
| (Structural, US$ per ton) | | | | 5,715 | 5,946 | 6,071 |
| Primary spending (change in percent) | 39.8 | -5.7 | 31.7 | 63.2 | 12.6 | 10.5 |

Sources: Ministry of Finance; and IMF staff projections.

## Table 3. Statement of Operations and Stock Positions of the General Government, 2009–13

| | 2009 | 2010 | 2011 | Proj. 2012 | Proj. 2013 |
|---|---|---|---|---|---|
| | | | (In billions of togrogs) | | |
| Revenue | 1,990 | 3,065 | 4,458 | 5,013 | 6,059 |
| Expenditure | 2,247 | 2,813 | 4,468 | 5,756 | 6,351 |
| Expense | 1,792 | 2,254 | 3,199 | 4,315 | 4,458 |
| Net acquisition of nonfinancial assets | 455 | 559 | 1,269 | 1,441 | 1,893 |
| Operating balance | 198 | 811 | 1,259 | 698 | 1,600 |
| Net lending/borrowing (overall balance) | -257 | 252 | -49 | -743 | -293 |
| Net acquisition of financial assets | 205 | 175 | 707 | 61 | 245 |
| Net incurrence of liabilities | 462 | -77 | 756 | 805 | 538 |
| Domestic | 162 | 30 | 557 | 735 | 220 |
| Foreign | 300 | -107 | 199 | 70 | 318 |
| | | | (In percent of GDP) | | |
| Revenue | 30.2 | 36.4 | 40.2 | 36.9 | 35.1 |
| Income tax | 7.9 | 11.6 | 8.3 | 7.0 | 6.4 |
| VAT | 4.9 | 6.9 | 10.1 | 9.4 | 8.5 |
| Excise tax | 2.5 | 3.2 | 2.7 | 2.6 | 3.6 |
| Customs and import duty | 1.7 | 2.3 | 3.0 | 2.5 | 2.3 |
| Royalty | 2.2 | 2.4 | 5.3 | 3.8 | 4.5 |
| Social contributions | 3.9 | 3.8 | 4.3 | 5.1 | 4.1 |
| Others | 7.0 | 6.2 | 6.6 | 6.5 | 5.7 |
| Expense | 27.2 | 26.8 | 28.9 | 31.8 | 25.8 |
| Compensation of employees | 8.8 | 7.7 | 7.2 | 9.0 | 7.3 |
| Use of goods and services | 5.9 | 6.2 | 6.3 | 5.8 | 5.6 |
| Interest | 0.4 | 0.5 | 0.0 | 1.1 | 1.8 |
| Subsidies | 0.6 | 1.0 | 1.1 | 0.8 | 1.0 |
| Social benefit | 11.5 | 11.4 | 14.2 | 15.1 | 10.2 |
| Net acquisition of nonfinancial assets | 6.9 | 6.6 | 11.4 | 10.6 | 11.0 |
| Operating balance | 3.0 | 9.6 | 11.4 | 5.1 | 9.3 |
| Net lending/borrowing (overall balance) | -3.9 | 3.0 | -0.4 | -5.5 | -1.7 |
| Net acquisition of financial assets | 3.1 | 2.1 | 6.4 | 0.5 | 1.4 |
| Policy lending | 1.3 | 2.8 | 4.3 | -0.3 | 0.7 |
| Stabilization fund | 0.0 | 0.0 | 2.2 | 0.7 | 0.7 |
| Net incurrence of liabilities | 7.0 | -0.9 | 6.8 | 5.9 | 3.1 |
| Domestic | 2.5 | 0.4 | 5.0 | 5.4 | 1.3 |
| Foreign | 4.5 | -1.3 | 1.8 | 0.5 | 1.8 |
| Stock positions: | | | | | |
| Net financial worth | -0.3 | 2.8 | 1.6 | -4.1 | -4.9 |
| Financial assets | 59.4 | 48.6 | 43.3 | 35.8 | 29.6 |
| Currency and deposits | 20.4 | 16.3 | 14.5 | 12.6 | 10.7 |
| Securities other than shares | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 |
| Loans | 28.4 | 24.1 | 22.6 | 18.2 | 15.0 |
| Shares and other equity | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 |
| Other accounts receivable | 10.4 | 8.2 | 6.2 | 5.1 | 4.0 |
| Liabilities | 59.7 | 45.8 | 41.6 | 39.9 | 34.5 |
| Securities other than shares | 11.3 | 8.5 | 9.3 | 9.6 | 7.5 |
| Loans | 45.0 | 34.7 | 30.3 | 28.7 | 25.7 |
| Other accounts payable | 3.4 | 2.6 | 2.0 | 1.6 | 1.3 |

Sources: Ministry of Finance; and IMF staff projections.

## Table 4. Mongolia: Monetary Aggregates, 2008–13

| | | | | | Proj. | |
|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
| | (In billions of togrog, end of period) | | | | | |
| Monetary survey | | | | | | |
| Broad money | 2,270 | 2,880 | 4,655 | 6,381 | 8,222 | 10,459 |
| Currency | 329 | 285 | 390 | 519 | 822 | 1,046 |
| Deposits | 1,941 | 2,595 | 4,266 | 5,862 | 7,400 | 9,413 |
| Net foreign assets | 672 | 1,520 | 2,728 | 3,057 | 3,008 | 3,198 |
| Net domestic assets | 1,598 | 1,359 | 1,927 | 3,324 | 5,214 | 7,261 |
| Domestic credit | 2,118 | 1,987 | 2,448 | 4,545 | 6,648 | 8,773 |
| Net credit to government | -574 | -717 | -836 | -1,114 | -659 | -528 |
| Claims on non-banks | 2,692 | 2,704 | 3,284 | 5,660 | 7,388 | 9,198 |
| Other items, net | -520 | -627 | -521 | -1,221 | -1,434 | -1,512 |
| Monetary authorities | | | | | | |
| Reserve money | 580 | 733 | 947 | 1,662 | 2,127 | 2,552 |
| Net foreign assets | 793 | 1,526 | 2,518 | 3,034 | 2,984 | 3,175 |
| BOM defined reserves 1/ | 808 | 1,652 | 2,628 | 3,153 | 3,021 | 3,085 |
| Net international reserves (NIR) 2/ | 627 | 1,335 | 2,140 | 2,811 | 1,732 | 1,667 |
| Other BOM defined reserves | 181 | 318 | 488 | 342 | 1,288 | 1,418 |
| Other assets, net | -14 | -126 | -110 | -119 | -36 | 90 |
| Net domestic assets | -213 | -793 | -1,571 | -1,372 | -857 | -623 |
| Net credit to government | -183 | -265 | -493 | -458 | -266 | -266 |
| Claims on deposit money banks | 243 | 198 | 131 | 342 | 304 | 350 |
| Minus: Central bank bills (net) | 120 | 393 | 1,101 | 879 | 486 | 408 |
| Other items, net | -154 | -333 | -109 | -377 | -410 | -299 |
| Memorandum items: | (In percent, unless otherwise indicated) | | | | | |
| Annual broad money growth | -5.1 | 26.9 | 61.6 | 37.1 | 28.8 | 27.2 |
| Annual reserve money growth | 8.4 | 26.4 | 29.2 | 75.5 | 28.0 | 20.0 |
| Velocity | 2.9 | 2.3 | 1.8 | 1.7 | 1.7 | 1.7 |
| Broad money/reserve money | 3.9 | 3.9 | 4.9 | 3.8 | 3.9 | 4.1 |
| Claims on non-banks growth | 28.7 | 0.4 | 21.5 | 72.3 | 30.5 | 24.5 |
| Claims on non-banks (in percent of GDP) | 41.1 | 41.0 | 39.0 | 51.0 | 54.5 | 53.3 |
| Total loans/deposits | 138.7 | 104.2 | 77.0 | 96.5 | 99.8 | 97.7 |
| BOM defined reserves (in millions of US$) 1/ | 638 | 1,145 | 2,090 | 2,258 | 2,163 | 2,209 |
| Net international reserves (NIR, in millions of US$) 2/ | 495 | 925 | 1,702 | 2,013 | 1,240 | 1,193 |

Sources: Mongolian authorities; and IMF staff projections.

1/ Evaluated at end-2011 exchange rate for 2012 and 2013.

2/ 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 and development bank of Mongolia foreign currency deposits and foreign currency current accounts held at the Bank of Mongolia. Evaluated at end-2011 exchange rate for 2012 and 2013.

## Table 5. Mongolia: Balance of Payments, 2008–13

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

| | | | | | Proj. | |
|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
| Current account balance (including official grants) | -722 | -410 | -931 | -2,774 | -3,605 | -2,839 |
| Trade balance | -613 | -194 | -278 | -1,008 | -1,840 | -983 |
| Exports | 2,534 | 1,876 | 2,899 | 4,780 | 4,420 | 5,811 |
| Mineral export 1/ | 836 | 1,560 | 2,521 | 4,377 | 4,061 | 5,456 |
| Non-mineral export | 600 | 316 | 378 | 403 | 359 | 354 |
| Imports | -3,147 | -2,070 | -3,177 | -5,788 | -6,260 | -6,794 |
| Oil imports | -891 | -528 | -676 | -1,135 | -1,244 | -1,238 |
| Food imports | -436 | -311 | -336 | -476 | -544 | -599 |
| For investment in mining 2/ | -190 | -143 | -576 | -1,790 | -1,948 | -2,054 |
| Other | -1,630 | -1,088 | -1,589 | -2,387 | -2,524 | -2,903 |
| Services, net | -191 | -164 | -279 | -1,161 | -1,088 | -900 |
| Income, net | -130 | -190 | -561 | -843 | -834 | -1,104 |
| Current transfers | 212 | 138 | 186 | 244 | 158 | 147 |
| General government 3/ | 87 | -1 | 49 | 24 | 34 | 22 |
| Other sectors | 125 | 140 | 137 | 220 | 124 | 125 |
| *Of which:* Workers remittances | 94 | 120 | 102 | 58 | 103 | 104 |
| Capital and financial account | 545 | 737 | 2,180 | 2,860 | 3,511 | 2,885 |
| Capital account | ... | 208 | 175 | 114 | 101 | 88 |
| Financial account | 545 | 529 | 2,005 | 2,746 | 3,410 | 2,797 |
| Direct investment | 836 | 496 | 1,574 | 4,620 | 2,789 | 1,907 |
| Portfolio investment | -18 | -93 | 879 | 77 | 920 | 353 |
| Trade credits, net | 72 | 13 | 53 | -406 | -741 | -297 |
| Currency and deposits, net | 120 | -45 | -624 | -2,012 | -1,695 | -780 |
| Loans, net | 189 | 274 | 94 | 465 | 2,285 | 1,397 |
| Other, net | -654 | -116 | 31 | 2 | -148 | 216 |
| Errors and omissions | -161 | 187 | -311 | 76 | 0 | 0 |
| Overall balance | -337 | 514 | 938 | 163 | -94 | 46 |
| Financing | 337 | -514 | -938 | -163 | 94 | -46 |
| Gross official reserves (- increase) | 342 | -670 | -960 | -159 | 128 | 46 |
| Use of IMF credit (+) | -5 | 156 | 23 | -4 | -35 | -92 |
| Memoranda items: | | | | | | |
| Current account balance (in percent of GDP) | | | | | | |
| Including official grants | -12.9 | -9.0 | -14.9 | -31.8 | -36.3 | -24.1 |
| Excluding mining related imports | -9.5 | -5.8 | -5.7 | -11.3 | -16.7 | -6.7 |
| Excluding official grants | -14.4 | -8.9 | -15.7 | -32.1 | -36.6 | -24.3 |
| Gross official reserves (end-period) | 658 | 1,328 | 2,288 | 2,447 | 2,319 | 2,273 |
| (In months of next year's imports of goods and services) | 3.0 | 4.0 | 3.6 | 3.6 | 3.2 | 3.2 |
| (In months of next year's non-mining imports of g. and s.) | 4.1 | 6.2 | 7.1 | 7.0 | 6.0 | 5.8 |
| (In percent of short-term debt (on a remaining maturity basis)) | 502 | 439 | 601 | 329 | 221 | 194 |
| Copper price (in U.S. dollars per ton) | 6,963 | 5,165 | 7,538 | 8,823 | 7,770 | 7,424 |
| Oil price (in U.S. dollars per barrel) | 97 | 62 | 79 | 104 | 102 | 97 |
| Gold price (in U.S. dollars per troy oz.) | 872 | 973 | 1,225 | 1,569 | ... | ... |
| Nominal GDP (in millions of U.S. dollars) | 5,607 | 4,574 | 6,244 | 8,709 | 9,932 | 11,785 |

Sources: Mongolian authorities; and IMF staff projections.

1/ Including copper, coal, gold and others.
2/ This covers Oyu Tolgoi copper project and Tavan Tolgoi coal project.
3/ Starting in 2009, investment-related grants have been reclassified in the capital account per BPM5.

## Table 6. Mongolia: Selected Economic and Financial Indicators, 2008–17 1/

| | 2008 | 2009 | 2010 | 2011 | Proj. 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | (In percent of GDP, unless otherwise indicated) | | | | | |
| Real sector | | | | | | | | | | |
| Nominal GDP (in billions of togrogs) | 6,556 | 6,591 | 8,415 | 11,088 | 13,566 | 17,257 | 21,045 | 24,796 | 30,771 | 35,366 |
| Per capita GDP (in US$) 2/ | 2,103 | 1,684 | 2,261 | 3,097 | 3,480 | 4,069 | 4,892 | 5,937 | 7,560 | 8,830 |
| Real GDP growth (percent change) | 8.9 | -1.3 | 6.4 | 17.5 | 11.2 | 16.8 | 12.7 | 8.0 | 15.2 | 8.3 |
| Mineral real GDP growth | 5.2 | 0.2 | 7.4 | 11.2 | 6.8 | 50.6 | 28.5 | 9.7 | 28.6 | 10.1 |
| Non-mineral real GDP growth | 10.3 | -1.8 | 6.0 | 19.9 | 12.8 | 5.4 | 5.0 | 7.0 | 7.0 | 7.0 |
| GDP deflator (percent change) | 21.4 | 1.8 | 20.0 | 12.1 | 10.0 | 8.9 | 8.3 | 9.1 | 7.8 | 6.1 |
| Consumer prices (End-period; percent change) | 23.2 | 1.9 | 14.3 | 9.4 | 12.9 | 10.2 | 8.5 | 7.9 | 7.3 | 6.8 |
| Copper prices (US$ per ton) | 6,963 | 5,165 | 7,538 | 8,823 | 7,770 | 7,424 | 7,423 | 7,411 | 7,400 | 7,380 |
| General government accounts | | | | | | | | | | |
| Total revenue and grants | 33.1 | 30.3 | 37.1 | 40.3 | 37.1 | 35.2 | 32.6 | 31.6 | 32.4 | 32.8 |
| Mineral revenue | 8.0 | 5.0 | 7.5 | 9.6 | 7.0 | 7.3 | 6.6 | 6.8 | 8.7 | 9.3 |
| Non-mineral revenue | 25.2 | 25.3 | 29.6 | 30.7 | 30.1 | 27.9 | 26.0 | 24.8 | 23.7 | 23.5 |
| Total expenditure and net lending | 37.6 | 35.5 | 36.6 | 45.1 | 42.3 | 37.6 | 34.1 | 33.1 | 32.6 | 34.5 |
| Primary balance | -4.2 | -4.7 | 1.0 | -4.4 | -4.1 | -0.5 | 0.4 | 0.2 | 1.2 | -0.5 |
| Overall balance | -4.5 | -5.2 | 0.5 | -4.8 | -5.2 | -2.4 | -1.5 | -1.5 | -0.2 | -1.7 |
| Non-mineral overall balance | -12.5 | -10.2 | -7.0 | -14.3 | -12.2 | -9.7 | -8.1 | -8.3 | -8.9 | -11.1 |
| Structural balance | … | … | … | -6.9 | -6.0 | -3.1 | -2.0 | -2.0 | -0.5 | -1.8 |
| | | | | | (In percent of non-mineral GDP ) | | | | | |
| Non-mineral revenue and grants | 38.9 | 38.8 | 50.3 | 47.8 | 50.9 | 52.0 | 49.2 | 44.3 | 42.9 | 57.0 |
| Total expenditure and net lending | 57.6 | 53.8 | 61.4 | 70.1 | 71.5 | 70.0 | 64.5 | 59.1 | 59.1 | 60.0 |
| Non-mineral overall balance | -19.1 | -15.4 | -11.8 | -22.3 | -20.6 | -18.0 | -15.3 | -14.8 | -16.2 | -19.2 |
| | | | | | (In percent of GDP, unless indicated otherwise) | | | | | |
| Monetary sector | | | | | | | | | | |
| Broad money (percent change) | -5.1 | 26.9 | 61.6 | 37.1 | 28.8 | 27.2 | 25.8 | 21.6 | 28.2 | 18.9 |
| Velocity (GDP/M2) | 2.9 | 2.3 | 1.8 | 1.7 | 1.7 | 1.7 | 1.6 | 1.6 | 1.5 | 1.5 |
| Balance of payments | | | | | | | | | | |
| Current account balance | -12.9 | -9.0 | -14.9 | -31.8 | -36.3 | -24.1 | -10.6 | 1.8 | 5.9 | 8.2 |
| Excluding mining-related imports | -9.5 | -5.8 | -5.7 | -11.3 | -16.7 | -6.7 | 3.2 | 10.0 | 13.4 | 3.6 |
| Gross official reserves (in millions of US$) | 658 | 1,328 | 2,288 | 2,447 | 2,319 | 2,273 | 2,187 | 2,854 | 3,097 | 4,191 |
| (In months of next year's imports of goods and services) | 3.0 | 4.0 | 3.6 | 3.6 | 3.2 | 3.2 | 3.4 | 4.0 | 4.0 | 4.5 |
| Debt indicators | | | | | | | | | | |
| Total public debt | 31.0 | 46.6 | 45.3 | 51.7 | 56.7 | 54.2 | 47.0 | 41.0 | 32.3 | 27.5 |
| Domestic public debt 3/ | 0.0 | 3.4 | 16.3 | 25.6 | 27.4 | 23.9 | 17.0 | 11.4 | 5.7 | 3.6 |
| External public debt | 31.0 | 43.2 | 28.9 | 26.1 | 29.4 | 30.2 | 30.0 | 29.7 | 26.6 | 23.9 |
| (In millions of US$) | 1,602 | 1,974 | 1,938 | 2,074 | 2,775 | 3,492 | 4,404 | 5,389 | 6,187 | 6,588 |

Sources: Mongolian authorities; and IMF staff projections.

1/ The medium-term projections are based on the assumption that the Fiscal Stability Law will be adhered to starting from 2014.
2/ Based on period average exchange rate, and population (end of year).
3/ 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.

## Table 7. Mongolia: Financial Soundness Indicators of the Banking Sector

| | 2007 | 2008 | 2009 | 2010 1/ | 2011 1/ | 2012 1/ Q2 |
|---|---|---|---|---|---|---|
| ***Capital adequacy*** | | | | | | |
| Regulatory capital to risk-weighted assets | 14.0 | 11.6 | 5.5 | 16.2 | 15.0 | 15.4 |
| Regulatory Tier I capital to risk-weighted assets | 11.8 | 8.7 | 2.3 | 11.9 | 11.0 | 11.5 |
| Total capital (in billion MNT) | 372.1 | 342.1 | 177.4 | 631.7 | 949.7 | 1118.6 |
| ***Sectoral distribution of lending 2/*** | | | | | | |
| Agriculture | 7.6 | 2.6 | 5.8 | 4.4 | 3.0 | 2.7 |
| Construction | 15.6 | 14.5 | 14.4 | 10.8 | 11.8 | 11.8 |
| Manufacturing | 13.0 | 14.5 | 15.5 | 14.1 | 11.3 | 10.8 |
| Mining | 6.3 | 6.4 | 13.2 | 12.0 | 12.0 | 12.9 |
| Real estate activities | 1.7 | 5.4 | 7.1 | 13.6 | 14.1 | 13.9 |
| Wholesale and retail trade | 29.2 | 22.7 | 18.0 | 18.6 | 17.0 | 16.8 |
| Other | 26.5 | 33.8 | 26.0 | 26.5 | 30.8 | 31.1 |
| ***Asset quality*** | | | | | | |
| Non-performing loans (NPL) to gross loans 3/ | 3.2 | 7.1 | 20.0 | 6.7 | 3.1 | 2.6 |
| Non-performing loans (NPL), incl. past due loans, to gross loans 4/ | 5.3 | 10.6 | 24.5 | 9.7 | 4.4 | 3.5 |
| Provisions to NPL 3/ | 87.1 | 75.8 | 67.4 | 62.4 | 69.1 | 70.0 |
| Provisions to NPL (incl. past due loans) 4/ | 53.1 | 50.9 | 55.0 | 43.2 | 48.2 | 53.4 |
| NPL net of provisions to capital 3/ | 2.4 | 13.7 | 99.8 | 12.5 | 5.5 | 4.3 |
| NPL (incl. past due loans) net of provisions to capital 4/ | 14.5 | 41.5 | 169.0 | 27.2 | 13.1 | 8.9 |
| ***Earnings and profitability*** | | | | | | |
| Return on assets (before tax) | 2.5 | -1.5 | -5.6 | 1.8 | 2.9 | 2.5 |
| Return on equity (before tax) | 21.2 | -21.2 | -131.9 | 11.2 | 18.6 | 16.9 |
| Interest margin to gross income | 42.3 | 11.7 | -42.1 | 34.2 | 28.0 | 28.4 |
| Non-interest expenses to gross income | 46.5 | 74.2 | 90.0 | 72.7 | 75.1 | 75.5 |
| Personnel expenses to non-interest expenses | 20.4 | 11.8 | 9.1 | 7.2 | 5.6 | 5.8 |
| Spread between reference loan and deposit rates | 6.5 | 6.8 | 7.9 | 7.2 | 5.0 | 6.9 |
| ***Liquidity*** | | | | | | |
| Liquid assets to total assets | 28.1 | 21.8 | 36.9 | 44.1 | 32.1 | 30.1 |
| Liquid assets to short-term liabilities | 27.4 | 23.9 | 31.8 | 53.3 | 37.6 | 35.3 |
| Foreign currency deposits to total deposits | 25.4 | 25.3 | 34.4 | 32.4 | 27.1 | 30.4 |
| Deposits to loans | 71.0 | 60.1 | 83.9 | 77.5 | 97.4 | 103.3 |

Sources: Mongolian authorities; and IMF staff estimates.

1/ The FSIs reported for 2010 onwards exclude Anod, Zoos, and Post Bank.
2/ The sectoral distribution of loans is taken from the quarterly loan report of the Bank of Mongolia, based on a survey.
3/ NPL according to the new regulation (introduced in 2004), i.e., past due loans are not included.
4/ NPL according to the old regulation, i.e., past due loans are included.

## APPENDIX I. Mongolia: Risk Assessment Matrix[1]

| Nature/Source of Main Threats | Overall Level of Concern: Likelihood of Realization in the Next Three Years (high, medium, or low) | Overall Level of Concern: Expected Impact on Economy if Risk is Realized (high, medium, or low) |
|---|---|---|
| **1. Overly expansionary fiscal policy raising inflation and BOP pressures**<br>Overly optimistic revenue projections imply that spending can be expanded without breaching the FSL's deficit ceiling. DBM spending circumvents the FSL. | **Medium to High**<br>Fiscal policy has historically been volatile and pro-cyclical. | **High**<br>Overly loose fiscal policy would raise inflation, undermine competitiveness, drag down non-mining growth and have a significant negative impact on the poor. |
| **2. Significant fall in non-oil commodity prices**<br>A global downturn could depress commodity prices which would have an important impact (commodity exports account for 90 percent of exports and 30 percent of government revenue). | **Medium**<br>The relatively strong growth performance of China could cushion—but not offset—the impact of a renewed global recession. | **High**<br>The deterioration in the fiscal and external accounts would have far-reaching effects. Government spending would have to be cut sharply and mining FDI would slow. The resulting recession would put pressure on household and corporate balance sheets, undermining banking sector stability through rapidly rising NPLs. |
| **3. A worsening of global liquidity and financing conditions** | **Medium**<br>Continued stress in the euro zone is being felt intermittently in international funding markets. | **Medium**<br>Low external exposure of the financial system limits the risk to Mongolia's economy. Still, global financial volatility could cause delays to major mining projects, negatively impacting growth. |
| **4. Financial stability risk**<br>The surge in bank credit has pushed up real estate prices, increased leverage, and heightened financial sector risk. | **Medium to High**<br>Lower growth or declining real estate prices could raise NPLs and, as in the past, create financial instability. | **Medium to High**<br>Renewed problems in the banking sector would be costly to resolve and would be a setback for growth. |
| **5. Socio-economic and political risks**<br>Amid rising inequality, social tensions could increase if inclusive growth is not realized. Political instability is an additional risk factor. | **Medium**<br>The mining sector boom, exacerbated by macroeconomic mismanagement, could raise income inequality. However, recent wage increases, and the implementation of a targeted social safety net could limit discontent. | **Medium**<br>The booming mining sector in conjunction with pro-cyclical macroeconomic policy could exacerbate inequalities and impede progress on economic diversification and inclusive growth. |

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path discussed in this report (which is the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline. The RAM reflects staff's views on the source of risks and overall level of concerns as of the time of discussions with the authorities.

INTERNATIONAL MONETARY FUND

# MONGOLIA

November 1, 2012

## STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION AND THIRD POST-PROGRAM MONITORING—INFORMATIONAL ANNEX

| | |
|---|---|
| Prepared By | Asia and Pacific Department (in collaboration with other Departments) |

## CONTENTS

# FUND RELATIONS

(As of September 30, 2012)

**Membership Status:** Joined February 14, 1991; Article VIII

## General Resources Account

| | SDR Million | Percent Quota |
|---|---|---|
| Quota | 51.10 | 100.00 |
| Fund holdings of currency (exchange rate) | 164.03 | 320.99 |
| Reserve tranche position | 0.14 | 0.27 |

## SDR Department

| | SDR Million | Percent Allocation |
|---|---|---|
| Net cumulative allocation | 48.76 | 100.00 |
| Holdings | 44.41 | 91.09 |

## Outstanding Purchases and Loans

| | SDR Million | Percent Quota |
|---|---|---|
| Stand-by Arrangements | 113.06 | 221.25 |
| ECF Arrangements | 1.63 | 3.19 |

## Financial Arrangements (In SDR Million)

| Type | Date of Arrangement | Expiration Date | Amount Approved | Amount Drawn |
|---|---|---|---|---|
| Stand-by | Apr. 01, 2009 | Oct. 01, 2010 | 153.30 | 122.64 |
| ECF [1] | Sep. 28, 2001 | Jul. 31, 2005 | 28.49 | 12.21 |
| ECF [1] | Jul. 30, 1997 | Jul. 29, 2000 | 33.39 | 17.44 |

## Projected Obligations to Fund [2]

(SDR Million; based on existing use of resources and present holdings of SDRs)

| | Forthcoming | | | | |
|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 |
| Principal | 11.50 | 61.03 | 40.24 | 1.92 | 0.00 |
| Charges/interest | 0.31 | 0.89 | 0.28 | 0.02 | 0.00 |
| Total | 11.80 | 61.92 | 40.52 | 1.93 | 0.00 |

[1] Formerly PRGF.

[2] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

## Safeguards Arrangements

An update safeguards assessment of the Bank of Mongolia (BOM) finalized in June, 2009 found that the BOM has continued to improve its safeguards framework since the previous assessment. The BOM's financial reporting and audit practices generally comply with international standards. The assessment made recommendations to (i) strengthen certain aspects of the BOM's oversight mechanism, (ii) remove external audit qualifications caused by lack of access to central bank's vaults, and (iii) improve the timeliness of audit completion and publication of the bank's financial statements. The authorities have since confirmed that the auditors were granted access to its vaults at end-2009 to end-2011, and the timing of audit completion has improved.

## Exchange Arrangement

On March 24, 2009, the BOM instituted a foreign exchange auction allowing the determination of the exchange rate mainly by market forces. The de facto and de jure exchange rate arrangements are currently both classified as floating.

Mongolia accepted the obligations of Article VIII, Sections 2, 3, and 4 on February 1, 1996. Mongolia maintains 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. The Executive Board approved the multi-price auction MCP until June 22, 2010 (Decision No. 14365 of June 23, 2009), and its further extension until March 15, 2012 or the next Article IV consultation whichever is earlier (Decision No. 14669 of June 23, 2010 and Decision No. 14365 of March 16, 2011). The MCP, however, could not be resolved by March 15, 2012, and would be continued as long as the multiple price foreign exchange auction mechanism remains in place. Therefore the MCP is unapproved, and since the criteria for approval of this MCP are not in place, staff does not recommend Executive Board approval of said measure. In addition, Mongolia has an official exchange rate (reference rate) that is mandatorily used for government transactions (as opposed to the commercial market rate). Therefore, by way of official action, the authorities have created a market segmentation. While Order #699 of the BOM issued on December 3, 2010, sets forth that the reference rate is determined based on the weighted average of market rates used from 4 PM of the previous day to 4 PM of the current day, staff is of the view that this Order does not eliminate the market segmentation and the multiplicity of effective rates arising from it. Accordingly, in the absence of a mechanism to ensure that the commercial rates and the reference rate do not deviate by more than 2 percent, the way the reference rate is used in government transaction gives rise to an MCP subject to Fund approval. Since the criteria for approval of this MCP are not in place, it remains unapproved. 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).

## Article IV Consultation

The 2011 Article IV consultation (IMF Country Report No. 11/76) was concluded by the Executive Board on March 16, 2011. Mongolia is on a 12–month cycle.

**ROSC Assessments**

The following ROSC assessments have been undertaken: Data Dissemination (May 2001), Fiscal Transparency Module (November 2001), Fiscal update (May 2005), Data Dissemination (April 2008), Monetary and Fiscal Policy Transparency (September 2008), Banking Supervision (September 2008).

**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 Executive Board successfully completed the final review on September 8, 2010.

**FSAP Participation**

Mongolia participates in the Financial Sector Assessment Program (FSAP). The first , second and third FSAP missions took place in May 2007, September 2007 and November 2010, respectively. The latest report (IMF Country Report No. 11/107) was published in May 2011.

**Technical Assistance Missions since 2011**

- AML/CFT (LEG), October 2012
- Taxation (LEG), April–May 2012
- Mining/Petroleum Taxation (FAD), March–April 2012
- National Accounts Statistics (STA), March, April 2012
- Tax administration (FAD), February–March, May-June, August–Sept. 2012
- Macroprudential Policy Implementation (MCM), January 2012
- Strengthening Debt and Financial Asset Management (FAD), November 2011
- Fiscal Regimes (TTF MNRW) (FAD), October–November 2011
- Tax administration (FAD), August- September, November 2011
- Monetary and Financial Statistics (STA), July–August 2011
- Taxation (LEG), June 2011
- Monetary policy (MCM), April 2011
- IBL (FAD), January, March, June, 2011
- Strengthening LTO operations (FAD), February–April 2011

**Resident Advisors**

- Budget Planning (FAD), June 2009–June 2012

**Resident Representative**

Since September 2011, the Fund no longer has a resident representative in Mongolia. The local office is being managed from the Regional Office for Asia and Pacific in Tokyo, Japan.

# WORLD BANK-IMF COLLABORATION

1. **The Bank and the Fund country teams maintain a close working relationship.** The teams, led by Ms. Chorching Goh (Lead Economist, EASPR) and Mr. Gerard Almekinders (Mission Chief) collaborate on a range of macroeconomic and structural issues.

2. **Cooperation and coordination is exemplary. It pertains to the following:**

- **Stand-by Arrangement (SBA) and post-program monitoring.** The World Bank participated in virtually all the negotiating missions' meetings with the authorities. This facilitated the discussions, especially as regards policies in areas of mutual interest such as bank restructuring, social welfare reform, and fiscal policy. The teams have also jointly participated in media events. After the completion of the SBA, Bank staff has continued to actively participate in post-program monitoring missions.
- **Development Policy Credits (DPC) and Country Partnership Strategy (CPS).** In turn, Fund staff participated in the design and review of the Bank's DPCs and was kept informed about the development of the Bank's new CPS for FY13-17.
- **Banking system issues**. Both country teams have been active in this area, including fielding numerous technical assistance missions. The teams coordinate closely to provide the authorities with consistent advice while avoiding unnecessary duplication of efforts. The two teams also continue to educate the public and parliamentarians on banking sector issues to build support for reforms.
- **Structural fiscal reforms.** Fund staff and the World Bank team have worked together successfully to provide technical assistance in expenditure management, the recently adopted fiscal responsibility law, the integrated budget law, the social welfare law, and mineral sector taxation.

3. **Based on the intensive collaboration, the Bank and the Fund share a common view about Mongolia's macroeconomic and structural reform priorities.** These include:

- **Promoting long-term growth.** Managing the mineral wealth to ensure strong, sustainable, and equitable growth with low inflation. This includes the importance of avoiding the "resource curse" and minimizing "Dutch disease" effects.
- **Macro-economic stability.** This includes ensuring that the boom-bust policies of the past are not repeated. The recently adopted fiscal responsibility law is a key step, and it is critical that it be strictly adhered to. At the same time, fiscal policy also has to be mindful of the macroeconomic policy mix and not over-burden monetary policy.
- **Monetary policy.** The central bank should continue to gear monetary policy to controlling inflation. The flexible exchange rate regime is working well and should be maintained. Monetary and exchange rate policy could be strengthened by giving the central bank more independence.
- **Protecting the poor.** The imminent introduction of a targeted poverty benefit under the recently adopted Social Welfare Law represents a big step forward in strengthening the social safety net and increasing fiscal flexibility.

• **Strengthening the banking system.** Key steps include continued improvement in bank regulation and supervision, and eventual introduction of deposit insurance to replace the blanket guarantee.

4. **The teams agreed to continue the close cooperation going forward.** Table 1 details the specific activities planned by the two country teams over the period September 2012 – August 2013 along with their expected deliveries. It was also agreed that further details on collaboration, as necessary, would be agreed at the technical level as work progresses.

**Table 1. Mongolia: Bank and Fund Planned Activities in Macro-Critical Structural Reform Areas, September 2012–August 2013**

| | Products | Expected Delivery Date |
|---|---|---|
| **Bank Work Program** | Analytical and Advisory Services | |
| | • Quarterly Economic Update | • Ongoing |
| | • Policy notes on selected economic topics | • Ongoing |
| | • Financial Sector Monitoring and Policy Dialogue (banking supervision, deposit insurance) | • Ongoing |
| | • Financial Sector Assessment Program (FSAP) Development Module (access to finance, capital markets, housing finance) | • Ongoing |
| | • Financial Literacy and Consumer Protection Assessment | • October 2012 |
| | • TA on procurement reform | • Ongoing |
| | • Analytical work on Decentralization and Accountability | • December 2012 |
| | Operational | |
| | • Supervision missions multi-sectoral TA Credit (Banking, social welfare, fiscal policy) | • Ongoing |
| | • Supervision missions Governance Assistance Project | • Ongoing |
| | • Supervision missions Economic Capacity TA Project | • Ongoing |
| | • Supervision Mongolia Statistical Capacity-Building Project | • Ongoing |
| **Fund Work Program** | • Article IV/PPM Mission-Board Meeting | • Sept.-November 2012 |
| | • PPM Mission-Board meeting | • April-June 2013 |
| | • STA: National account statistics | • Ongoing |
| | • FAD: Tax administration for large taxpayers, mineral taxation regime | • Ongoing |
| | • MCM: Banking supervision | • Ongoing |

# RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

Mongolia became a member of the Asian Development Bank (AsDB) in February 1991. AsDB has been Mongolia's largest source of official development assistance, playing a key role in the country's transformation to a market based economy. Going forward, AsDB's assistance will be scaled-up to meet urgent and large-scale financing needs, particularly in infrastructure, and will support innovative financing mechanisms including public-private partnerships.

Between 1991 and 2011, Mongolia received loans from AsDB for 46 projects totaling $825.17 million in agriculture and natural resources, education, energy, financial, health and social protection, industry and trade, public sector management, transport, information and communication technology, water, other municipal infrastructure and services sectors. In addition, 12 Asian Development Fund (ADF) grant projects totaling $172.2 million were approved from 2007, when Mongolia became eligible for ADF grant financing. Including other trust fund sources, Mongolia received 33 grants amounting to $210.7 million. Current assistance to Mongolia is guided by the Country Operations Business Plan for 2012-14.

With enhanced creditworthiness and significant progress in economic development, Mongolia was reclassified as a Group B country in August 2011, making it eligible for funding from AsDB's ordinary capital resources, while maintaining access to concessional financing from the ADF.

The Mongolia Country Partnership Strategy 2012-16 was approved by AsDB management in March 2012. During this period, assistance will focus on transport, energy, and water; education and health services; and regional economic cooperation.

Subject to regional ADF allocation and country performance-based allocation, a total indicative sovereign lending program of $138.0 million for 2013–2014 is envisaged, of which $75.0 million would be provided from ADF country allocation, $63.0 million provided from OCR financing, and some $30.0 million is envisaged to be financed through AsDB's ADF regional program of assistance. An average of $4.7 million in TA resources is to be provided annually. Private sector operations are expected to play a growing financial and catalytic role as progress is made in fostering PPPs. Larger interventions, especially in power, heating, and other municipal infrastructure, will improve service delivery and create opportunities for private sector participation

AsDB's operations will concentrate on the following sectors in next 5 years:

***Transport.*** Under the Central Asia Regional Economic Cooperation program, Mongolia is harmonizing cross-border transport procedures, and developing key economic corridors, including

[1] Data provided by the Asian Development Bank staff.

the Western Regional Road Corridor, which will link the relatively isolated western region to its neighboring economies. AsDB is also developing a public transport system for Ulaanbaatar, and will construct logistics infrastructure and systems—initially in Zamyn Uud at the People's Republic of China border and thereafter in Ulaanbaatar.

***Energy.*** Insufficient and unreliable power and heating are becoming bottlenecks to growth and threaten livelihoods. AsDB is improving energy efficiency and capacity in Ulaanbaatar, through the country's first major public–private partnership in constructing a new energy efficient combined heating and power plant in Ulaanbaatar with proper emission reduction equipment. AsDB has been piloting the application of renewable energies, and is supporting Mongolia to access multilateral climate change funds.

***Urban Development.*** AsDB is helping to meet basic infrastructure needs in small towns, including those playing a central role in the mineral-rich Gobi area, where communities are coping with a large population influx in response to new mining operations. At the same time, AsDB is preparing a program to develop services and economic opportunities in poor areas of Ulaanbaatar.

***Education.*** Since the mid-1990s AsDB has supported the Government of Mongolia in strengthening basic and secondary education, which succeeded in maintaining Mongolia's high levels of access and education achievements. To meet pressing labor market demands, AsDB is also supporting reform of higher education and will help modernize vocational training.

***Health.*** AsDB has made major investments to improve primary health services and health insurance, and is supporting policy reforms and investments in the hospital sector and in drug safety.

# STATISTICAL ISSUES

(As of August 31, 2012)

| I. Assessment of Data Adequacy for Surveillance |
|---|
| **General:** Data provision to the Fund is broadly adequate for surveillance. The priority areas for improvement are national accounts and government finance statistics. |
| **National Accounts:** The national accounts statistics compiled by the National Statistics Office (NSO) are broadly in line with the guidelines of the 1993 system of national accounts (SNA). They have improved the quality of national accounts data, but weaknesses remain, including in the estimation of capital formation, estimation of GDP price deflators, and coverage of the informal sector and small-scale activity (especially in the services sector). The compilation of constant price expenditure-based national accounts, in line with the pilot done in 2008, would serve as a useful check for the production side estimates. NSO disseminates annual expenditure-based GDP series both in value terms and in real terms, and to pilot quarterly estimates of GDP by expenditure currently while not yet disseminated.<br>**Price Statistics:** The consumer price index (CPI) was rebased in January 2008 with expenditure-derived weights from the 2005 Household Income and Expenditure Survey. NSO has published a national CPI for Ulaanbaatar and 21 aimags (provinces) since January 2008, and a housing price index since October 2008. Priority areas for improvement are data on wages and earnings. NSO plans to disseminate a producer price index and a retail price index in early 2013. |
| **External Sector Statistics:** The Bank of Mongolia (BOM) follows the concepts and methods in the Balance of Payment Manual fifth edition and is expected to begin implementing the recommendations of the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) in 2012. The BOM disseminates the data according to the IMF standard presentation table. The coverage of the balance of payments statistics has been broadened by extending the International Transaction Reporting System (ITRS) to nonbank financial institutions and by increasing the number of direct reporting private enterprises. Priorities for improvement are in the analysis of balance of payments and the quarterly survey of foreign investment enterprises. The BOM compiled an experimental International Investment Position (IIP) for 2007, and started to publish IIP in 2011 covering data from 2010. |
| **Monetary and Financial Statistics:** BOM's monetary and financial statistics conform to the concepts and definitions of the MFSM methodology as the authorities implemented majority of recommendations of the latest MFS missions. In particular, the monetary data were improved by the proper classification of repurchase agreements, accrued interest, and financial derivatives. The coverage of monetary statistics was expanded beginning in February 2010 to include data of Savings and Credit Cooperatives (SCCs) that collect deposits and since May 2010 data for some other financial institutions (OFIs) have been disseminated in the BOM monthly statistical bulletin. Monetary data based on the standardized report forms are disseminated in International Financial Statistics beginning in November 2009. The July/August 2011 mission discussed the quality of data of the nonbank financial institutions (NBFIs), insurance companies, and securities companies that are reported to the Financial Regulatory Commission (FRC) and recommended their use in the compilation of monetary statistics. However, due to a pure cooperation received from the FRC, this recommendation has not been implemented yet. The BOM is taking steps to improve the quality of its monetary data with respect to the proper sectorization of other depository corporations' accounts. Such improved data will be available towards the end of 2012. |

| | |
|---|---|
| **Government Finance Statistics:** Currently, the concepts, classifications, and definitions used to compile sub-annual and annual fiscal statistics reported to the Fund fiscal statistics generally follow the guidelines of the GFSM 1986. While no formal decision has yet been taken on adopting a migration path to the GFSM 2001 methodology, Mongolia also compiles annual GFSM 2001-based Statement of government Operations, Statement of Sources and Uses of cash, and a complete Balance Sheet for the consolidated general government. | |
| **II. Data Standards and Quality** | |
| Mongolia participates in the General Data Dissemination System (GDDS), and maintains its efforts to subscribe the Special Data Dissemination Standards (SDDS). | A data ROSC mission visited Mongolia in September 2007 to update the May 2000 assessment of the macroeconomic statistics, complemented by an assessment of data quality based on the IMF's Data Quality Assessment Framework. The report was published in April 2008. |

## Mongolia—Table of Common Indicators Required for Surveillance
## As of August 31, 2012

| | Date of Latest Observation | Date Received | Frequency of Data[6] | Frequency of Reporting[6] | Frequency of Publication[6] | Memo Items: Data Quality – Methodological soundness[7] | Memo Items: Data Quality – Accuracy and Reliability[8] |
|---|---|---|---|---|---|---|---|
| Exchange rates | 8/31/12 | 8/31/12 | D | M | D | | |
| International reserve assets and reserve liabilities of the Monetary Authorities[1] | 8/31/12 | 8/31/12 | D | M | M | | |
| Reserve/base money | 7/2012 | 8/20/12 | M | M | M | O, LO, LO, LO | O, O, O, O, LNO |
| Broad money | 7/2012 | 8/20/12 | M | M | M | | |
| Central bank balance sheet | 7/2012 | 8/20/12 | M | M | M | | |
| Consolidated balance sheet of the banking system | 7/2012 | 8/20/12 | M | M | M | | |
| Interest rates[2] | 7/2012 | 8/20/12 | M | M | M | | |
| Consumer price index | 7/2012 | 8/20/12 | M | M | M | O, LO, O, O | LO,LO,LO,O,O |
| Revenue, expenditure, balance and composition of financing[3] – general government[4] | 7/2012 | 8/20/12 | M | M | M | LO, LNO, LO, O | LO, O, LO, LO, LNO |
| Revenue, expenditure, balance and composition of financing[3]– central government | 7/2012 | 8/20/12 | M | M | M | | |
| Stocks of central government and central government-guaranteed debt[5] | 2011 | 8/2012 | A | A | A | | |
| External current account balance | 7/2012 | 8/2012 | M | M | M | O, O, O, LO | LO, O, LO, LO, LO |
| Exports and imports of goods | 7/2012 | 8/2012 | M | M | M | | |
| GDP/GNI | Q2/2012 | 7/2012 | Q | Q | Q | O, LNO, O, LO | O, LO, LO, LO, LNO |
| Gross external debt | Q2/2012 | 7/2012 | Q | Q | Q | | |

[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, and 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).
[7] Reflects the assessment provided in the data ROSC or the Substantive Update (published in April 2008, and based on the findings of the mission that took place during September 1–28) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[8] Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

# MILLENNIUM DEVELOPMENT GOALS

| | 1995 | 2000 | 2005 | 2010 |
|---|---|---|---|---|
| **Goal 1: Eradicate extreme poverty and hunger** | | | | |
| Employment to population ratio, 15+, total (%) | 54 | 56 | 54 | 57 |
| Employment to population ratio, ages 15-24, total (%) | 37 | 37 | 33 | 32 |
| GDP per person employed (constant 1990 PPP $) | .. | .. | .. | .. |
| Income share held by lowest 20% | 7 | 7 | .. | 7 |
| Malnutrition prevalence, weight for age (% of children under 5) | .. | 12 | 5 | .. |
| Poverty gap at $1.25 a day (PPP) (%) | .. | .. | .. | .. |
| Poverty headcount ratio at $1.25 a day (PPP) (% of population) | .. | .. | .. | .. |
| Vulnerable employment, total (% of total employment) | .. | 57 | 62 | 58 |
| **Goal 2: Achieve universal primary education** | | | | |
| Literacy rate, youth female (% of females ages 15-24) | .. | 98 | .. | 97 |
| Literacy rate, youth male (% of males ages 15-24) | .. | 97 | .. | 95 |
| Persistence to last grade of primary, total (% of cohort) | .. | 89 | 84 | .. |
| Primary completion rate, total (% of relevant age group) | 74 | 86 | 96 | .. |
| Total enrollment, primary (% net) | 86 | 92 | 91 | 100 |
| **Goal 3: Promote gender equality and empower women** | | | | |
| Proportion of seats held by women in national parliaments (%) | 8 | 8 | 7 | 4 |
| Ratio of female to male primary enrollment (%) | 105 | 101 | 100 | 98 |
| Ratio of female to male secondary enrollment (%) | 137 | 122 | 111 | 108 |
| Ratio of female to male tertiary enrollment (%) | .. | 172 | 154 | 148 |
| Share of women employed in the nonagricultural sector (% of total nonagricultural employment) | 46.2 | 48.6 | 51.2 | 51.1 |
| **Goal 4: Reduce child mortality** | | | | |
| Immunization, measles (% of children ages 12-23 months) | 85 | 92 | 97 | 97 |
| Mortality rate, infant (per 1,000 live births) | 61 | 47 | 35 | 26 |
| Mortality rate, under-5 (per 1,000) | 83 | 61 | 44 | 32 |
| **Goal 5: Improve maternal health** | | | | |
| Adolescent fertility rate (births per 1,000 women ages 15-19) | 33 | 26 | 21 | 20 |
| Births attended by skilled health staff (% of total) | .. | 97 | 99 | 100 |
| Contraceptive prevalence (% of women ages 15-49) | 57 | 67 | 66 | 55 |
| Maternal mortality ratio (modeled estimate, per 100,000 live births) | 110 | 96 | 84 | 63 |
| Pregnant women receiving prenatal care (%) | .. | 97 | 99 | 100 |
| Unmet need for contraception (% of married women ages 15-49) | .. | .. | 14 | .. |
| **Goal 6: Combat HIV/AIDS, malaria, and other diseases** | | | | |
| Children with fever receiving antimalarial drugs (% of children under age 5 with fever) | .. | .. | .. | .. |
| Condom use, population ages 15-24, female (% of females ages 15-24) | .. | .. | .. | .. |
| Condom use, population ages 15-24, male (% of males ages 15-24) | .. | .. | .. | .. |
| Incidence of tuberculosis (per 100,000 people) | 314 | 254 | 225 | 224 |
| Prevalence of HIV, female (% ages 15-24) | .. | .. | .. | 0.1 |
| Prevalence of HIV, male (% ages 15-24) | .. | .. | .. | 0.1 |
| Prevalence of HIV, total (% of population ages 15-49) | 0.1 | 0.1 | 0.1 | 0.1 |
| Tuberculosis case detection rate (all forms) | 38.0 | 51.0 | 80.0 | 72.0 |
| **Goal 7: Ensure environmental sustainability** | | | | |
| CO2 emissions (kg per PPP $ of GDP) | 2 | 2 | 1 | 1 |
| CO2 emissions (metric tons per capita) | 3 | 3 | 3 | 4 |
| Forest area (% of land area) | .. | 8 | 7 | 7 |
| Improved sanitation facilities (% of population with access) | 50 | 49 | 50 | 51 |
| Improved water source (% of population with access) | 56 | 65 | 75 | 82 |
| Marine protected areas (% of territorial waters) | .. | .. | .. | .. |
| **Goal 8: Develop a global partnership for development** | | | | |
| Net ODA received per capita (current US$) | 91 | 90 | 86 | 110 |
| Debt service (PPG and IMF only, % of exports, excluding workers' remittances) | 10 | 6 | 3 | 4 |
| Internet users (per 100 people) | 0 | 1 | .. | 13 |
| Mobile cellular subscriptions (per 100 people) | 0 | 6 | 22 | 91 |
| Telephone lines (per 100 people) | 3 | 5 | 6 | 7 |

Source: World Bank, World Development Indicators database.

# 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

**Ministry of Economic Development** (www.med.gov.mn))
- Long- and medium-term development strategy
- Economic and social policies
- Investment policy coordination
- Development Bank of Mongolia

**Financial Regulatory Commission** (www.frc.mn)
- FRC decisions
- Total assets of regulated entities (insurance companies, securities and broker firms, non-bank financial institutions, savings and credit unions)
- Consolidated income statements of regulated entities (insurance companies, securities and broker firms, non-bank financial institutions, savings and credit unions)

INTERNATIONAL MONETARY FUND

# MONGOLIA

## STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION AND THIRD POST-PROGRAM MONITORING—DEBT SUSTAINABILITY ANALYSIS

November 1, 2012


Approved By
**Markus Rodlauer and Masato Miyazaki (IMF) and Jeffrey Lewis and Sudhir Shetty (IDA)**


The Debt Sustainability Analysis (DSA) has been prepared jointly by IMF and World Bank staff, in consultation with the Asian Development Bank (AsDB), using the debt sustainability framework for low-income countries approved by the Boards of both institutions.

*The results of the debt sustainability analysis (DSA) are similar to those of the previous DSA.[1] Mongolia's risk of debt distress remains low based on indicators of external and public debt. The successful Eurobond issuance by the Development Bank of Mongolia (DBM) earlier this year pushed up the country's public and publicly-guaranteed external debt. However, under the baseline scenario, with the economy expanding and large mining projects coming on stream, Mongolia's external and public debt ratios are projected to improve substantially over the medium term and external debt burden indicators remain below the relevant policy-dependent indicative thresholds.[2]*

[1] The 2011 DSA (see IMF Country Report No. 11/76) was based on end-2009 debt data. The current DSA is based on end-2011 debt data. The fiscal year for Mongolia is January–December.

[2] The low-income country debt sustainability framework (LIC DSF) recognizes that better policies and institutions allow countries to manage higher levels of debt, and thus the threshold levels are policy-dependent. Mongolia's policies and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA), place it as a "medium performer," with an average rating of 3.41 during 2009-11. The relevant indicative thresholds for this category are: 40 percent for the NPV of debt-to-GDP ratio, 150 percent for the NPV of debt-to-exports ratio, 250 percent for the NPV of debt-to-revenue ratio, 20 percent for the debt service-to-exports ratio, and 20 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed external debt.

# BACKGROUND

1. **This DSA incorporates an updated baseline macroeconomic outlook, including revised assumptions on the public sector's external and domestic borrowing plans.** The economy is experiencing a structural shift as the development of the Oyu Tolgoi (OT) copper-gold mining complex nears completion. The assumptions and projections regarding the development of the OT and Tavan Tolgoi (TT) mining projects in this DSA are broadly in line with those in the previous DSA (Box 1 ). At the same time, expansionary fiscal policy has been causing double-digit inflation and balance of payments (BOP) pressures. Moreover, to address the country's large infrastructure needs, the DBM raised US$600 million through the issuance of five-year government-guaranteed Eurobonds (Box 2). Compared to the previous DSA, public and publicly guaranteed external debt is on a higher path, reflecting for the most part DBM borrowing:

- The face value of public external debt is now projected to amount to 29.4 percent of GDP in 2012, up from 19.8 percent of GDP in the previous DSA. The higher public external debt ratio is mostly accounted for by DBM borrowing (6 percent of GDP) and the U.S. dollar value of GDP being 6 percent lower than projected in the previous DSA.

- Reflecting the likely extent of DBM borrowing, the face value of public external debt is now projected to decline by 5½ percentage points of GDP over the next five years, compared to a 17½ percentage points of GDP decline projected in the previous DSA.

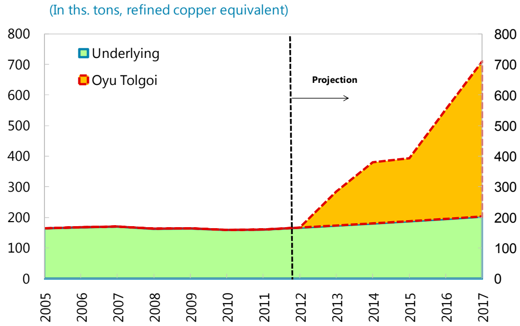
### Box 1. Mongolia: Two Large Mining Projects

**Exports of copper and coal are set to rise significantly over the medium term:**

- **The Oyu Tolgoi mine**, located in the south near the border with China, will be one of the largest copper and gold mines in the world. The government owns 34 percent of the mine, and the rest is owned by Turquoise Hills Resources (Canada), in which Rio Tinto (UK) has a 51 percent stake. Production is expected to start in early 2013.

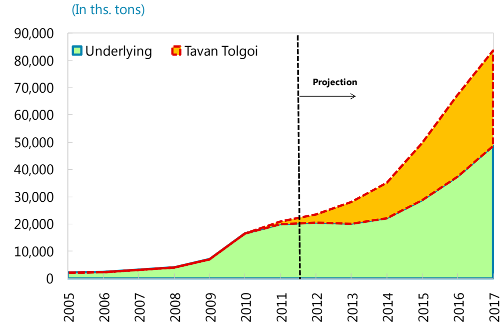
- **Tavan Tolgoi**, also located in southern Mongolia, is one of the world's largest untapped coal deposits with estimated reserves of about 6.4 billion tons. Erdenes Tavan Tolgoi LLC, a subsidiary of a 100 percent state-owned enterprise, has the mining license for what is called the eastern bloc (East Tsankhi) as well as the western bloc (West Tsankhi). An operating contract with foreign companies for the eastern bloc was concluded in October 2011. An initial public offering of 20 percent of Erdenes Tavan Tolgoi shares is expected to take place in the first half of 2013. The modalities for developing the western bloc are under discussion.

**Copper: Export Volume**
(In ths. tons, refined copper equivalent)




Sources: Mongolian authorities; and IMF staff estimates.

**Coal: Export Volume**
(In ths. tons)




Sources: Mongolian authorities; and IMF staff estimates.

### Box 2: The Development Bank of Mongolia

The DBM was set up in May 2011 with the mandate to finance Mongolia's large infrastructure needs to develop the country's mineral wealth and associated transportation networks. The project portfolio of the DBM includes railroads, roads and infrastructure for housing projects, energy, and industrial development. A large number of mostly road projects were also shifted to the DBM's portfolio from the budget in 2011. The government signed a four-year management contract in 2011 with the Korean Development Bank. And a recent World Bank technical assistance mission provided specific recommendations to amend the Law on the DBM to bring it in line with international best practice.

Wholly-owned by the government, DBM borrowing carries a sovereign guarantee. The risk of contingent liabilities could be mitigated somewhat by the recently passed IBL which requires that all guarantees provided by the state, including for the DBM, be fully reflected in the budget (Box 4).

The DBM debuted its first foreign currency bond offering on international financial markets in March. The five-year US$580 million bond offering drew orders of US$6.25 billion, with a yield of 5.75 percent, much lower than the initial guidance of 6–6.25 percent. The bonds are rated B1 by Moody's and BB- by S&P, which is the same rating as the Mongolian sovereign. Along with an earlierUS$20 million in a private placement at the end of 2011, the offering completes its US$600 million program of issuance during 2012 to fund several infrastructure projects including roads and railway projects. The DBM is expected to continue issuing similarly large amounts of debt on international markets over the next few years, a scenario which is incorporated into the DSA.

Sources: World Bank and IMF.

2. **The macroeconomic outlook, summarized in Box 3, assumes that the government budget will observe the Fiscal Stability Law's ( FSL) ceiling for the structural deficit of 2 percent of GDP from 2014 onwards**. The macro-economic outlook also takes into account the likely extent of off-budget spending by the DBM on public investment projects.

- The 2013 draft budget sent to Parliament targets a general government deficit of 1.2 percent of GDP in 2013. This is consistent with the FSL's structural deficit ceiling of 2 percent of GDP. However, revenues may be overestimated by as much as 6¾ percent of GDP. As a result, revenue shortfalls will likely cause the FSL's structural deficit ceiling to be breached in 2013. Meanwhile, any potential delay in the start of full commercial production at Oyu Tolgoi would also delay net revenue inflows into the budget, constraining fiscal space and growth prospects in the near term.

## Box 3. Mongolia—Macroeconomic Outlook and Assumptions

*The baseline macroeconomic framework assumes that growth will be driven by completion of the OT copper and gold mine and rising output from the eastern bloc of the TT coal mine, with the economy experiencing significant structural changes in the process.*

- The medium-term outlook for real GDP growth is dominated by OT and TT. Production from the OT mine is expected to start in early 2013, with the mine expected to produce at full capacity by around 2016. Total mining output is projected to expand by more than 20 percent per annum, on average, over the next five years. As the mineral sector expands in size, there will also be significant spillovers to other sectors through changes in relative factor prices and factor movements. Overall growth is projected to average 12 percent per annum during 2012–17. Long-run growth is projected to average about 5½ percent, unchanged from the previous DSA. This could be higher, depending on the development of new mining projects. With progress on the development of the western part of the TT coal mine currently stalled, the macroeconomic framework only incorporates output projections from the eastern part of TT over the next few years.
- The baseline assumes that structural fiscal reforms including on pensions, civil service, social transfers will contribute to an improved business climate and overall competitiveness of the economy, while public investment management reforms should help to mitigate risks of contingent liabilities.
- The copper and coal price projections through 2017 are based on the WEO projections as of August 2012 and are assumed constant in real terms afterwards, but take into account transportation costs which reduced the price received by Mongolia.
- The continued strong growth of domestic demand is expected to prevent a rapid decline in inflation and the increase in consumer prices is projected to remain in double digits throughout 2013. Over the long term, with fiscal policy anchored by the FSL, inflation will decelerate to about 5 percent.
- The BOP will go through large swings. The current account is expected to gradually shift into surplus by 2015 as imports of mining-related investment goods ease and a larger share of the gross export proceeds from the OT mine accrue to the government in the form of tax and dividend payments. However, foreign direct investment (FDI) inflows are also expected to fall back.
- A restrained fiscal policy is projected over the medium to long term, supported by the FSL and Integrated Budget Law (IBL). The structural fiscal balance is expected to gradually converge to the numerical targets specified in the FSL starting from 2013 (when the structural deficit and spending growth rules take effect). Rising commodity exports will boost fiscal revenue. Implementation of the FSL is expected to 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 in a Stabilization Fund that was established in 2011. As a result, the primary deficit would average less than 1 percent of GDP during 2012–17.
- To take into account the likely extent of external borrowing by the DBM, the baseline macroeconomic projections assume the issuance of US$500 million in new government-guaranteed international bonds each year for the next five years.

- Considerable capital spending will be channeled through the DBM. This spending is not included in the budget. It is also not covered by the FSL's limits on the structural deficit or expenditure growth, even though, for the most part, it will not generate revenues and eventually require funding from the budget to repay principal and interest on the DBM's external loans. Off-budget DBM spending will add to overheating pressures and will undermine the FSL's integrity and meaningfulness. DBM borrowing is guaranteed by the government and projected DBM borrowing is included in the DSA.

- The enactment of the IBL in late-2011 should support the observance of the FSL in 2014 and beyond (Box 4). At the same time, for the next few years, there will also be off-budget capital spending by the DBM which will add to external debt accumulation and put pressure on inflation.

**Mongolia: Structure of External Public Debt, 2011**

| | Nominal value (in US$m) | In percent of GDP | NPV (in US$m) |
|---|---|---|---|
| Public debt | 2,074 | 26.1 | 1,579 |
| Multilaterals | 1,291 | 16.3 | 973 |
| IMF | 178 | 2.2 | 167 |
| World Bank | 447 | 5.6 | 276 |
| AsDB | 612 | 7.7 | 493 |
| Official bilaterals | 754 | 9.5 | 600 |
| Paris Club | 484 | 6.1 | 378 |
| Non-Paris Club | 270 | 3.4 | 222 |
| Commercial | 7 | 0.1 | 6 |

Source: Mongolian authorities.

3. **Mongolia's stock of public and publicly- guaranteed external debt had a face value of US$2.1 billion (26.1 percent of GDP) at end-2011.** Nearly two-thirds of Mongolia's external public debt is owed to multilateral creditors on concessional terms, and most of the remainder is owed to official bilateral creditors on relatively concessional terms. Private external debt is significant, but mainly reflects intercompany lending for mining projects, including by the Rio-Tinto/Ivanhoe mining conglomerate, to finance the development of the OT copper and gold mine.

4. **Domestic public debt amounted to 25.6 percent of GDP at end-2011, up from 16.3 percent in the previous year.** The sharp increase mainly advance tax payments by the OT and TT mining companies, additional loans to the government from the local subsidiary of the OT mining conglomerate to finance the government's investment share in the OT mining project, as well as bond issuances in support of the wool, cashmere, and small-and-medium enterprise sectors (see text table).

**Mongolia: Public Domestic Debt**

(In billions of togrogs, unless otherwise noted)

| | 2010 | 2011 |
|---|---|---|
| Government bonds | 200 | 517 |
| Bank restructuring bonds | 100 | 80 |
| Civil servants housing | 95 | 137 |
| Wool, cashmere, SMEs | 5 | 300 |
| Liabilities to mining companies | 1,175 | 2,316 |
| Oyu Tolgoi | 1,175 | 1,978 |
| Tax prepayments | 202 | 318 |
| Equity loan | 973 | 1,660 |
| Tavan Tolgoi | 0 | 338 |
| Tax prepayments | 0 | 339 |
| Total | 1,375 | 2,833 |
| (in percent of GDP) | 16.3 | 25.6 |

Source: Mongolian authorities.

**Box 4: Key provisions of the Integrated Budget Law**

- The IBL (passed December 2011) is a comprehensive law which reforms the entire budget process, from public investment planning to budget execution and auditing, secures the implementation of the FSL, and fully accounts for contingent liabilities. Its key provisions are:
- On fiscal stability, the IBL mandates that budgets observe the 2 percent structural deficit ceiling and expenditure and debt rules set in the FSL and the expenditure limits set out in Medium-Term Budget Frameworks. The deficit and spending rules become binding in 2013.
- The law also explicitly states that the budget includes the state (central government) budget, the Human Development Fund, and the Social Insurance Fund; that the budget should list projects to be executed through concessions contracts, and include information on government guarantees and contingent liabilities, including those made to the newly formed DBM, thereby improving the budget's comprehensiveness. It therefore makes clear that any investments and debts by the DBM are public investments and debts, and that the safeguards of the FSL and IBL apply.
- It significantly strengthens capital budgeting, mandating that only projects that have gone through a proper appraisal process be considered for financing, and introduces the concept of a rolling four-year public investment program for large projects (greater than 30 billion MNT) as a stock of potentially financeable projects that have passed a pre-feasibility study. All financing decisions—whether to fund projects from the budget, loans, concessions, or the DBM—are then made by the Ministry of Finance (MOF), abiding by the good principle of the MOF as a single point of control on such matters.

Source: World Bank.

5. **Reflecting Mongolia's rapid economic development, strong growth prospects and improved credit-worthiness, the World Bank and Asian Development Bank (AsDB) confirmed its eligibility for non-concessional borrowing,**[3] while still retaining access to concessional funding.[4] With non-concessional borrowing from the two institutions expected to increase over the next few years alongside borrowing by the DBM through international bond issuances, the grant element of new external borrowing—as reflected by the grant-equivalent financing component—is projected to fall over the medium term. Meanwhile, however, an increase in concessional lending from multilateral and bilateral development partners in 2013 and 2014 is expected to cause the grant element of new borrowing to rise in those years. Interest rates in the medium term reflect International Development Association (IDA) blend terms and AsDB terms for concessional borrowing and market conditions for commercial loans.

[3]The process of graduation from IDA begins when a country exceeds its operational per capita income guidelines for a few years in a row. Mongolia's GNI per capita has nearly quadrupled since 2004, from $480 to $1,890 in 2010, a level well above the 2010 cut-off mark set for low-income countries of $1,005 per capita.

[4] Mongolia has been granted "Blend" status (in August 2011 by the AsDB, and in March 2012 by the World Bank, taking full effect in May 2012), which allows it to access both concessional and non-concessional (IBRD funding from the World Bank, and OCR funding from the AsDB) resources. Non-concessional funding from the World Bank is expected to be phased in over the next few years, while Mongolia will tap such funding from the AsDB from 2012 onwards.

6. **A comprehensive assessment of debt management operations using the Debt Management Performance Assessment tool was undertaken by a World Bank mission in December 2010.** The mission found that relative strengths of Mongolia's debt management are in governance and strategy development. The mission noted room for improvement in the areas of cash flow forecasting and cash management as well as operational risk management and reporting.

# DEBT SUSTAINABILITY

## A. External DSA

7. **All external debt indicators remain well below the policy-dependent debt burden thresholds under the baseline scenario.** There would be a one-off breach of a threshold under one of the standardized stress tests. The main results of the external DSA are as follows:

- **All debt indicators in the baseline scenario are expected to decline over the 20-year projection period** (Table 1). During the projection period, the present value (PV) of the external debt-to-GDP ratio decreases from 20 percent in 2011 to about 8 percent in 2032 (compared to an indicative threshold of 40 percent), while the PV of the debt-to-exports ratio is projected to hover around 45 percent over the medium term and decrease to around 20 percent in 2032 (compared to an indicative threshold of 150 percent).

- **The standard stress tests do reveal some vulnerabilities** (Table 3 and Figure 1). The standard exports shock causes a one-off breach of the threshold by the PV of the debt-to-exports ratio. This underscores that, to limit vulnerability, recourse to non-concessional foreign financing should be limited to commercially viable projects. As indicated in the previous DSAs, the prospective strong increase in real GDP related to the start of OT mining operations is so large that historical scenarios with key variables at their historical averages do not seem to represent relevant comparators. [5]

## B. Public DSA

8. In the baseline scenario, the PV of public debt-to-GDP ratio peaks at 52 percent of GDP in 2012 and then falls rapidly over the medium term to 25 percent of GDP in 2017 before stabilizing at about 22 percent of GDP over the long run (Table 2). The domestic debt to GDP ratio declines rapidly as the advance tax payments and the government's investment share borrowing are repaid from the mining

[5] At the same time, it should be noted that, despite the structural changes, the current account deficits during 2012-14 will still be larger than the average current account deficit of the past 10 years (4.5 percent of GDP). Therefore, if the large current account deficits (and hence large external borrowing requirements) in the baseline scenario in 2012–14 are replaced by the smaller current account deficits (and hence smaller external borrowing requirements) in the historical scenario, then the debt to GDP ratio, the debt to export ratio and the debt to revenue ratio decline very rapidly. However, for the subsequent five years the reverse is the case: the projected current account balance is much stronger (moving into surplus). Therefore, whereas the debt to GDP ratio, the debt to export ratio, and the debt to revenue ratio decline in the baseline scenario, they rise in the historical scenario.

projects' forthcoming revenue streams. Meanwhile, new external borrowing by the DBM prevents a rapid decline in the PV of external public debt-to-GDP ratio over the medium term.

**9.** The alternative scenarios and bound tests indicate that the projected paths of debt indicators are sensitive to alternative assumptions and point to some risks (Table 4 and Figure 2). A case in point is the scenario in which GDP growth in 2013–14 is one standard deviation below its historical average. In this scenario the PV of debt-GDP ratio rises from 52 percent in 2012 to 115 percent in 2032.

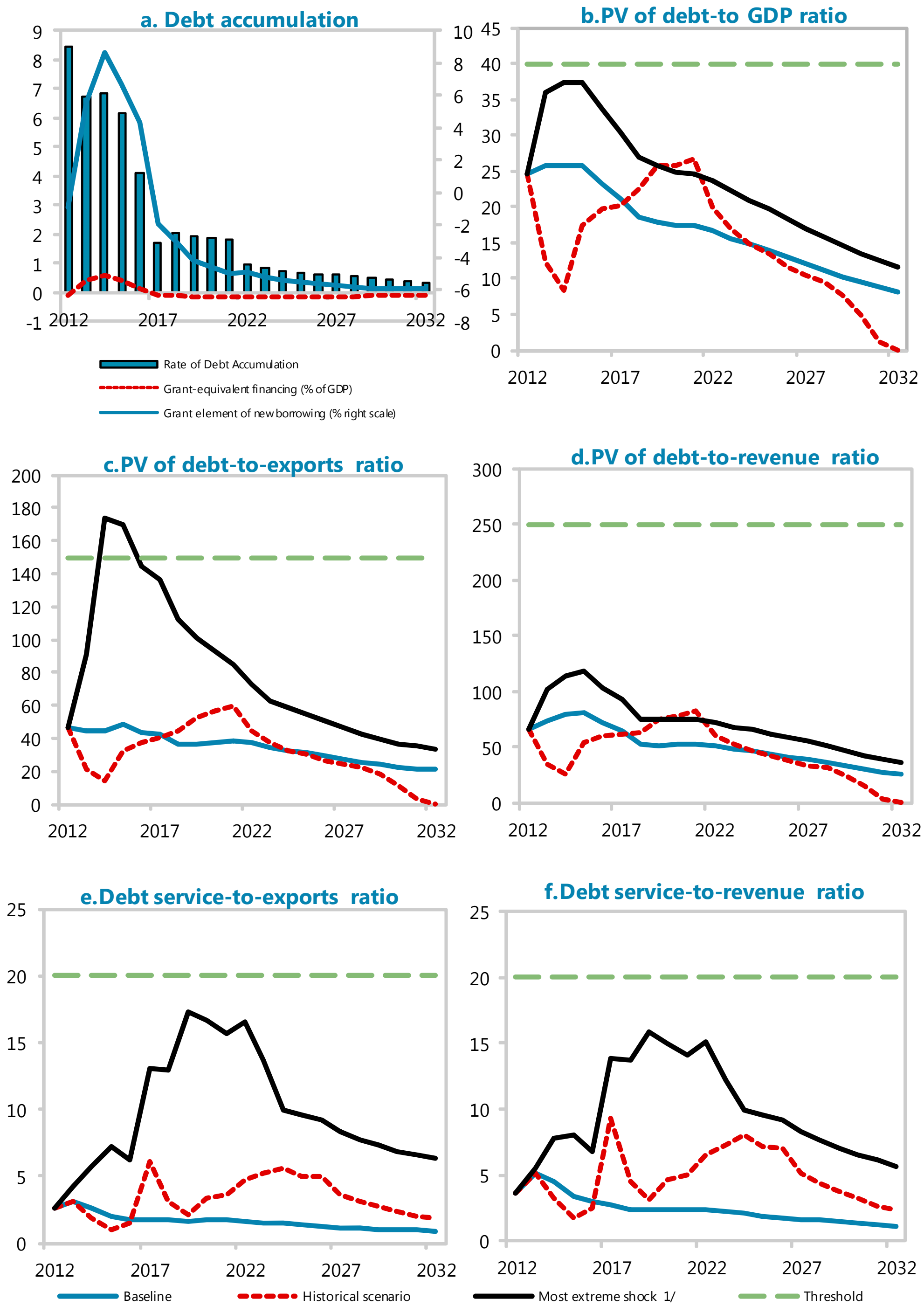
# AUTHORITIES' VIEW

**10. The authorities concurred with the overall assessment**. With regard to the DBM's external borrowing, they emphasized the need to increase investment in infrastructure. They viewed this as essential to facilitate exports, reduce the economy's reliance on the mining sector, and ease supply-side price pressures, by improving the connections of traders and farmers to markets. The authorities confirmed that the main purpose of the DBM is to finance bankable projects. Over time, DBM funding for non-bankable social benefit projects would decrease.

# CONCLUSION

**11. In the staff's view, Mongolia is at a low risk of debt distress based on external indicators.** The overall medium- to long-term macroeconomic outlook is favorable. However, short-term risks remain as expansionary policies lead to overheating pressures and increase Mongolia's vulnerability to a commodity price downturn, which remains a substantial risk in the current global environment. Under the baseline scenario, public debt ratios are projected to peak in 2013 and then fall steadily over the medium term with the rapid growth in the economy. On that basis, and taking into account possible contingent fiscal liabilities related to government-guaranteed external borrowing by the DBM to fund infrastructure projects, the projected path of public debt ratios does not alter the external DSA's assessment.

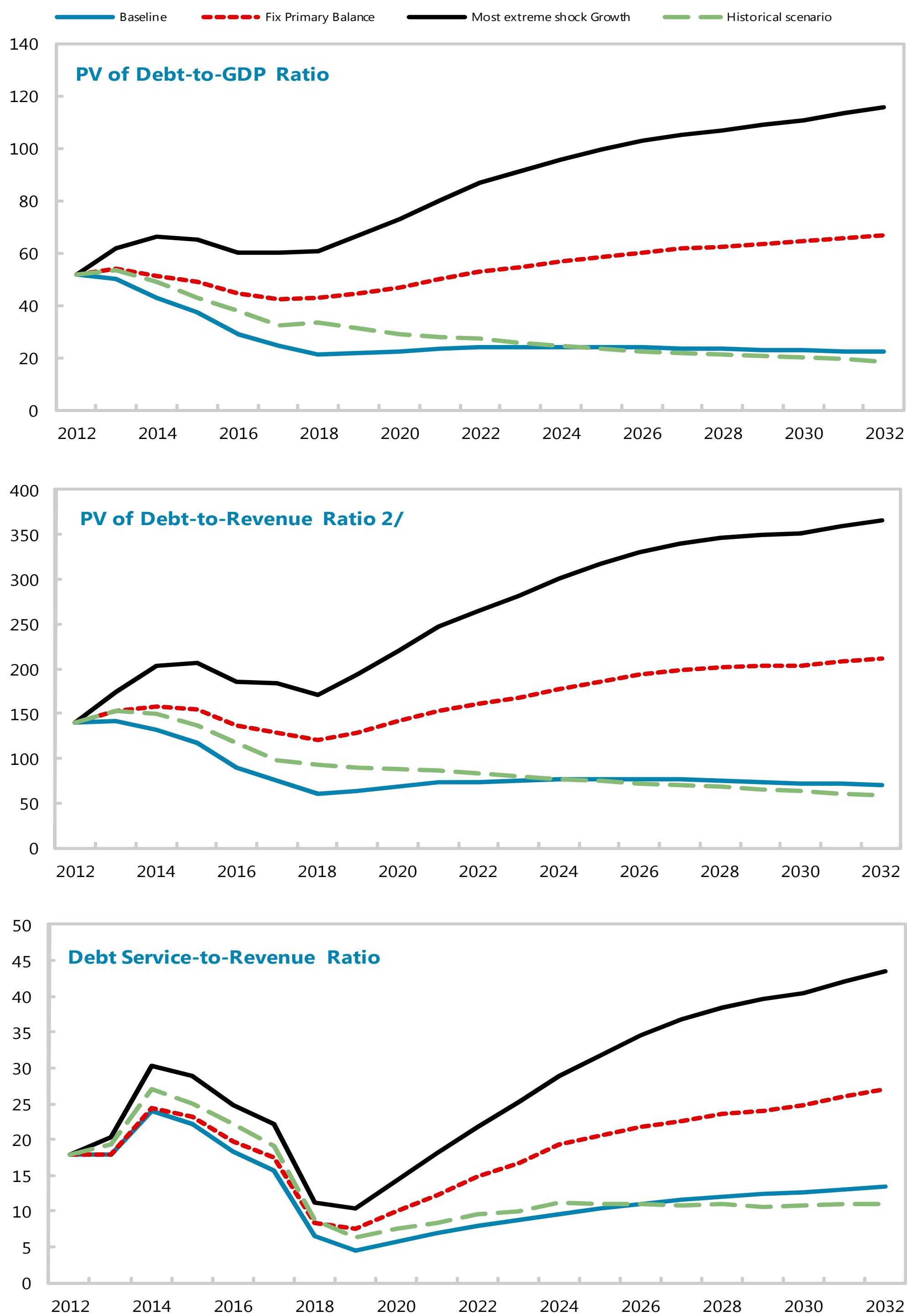
## Figure 1. Mongolia: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2012–32 1/




Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022. 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 figure f. to a Combination shock

**Figure 2. Mongolia: Indicators of Public Debt Under Alternative Scenarios, 2012-32 1/**




Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2022.
2/ Revenues are defined inclusive of grants.

### Table 1. External Debt Sustainability Framework, Baseline Scenario, 2009–32 1/

(In percent of GDP, unless otherwise indicated)

| | Actual | | | Historical [6/] | Standard [6/] | Projections | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Average | Deviation | | | | | | | 2012-2017 | | | 2018-2032 |
| | 2009 | 2010 | 2011 | | | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Average | 2022 | 2032 | Average |
| **External debt (nominal) 1/** | **63.4** | **60.4** | **111.4** | | | **131.4** | **122.8** | **108.3** | **86.2** | **66.8** | **56.0** | | **35.0** | **15.0** | |
| Of which: public and publicly guaranteed (PPG) | 43.2 | 28.9 | 26.1 | | | 29.4 | 30.2 | 30.0 | 29.7 | 26.6 | 23.9 | | 18.2 | 8.9 | |
| Change in external debt | 32.0 | -2.9 | 51.0 | | | 20.0 | -8.5 | -14.5 | -22.1 | -19.4 | -10.8 | | -2.2 | -1.4 | |
| Identified net debt-creating flows | 5.2 | -27.2 | -38.4 | | | 12.4 | -11.2 | -10.8 | -17.8 | -18.3 | -14.6 | | -6.9 | -3.3 | |
| **Non-interest current account deficit** | **8.5** | **14.0** | **30.2** | **4.5** | **11.7** | **32.1** | **18.2** | **5.2** | **-6.4** | **-9.3** | **-10.3** | | **-5.9** | **-3.0** | -8.7 |
| Deficit in balance of goods and services | 7.8 | 8.9 | 24.9 | | | 29.5 | 15.9 | 1.6 | -10.0 | -15.8 | -15.7 | | -9.4 | -3.6 | |
| Exports | 49.9 | 54.3 | 62.0 | | | 52.4 | 57.9 | 57.6 | 53.6 | 53.2 | 49.9 | | 45.1 | 39.6 | |
| Imports | 57.8 | 63.2 | 86.9 | | | 81.9 | 73.8 | 59.2 | 43.6 | 37.4 | 34.2 | | 35.7 | 36.0 | |
| Net current transfers (negative = inflow) | -2.6 | -2.4 | -0.9 | -4.0 | 3.8 | -1.4 | -1.1 | -0.9 | -0.6 | -0.5 | -0.4 | | -0.3 | -0.2 | -0.3 |
| Of which: official | 0.0 | -0.8 | -0.2 | | | -0.3 | -0.2 | -0.1 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | |
| Other current account flows (negative = net inflow) | 3.3 | 7.5 | 6.2 | | | 4.0 | 3.3 | 4.5 | 4.2 | 6.9 | 5.8 | | 3.7 | 0.8 | |
| **Net FDI (negative = inflow)** | **-10.8** | **-25.2** | **-53.1** | **-13.8** | **15.6** | **-13.0** | **-16.2** | **-8.2** | **-8.5** | **-2.0** | **-1.5** | | **-0.5** | **-0.3** | -0.9 |
| **Endogenous debt dynamics 2/** | **7.6** | **-16.0** | **-15.5** | | | **-6.7** | **-13.2** | **-7.8** | **-2.8** | **-6.9** | **-2.8** | | **-0.5** | **-0.1** | |
| Contribution from nominal interest rate | 0.5 | 0.9 | 1.6 | | | 4.3 | 5.4 | 4.9 | 4.2 | 3.2 | 1.8 | | 1.1 | 0.5 | |
| Contribution from real GDP growth | 0.5 | -3.0 | -7.6 | | | -11.0 | -18.6 | -12.7 | -7.0 | -10.1 | -4.7 | | -1.6 | -0.6 | |
| Contribution from price and exchange rate changes | 6.6 | -14.0 | -9.5 | | | ... | ... | ... | ... | ... | ... | | ... | ... | |
| **Residual (3-4) 3/** | **33.3** | **10.3** | **79.8** | | | **7.5** | **2.7** | **-3.8** | **-4.3** | **-1.1** | **3.8** | | **4.7** | **2.0** | |
| 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/ | ... | ... | 105.2 | | | 126.5 | 118.4 | 104.1 | 82.3 | 63.5 | 53.1 | | 33.5 | 14.3 | |
| In percent of exports | ... | ... | 169.5 | | | 241.3 | 204.6 | 180.7 | 153.7 | 119.3 | 106.3 | | 74.2 | 36.2 | |
| **PV of PPG external debt** | **...** | **...** | **19.9** | | | **24.5** | **25.8** | **25.8** | **25.8** | **23.2** | **21.1** | | **16.7** | **8.2** | |
| **In percent of exports** | **...** | **...** | **32.1** | | | **46.7** | **44.6** | **44.8** | **48.2** | **43.7** | **42.2** | | **37.0** | **20.7** | |
| **In percent of government revenues** | **...** | **...** | **49.4** | | | **66.1** | **73.3** | **79.3** | **81.6** | **71.7** | **64.3** | | **51.0** | **25.9** | |
| **Debt service-to-exports ratio (in percent)** | **3.9** | **5.3** | **3.9** | | | **17.5** | **22.5** | **27.7** | **33.5** | **21.0** | **15.1** | | **6.5** | **2.6** | |
| **PPG debt service-to-exports ratio (in percent)** | **3.8** | **4.4** | **1.7** | | | **2.6** | **3.2** | **2.6** | **2.0** | **1.8** | **1.8** | | **1.7** | **0.9** | |
| **PPG debt service-to-revenue ratio (in percent)** | **6.3** | **6.5** | **2.7** | | | **3.6** | **5.2** | **4.5** | **3.4** | **2.9** | **2.7** | | **2.3** | **1.1** | |
| Total gross financing need (Millions of U.S. dollars) | -18 | -453 | -1,529 | | | 3,459 | 2,772 | 3,127 | 1,941 | 1,440 | 322 | | -397 | -2,261 | |
| Non-interest current account deficit that stabilizes debt ratio | -23.5 | 16.9 | -20.7 | | | 12.1 | 26.7 | 19.8 | 15.7 | 10.1 | 0.5 | | -3.8 | -1.6 | |

**Table 1. External Debt Sustainability Framework, Baseline Scenario, 2009–32 1/ (concluded)**

(In percent of GDP, unless otherwise indicated)

| | Actual | | | Historical 6/ Average | Standard 6/ Deviation | Projections | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2009 | 2010 | 2011 | | | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2012-2017 Average | 2022 | 2032 | 2018-2032 Average |
| **Key macroeconomic assumptions** | | | | | | | | | | | | | | | |
| Real GDP growth (in percent) | -1.3 | 6.4 | 17.5 | 8.0 | 4.8 | 11.2 | 16.8 | 12.7 | 8.0 | 15.2 | 8.3 | 12.0 | 4.8 | 4.1 | 5.4 |
| GDP deflator in U.S. dollar terms (change in percent) | -17.4 | 28.3 | 18.7 | 13.1 | 13.1 | 2.6 | 1.6 | 8.3 | 14.0 | 12.2 | 9.5 | 8.0 | 4.7 | 7.8 | 7.4 |
| Effective interest rate (percent) 5/ | 1.3 | 2.0 | 3.6 | 1.7 | 0.8 | 4.4 | 4.9 | 4.9 | 4.8 | 4.8 | 3.3 | 4.5 | 3.4 | 3.7 | 3.4 |
| Growth of exports of G&S (U.S. dollar terms, in percent) | -23.8 | 48.4 | 59.4 | 26.7 | 26.7 | -3.6 | 30.9 | 21.5 | 14.5 | 28.4 | 11.3 | 17.2 | 10.4 | 8.8 | 11.4 |
| Growth of imports of G&S (U.S. dollar terms, in percent) | -30.5 | 49.3 | 91.8 | 32.6 | 38.7 | 7.5 | 6.9 | -2.0 | -9.4 | 10.9 | 8.5 | 3.7 | 31.8 | 18.4 | 13.6 |
| Grant element of new public sector borrowing (in percent) | ... | ... | ... | ... | ... | -0.9 | 5.6 | 8.7 | 6.7 | 4.3 | -2.0 | 3.7 | -4.9 | -6.0 | -5.3 |
| Government revenues (excluding grants, in percent of GDP) | 30.0 | 36.7 | 40.3 | | | 37.1 | 35.2 | 32.6 | 31.6 | 32.4 | 32.8 | | 32.7 | 31.6 | 32.2 |
| Aid flows (in Millions of U.S. dollars) 7/ | 13.5 | 28.8 | 1.5 | | | 35.2 | 33.3 | 34.2 | 31.1 | 25.0 | 24.3 | | 0.0 | 0.8 | |
| Of which: Grants | 13.2 | 28.6 | 1.2 | | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | |
| Of which: Concessional loans | 0.3 | 0.2 | 0.2 | | | 35.2 | 33.3 | 34.2 | 31.1 | 25.0 | 24.3 | | 0.0 | 0.8 | |
| Grant-equivalent financing (in percent of GDP) 8/ | ... | ... | ... | | | -0.1 | 0.4 | 0.6 | 0.4 | 0.2 | -0.1 | | -0.1 | -0.1 | -0.1 |
| Grant-equivalent financing (in percent of external financing) 8/ | ... | ... | ... | | | -0.9 | 5.6 | 8.7 | 6.7 | 4.3 | -2.0 | | -4.9 | -6.0 | -5.3 |
| *Memorandum items:* | | | | | | | | | | | | | | | |
| Nominal dollar GDP growth | -18.4 | 36.5 | 39.5 | | | 14.0 | 18.7 | 22.0 | 23.2 | 29.2 | 18.6 | 21.0 | 9.7 | 12.3 | 13.1 |
| PV of PPG external debt (in Millions of U.S. dollars) | | | 1,579 | | | 2,317 | 2,985 | 3,794 | 4,684 | 5,411 | 5,799 | | 9,044 | 14,031 | |
| PV of PPG external debt (in percent of GDP + remittances) | ... | ... | 19.8 | | | 24.3 | 25.6 | 25.6 | 25.7 | 23.1 | 21.0 | | 16.6 | 8.2 | |
| PV of PPG external debt (in percent of exports + remittances) | ... | ... | 31.7 | | | 45.8 | 44.0 | 44.3 | 47.7 | 43.3 | 41.8 | | 36.7 | 20.6 | |
| Debt service of PPG external debt (in percent of exports + remittances) | ... | ... | 1.7 | | | 2.5 | 3.1 | 2.5 | 2.0 | 1.8 | 1.8 | | 1.7 | 0.9 | |

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = 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, 2009–32
(In percent of GDP, unless otherwise indicated)

| | Actual | | | Average 5/ | Standard Deviation 5/ | Projections | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2009 | 2010 | 2011 | | | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2012-17 Average | 2022 | 2032 | 2018-32 Average |
| **Public sector debt 1/** | 46.6 | 45.3 | 51.7 | | | 56.7 | 54.2 | 47.0 | 41.0 | 32.3 | 27.5 | | 25.6 | 23.0 | |
| Of which: foreign-currency denominated | 45.4 | 42.9 | 47.0 | | | 49.6 | 46.7 | 41.0 | 35.7 | 28.2 | 22.5 | | 18.2 | 8.9 | |
| Change in public sector debt | 15.6 | -1.3 | 6.4 | | | 5.0 | -2.5 | -7.2 | -5.9 | -8.8 | -4.7 | | 0.4 | -0.2 | |
| Identified debt-creating flows | 9.3 | -15.3 | -2.6 | | | -3.2 | -8.2 | -9.8 | -7.3 | -8.7 | -3.2 | | -0.2 | -0.6 | |
| Primary deficit | 4.8 | -1.1 | 4.0 | 0.3 | 4.1 | 4.1 | 0.5 | -0.4 | -0.2 | -1.2 | 0.5 | 0.5 | 0.8 | 0.2 | 0.4 |
| Revenue and grants | 30.3 | 37.1 | 40.3 | | | 37.1 | 35.2 | 32.6 | 31.6 | 32.4 | 32.8 | | 32.7 | 31.6 | |
| Of which: grants | 0.3 | 0.5 | 0.0 | | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | |
| Primary (noninterest) expenditure | 35.0 | 36.0 | 44.3 | | | 41.2 | 35.8 | 32.2 | 31.4 | 31.2 | 33.3 | | 33.5 | 31.8 | |
| Automatic debt dynamics | 4.5 | -14.2 | -6.5 | | | -7.3 | -8.7 | -9.4 | -7.1 | -7.5 | -3.6 | | -1.0 | -0.8 | |
| Contribution from interest rate/growth differential | 7.4 | -11.9 | -11.9 | | | -5.5 | -7.5 | -7.9 | -7.0 | -7.7 | -3.7 | | -1.0 | -0.8 | |
| Of which: contribution from average real interest rate | 7.0 | -9.1 | -5.2 | | | -0.3 | 0.7 | -1.8 | -3.5 | -2.3 | -1.2 | | 0.1 | 0.1 | |
| Of which: contribution from real GDP growth | 0.4 | -2.8 | -6.8 | | | -5.2 | -8.2 | -6.1 | -3.5 | -5.4 | -2.5 | | -1.1 | -0.9 | |
| Contribution from real exchange rate depreciation | -2.9 | -2.3 | 5.5 | | | -1.7 | -1.2 | -1.6 | -0.1 | 0.2 | 0.1 | | ... | ... | |
| Other identified debt-creating flows | 0.0 | 0.0 | -0.1 | | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | |
| Privatization receipts (negative) | 0.0 | 0.0 | -0.1 | | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | |
| Recognition of implicit or contingent liabilities | 0.0 | 0.0 | 0.0 | | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | |
| Debt relief (HIPC and other) | 0.0 | 0.0 | 0.0 | | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | |
| Other (specify, e.g., bank recapitalization) | 0.0 | 0.0 | 0.0 | | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | |
| Residual, including asset changes | 6.3 | 14.0 | 9.0 | | | 8.2 | 5.6 | 2.6 | 1.3 | 0.0 | -1.6 | | 0.7 | 0.4 | |
| **Other sustainability indicators** | | | | | | | | | | | | | | | |
| **PV of public sector debt** | ... | ... | 45.4 | | | 51.9 | 49.8 | 42.8 | 37.2 | 28.9 | 24.7 | | 24.1 | 22.3 | |
| Of which: foreign-currency denominated | ... | ... | 40.8 | | | 44.7 | 42.3 | 36.9 | 31.8 | 24.9 | 19.7 | | 16.7 | 8.2 | |
| Of which: external | ... | ... | 19.9 | | | 24.5 | 25.8 | 25.8 | 25.8 | 23.2 | 21.1 | | 16.7 | 8.2 | |
| PV of contingent liabilities (not included in public sector debt) | ... | ... | ... | | | ... | ... | ... | ... | ... | ... | | ... | ... | |
| Gross financing need 2/ | 6.7 | 3.8 | 6.2 | | | 10.7 | 6.8 | 7.4 | 6.8 | 4.7 | 5.6 | | 3.4 | 4.5 | |
| PV of public sector debt-to-revenue and grants ratio (in percent) | ... | ... | 112.8 | | | 139.9 | 141.3 | 131.5 | 117.6 | 89.3 | 75.3 | | 73.8 | 70.6 | |
| PV of public sector debt-to-revenue ratio (in percent) | ... | ... | 112.8 | | | 139.9 | 141.3 | 131.5 | 117.6 | 89.3 | 75.3 | | 73.8 | 70.6 | |
| Of which: external 3/ | ... | ... | 49.4 | | | 66.1 | 73.3 | 79.3 | 81.6 | 71.7 | 64.3 | | 51.0 | 25.9 | |
| Debt service-to-revenue and grants ratio (in percent) 4/ | 6.3 | 7.3 | 5.6 | | | 17.8 | 17.9 | 24.0 | 22.1 | 18.4 | 15.6 | | 7.9 | 13.3 | |
| Debt service-to-revenue ratio (in percent) 4/ | 6.4 | 7.4 | 5.6 | | | 17.8 | 17.9 | 24.0 | 22.1 | 18.4 | 15.6 | | 7.9 | 13.3 | |
| Primary deficit that stabilizes the debt-to-GDP ratio | -10.8 | 0.2 | -2.4 | | | -0.9 | 3.1 | 6.8 | 5.7 | 7.5 | 5.2 | | 0.4 | 0.5 | |
| **Key macroeconomic and fiscal assumptions** | | | | | | | | | | | | | | | |
| Real GDP growth (in percent) | -1.3 | 6.4 | 17.5 | 8.0 | 4.8 | 11.2 | 16.8 | 12.7 | 8.0 | 15.2 | 8.3 | 12.0 | 4.8 | 4.1 | 5.4 |
| Average nominal interest rate on forex debt (in percent) | 1.2 | 1.4 | 0.9 | 1.4 | 0.5 | 1.0 | 1.4 | 2.0 | 2.2 | 2.3 | 2.6 | 1.9 | 3.3 | 3.8 | 3.4 |
| Average real interest rate on domestic debt (in percent) | 3.5 | -12.6 | 14.4 | 4.3 | 13.2 | 8.2 | 12.7 | 9.8 | 8.3 | 9.0 | 11.3 | 9.9 | 6.2 | 3.1 | 4.6 |
| Real exchange rate depreciation (in percent, + indicates depreciation) | -7.6 | -6.8 | 17.6 | 1.1 | 7.3 | -4.2 | ... | ... | ... | ... | ... | ... | ... | ... | ... |
| Inflation rate (GDP deflator, in percent) | 1.8 | 20.0 | 12.1 | 14.2 | 6.9 | 10.0 | 8.9 | 8.3 | 9.1 | 7.8 | 6.1 | 8.4 | 5.4 | 8.6 | 7.3 |
| Growth of real primary spending (deflated by GDP deflator, in percent) | -0.1 | 0.1 | 0.4 | 0.1 | 0.2 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.0 | 0.1 |
| Grant element of new external borrowing (in percent) | ... | ... | ... | ... | ... | -0.9 | 5.6 | 8.7 | 6.7 | 4.3 | -2.0 | 3.7 | -4.9 | -6.0 | ... |

Sources: Country authorities; and staff estimates and projections.

1/ Gross debt of the general government including Development Bank of Mongolia

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 and Publicly Guaranteed External Debt, 2012–32**
(In percent)

| | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | **2022** | 2032 |
| **PV of debt-to GDP ratio** | | | | | | | | |
| **Baseline** | 25 | 26 | 26 | 26 | 23 | 21 | **17** | 8 |
| **A. Alternative Scenarios** | | | | | | | | |
| A1. Key variables at their historical averages in 2012-2032 1/ | 25 | 12 | 8 | 17 | 20 | 20 | **20** | -6 |
| A2. New public sector loans on less favorable terms in 2012-2032 2/ | 25 | 27 | 30 | 31 | 28 | 26 | **21** | 13 |
| **B. Bound Tests** | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2013-2014 | 25 | 29 | 32 | 33 | 29 | 26 | **21** | 10 |
| B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/ | 25 | 40 | 63 | 57 | 48 | 43 | **21** | 8 |
| B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2013-2014 | 25 | 26 | 29 | 29 | 26 | 23 | **18** | 9 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/ | 25 | 46 | 56 | 51 | 43 | 39 | **20** | 8 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 25 | 47 | 65 | 60 | 51 | 45 | **23** | 9 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/ | 25 | 36 | 37 | 37 | 34 | 30 | **24** | 12 |
| **PV of debt-to-exports ratio** | | | | | | | | |
| **Baseline** | 47 | 45 | 45 | 48 | 44 | 42 | **37** | 21 |
| **A. Alternative Scenarios** | | | | | | | | |
| A1. Key variables at their historical averages in 2012-2032 1/ | 47 | 21 | 14 | 32 | 37 | 41 | **44** | -15 |
| A2. New public sector loans on less favorable terms in 2012-2032 2/ | 47 | 47 | 52 | 58 | 53 | 52 | **47** | 32 |
| **B. Bound Tests** | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2013-2014 | 47 | 44 | 46 | 49 | 44 | 43 | **37** | 21 |
| B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/ | 47 | 91 | 173 | 170 | 144 | 136 | **73** | 33 |
| B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2013-2014 | 47 | 44 | 46 | 49 | 44 | 43 | **37** | 21 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/ | 47 | 80 | 97 | 96 | 82 | 77 | **43** | 21 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 47 | 89 | 123 | 121 | 103 | 98 | **54** | 26 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/ | 47 | 44 | 46 | 49 | 44 | 43 | **37** | 21 |
| **PV of debt-to-revenue ratio** | | | | | | | | |
| **Baseline** | 66 | 73 | 79 | 82 | 72 | 64 | **51** | 26 |
| **A. Alternative Scenarios** | | | | | | | | |
| A1. Key variables at their historical averages in 2012-2032 1/ | 66 | 35 | 25 | 55 | 61 | 62 | **61** | -19 |
| **B. Bound Tests** | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2013-2014 | 66 | 81 | 100 | 103 | 90 | 81 | **63** | 32 |
| B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/ | 66 | 115 | 193 | 180 | 149 | 131 | **63** | 26 |
| B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2013-2014 | 66 | 73 | 89 | 92 | 80 | 72 | **56** | 28 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/ | 66 | 131 | 171 | 162 | 134 | 118 | **60** | 26 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 66 | 133 | 200 | 189 | 156 | 137 | **69** | 30 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/ | 66 | 102 | 115 | 118 | 103 | 93 | **72** | 37 |
| **Debt service-to-exports ratio** | | | | | | | | |
| **Baseline** | 3 | 3 | 3 | 2 | 2 | 2 | 2 | 1 |
| **A. Alternative Scenarios** | | | | | | | | |
| A1. Key variables at their historical averages in 2012-2032 1/ | 3 | 3 | 2 | 1 | 1 | 6 | 5 | 2 |
| **B. Bound Tests** | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2013-2014 | 3 | 3 | 3 | 2 | 2 | 6 | 5 | 4 |
| B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/ | 3 | 4 | 6 | 7 | 6 | 13 | 17 | 6 |
| B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2013-2014 | 3 | 3 | 3 | 2 | 2 | 6 | 5 | 4 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/ | 3 | 3 | 4 | 4 | 4 | 8 | 9 | 4 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 3 | 4 | 5 | 5 | 4 | 10 | 12 | 5 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/ | 3 | 3 | 3 | 2 | 2 | 6 | 5 | 4 |

**Table 3. Mongolia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012–32 (concluded)**

(In percent)

| | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | **2022** | 2032 |
| **Debt service-to-revenue ratio** | | | | | | | | |
| **Baseline** | 4 | 5 | 5 | 3 | 3 | 3 | 2 | 1 |
| **A. Alternative Scenarios** | | | | | | | | |
| A1. Key variables at their historical averages in 2012-2032 1/ | 4 | 5 | 3 | 2 | 2 | 9 | 6 | 2 |
| **B. Bound Tests** | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2013-2014 | 4 | 6 | 6 | 5 | 4 | 12 | 9 | 6 |
| B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/ | 4 | 5 | 6 | 8 | 6 | 13 | 14 | 5 |
| B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2013-2014 | 4 | 5 | 5 | 4 | 4 | 11 | 8 | 5 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/ | 4 | 5 | 7 | 7 | 6 | 12 | 13 | 5 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 4 | 6 | 8 | 8 | 7 | 14 | 15 | 6 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/ | 4 | 7 | 7 | 5 | 5 | 14 | 10 | 7 |

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ 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 assu 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 4. Mongolia: Sensitivity Analysis for Key Indicators of Public Debt 2012–32

| | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2022 | 2032 |
| **PV of Debt-to-GDP Ratio** | | | | | | | | |
| **Baseline** | 52 | 50 | 43 | 37 | 29 | 25 | 24 | 22 |
| **A. Alternative scenarios** | | | | | | | | |
| A1. Real GDP growth and primary balance are at historical averages | 52 | 54 | 49 | 43 | 38 | 32 | 27 | 18 |
| A2. Primary balance is unchanged from 2012 | 52 | 54 | 51 | 49 | 44 | 42 | 53 | 67 |
| A3. Permanently lower GDP growth 1/ | 52 | 51 | 45 | 40 | 33 | 30 | 43 | 80 |
| **B. Bound tests** | | | | | | | | |
| B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014 | 52 | 62 | 66 | 65 | 60 | 60 | 87 | 115 |
| B2. Primary balance is at historical average minus one standard deviations in 2013-2014 | 52 | 54 | 52 | 45 | 35 | 30 | 28 | 24 |
| B3. Combination of B1-B2 using one half standard deviation shocks | 52 | 57 | 56 | 54 | 49 | 49 | 70 | 93 |
| B4. One-time 30 percent real depreciation in 2013 | 52 | 67 | 56 | 48 | 37 | 32 | 29 | 26 |
| B5. 10 percent of GDP increase in other debt-creating flows in 2013 | 52 | 61 | 52 | 45 | 35 | 30 | 28 | 24 |
| **PV of Debt-to-Revenue Ratio 2/** | | | | | | | | |
| **Baseline** | 140 | 141 | 131 | 118 | 89 | 75 | 74 | 71 |
| **A. Alternative scenarios** | | | | | | | | |
| A1. Real GDP growth and primary balance are at historical averages | 140 | 152 | 150 | 136 | 117 | 98 | 83 | 59 |
| A2. Primary balance is unchanged from 2012 | 140 | 153 | 157 | 155 | 137 | 129 | 161 | 211 |
| A3. Permanently lower GDP growth 1/ | 140 | 144 | 137 | 127 | 101 | 92 | 130 | 255 |
| **B. Bound tests** | | | | | | | | |
| B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014 | 140 | 175 | 203 | 206 | 185 | 184 | 265 | 365 |
| B2. Primary balance is at historical average minus one standard deviations in 2013-2014 | 140 | 154 | 159 | 141 | 108 | 92 | 84 | 76 |
| B3. Combination of B1-B2 using one half standard deviation shocks | 140 | 162 | 170 | 172 | 152 | 149 | 214 | 293 |
| B4. One-time 30 percent real depreciation in 2013 | 140 | 189 | 172 | 152 | 116 | 98 | 90 | 83 |
| B5. 10 percent of GDP increase in other debt-creating flows in 2013 | 140 | 173 | 160 | 142 | 108 | 92 | 85 | 76 |
| **Debt Service-to-Revenue Ratio 2/** | | | | | | | | |
| **Baseline** | 18 | 18 | 24 | 22 | 18 | 16 | 8 | 13 |
| **A. Alternative scenarios** | | | | | | | | |
| A1. Real GDP growth and primary balance are at historical averages | 18 | 19 | 27 | 25 | 22 | 19 | 10 | 11 |
| A2. Primary balance is unchanged from 2012 | 18 | 18 | 24 | 23 | 20 | 17 | 15 | 27 |
| A3. Permanently lower GDP growth 1/ | 18 | 18 | 24 | 23 | 19 | 17 | 11 | 30 |
| **B. Bound tests** | | | | | | | | |
| B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014 | 18 | 20 | 30 | 29 | 25 | 22 | 22 | 44 |
| B2. Primary balance is at historical average minus one standard deviations in 2013-2014 | 18 | 18 | 24 | 23 | 19 | 16 | 10 | 14 |
| B3. Combination of B1-B2 using one half standard deviation shocks | 18 | 20 | 29 | 27 | 23 | 20 | 17 | 36 |
| B4. One-time 30 percent real depreciation in 2013 | 18 | 19 | 26 | 24 | 20 | 17 | 10 | 15 |
| B5. 10 percent of GDP increase in other debt-creating flows in 2013 | 18 | 18 | 25 | 23 | 19 | 16 | 10 | 14 |

Sources: Country authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

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# IMF Executive Board Concludes 2012 Article IV Consultation and Third Post-Program Monitoring with Mongolia

On November 16, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the 2012 Article IV Consultation[1] and Post-Program Monitoring[2] with Mongolia.

**Background**

Mongolia has made impressive progress in developing its economy. Spearheaded by the FDI-financed development of the mining sector, growth averaged 8 percent per annum over the past 10 years, among the highest in the region. As a result, per capita GDP increased five-fold, to about US$3,000, and Mongolia has gained access to international capital markets. The authorities are addressing the key challenge of medium-term natural resource management and Dutch Disease by putting in place a fiscal framework anchored

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[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.

[2] Post-Program Monitoring provides for more frequent consultations between the Fund and members whose arrangement has expired but that continue to have Fund credit outstanding, with a particular focus on policies that have a bearing on external viability. There is a presumption that members whose credit outstanding exceeds 200 percent of quota would engage in Post-Program Monitoring.

by the 2010 Fiscal Stability Law (FSL), the 2011 Integrated Budget Law (IBL), and the 2012 Social Welfare Law (SWL).

Growth is decelerating from the very rapid pace in 2011. The expansion of the economy slowed to 10 percent during the first nine months of 2012 (year-on-year), down from 17 percent in 2011. Growth has been buoyed by expanding coal and copper production, the ongoing development of new large mining projects, a relatively mild winter boosting agriculture, and highly expansionary fiscal policy.

Meanwhile, inflation remains high and the balance of payments is under pressure. Inflation is around 15 percent, primarily due to rapidly rising government spending. Strong domestic demand is driving up imports, and the resulting balance of payment pressures are compounded by slowing foreign direct investment (FDI) inflows and slowing export growth. In recent months, coal exports to China slumped amid China's overall decelerating imports.

Monetary policy has been tightened. Over the past year, in response to inflation rising substantially above the official target of less than 10 percent, the central bank increased its policy rate and reserve requirements. These tightening measures contributed to a marked slowdown in credit growth, from 72 percent in 2011 to 36 percent in September 2012 (year-on-year).

But fiscal policy has remained excessively expansionary. The overall fiscal balance worsened by 5⅓ percentage points of GDP in 2011, to a deficit of 4¾ percent of GDP. Revenue surged, thanks to the value added tax and customs duties collected on imports of capital goods for mining sector development. But this was more than offset by a 62 percent increase in government spending. Government spending continued to soar during the first half of 2012.

Over the past year, the togrog/U.S. dollar exchange rate has depreciated by 7 percent. At the same time, Mongolia's Net International Reserves (NIR) declined by a third (US$0.7 billion) to a two-year low of US$1.5 billion. The effect of the balance of payment pressures on gross international reserves (GIR) has been offset by BOM drawings on the swap line with the central bank of China (US$0.2 billion) and by BOM deposit taking from the DBM (US$0.4 billion) and commercial banks (US$0.2 billion). Thus, GIR remains near an all-time high of US$2.6 billion (6.3 months of prospective non-mining imports).

The near-term outlook for growth is favorable, but inflation is projected to remain in double digits. The external position is projected to remain under pressure. Coal export capacity will expand further, and copper exports are projected to rise. However, imports will also rise, owing to the DBM's public investment projects.

Mongolia's medium-term prospects are promising. Coal and copper production will be ramped up and activity outside the mining sector is also projected to remain buoyant, although this would need to be supported by continued reforms to strengthen the business climate.

However, a number of challenges need to be addressed as the new government embarks on implementing its Action Plan for 2012–16. Importantly, policies need to be set against the continued uncertainties in the global economic outlook. Potential spillovers to Mongolia are significant, possibly affecting export volumes, commodity prices, and FDI inflows.

**Executive Board Assessment**

The Executive Directors commended the authorities for an impressive record of economic growth over the last few years, but noted that there is scope to make growth more inclusive. Directors considered that the key policy challenge going forward will be to meet large investment needs without undermining macroeconomic stability. They agreed that this task would be facilitated by the recently revamped legal underpinnings of the fiscal framework.

While taking note of Mongolia's favorable outlook for the medium term, Directors noted that inflation remains high, and that booming domestic demand is putting pressure on the balance of payments. Against this background, they emphasized that fiscal policy needs to be tightened, and that the 2013 budget will be key to safeguarding domestic and external stability. Accordingly, Directors encouraged the authorities to fully observe the Fiscal Stability Law in the 2013 budget design and implementation, including the 2 percent of GDP structural deficit ceiling. In light of a likely revenue shortfall and the uncertain external environment, Directors recommended cautious revenue projections and lower budget spending, mainly by deferring lower-priority capital projects.

Directors emphasized the need for a clear policy to ensure that the Development Bank of Mongolia (DBM) can help meet the long-term infrastructure needs of Mongolia in a macro-economically sustainable manner with minimal fiscal risks. In particular, public investment projects financed by the DBM should be taken into account when setting the path of fiscal policy, consistent with the new fiscal framework. Directors welcomed efforts to explore the establishment of a sovereign wealth fund, which could be an important complement to the fiscal framework.

Directors considered the tightening of monetary policy over the past year to be appropriate. With inflation still in excess of the authorities' target, they saw no scope to loosen the monetary stance unless fiscal policy is tightened and inflationary pressures abate. Directors welcomed the authorities' commitment to allowing the exchange rate to move in line with market conditions. They noted, however, that expansionary fiscal policy has put net international reserves on a downward trajectory that is not sustainable.

Directors commended the authorities' efforts to strengthen and deepen the financial sector, including the phased increase in capital adequacy ratios of systemically important banks. They encouraged further steps to develop a government bond market, reduce banking sector risks including those arising from unhedged foreign currency lending, deepen the foreign exchange market, strengthen the monetary transmission channel, and address deficiencies in the regime to combat money laundering and the financing of terrorism. To promote a more diversified economy, Directors stressed the importance of continued reforms to strengthen the business climate and clarify the foreign investment regime.

***Public Information Notices (PINs)*** form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

**Mongolia: Selected Economic and Financial Indicators, 2009–13**

| | 2009 | 2010 | 2011 | Proj. 2012 | Proj. 2013 |
|---|---|---|---|---|---|
| **Real sector (percent change)** | | | | | |
| Real GDP growth | -1.3 | 6.4 | 17.5 | 11.2 | 16.8 |
| Mineral | 0.2 | 7.4 | 11.2 | 6.8 | 50.6 |
| Non-mineral | -1.8 | 6.0 | 19.9 | 12.8 | 5.4 |
| Consumer prices (period average) | 6.3 | 10.2 | 7.7 | 14.1 | 10.9 |
| Consumer prices (end-period) | 1.9 | 14.3 | 9.4 | 12.9 | 10.2 |
| GDP deflator | 1.8 | 20.0 | 12.1 | 10.0 | 8.9 |
| **General government budget (in percent of GDP)** | | | | | |
| Revenue and grants | 30.3 | 37.1 | 40.3 | 37.1 | 35.2 |
| Expenditure and net lending | 35.5 | 36.6 | 45.1 | 42.3 | 37.6 |
| Current balance | 2.8 | 9.8 | 11.0 | 5.1 | 9.3 |
| Primary balance | -4.7 | 1.0 | -4.4 | -4.1 | -0.5 |
| Overall balance (including grants) | -5.2 | 0.5 | -4.8 | -5.2 | -2.4 |
| Non-mineral overall balance | -10.2 | -7.0 | -14.3 | -12.2 | -9.7 |
| Structural balance 1/ | … | … | -6.9 | -6.0 | -3.1 |
| **Money and credit (percent change)** | | | | | |
| Broad money | 26.9 | 61.6 | 37.1 | 28.8 | 27.2 |
| Broad money velocity (GDP/BM) | 2.3 | 1.8 | 1.7 | 1.7 | 1.7 |
| Interest rate on 7-day central bank bills, end-period (percent) | 10.0 | 11.0 | 12.3 | … | … |
| **Balance of payments (in millions of US$)** | | | | | |
| Current account balance (including official transfers) | -410 | -931 | -2,774 | -3,605 | -2,839 |
| (In percent of GDP) | -9.0 | -14.9 | -31.8 | -36.3 | -24.1 |
| (In percent of GDP, excluding mining related imports) | -5.8 | -5.7 | -11.3 | -16.7 | -6.7 |
| Trade balance | -194 | -278 | -1,008 | -1,840 | -983 |
| Exports | 1,876 | 2,899 | 4,780 | 4,420 | 5,811 |
| Imports | -2,070 | -3,177 | -5,788 | -6,260 | -6,794 |
| Foreign direct investment | 496 | 1574 | 4,620 | 2,789 | 1,907 |
| Gross official international reserves (end-period) | 1,328 | 2,288 | 2,447 | 2,319 | 2,273 |
| (In months of next year's imports of goods and services) | 4.0 | 3.6 | 3.6 | 3.2 | 3.2 |
| **Trade prices** | | | | | |
| Export prices (US$, percent change) | -8.2 | 3.7 | 8.3 | -0.5 | -0.5 |
| Import prices (US$, percent change) | -14.1 | 8.8 | 13.1 | -0.7 | -1.5 |
| Terms of trade (percent change) | 6.9 | -4.7 | -4.3 | 0.2 | 1.0 |
| **Public and publicly guaranteed debt (in percent of GDP)** | | | | | |
| Total public debt | 46.6 | 45.3 | 51.7 | 56.7 | 54.2 |
| Domestic debt 2/ | 3.4 | 16.3 | 25.6 | 27.4 | 23.9 |
| External debt | 43.2 | 28.9 | 26.1 | 29.4 | 30.2 |
| (In millions of US$) | 1,974 | 1,938 | 2,074 | 2,775 | 3,492 |
| **Exchange rate** | | | | | |
| Togrogs per US$ (end-period) | 1,443 | 1,257 | ... | ... | ... |
| Togrogs per US$ (period average) | 1,441 | 1,348 | ... | ... | ... |
| Nominal effective exchange rate (end-period; percent change) | -15.8 | 3.4 | ... | ... | ... |
| Real effective exchange rate (end-period; percent change) | -11.2 | 11.2 | ... | ... | ... |
| Nominal GDP (in billions of togrogs) | 6,591 | 8,415 | 11,088 | 13,566 | 17,257 |

Sources: Mongolian authorities; and IMF staff projections.

1/ As defined in the Fiscal Stability Law, which uses smoothed instead of actual commodity prices to calculate revenue.
2/ Domestic debt in 2009-2011 includes the Oyu Tolgoi tax prepayment.