INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/98

MONGOLIA

April 2018

STAFF REPORT FOR THE THIRD REVIEW UNDER THE EXTENDED FUND FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MONGOLIA

In the context of the Staff Report for the Third Review Under the Extended Fund Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 28, 2018, following discussions that ended on February 6, 2018, with the officials of Mongolia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on March 12, 2018.
- A **Statement by the Executive Director** for Mongolia.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 18/113
FOR IMMEDIATE RELEASE
March 28, 2018

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third Review under the Extended Arrangement for Mongolia and Approves US$ 30.55 Million Disbursement

On March 28, 2018, the Executive Board of the International Monetary Fund (IMF) completed the third review of Mongolia's performance under the program supported by a three-year extended arrangement under the Extended Fund Facility (EFF). Completion of the review enables Mongolia to draw the equivalent of SDR 20.9598 million (about US$ 30.55 million), bringing total disbursements under the arrangement to SDR 104.8278 million (about US$ 152.79 million).

Mongolia's performance under the program thus far has been strong. The economy is recovering better than expected, with real GDP growth of 5.1 percent in 2017 and a significant improvement in the fiscal balance of 15 percentage points of GDP. The combination of strong policy implementation and a supportive external environment has helped the authorities over-perform on all end-December 2017 quantitative targets. However, the performance on structural reforms has been mixed with some delays on structural benchmarks under the program and reversals of three fiscal measures considered during previous reviews.

Mongolia's three-year extended arrangement was approved on May 24, 2017, in an amount equivalent to SDR 314.5054 million, or about US$434.3 million[1] at the time of approval of the arrangement (see Press Release No. 17/193). The government's Economic Recovery Program, supported by the IMF, aims to stabilize the economy, reduce the fiscal deficit and debt, rebuild foreign exchange reserves, introduce measures to mitigate the boom-bust cycle and promote sustainable and inclusive growth.

Following the Executive Board's discussion of the review, Mr. Mitsuhiro Furusawa, Acting Chair and Deputy Managing Director, said:

"Mongolia's performance under the Fund-supported program has been favorable. The economy is recovering better than anticipated due to good program implementation, buoyant external demand, and a return of confidence. The fiscal deficit fell sharply due to a substantial pick up in revenues and strict expenditure control, yielding a notable

[1] The dollar amount is calculated based on the SDR-dollar rate of May 24, 2017, equivalent to $425mn at SDR-dollar rate of 1.35274 as of February 27, 2017.

improvement in the public debt outlook. External financing costs continue to fall, with external bonds maturing in 2018 rolled over at lower interest rates, and foreign exchange reserves have recovered further.

"All end-December 2017 quantitative targets under the program have been met. Fiscal and banking sector reforms are proceeding, albeit with some deviations and delays. Fiscal results have been significantly better than expected, with a major reduction in the deficit, supported by expenditure restraint and a strong recovery in mining-related revenues. Official reserves have more than doubled over 2017, reflecting a jump in coal exports, capital inflows, and disbursements under the external financing package from donors and the IMF.

"The authorities are moving ahead with ambitious structural reforms designed to sustain growth over the medium term, promote competitiveness and diversification, and mitigate the boom-bust cycle. In the financial sector, the rehabilitation and strengthening of the banking system is underway, building on the recently completed comprehensive Asset Quality Review and several new laws passed by Parliament. Sustaining the reform momentum in this area will be critical. On the fiscal side, the authorities remain committed to the strengthened path of adjustment, with continuing restraint on spending paired with efforts to sustain the recent strong revenue performance. To this end, building on technical assistance from the IMF, they are particularly focused on improving the quality of tax administration.

"With debt still high and the economy exposed to global commodity developments, it is critical that the authorities maintain their strong commitment to the program. Firm program implementation is needed to sustain the virtuous cycle of recovering growth, improving confidence, rising reserves, falling debt, and strong support from the donor community."

INTERNATIONAL MONETARY FUND

MONGOLIA

THIRD REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT

March 12, 2018

EXECUTIVE SUMMARY

Context. A three-year arrangement for Mongolia under the Extended Fund Facility (EFF) was approved on May 24, 2017, in an amount equivalent to SDR 314.5054 million (435 percent of quota, or approximately $425 million). The arrangement forms part of a $5.5 billion multi-donor financing package that supports the authorities Economic Recovery Plan and lays the basis for sustainable, inclusive growth. The extended arrangement is subject to quarterly reviews.

Recent Developments and Outlook. With 5.1 percent growth in 2017, the economy continues to surprise on the upside due primarily to strong coal exports, positive terms of trade, and large-scale foreign investment in the commodity sector. This positive external environment, combined with expenditure containment, prudent monetary policy, and large-scale official sector support, has helped reduce deficits and build reserves beyond originally programmed levels. The recently completed Asset Quality Review found a relatively modest capital shortfall in the banking system. Growth is expected to remain strong in 2018 but, amid still high public debt, several risks remain including changes in global commodity demand and bottlenecks at the border.

Program Performance. All end-December quantitative performance criteria were met, generally by large margins. Performance on structural benchmarks was more mixed. Of the 10 structural benchmarks (SBs) for this review, five were met, three (tax administration legislation and a recapitalization law) will likely be passed in the next parliamentary session (April-June) and two are unlikely to be implemented. In addition, the authorities reversed three fiscal measures considered during previous reviews.

Policy Discussions. Given the strong performance to date, continued improvement in the macro outlook, and still high public debt, the authorities committed to tightening the fiscal and reserve targets. They plan to remain cautious on monetary policy and explore the scope for relying more on macro-prudential tools to address risks in the financial sector. They remain committed to ensuring that the banking system re-builds its capital buffers and the supervisory framework is strengthened.

Approved By	
Markus Rodlauer (APD) and Daria Zakharova (SPR)	Discussions were held in Ulaanbaatar during January 25 to February 6, 2018. The team included Geoff Gottlieb (head), Neil Saker (resident representative), Johanna Schauer, Jongsoon Shin (all APD), Wendell Daal (FAD), Pierpaolo Grippa, and Laszlo Butt (both MCM), and Pragyan Deb (SPR). The team was supported by Mmes. Selenge Sandagsuren, Ardak Bazarbai and Khulan Buyankhishig (all economists in the res. rep. office), as well as Mmes. Medha Madhu Nair and Livia Tolentino (both APD). Mr. Gantsogt Khurelbaatar (OED) participated in some of the discussions. The mission met Prime Minister U. Khurelsukh, Finance Minister Ch. Khurelbaatar, Bank of Mongolia Governor N. Bayartsaikhan, and other senior officials as well as private sector representatives.

CONTENTS

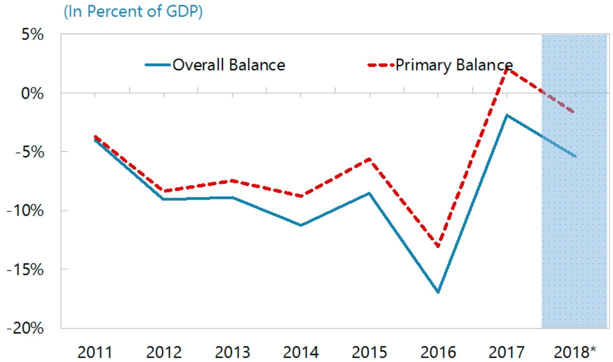
ANNEX

APPENDIX

CONTEXT

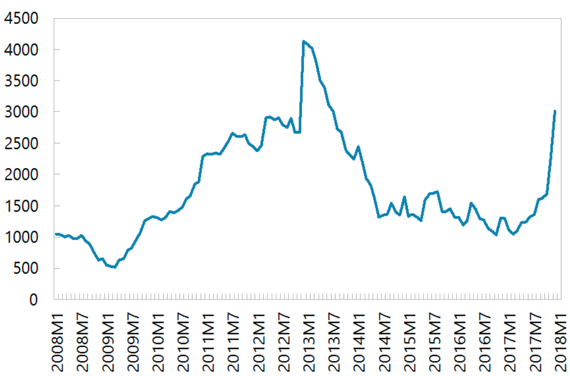
1. **The economy is recovering better than anticipated due to buoyant external demand and a return of confidence.** The situation facing Mongolia has changed considerably. One year ago, public debt was on track to reach 100 percent of GDP, yields on government debt were nearly 20 percent, reserves were 2 months of imports and the exchange rate had depreciated over 20 percent. Since then, a pick-up in external demand for coal and a rise in commodity prices have triggered a large recovery in activity. Steady implementation of the second phase of the Oyu Tolgoi copper mine has driven a recovery in investment as well as related services and manufacturing. The fiscal deficit fell sharply due to a substantial pick up in revenues and strict expenditure control, helping reduce public debt to roughly 85 percent of GDP. Implementation of the government's Economic Recovery Program with large support from key donors and the IMF helped restore confidence: external bonds maturing in 2018 have been rolled over at much lower interest rates than before, private and official inflows have boosted reserves by $1.3 billion more than targeted, and the authorities face no external private maturities until 2021.

Fiscal Balance
(In Percent of GDP)



Sources: Mongolian authorities; and IMF staff calculations.
Note: 2018 is an estimate

Foreign Exchange Reserves
(In USD Millions)

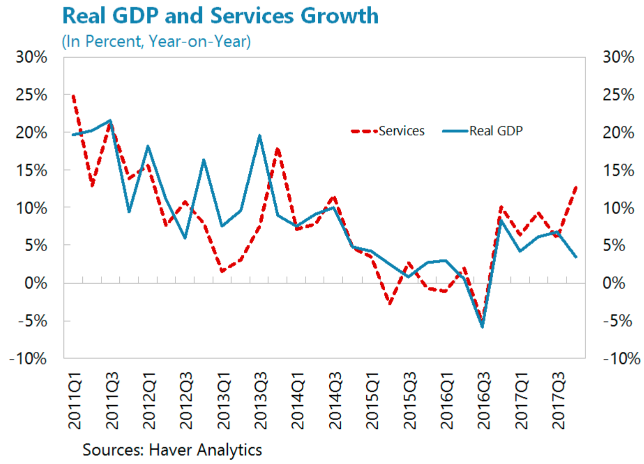


Sources: Bank of Mongolia

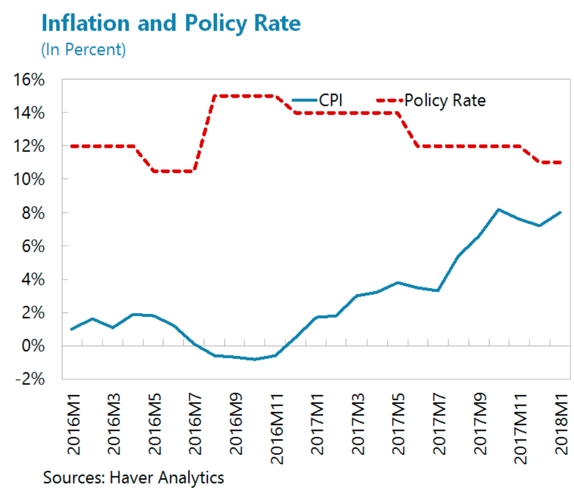
2. **Despite these positive outcomes, significant risks and challenges still lie ahead.** First, coal will not continue to provide the same support to growth in the near term because of the high 2017 base and ongoing bottlenecks at the border. Second, preserving the positive medium-term outlook rests critically on the continuation of the OT copper mine and the more uncertain expansion of the TT coal project. Third, progress on diversification of the economy remains limited. And fourth, the domestic political environment has become more unsettled. Although the ruling Mongolian People's Party has a large majority in parliament, maintaining consensus on program policies has proven challenging, which is perhaps not surprising given the sharp fiscal adjustment underway and the broad and deep scope of the reform program. Popular opposition has led to reversals or delays on some reforms under the program. If such slippages continued, they would undermine reform progress and donor assistance. Given still high public debt at almost 85 percent of GDP, it is critical that Mongolia push forward on key reforms needed to generate sustainable growth in the future.

RECENT DEVELOPMENTS

3. **In 2017, real GDP increased by 5.1 percent, compared with -0.2 percent in the program.** On the supply side, the mining sector contracted by 7 percent (temporarily weak copper and gold production at OT due to geological factors) but still indirectly drove the overall recovery: the 30 percent increase in real coal exports supported suppliers in the services and manufacturing sectors while the 23 percent improvement in terms of trade supported nominal incomes. On the expenditure side, the turnaround stemmed primarily from a sharp increase in investment (primarily foreign-financed mining related inflows) but consumption also recovered thanks to better employment but also a 23 percent increase in household lending. Mining became less of a driver in the second half of the year because border bottlenecks sharply reduced coal exports, but the engines of growth had sufficiently broadened by the 4th quarter to avoid the sharp slowdown anticipated at the time of the last review.



4. **After accelerating throughout the year, inflation has begun to stabilize, leading to some easing in policy rates.** Inflation has risen significantly due to the delayed impact of exchange rate pass-through, as businesses have begun to rebuild profit margins by passing on previous cost increases as the economic recovery continues. However, since October, inflation has hovered around the target of 8 percent. With inflation data levelling off and favorable balance-of-payments developments continuing, the Bank of Mongolia (BOM) viewed price pressures as contained going forward, leaving scope for further normalization in rates. They lowered the policy rate by 100 basis points to 11 percent in December 2017, bringing the accumulated rate cuts to 300 basis points in 2017.

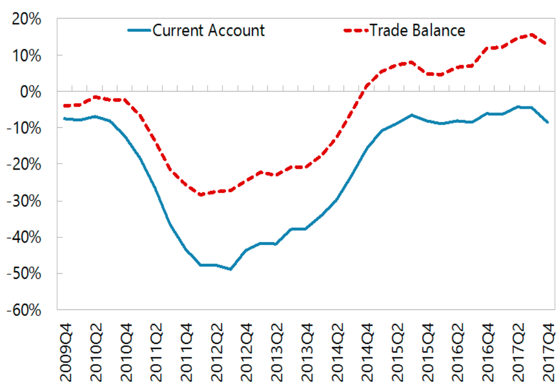


5. **A recovery in revenues and significant expenditure cuts improved the primary balance by 15 percentage points of GDP in 2017, significantly improving the public debt outlook**. The primary balance reached a surplus of 2.1 percent of GDP, seven percentage points of GDP better than the level targeted at the start of the program. Two-thirds of the overall adjustment came from expenditures and, particularly, capital spending (including the Development Bank of Mongolia). While the size of the expenditure reduction might raise questions about the sustainability of the

adjustment and the longer-term growth impact, it primarily reflects the excessive levels capital expenditure had reached in 2016. On the revenue side, the key driver was higher mining profits which boosted corporate income tax and mining royalties. In addition, the introduction of an e-receipt system on VAT payments might have led to substantial tax administration gains which could be durable outside of the cyclical recovery. The strength of the fiscal result, even relative to projections at the time of the last review, reflects, in roughly equal parts, the authorities' under-execution of the budget and greater-than-expected resilience in mining-related revenues. This strong fiscal outcome and the sharp recovery in nominal GDP led public debt to fall 3 percentage points to about 85 percent of GDP.

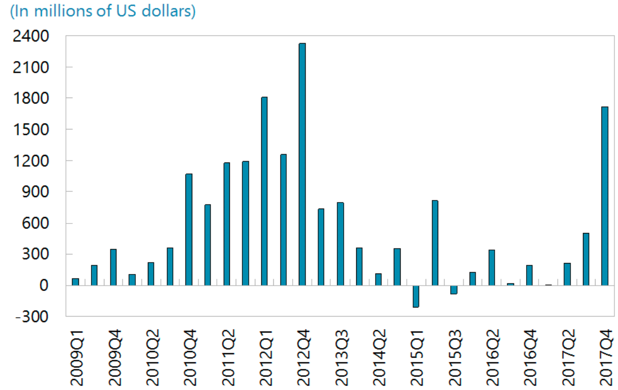
6. **Despite a larger current account deficit, reserves increased sharply in 2017 due to a recovery in capital inflows.** Exports grew roughly 25 percent in nominal terms due to higher international commodity prices and strong demand for coal from China. This was offset by higher mining-related imports and profit repatriation by mining companies, raising the current account deficit to 8.8 percent of GDP. Meanwhile, there was broad-based improvement in the financial account mainly due to higher FDI, donor flows, and private sector deposits. The recovery in capital flows allowed gross reserves to rise from $1.3 billion in 2016 (2.4 months of imports) to $3 billion in 2017 (5.2 months of imports). The increase in net international reserves ($1.9 billion) was even greater because the Bank of Mongolia used the strong inflows to pay down some foreign liabilities.

Current Account and Trade Balance
(Rolling 4 Quarters, Percent of GDP)



Sources: Haver Analytics

Net Capital Inflows
(In millions of US dollars)

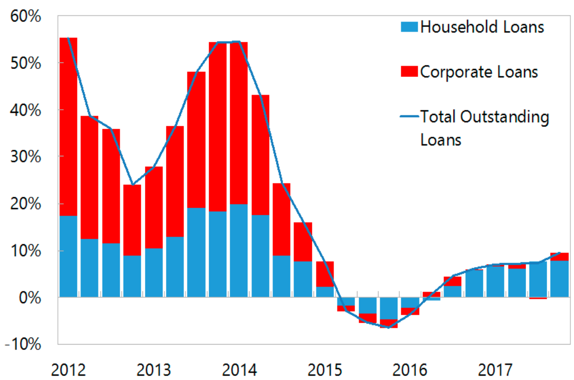


Sources: Haver Analytics

7. **The banking system needs more capital but the aggregate shortfall is relatively small.** The recently completed asset quality review (AQR) concluded that the banking system's aggregate capital adequacy shortfall was about 1.9% of GDP at end-2017, with a system-wide capital adequacy ratio of 13.7% at end-2017. Official numbers previously did not reflect capital adequacy correctly for two main reasons. First, there were deficiencies in banks' credit risk management. For example, asset classification was weak for non-retail corporate loans while collateral valuation did not adequately consider the time necessary to enforce collateral collection in the Mongolian judicial system. And second, there was forbearance by the Bank of Mongolia in 2016 to avoid forcing banks to raise capital amid a sharp downturn in the economy. The Bank of Mongolia has now communicated the capital positions, and shortfall if relevant, to each bank and announced the aggregate results to the public.

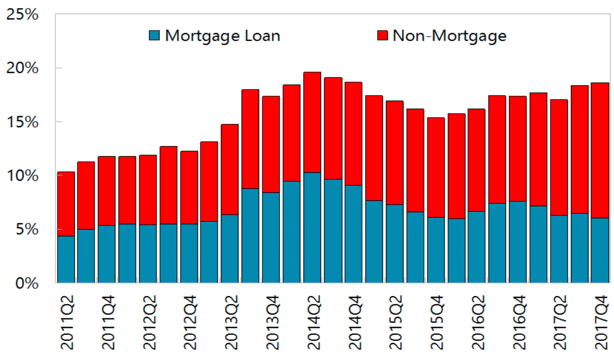
8. Notwithstanding some uncertainty related to the ongoing AQR process, private sector credit growth recovered in 2017, reaching 11 percent. The AQR and broader concerns about asset quality did limit loan growth to corporates which was broadly unchanged on the year. However, loans to households rose 23 percent, primarily driven by non-mortgage loans. The strong loan growth to households stemmed from the combination of a recovery in liquidity conditions (broad money and deposits rose 30 percent in 2017) and the relative health of household balance sheets in aggregate (loans to individuals are only 24 percent of GDP). Foreign currency loans, which are almost entirely to corporates, were broadly stable and continue to account for about one fifth of all loans, down from a peak of 37 percent in 2009.

Credit to Private Sector
(In Percent Change,by contribution)



Sources: Bank of Mongolia, Staff Estimates

Household Loans
(In Percent of GDP)



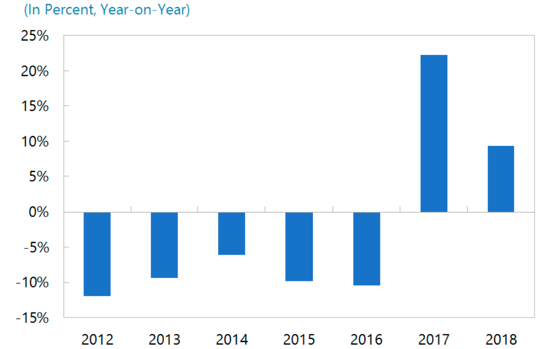
Sources: Bank of Mongolia

OUTLOOK AND PROGRAM POLICIES

A. Outlook and Risks

9. The near-term outlook has continued to improve. Growth in 2018 has been revised up to 5 percent primarily because of a better outlook for terms of trade, more scope for a post-AQR recovery in corporate lending, and ongoing improvements to sentiment on the back of last year's strong recovery. The upward revision would be larger but bottlenecks at the border, while still expected to be temporary, have persisted longer than initially expected. Inflation is projected to remain just below the 8 percent target as stronger demand pressure on non-tradables will be offset by several one-off factors dropping out of the y/y index (e.g. car and car wheels taxes, weather effects on vegetables). In the balance of payments, gross reserves are expected to rise by roughly $600 million in 2018.

Terms of Trade
(In Percent, Year-on-Year)



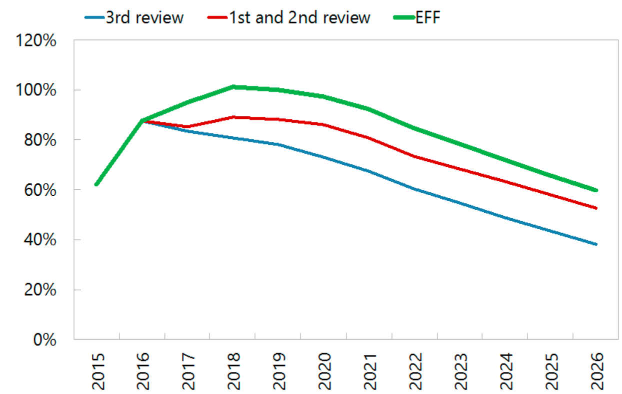
Sources: IMF *WEO database*; and IMF staff estimates

10. For the medium-term, the growth outlook remains favorable while projected fiscal and external buffers have improved.

- The medium-term macro path continues to be anchored by assumptions related to two large construction projects which will unlock higher growth rates. First, FDI and growth in 2019 will benefit from several large projects related to the TT coal mine (open pit, washing, power plant, and railway to China). Second, the expected start of production of the second phase (deep shaft) OT gold and copper mine in 2022 will reduce investment but dramatically increase exports and overall growth. The recent positive shock to external coal demand, resulting largely from China's environmentally-driven decision to reduce domestic production, is modelled in the baseline as a largely permanent positive shock (level-shift in demand) but one that does not continue to rise going forward.

- The projected public debt trajectory has improved substantially—now reaching 55 percent of GDP in 2023 vs. 68 percent of GDP in the last review. This reflects three factors: (1) improved primary path; (2) revised assumptions about the exchange rate path and (3) the contingency of 3.5 percent of GDP that had been included in the debt stock to account for potential public-sector recapitalization costs has been reduced to 1.5 percent of GDP given the better than expected AQR results; this is subject to further revision in future reviews.

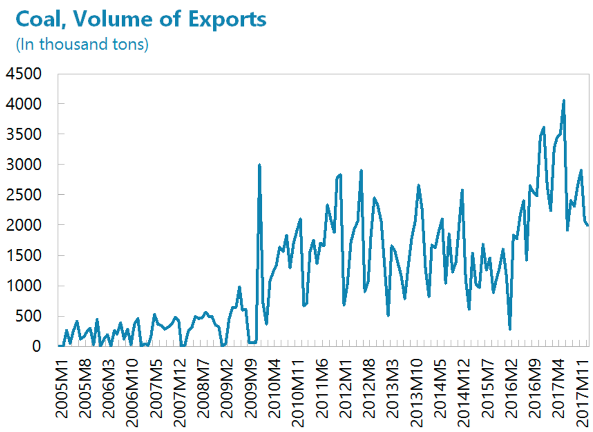
Public Debt Projections
(As percent of GDP)



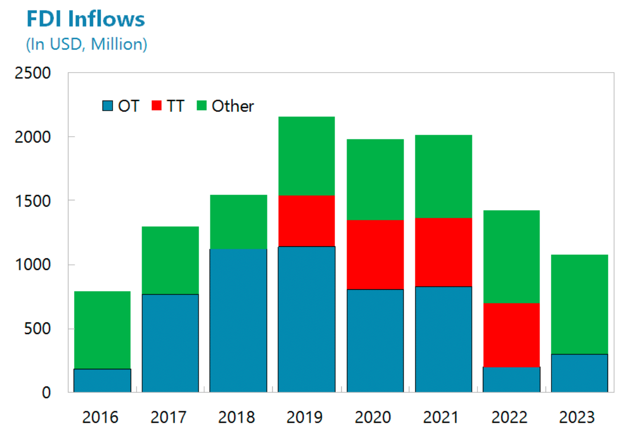
Sources: MOF, staff estimates and projections.

- Finally, the faster-than-expected recovery in the balance of payments, revisions to commodity prices, and better external financing conditions imply greater progress on improving external buffers than originally forecast. Reserves are now projected to reach about 8 months of imports in 2022 versus 7 months at the time of program approval.

11. Notwithstanding the improved outlook, the economy still faces substantial downside risks. The main risks in the near-term stem from rising resistance to program policies. With much stronger reserves and no near-term bond maturities, consensus on the program could significantly weaken, derailing adjustment, reforms and donor support. A deterioration in the investment climate could delay the critical OT or TT construction projects, undermining FDI and the medium-term outlook, and bottlenecks at the border could persist which would prevent Mongolia from taking advantage of strong global commodity demand and prices. There are also upside risks, mainly if the construction projects materialize faster than expected or commodity prices continue to rise.



Sources: Haver Analytics



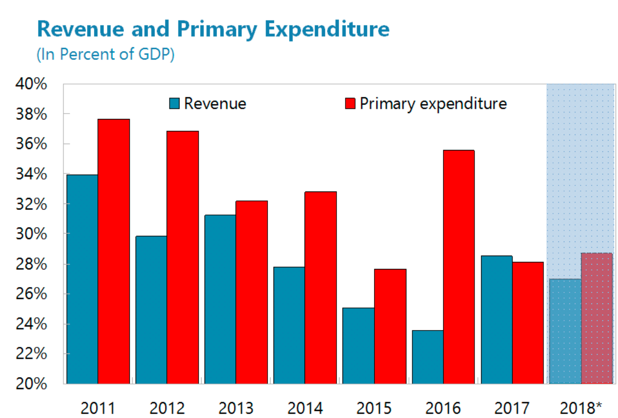
Sources: Bank of Mongolia, Staff Estimates

B. Economic Policies

12. As the economy has been stabilized and an external payments crisis averted, the government can increasingly focus on policies needed for strong, sustainable, and inclusive medium-term growth. While continuing to ensure macroeconomic stability and accumulating buffers, a priority now is implementing a policy mix that avoids another boom bust cycle. Three areas are paramount: (1) Prudent fiscal and monetary policies with sufficient revenue mobilization, high-quality expenditures especially on human capital development and social protection, and vigilance against inflation and excessive credit growth. These policies would allow a buildup in savings and continuous fall in public sector debt. (2) Rehabilitation and strengthening of the financial sector, including appropriate remedial actions based on the findings of the AQR, and improving the regulatory and supervisory framework—eventually allowing the financial sector to support economic growth and diversification with lower real interest rates. And (3) improving competitiveness through macroeconomic stability and well targeted microeconomic policies, allowing greater diversification of the economy and supporting inclusive and job-creating growth.

Fiscal Policy

13. Considering still high debt and a stronger macro-economic outlook, the primary balance target has been strengthened further. Budget revenues have been revised up moderately from the last review to reflect the stronger growth outlook. On the expenditure side, the authorities have maintained the expenditure ceilings in the budget as passed by Parliament and indicated they do not intend to submit a supplementary budget regardless of potential revenue over-performance. Thus, the projected 2018 primary deficit has improved from -2.6 percent of GDP



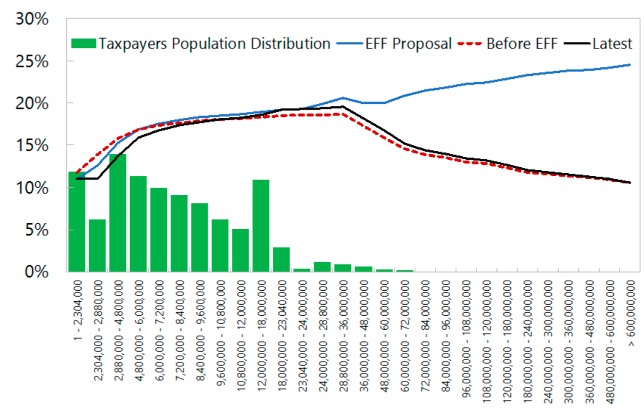
Sources: Haver Analytics Staff Estimates
Note: 2018 is an estimate

in the last review to -1.5 percent of GDP. Even though this represents a deterioration in the primary balance relative to 2017, it allows for a level of expenditures that is more consistent with growth objectives, is still 1.5 percentage points stronger than targeted in the original program, and remains consistent with rapid debt reduction.

14. While deficit reduction has been substantial, there has been less progress on improving the efficiency, administration, and equity of fiscal policy. Amid domestic resistance to the speed and size of some reforms, some program measures have been reversed while others due in recent months have been delayed. The authorities have committed to some corrective measures though they fall short of fully compensating for the policy changes. Overall, the deviations can be accommodated in the program given that much of the recent fiscal expenditure containment and higher coal exports are expected to be permanent. Nonetheless, these reversals do limit the structural improvement in Mongolia's fiscal framework during the program period.

- *Personal Income Tax*—The authorities reversed the programmed introduction of progressivity in the personal income tax—scheduled to take effect as of January 1, 2018—and went back to a flat 10-percent rate structure. The measure had called for the top 5 percent of wage earners to pay 15-25 percent marginal rates while all others would continue to pay 10 percent. While only raising 0.2 percent of GDP, the measure was aimed at increasing the distributional impact of the tax code while respecting the preference for still low tax rates by international standards. The authorities did increase tax credit thresholds which disproportionately help lower income households, but given the low starting level (the thresholds had not been changed in 10 years), the size of the increase was too small to improve progressivity to a significant degree.

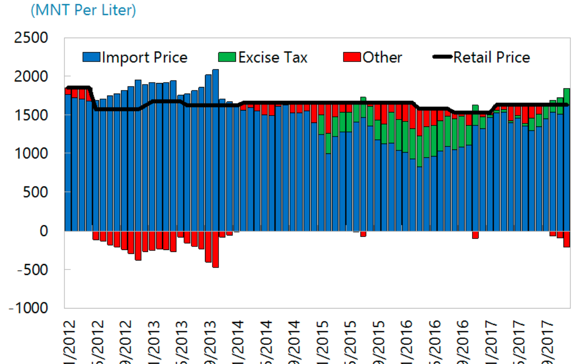
PIT Progressivity
(Tax rates and population distribution by income level)



Sources: Ministry of Finace; IMF Staff Calculations

- *Excise Tax on Fuel*—The program included a sizable increase in the very low excise tax on fuel, both to have a reliable revenue source and to address pollution and congestion, which are major problems in Ulaanbaatar. However, with import prices rising and strong domestic resistance to higher gasoline prices, the authorities decided to eliminate the excise tax on the two more popular types of fuel while keeping the retail price unchanged.

AI92 Fuel Price Breakdown
(MNT Per Liter)

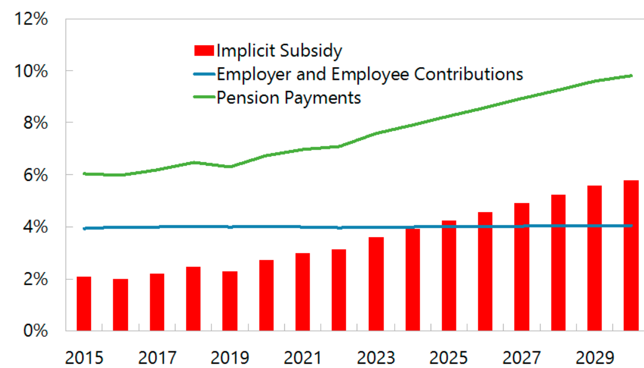


Sources: Ministry of Finance, Staff Estimates

The revenue loss is estimated at only 0.2 percent of GDP but the move takes Mongolia further away from the tax level needed to correct for externalities and risks entrenching political pressures to stabilize retail prices which is not sustainable. The authorities recognized that this is not a long-term solution and committed to greater price flexibility and a gradual increase in the excise tax within six months.

- *Pensions*—Mongolia has a pay-as-you-go pension system in which benefits are rising faster than social security contributions, implying increasing reliance on general budget revenue to meet obligations. The "implicit state subsidy" is currently around 2 percent of GDP and scheduled to rise to almost 6 percent by 2030 in the current baseline. Failure to address this means less resources for other priorities or more fiscal borrowing. As an initial effort at parametric reform, the program had called for a gradual increase in the minimum retirement age by 6 months per year until it reached 65 (currently it is 60 for men and 55 for women). In January, the authorities eliminated this increase in the face of public resistance. They increased the wage base used for calculating benefits from the last 5 to the last 7 years of wages, but as a parametric reform it does not replace increases in the retirement age. The authorities are aware of the broader need to improve the sustainability of the pension system and remain committed to such reforms in the context of ongoing work with the World Bank. Nonetheless, the political consensus around improving inter-generational equity is very low.

Implicit State Pension Subsidy
(In Percent of GDP)



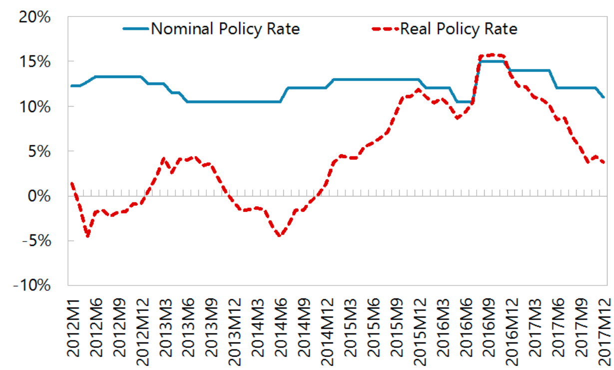
Sources: World Bank
Note: Contributions and benefits based on mandatory and voluntary pension systems

15. Staff are working with the authorities to protect social spending and strengthen the social safety net in the context of the needed fiscal adjustment. Given that the overall envelope of social spending at the time of program approval compared favorably with peers, the program has focused on shielding it from cuts and now includes an indicative target which helps ensure this spending does not fall going forward. Within this overall envelope, to better protect the poor during adjustment, the program has sought to increase the share of resources which go to the most vulnerable. Specifically, at the time of program approval, the authorities sought to restrict eligibility of the universal Child Money Program to the poorest 40 percent (later 60 percent) of children and use the savings to increase spending on the targeted Food Stamps Program (FSP). Nonetheless, in the period since program approval, the authorities have expressed a desire to return to broader coverage of the Child Money program (at least 80 percent). Recognizing this preference and noting the significant improvement in the fiscal accounts, the donors are now working with the authorities to increase coverage of the Child Money Program (an additional cost of 0.2 percent of GDP) while maintaining their commitments on increasing other poverty-targeted programs. Nonetheless, there is still scope for large increases in efficiency as the envelope for social assistance (e.g. cash and in-kind transfers) is currently spread over 71 programs, leading to high administrative costs and waste.

Monetary and Exchange Rate Policy

16. The current monetary stance appears consistent with program objectives and further easing should await firm evidence that inflationary pressures have abated. Monetary policy in Mongolia faces many of the challenges seen in other frontier markets such as limited pass-through from policy rates to lending rates. In addition, a particularly large share of the consumer basket is imported given limited domestic manufacturing. As a result, consumer prices are heavily influenced by import prices which are a function of global demand and supply conditions, not domestic policy settings. Nevertheless, monetary policy still plays an important role via its impact on expectations and the balance of payments. In this regard, it is critical that monetary policy does not ease prematurely, leading to excess demand for imports and capital outflows. The resulting pressure on the exchange rate would undermine the goal of reserve accumulation and weigh on inflation via depreciation.

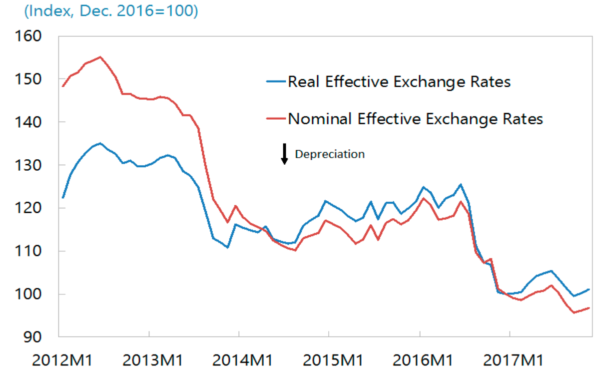
Nominal and Real Policy Rate
(In Percent)



Sources: Staff calculations.

17. The stronger balance of payments outlook allows a further increase in NIR targets. Since the start of the program, the authorities have appropriately used the strengthening external sector for reserve accumulation rather than currency appreciation. As noted above, gross official reserves rose by almost USD2 billion over the course of 2017, to end at over USD3 billion (5.2 months of imports), well above levels projected at the time of program approval. There has been a small real effective appreciation (1.4 percent in 2017) because Mongolia's inflation is considerably higher than its main trading partners (China and Russia); overall, the exchange rate is assessed to be in line with fundamentals.[1] Going forward, the authorities want to avoid excessive real appreciation, to help the nascent non-mining export sector and avoid excessive import growth. Given the stronger balance of

Exchange Rates of the Togrog
(Index, Dec. 2016=100)



Sources: IMF Direction of Trade Statistics, Haver, and IMF staff calcuations

[1] The EBA-lite macroeconomic balance approach suggests that the exchange rate is in line with fundamentals, while direct estimates of the REER suggest a small undervaluation of around 4 percent. The external sustainability approach also finds a modest undervaluation of 2.1 percent.

payments, the NIR target has been increased by $700 million in 2018 (raising gross reserves from 5.2 to 5.6 months of imports).

Financial Sector

18. Banks with a capital shortfall will have until end-2018 to address them. With the finalization of the AQR, BOM is calculating the final capital need for banks found to have a shortfall. This determination is a function of i) the provisioning gap identified by the AQR, and ii) the supervisor's request for a tier 1 capital buffer on top of the prudential minimum. The calculation of this buffer is informed by a stress test exercise run by BOM. Banks will be able to address the capital shortfall by a combination of i) accumulating profits, ii) divesting assets, and iii) raising Tier 1 or Tier 2 capital instruments. In this regard, BOM has already received from each bank preliminary plans, which are under review and will be finalized after final capital shortfalls are communicated by end-March. The law on bank recapitalization, which would allow capital injections in systemic banks from public sources but under strict conditions, has been drafted and is planned to be submitted early in the next Parliamentary session (end-May). The Recapitalization law, together with the improved Banking and Deposit Insurance laws, are important contributions to a credible safety net for the Mongolian banking sector and depositors.

19. The BOM is working to strengthen the regulatory and supervisory regime. Revised Central Bank, Banking and DICOM laws have been adopted by Parliament and, while some amendments adopted were not in line with staff recommendations, the laws represent an important step forward. In addition to issuing regulations as mandated by the newly amended banking law, BOM will issue other regulations, guidelines, and internal manuals aimed at improving risk management and internal controls at banks (e.g. requirements for bank's internal governance and controls, credit underwriting, and risk management) and at strengthening banking supervision. The prudential regulation will be revised to incorporate selected elements of the Basel II/III standards, including a Pillar II process to promote the formulation of banks' own assessments of capital and liquidity adequacy and a supervisory dialogue based on such assessments. Based also on the lessons learnt through the AQR, BOM will revise its regulation on asset classification and provisioning and the methodology and process for off-site and on-site supervision, to move towards a more risk-based, forward-looking, and proactive form of supervision. A protocol will be established between BOM and the Financial Regulatory Commission (FRC) for the consolidated supervision of financial conglomerates.

20. The authorities are working on reforms to improve NPL resolution, though progress on this is slow and requires active involvement of several institutions. In parallel to bank efforts to ensure sufficient capital, improving NPL resolution is a critical step to ensuring a healthy banking system going forward. At present, banks are unable to properly manage NPLs, limiting their lending capacity. To address this, BOM is working along three lines. First, a working group of BOM, Ministry of Finance (MoF), Ministry of Justice (MoJ) and FRC has prepared a draft national strategy. However, the strategy needs to be more concrete and the action plan should include a realistic timeline for the reforms. Most needed reforms relate to the judicial and legal environment, where MoJ will have to take the lead going forward. Under the program, the authorities have committed to adopt and publish the national NPL resolution strategy in April. Second, the BOM has drafted a regulation for banks on NPL management and reporting, also to be issued in April. And third, as a complement to bank-based resolution, the authorities are considering the potential benefits of a public Asset Management Company. Staff see considerable fiscal and governance risks related to a public AMC, and since very few NPLs are managed by more than one bank and there is already substantial concentration of NPLs, the efficiency gains of an AMC would likely be limited. The authorities recognize these concerns but want to fully assess international experience before making a final decision. Work on this is ongoing, with support from ADB and IMF staff.

21. The authorities have identified new banking sector risks that could be addressed with macro-prudential policies, though implementation should proceed cautiously. The recently passed Central Bank law gives the Bank of Mongolia power to determine and implement macro-prudential policies. The authorities intend to use this new power to address two risks:

- *Household lending* – The authorities are concerned by the speed of growth in household credit (particularly non-mortgage) and the level of indebtedness of some borrowers. They would like to introduce a 60-percent debt service to income limit on non-mortgage loans. They would also reduce the maximum maturity of such lending from 5 to 3 years to ensure that banks do not evade the regulation through longer-maturity loans.

- *FX Lending* – While FX loans are only about 20 percent of all loans (almost entirely to corporates), over 60 percent are unhedged and they account for a disproportionate share of NPLs. To address this, the authorities are considering increasing the risk weight on unhedged FX loans from 120 percent to 150 percent.

Focusing on these risks is appropriate to help maintain financial stability, though several caveats are worth noting. First, the risk of potential financial sector stress can be reduced by applying the measure only to new lending, per standard practice, rather than also to existing loans, at least initially. Second, the authorities should be careful that such measures do not force retail lending into the non-banking sector which faces less extensive supervisory scrutiny. And third, a bank-by-bank impact study could be helpful before proceeding, particularly regarding the new risk weights for FX loans before proceeding, to examine the impact on individual banks' capital positions (given the additional capital needs due to the AQR). Planned IMF technical assistance in coming months will support the authorities' goal of strengthening the macro-prudential toolkit.

22. Urgent action is needed to address money laundering concerns raised by the Asia Pacific Group (APG). In a July 2017 AML/CFT assessment, the APG, a regional body of the Financial Action Task Force, found serious deficiencies with respect to Mongolia's legal framework and enforcement. Progress thus far in addressing these concerns has been slow, as it was taken over by other priorities. In addition, relevant institutions, particularly the Financial Regulatory Commission which regulates all non-banks, have not received sufficient resources. Concerns about money laundering have already started weighing on Mongolia's correspondent banking relationships, pushing up the cost of capital, and this could deteriorate further absent concrete action. The authorities recognize the need for a stepped-up action plan and will start by passing a new Anti-Money Laundering law in coming months.

Program Modalities

23. Performance under the program is strong in some areas and mixed in others. End-December QPCs were met by large margins, including on the primary balance and NIR (see Appendix). Fiscal and banking sector reforms are proceeding for the most part, though often with delays. Of the 10 structural benchmarks (SBs) for this review, five were met and three (2 items of tax administration legislation and the recapitalization law) will likely be passed in the next parliamentary session. Failure to meet the remaining two reflects either the authorities' view that the measure may no longer be an immediate priority (credit line for deposit insurance agency DICOM) or there was inadequate Parliamentary support (non-partisan fiscal oversight of the fiscal council). The lack of a credit line for DICOM is manageable, particularly if the authorities pass a Recapitalization law (now expected in May), while the lack of full independence for the fiscal council will likely limit its effectiveness. The 2018 budget targets the Child Money Program to 60 percent (SB for end-December) but the authorities plan to increase this to 80 percent in coming months. As discussed above, there were also three fiscal measures in the program (introduction of PIT progressivity, increase in fuel excise tax, and increase in retirement age) that were reversed in January. Given that a) the initial motivation of these measures was fiscal adjustment and there has been large over-performance with a significant part of it expected to be permanent and b) a material part of the rise in coal demand is expected to be permanent, this reversal in fiscal measures can be accommodated in the program. Nonetheless, the failure to implement them undermines policy credibility and limits the scope for addressing inequality, environmental externalities, and inter-generational equity.

Structural Benchmarks Considered for Third Review

	Due Date	Status
Fiscal		
Establishment of a Fiscal Council in line with international best practice	end-Dec 2017	Not Met (1)
Submission of the Tax-Working Group's Report to the Ministry of Finance	end-Dec 2017	Met
Start Implementation of the 2018 Tax Compliance Improvement Strategies	end-Jan 2018	Met
Submission of Revised General Taxation Law	end-Feb 2018	Not Met (2)
Submission of legislation to create a simplified regime for micro/small businesses	end-Feb 2018	Not Met (2)
Social Protection		
Target Child Money Program in the 2018 Budget to the Poorest 60 percent	end-Dec 2017	Met
Banking		
Completion of the AQR	end-Dec 2017	Met
Enact a Law/amend existing law on use of public funds (Recapitalization Law)	end-Jan 2018	Not Met (3)
Set Up Back-up Funding for DICOM	end-Feb 2018	Not Met (4)
Amendment of DICOM law to bring in line with IADI Core Principles	end-Feb 2019	Met

(1) The parliament did approve regulation for a fiscal council but it did not guarantee political independence in line with advice.
(2) Expected to be passed in April. Delays related in part due to recently joined tax groups (e.g. BEPS). See LOI para 4.
(3) Expected to be passed in May.
(4) Can be accomodated, particularly if there is a Recapitalization Law to address systemic banks.

24. Forward-looking conditionality has been updated. Quantitative targets have been revised to reflect the stronger macro outlook. On fiscal policy, this includes the impact of strong growth on revenues and the primary balance. In the balance of payments, the end-2018 net international reserves target has been updated to lock in the over-performance registered last year.

Regarding structural benchmarks, no new conditions have been added but there have been five changes to deadlines on existing conditions going forward.

Changes in Structural Benchmark Deadlines

	Original Due Date	New Due Date
Fiscal		
Complete an audit of all existing concessions contracts, develop a repayment plan based on audit recommendations, contractual obligations and fiscal path, and incorporate in the medium-term fiscal framework (MTFF) repayment plan to be paid by the budget i) for each year of the MTFF and ii) the nominal sum for future years not covered by the MTFF	end-June 2018	end-August 2018
MOF to approve a Guideline on appraisal and selection of public investment projects, including specific methodology and evaluation criteria.	end-September 2018	end-December 2018
Banking		
Enact a Law or amend existing law on the use of public funds (Recapitalization Law)	end-January 2018	end-May 2018
Financial Stability Council approval and publication of NPL resolution strategy	end-March 2018	end-April 2018
Completion of the recapitalization process for viable banks and of resolution of nonviable ones	end-November 2018	end-December 2018

25. **The program remains fully financed given the stronger underlying balance of payments as well as ongoing engagement by the ADB, WB and key bilateral donors.** A USD700 million concessional loan agreement with the government of Korea was signed in January 2018 that will be disbursed through end-2019. This is in addition to the USD850 million concessional loan from Japan International Cooperation Agency (JICA) that was signed in December 2017. Capacity to repay the Fund is adequate under the baseline scenario (Table 7) with higher reserves and lower public debt compared to the original program scenario. While external developments have been favorable, program financing from the IMF remains critically important to build adequate reserves and decrease reliance on borrowed reserves, catalyze donor and private financing and help restore debt sustainability. While the program has succeeded to avert a payments crisis and medium-term outlook has improved, it remains subject to significant risks, particularly with respect to domestic political consensus on sustained adjustment and reforms, and Mongolia's exposure to volatile commodity markets.

26. **The BOM has taken steps to address key recommendations from the 2017 safeguards assessment.** These include amending the central bank law to improve the governance frameworks and autonomy of the BOM, establishing an MoU with the MoF to limit the central bank's involvement in the mortgage program, and setting up a working group to review the veracity of program monetary data. Remaining developmental areas include building capacity in the internal audit function, expanding the scope of risk management activity, and improving controls in the currency area.

STAFF APPRAISAL

27. **The authorities have averted a debt crisis and the economy is recovering better than programmed.** After several years of stagnation, GDP growth has revived to over 5 percent, driven by buoyant demand for commodities and a return of confidence under the IMF-supported Economic Recovery Program. The recovery has led to buoyant revenues and, combined with expenditure restraint, has driven a large improvement in the fiscal deficit. Better fiscal performance and high levels of concessional assistance have helped the debt position to turn from near-default

to favorable debt dynamics. Foreign exchange reserves have strengthened and maturing debts have been rolled over at lower interest rates.

28. However, these achievements cannot be taken for granted. While the short-term outlook has improved, vulnerabilities and risks remain - especially in such a commodity dependent economy. Prospects for coal exports depend critically on idiosyncratic factors in the international coal market; the outlook for large mining projects and related FDI inflows and exports remains uncertain; and weakening domestic consensus is a serious risk to the program. Recent fiscal measures have departed from program commitments, although they can be accommodated given the large fiscal over-performance. It is important that such slippages do not continue as they limit reform progress, undermine policy credibility, and threaten continued donor assistance.

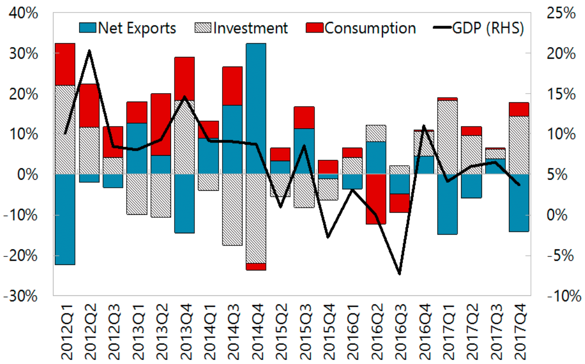
29. The recovery gives a unique opportunity for policy makers to lay the foundations for more stable, high-quality growth. Now is the time for decisive measures to strengthen the resilience of the economy and ensure that future growth is less volatile and more equally distributed. Key to this is continued fiscal discipline with better revenue mobilization and judicious expenditure control. This will help to reduce debt, accumulate savings, and rebuild external buffers. Rehabilitating and strengthening the financial system in line with international best practices is also crucial. A well-capitalized and supervised financial sector will ensure that banks and other financial institutions contribute to inclusive growth at reasonable interest rates. A well-designed capitalization framework that limits the burden on public finances and limits moral hazard is a priority as is sustained inter agency actions to implement an effective AML-CFT framework. Finally, maintaining macro-economic stability and putting in place well targeted micro reforms will help diversify the economy and ensure that growth is equitable. Failure to implement such policies would run the risk of a return of the boom-bust cycle.

30. Given the achievements to date and the authorities' continuing commitment to the program, staff recommends completion of the third review.

Figure 1. Real Sector Developments

Growth rebounded sharply in 2017. On the expenditure side, this was driven by a recovery in domestic demand.

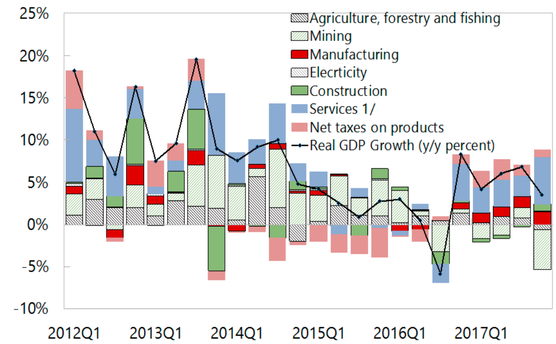
Real GDP Growth
(Contribution; Year-on-Year percentage change)



Source: Haver Analytics.

On the supply side, mining contracted, but services sector increased by almost 9 percent.

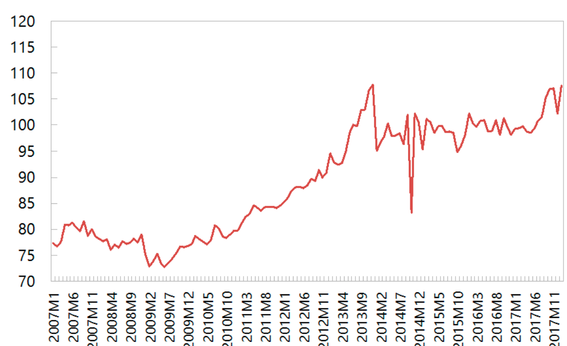
Contribution to Growth
(In Year-on-Year percentage point, unless otherwise noted)



Sources: BOM, and IMF staff estimates
1/ includes trade, transportation, and information and communication.

The recovery in 2017 was accompanied by improvement in employment, particularly in manufacturing…

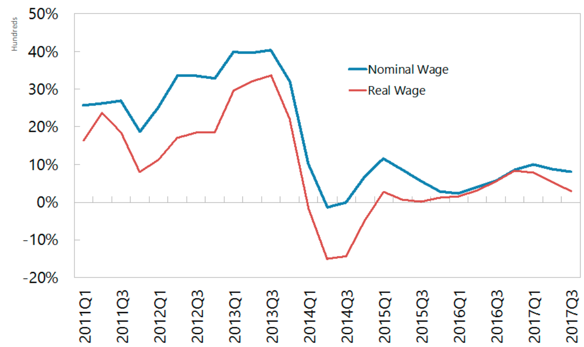
Employment
(Seasonally Adjusted, 2016=100)



Sources: Haver Analytics

…while real wage growth moderated due to stronger inflation.

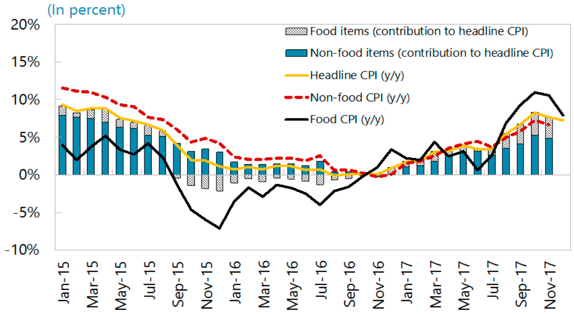
Nominal and Real Wage Growth
(In Percent, Year-on-Year)



Sources: CEIC, Haver Analytics and IMF Staff Calculations

After accelerating in most of 2017, inflation has begun to stabilize…

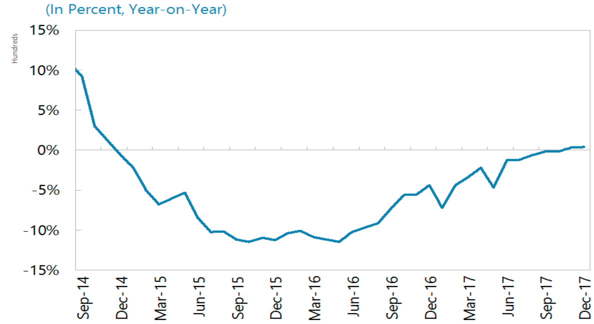
Consumer Price Inflation
(In percent)



Sources: Mongolian authorities; and IMF staff calculations.

…and housing prices stabilized after years of deflation, in line with stronger economic activity and household lending.

Housing Prices
(In Percent, Year-on-Year)

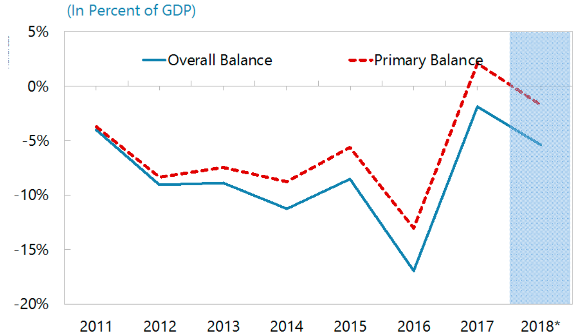


Sources: Haver Analytics; and IMF staff calculations.

Figure 2. Fiscal Sector Developments

Fiscal performance improved substantially in 2017…

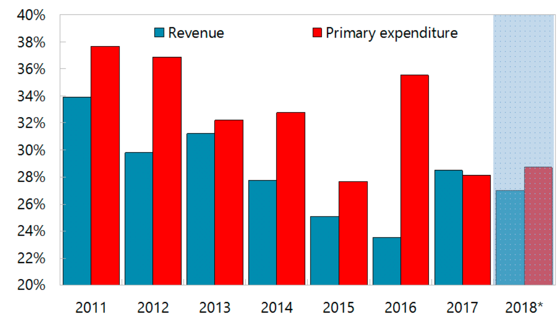
Fiscal Balance
(In Percent of GDP)



Sources: Mongolian authorities; and IMF staff calculations.
Note: 2018 is an estimate

…supported by both significant expenditure cuts and strong revenue performance.

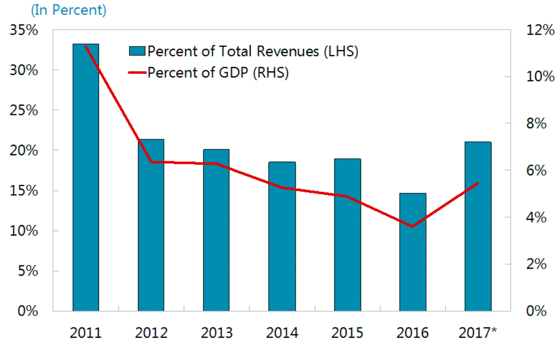
Revenue and Primary Expenditure
(In Percent of GDP)



Sources: Staff Estimates
Note: 2018 is an estimate

The strong revenues stem primarily from a recovery in mining-related receipts.

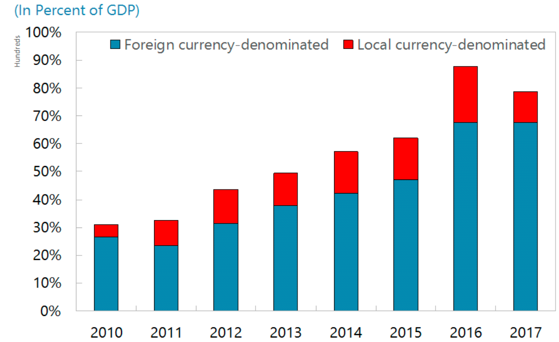
Mining Revenues
(In Percent)



Sources: Mongolian Authorities and IMF Staff Calculations
*Estimate

The public debt ratio has now started to decline…

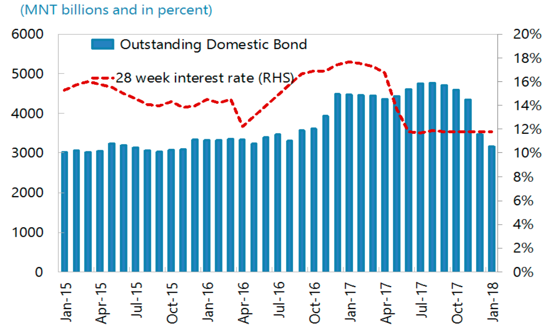
Public Debt
(In Percent of GDP)



Sources: Mongolian Authorities, IMF Staff Estimates

…and the authorities have used better fiscal performance and donor support to reduce high-cost domestic bonds…

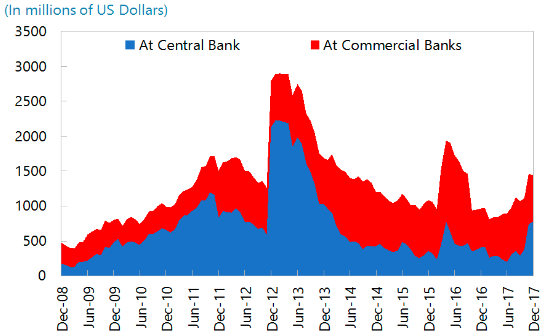
Government Securities
(MNT billions and in percent)



Sources: Ministry of Finance

…and build deposits.

General Government Deposits
(In millions of US Dollars)

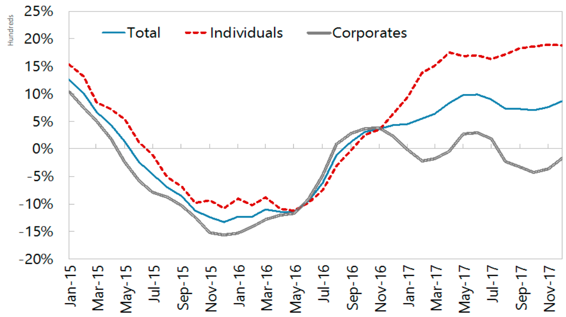


Sources: Haver Analytics

Figure 3. Financial Sector Developments

Private sector credit growth recovered in 2017, driven by strong lending to households.

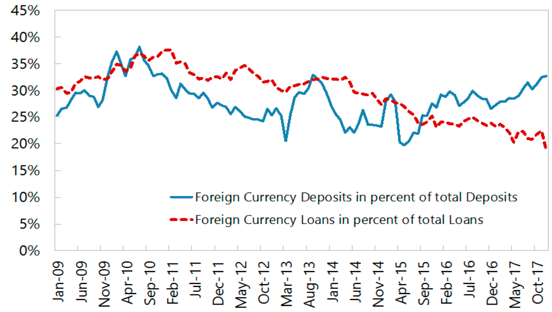
Credit Growth
(In Year-on-Year percent change of 3-Month Moving Average)



Sources: Haver Analytics Inc.; and IMF staff calculations.

The share of foreign currency loans has fallen in recent years while the share of FX deposits has been rising

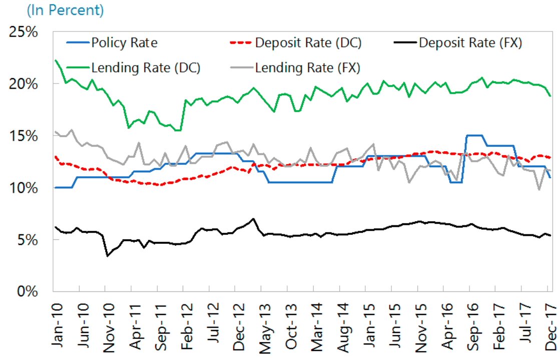
Loans and Deposits in FX
(In Percent)



Sources: CEIC and IMF Staff Calculations

BOM continued to lower its policy rates, though lending rates remained high and largely unchanged.

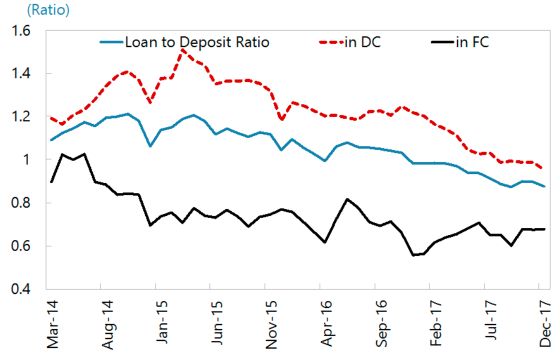
Interest Rates
(In Percent)



Sources: CEIC and Haver Analytics

Loan-to-Deposit Ratios continue to trend down.

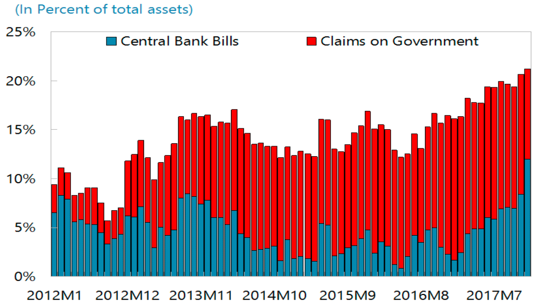
Loans to Deposit
(Ratio)



Sources: IMF Staff Calculations

Amid substantial FX purchases by BOM, banks have significantly increased holdings of sterilization bills.

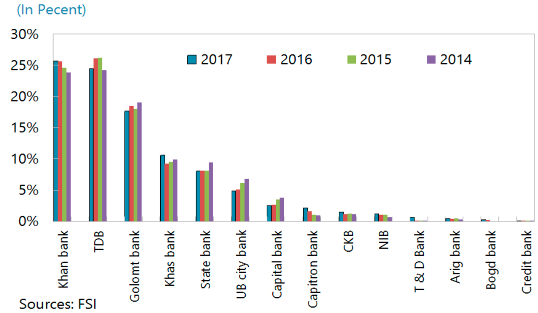
Government and Central Bank Bills held by Banks
(In Percent of total assets)



Sources: Haver Analytics.

The banking system remains highly concentrated in a few large banks.

Market Share by Bank
(In Pecent)

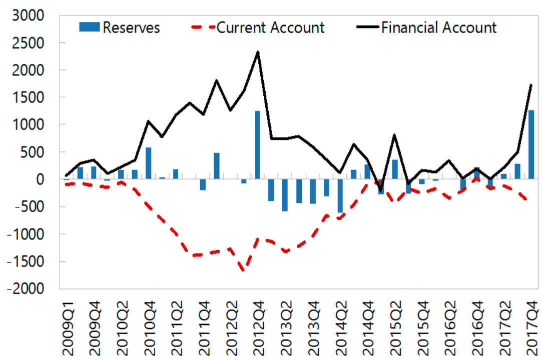


Sources: FSI
Note: TDB stands for Trade and Development Bank; CKB stands for Chinggis Khan Bank; T&D Bank stands for Transport and Development Bank; NIB stands for National Investment Bank

Figure 4. External Sector Developments

Overall, the external accounts improved significantly in 2017.

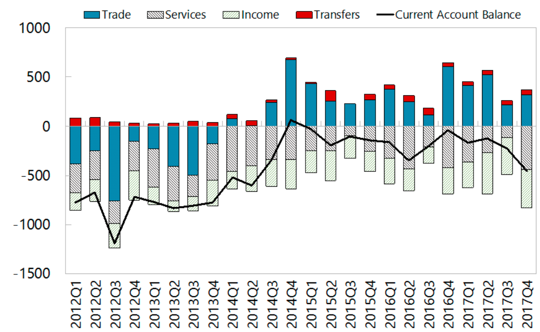
Balance of Payments
(In millions of US dollars)



Sources: Haver Analytics

While the current account has slightly worsened due to greater profit repatriation by mining companies…

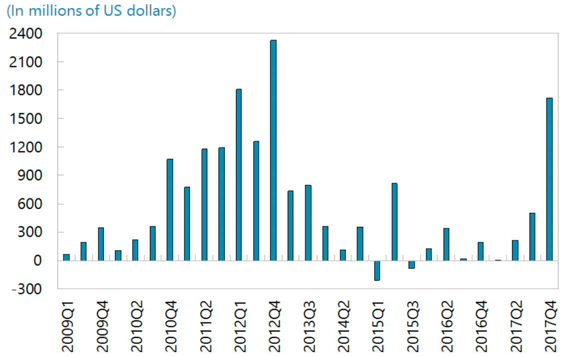
Current Account Balance
(In millions of US dollars)



Source: Haver Analytics.

…there was a significant recovery in total capital inflows…

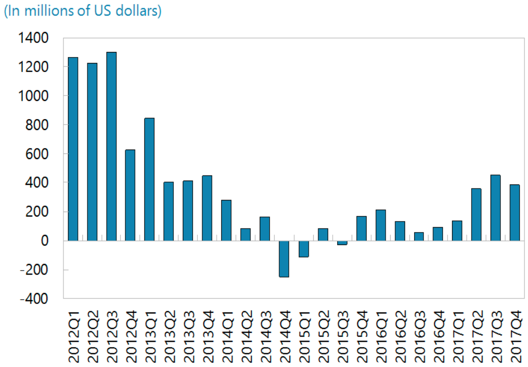
Net Capital Inflows
(In millions of US dollars)



Sources: Haver Analytics

…which included rising FDI.

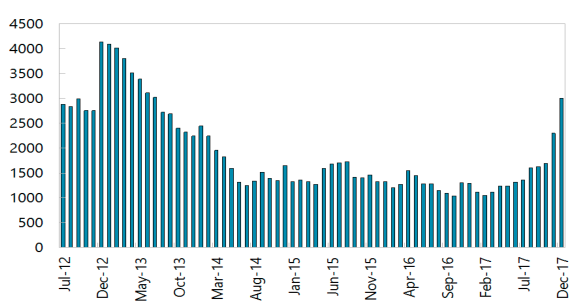
Foreign Direct Investment
(In millions of US dollars)



Source: Mongolian authorities.

The authorities have used the strengthening external sector for reserve accumulation

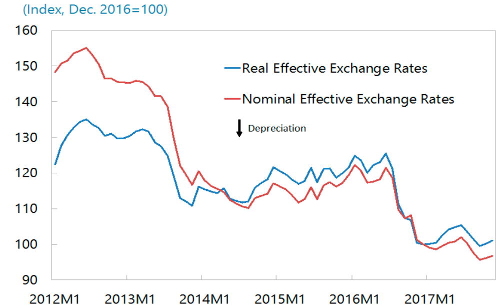
Gross International Reserves
(In millions of US dollars)



Source: Mongolian authorities.

……rather than nominal currency appreciation. The real exchange rate appreciated modestly due to high inflation.

Exchange Rates of the Togrog
(Index, Dec. 2016=100)

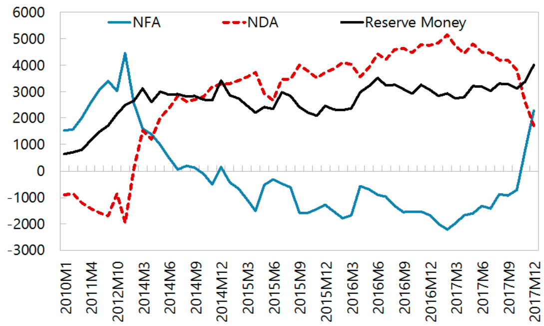


Sources: IMF Direction of Trade Statistics, Haver, and IMF staff calcuations

Figure 5. Monetary Sector

Since beginning of 2017, net foreign assets of BOM strengthened due to foreign exchange accumulation…

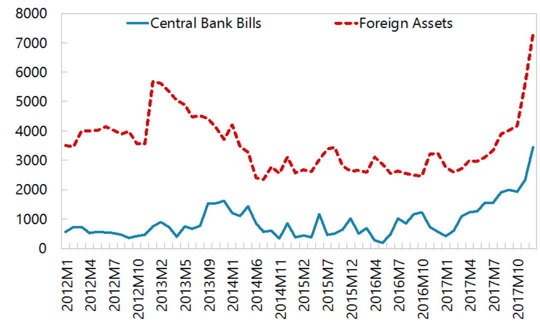
BOM NFA, NDA and Reserve Money
(In billions of togrog)



Sources: BOM.

… and the BOM sterilized the impact on domestic liquidity through issuance of central bank bills.

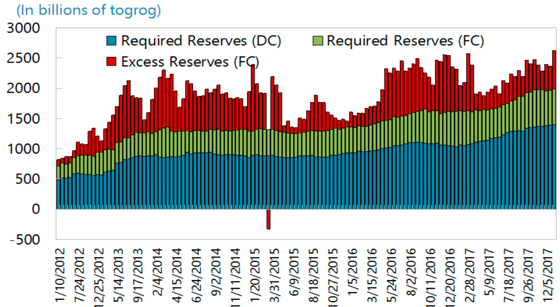
BOM Foreign Assets and Central Bank Bills
(In billions of togrog)



Sources: BOM.

Banks have continued to hold excess reserves in FX, albeit at a lower level.

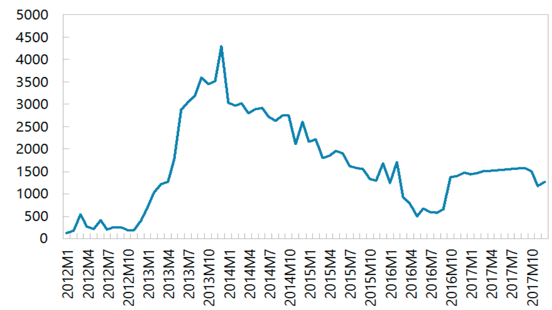
Required and Excess Reserves
(In billions of togrog)



Sources: BOM
Note: Required reserve ratio in FC and DC has been 12 percent since 2012. Actual excess reserves in DC are not included in the chart and are de minimis.

After years of unwinding mortgage exposure to banks, BOM claims have stabilized.

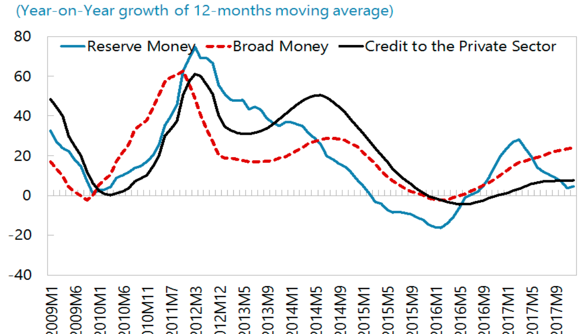
BOM Claims on Banks
(In billions of togrog)



Sources: BOM.

Broad money growth accelerated rapidly, contributing to an acceleration in private credit.

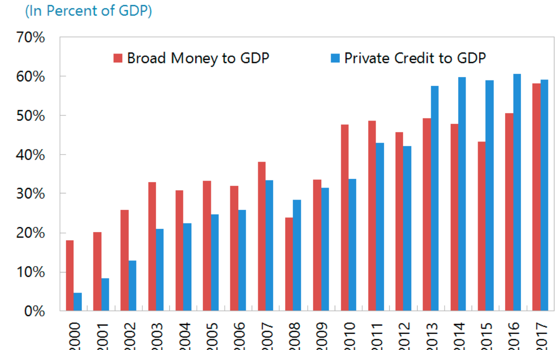
Reserve Money, Broad Money and Private Credit
(Year-on-Year growth of 12-months moving average)



Sources: BOM, Staff calculations.

Private credit relative to GDP remains significantly higher than a decade ago, in line with financial deepening.

Broad Money and Private Credit
(In Percent of GDP)



Sources: BOM, Staff calculations.

Table 1. Mongolia: Selected Economic and Financial Indicators, 2015-23

	2015	2016	2017			2018			2019	2020	2021	2022	2023
		Est.	EFF	1st/2nd review	Proj.	EFF	1st/2nd review	Proj.			Proj.		
					(In percent of GDP, unless otherwise indicated)								
Real sector													
Nominal GDP (in billions of togrogs)	23,150	23,936	26,047	27,438	27,167	27,688	30,378	30,662	34,383	38,014	42,291	48,205	54,174
Real GDP growth (percent change)	2.4	1.2	-0.2	3.3	5.1	1.8	4.2	5.0	6.3	5.0	5.8	8.2	7.0
GDP deflator (percent change)	1.7	2.1	9.3	11.0	7.9	4.4	6.2	7.5	5.5	5.3	5.2	5.3	5.0
Consumer prices	1.1	0.9	6.1	8.0	7.2	6.1	8.0	7.8	6.9	6.5	6.5	6.5	6.0
(End-period; percent change)													
Gross national saving	20.7	26.0	30.3	27.1	28.5	30.1	29.5	31.9	34.7	37.8	40.7	44.3	46.5
Public	0.4	-4.2	-3.4	0.1	3.4	-1.5	1.0	2.4	3.5	4.8	5.5	5.5	5.6
Private	20.3	30.3	33.8	26.9	25.1	31.6	28.5	29.5	31.2	33.0	35.2	38.8	40.9
Gross capital formation	26.4	29.4	34.8	34.0	37.3	39.6	38.1	38.3	43.0	43.7	44.3	44.3	44.5
Public	9.2	13.1	7.7	8.1	5.5	7.5	7.8	6.5	6.9	6.0	5.7	5.6	5.6
Private	17.2	16.3	27.1	26.0	31.8	32.2	30.4	31.8	36.1	37.8	38.6	38.7	38.9
General government accounts													
Total revenue and grants	25.1	23.5	24.7	25.9	29.2	26.3	25.9	27.0	27.3	27.3	27.2	27.2	27.1
Total expenditure and net lending 1/	33.6	40.5	35.3	33.6	31.1	34.8	32.3	32.3	31.0	29.3	27.4	27.2	27.8
Overall balance (IMF definition) 2/	-8.5	-17.0	-10.6	-7.6	-1.9	-8.5	-6.4	-5.3	-4.0	-1.7	-0.4	-0.8	-0.7
Primary balance (IMF definition)	-5.6	-13.0	-5.5	-3.4	2.1	-3.1	-2.6	-1.5	-1.0	0.8	1.5	1.5	1.5
					(In percent of GDP, unless indicated otherwise)								
Monetary sector													
Broad money growth (percent change)	-5.9	-0.9	16.1	23.3	30.4	13.3	14.7	21.1	16.6	12.6	17.3	14.0	17.4
Reserve money growth (percent change)	-28.2	24.6	21.8	13.2	30.5	19.3	19.1	19.5	16.6	12.6	17.3	14.0	17.4
Credit growth (percent change)	2.9	6.1	9.0	10.5	10.9	10.3	12.7	13.6	12.9	12.3	11.9	14.6	11.2
Balance of payments													
Current account balance	-4.0	-6.3	-4.4	-7.0	-8.8	-9.5	-8.6	-6.4	-8.3	-6.0	-3.6	0.0	2.0
Excluding mining-related imports	8.2	-1.1	2.2	-1.0	-3.0	-2.0	-2.5	-0.3	-2.3	0.1	2.5	3.6	4.5
Exports of goods (y/y percent change)	-20.1	4.2	1.8	18.0	21.4	-15.3	-7.7	7.8	4.9	-7.2	-6.2	6.7	16.1
Imports of goods (y/y percent change)	-28.1	1.0	4.6	22.4	25.9	-9.1	-1.5	5.2	15.3	-5.0	0.2	-0.2	8.1
Gross official reserves (in USD millions) 3/	1,324	1,297	1,692	1,919	3,012	2,515	2,534	3,595	4,762	4,959	5,815	5,832	6,230
(In months of imports)	2.8	2.4	3.4	3.5	5.2	4.4	4.1	5.5	7.3	7.3	8.5	8.3	8.2
Debt indicators 4/													
General government debt	62.1	87.6	94.9	85.3	84.6	101.3	89.0	81.7	78.7	73.8	67.9	60.9	55.2
Domestic	15.2	20.2	21.4	12.3	13.6	19.4	13.7	12.6	9.0	8.3	8.9	10.5	12.9
External	46.9	67.5	73.4	73.1	71.0	81.9	75.3	69.0	69.8	65.5	59.0	50.4	42.3
GFN	10.7	18.0	22.4	19.4	3.6	21.5	14.2	18.5	13.3	9.7	11.6	14.8	15.7
Exchange rate													
Togrog per U.S. dollar (eop)	1,996	2,490	...	...	2,427	...	...	...	...	...	...	...	...
Nominal Effective Exchange Rate 5/	101.9	85.4	...	...	82.7	...	...	...	...	...	...	...	...
Real Effective Exchange Rate 5/	100.0	82.3	...	...	83.4	...	...	...	...	...	...	...	...
Memorandum items:													
Copper prices (US$ per ton)	5,510	4,868	5,722	6,030	6,170	5,733	6,430	7,075	7,156	7,177	7,178	7,178	7,178
Gold prices (US$ per ounce)	1,160	1,248	1,212	1,254	1,257	1,225	1,291	1,344	1,378	1,418	1,449	1,482	1,482
Oil price (in U.S. dollars per barrel)	50.8	42.8	54.9	50.3	52.8	55.7	50.2	65.2	61.3	58.5	57.0	56.4	56.4

Sources: Mongolian authorities; and Fund staff projections.

1/ Includes DBM spending.

2/ Excludes privatization receipts; includes DBM commercial spending and from 2017 onwards mortgage interest financed mortgage spending.

3/ Gross official reserves includes drawings

4/ General government debt data excludes SOEs debt and central bank's liabilities from PBOC swap line.

5/ December 2014 =100

Table 2a. Mongolia: Summary Operations of the General Government, 2016–23

(In billions of togrogs)

	2016	2017			2018			2019	2020	2021	2022	2023
	Prelim	EFF	2nd Rev. Proj.	Proj.	EFF	2nd Rev. Proj.	Proj.	Projections				
Total revenue and grants	5,635	6,431	7,113	7,922	7,279	7,862	8,281	9,388	10,372	11,513	13,090	14,701
Current revenue	5,556	6,285	7,037	7,868	7,169	7,752	8,170	9,263	10,235	11,360	12,916	14,505
Tax revenue and social security contributions	4,875	5,523	6,237	6,986	6,346	6,900	7,337	8,340	9,226	10,243	11,637	13,070
Income taxes	1,043	1,120	1,332	1,610	1,292	1,408	1,510	1,858	2,165	2,450	2,769	3,093
CIT	520	520	729	962	556	691	863	1,128	1,353	1,538	1,741	1,928
PIT	523	600	602	648	735	716	647	731	812	912	1,028	1,166
Social security contributions	1,034	1,199	1,249	1,314	1,410	1,431	1,481	1,640	1,782	2,010	2,276	2,557
VAT	1,141	1,279	1,449	1,619	1,434	1,517	1,682	1,866	2,036	2,247	2,556	2,900
Excise taxes	630	487	512	520	659	684	645	794	880	939	1,078	1,203
Customs duties and export taxes	328	417	490	512	476	537	568	612	626	664	741	850
Other taxes	698	1,020	1,205	1,411	1,076	1,323	1,452	1,569	1,738	1,933	2,216	2,466
Non-tax revenue	682	762	800	882	823	852	833	924	1,009	1,118	1,279	1,435
Capital revenue and grants	78	146	76	54	110	110	111	124	137	153	174	196
Total expenditure and net lending	9,699	9,183	9,211	8,448	9,640	9,813	9,895	10,847	11,151	11,909	13,492	15,076
Current expenditure	6,571	7,178	7,000	6,948	7,574	7,452	7,440	8,053	8,423	9,025	10,255	11,463
Wages and salaries	1,747	1,764	1,766	1,775	1,796	1,797	1,853	2,002	2,213	2,462	2,807	3,154
Purchase of goods and services	1,386	1,426	1,322	1,337	1,497	1,455	1,455	1,631	1,804	2,007	2,287	2,571
Subsidies	229	233	199	261	245	236	236	265	283	302	345	387
Transfers	2,265	2,431	2,556	2,477	2,522	2,814	2,758	3,024	3,034	3,217	3,691	4,148
Interest payments	943	1,324	1,156	1,098	1,514	1,151	1,139	1,130	1,088	1,036	1,125	1,202
Capital expenditure and net lending 1/	3,128	2,005	2,211	1,500	2,066	2,361	2,454	2,793	2,728	2,884	3,237	3,614
Capital expenditure	2,360	1,607	1,802	1,646	1,623	1,989	1,991	2,371	2,272	2,402	2,687	3,023
Domestically-financed	1,664	949	1,144	1,093	816	1,182	1,184	1,411	1,501	1,543	1,735	2,225
o/w DBM noncommercial spending	240	173	0	0	0	0	0	0	0	0	0	0
Foreign-financed	696	658	658	553	807	807	807	960	771	858	952	798
Net lending	768	398	409	-146	443	371	463	423	456	483	550	591
o/w DBM commercial spending 2/	247	150	70	-475	159	161	253	172	190	211	241	270
o/w Mortgage program net lending	0	111	111	0	120	120	120	130	140	151	172	186
Overall balance (Authorities' definition)	-3,660	-2,330	...	-1,416	-2,126	...	...	...	...	...	...	...
Structural overall balance (Authorities' definition)	-3,660	-2,321	...	-1,742	-2,126	...	...	...	...	...	...	...
DBM spending	487	323	70	-475	159	161	253	172	190	211	241	270
Overall balance (IMF definition)	-4,065	-2,753	-2,098	-526	-2,361	-1,951	-1,614	-1,459	-779	-396	-402	-375
Primary balance (IMF definition)	-3,121	-1,428	-942	572	-846	-800	-475	-329	309	640	723	827
Financing	4,065	2,753	2,098	168	2,361	1,951	1,614	1,459	779	396	402	375
External	1,214	2,024	2,787	1,716	2,560	1,563	1,167	2,100	611	-130	-526	-1,130
Disbursement	1,350	2,646	3,393	1,881	3,268	3,503	2,914	3,708	2,501	3,079	3,963	3,577
Amortization	-136	-622	-606	-165	-708	-1,940	-1,747	-1,608	-1,889	-3,209	-4,489	-4,706
Domestic (net)	2,850	729	-689	-1,548	-199	387	447	-641	168	526	928	1,505
Government bonds	2,454	1,069	-220	-1,306	-274	286	346	-641	168	526	928	1,505
Privatization	1	100	100	0	75	101	101	0	0	0	0	0
Other	396	-440	-569	-242	0	0	0	0	0	0	0	0
Memorandum items:												
Mineral revenue (in percent of GDP)	2.5	3.74	4.52	5.1	3.7	4.3	3.9	4.2	4.5	4.6	4.6	4.4
Non-mineral revenue (in percent of GDP)	21.1	20.95	21.40	24.0	22.6	21.6	23.1	23.1	22.8	22.7	22.5	22.7
Total expenditure 3/	50.7	46.42	43.09	39.8	45.9	40.9	41.2	40.0	37.7	36.6	37.3	36.7
Non-mineral overall balance 3/	-24.4	-25.47	-15.62	-9.0	-23.4	-13.6	-11.7	-10.7	-8.4	-7.1	-7.3	-6.7
Primary spending (change in percent)	23.1	-10.48	-8.25	-16.1	3.4	7.5	19.1	11.0	3.6	8.0	13.7	12.2

Sources: Mongolian authorities; and Fund staff projections.

1/ Includes DBM spending.

2/ Interest payments not in the budget, using instead USD IMF projection and ER in the budget.

3/ In percent of non-mineral GDP.

Table 2b. Mongolia: Summary Operations of the General Government, 2016–23

(In percent of GDP)

	2016	2017			2018			2019	2020	2021	2022	2023
	Prelim	EFF	2nd. Rev.Proj.	Proj.	EFF	2nd Rev. Proj.	Proj.	Projections				
Total revenue and grants	23.5	24.7	25.9	29.2	26.3	25.9	27.0	27.3	27.3	27.2	27.2	27.1
Current revenue 1/	23.2	24.1	25.6	29.0	25.9	25.5	26.6	26.9	26.9	26.9	26.8	26.8
Tax revenue and social security contributions	20.4	21.2	22.7	25.7	22.9	22.7	23.9	24.3	24.3	24.2	24.1	24.1
Income taxes	4.4	4.3	4.9	5.9	4.7	4.6	4.9	5.4	5.7	5.8	5.7	5.7
CIT	2.2	2.0	2.7	3.5	2.0	2.3	2.8	3.3	3.6	3.6	3.6	3.6
PIT	2.2	2.3	2.2	2.4	2.7	2.4	2.1	2.1	2.1	2.2	2.1	2.2
Social security contributions	4.3	4.6	4.6	4.8	5.1	4.7	4.8	4.8	4.7	4.8	4.7	4.7
VAT	4.8	4.9	5.3	6.0	5.2	5.0	5.5	5.4	5.4	5.3	5.3	5.4
Excise taxes	2.6	1.9	1.9	1.9	2.4	2.3	2.1	2.3	2.3	2.2	2.2	2.2
Customs duties and export taxes	1.4	1.6	1.8	1.9	1.7	1.8	1.9	1.8	1.6	1.6	1.5	1.6
Other taxes	2.9	3.9	4.4	5.2	3.9	4.4	4.7	4.6	4.6	4.6	4.6	4.6
Non-tax revenue	2.8	2.9	2.9	3.2	3.0	2.8	2.7	2.7	2.7	2.6	2.7	2.6
Capital revenue and grants	0.3	0.6	0.3	0.2	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Total expenditure and net lending	40.5	35.3	33.6	31.1	34.8	32.3	32.3	31.5	29.3	28.2	28.0	27.8
Current expenditure	27.5	27.6	25.5	25.6	27.4	24.5	24.3	23.4	22.2	21.3	21.3	21.2
Wages and salaries	7.3	6.8	6.4	6.5	6.5	5.9	6.0	5.8	5.8	5.8	5.8	5.8
Purchase of goods and services	5.8	5.5	4.8	4.9	5.4	4.8	4.7	4.7	4.7	4.7	4.7	4.7
Subsidies	1.0	0.9	0.7	1.0	0.9	0.8	0.8	0.8	0.7	0.7	0.7	0.7
Transfers	9.5	9.3	9.3	9.1	9.1	9.3	9.0	8.8	8.0	7.6	7.7	7.7
Interest payments 2/	3.9	5.1	4.2	4.0	5.5	3.8	3.7	3.3	2.9	2.5	2.3	2.2
Capital expenditure and net lending 3/	13.1	7.7	8.1	5.5	7.5	7.8	8.0	8.1	7.2	6.8	6.7	6.7
Capital expenditure	9.9	6.2	6.6	6.1	5.9	6.5	6.5	6.9	6.0	5.7	5.6	5.6
Domestically-financed	7.0	3.6	4.2	4.0	2.9	3.9	3.9	4.1	3.9	3.6	3.6	4.1
o/w DBM noncommercial spending	1.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign-financed	2.9	2.5	2.4	2.0	2.9	2.7	2.6	2.8	2.0	2.0	2.0	1.5
Net lending	3.2	1.5	1.5	-0.5	1.6	1.2	1.5	1.2	1.2	1.1	1.1	1.1
o/w DBM commercial spending 4/	1.0	0.6	0.3	-1.7	0.6	0.5	0.8	0.5	0.5	0.5	0.5	0.5
o/w Mortgage program net lending	0.0	0.4	0.4	0.0	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3
Overall balance (Authorities' definition)	-15.3	-8.9	...	-5.2	-7.7	...	...	...	...	...	...	...
Structural overall balance (Authorities' definition)	-15.3	-8.9	...	-6.4	-7.7	...	...	...	...	...	...	...
DBM spending	2.0	1.2	0.3	-1.7	0.6	0.5	0.8	0.5	0.5	0.5	0.5	0.5
Overall balance (IMF definition)	-17.0	-10.6	-7.6	-1.9	-8.5	-6.4	-5.3	-4.2	-2.0	-0.9	-0.8	-0.7
Primary balance (IMF definition)	-13.0	-5.5	-3.4	2.1	-3.1	-2.6	-1.5	-1.0	0.8	1.5	1.5	1.5
Financing	17.0	10.6	7.6	0.6	8.5	6.4	5.3	4.2	2.0	0.9	0.8	0.7
External	5.1	7.8	10.2	6.3	9.2	5.1	3.8	6.1	1.6	-0.3	-1.1	-2.1
Disbursement	5.6	10.2	12.4	6.9	11.8	11.5	9.5	10.8	6.6	7.3	8.2	6.6
Amortization	-0.6	-2.4	-2.2	-0.6	-2.6	-6.4	-5.7	-4.7	-5.0	-7.6	-9.3	-8.7
Domestic (net)	11.9	2.8	-2.5	-5.7	-0.7	1.3	1.5	-1.9	0.4	1.2	1.9	2.8
Government bonds	10.3	4.1	-0.8	-4.8	-1.0	0.9	1.1	-1.9	0.4	1.2	1.9	2.8
Privatization	0.0	0.4	0.4	0.0	0.3	0.3	0.3	0.0	0.0	0.0	0.0	0.0
Other	1.7	-1.7	-2.1	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Mineral revenue (in percent of GDP)	2.5 ..	3.7	4.5	5.1	3.7	4.3	3.9	4.2	4.5	4.6	4.6	4.4
Non-mineral revenue (in percent of GDP)	21.1 ..	20.9	21.4	24.0	22.6	21.6	23.1	23.1	22.8	22.7	22.5	22.7
Total expenditure 3/ 4/	50.7 ..	0.2	43.1	39.8	0.2	40.9	41.2	40.0	37.7	36.6	37.3	36.7
Non-mineral overall balance 3/ 4/	-24.4 ..	20.8	-15.6	-9.0	22.4	-13.6	-11.7	-10.7	-8.4	-7.1	-7.3	-6.7
Primary spending (change in percent)	23.1	-17.9	-8.2	-16.1	-2.7	7.5	19.1	11.0	3.6	8.0	13.7	12.2
Nominal GDP (in billions of togrogs)	23,936		27,438	27,167		30,377	30,662	34,383	38,014	42,291	48,205	54,174

Sources: Mongolian authorities; and Fund staff projections.

1/ Interest payments not in the budget, using instead USD IMF projection and ER in the budget.

2/ The 2017 budget revenue estimates are understated because accumulations to the FSF and FHF are not included, nor are interest payments from DBM.

3/ Includes DBM spending.

4/ In percent of non-mineral GDP.

Table 3. Mongolia: Balance of Payments, 2015–23

	2015	2016	2017			2018			2019	2020	2021	2022	2023
			EFF	1st/2nd review	Proj.	EFF	1st/2nd review	Proj.	Proj,				
	(In millions of U.S. dollars, unless otherwise indicated) 1/												
Current account balance (including official grants)	-469	-700	-456	-772	-980	-1,004	-1,034	-804	-1,145	-899	-591	-5	425
Trade balance	1,178	1,337	1,266	1,428	1,467	968	1,082	1,584	1,173	1,326	1,569	2,068	2,856
Exports	4,616	4,809	4,898	5,677	5,840	4,943	5,389	6,277	6,583	6,782	7,311	7,797	9,050
Mineral export	4,099	3,999	4,314	5,007	5,144	4,351	4,760	5,598	5,889	6,079	6,584	7,051	8,251
Non-mineral export	517	810	584	670	696	592	629	678	694	703	726	747	799
Imports	-3,438	-3,473	-3,632	-4,249	-4,372	-3,975	-4,308	-4,692	-5,410	-5,456	-5,742	-5,729	-6,194
Services, net	-857	-1,337	-1,017	-1,082	-1,196	-1,174	-1,211	-1,262	-1,347	-1,291	-1,305	-1,294	-1,687
Income, net	-966	-911	-937	-1,294	-1,430	-1,033	-1,110	-1,357	-1,215	-1,197	-1,141	-1,051	-1,040
Current transfers	205	181	231	176	176	234	206	230	244	263	287	272	296
General government	56	25	31	18	22	32	40	65	64	70	77	40	41
Other sectors	148	156	200	159	154	202	166	166	180	193	209	232	255
Of which: Workers remittances	76	117	88	119	130	88	125	125	138	151	166	188	210
Capital and financial account	382	903	91	910	1,913	785	664	693	1,520	755	1,350	-76	120
Capital account	114	91	114	64	77	117	144	213	234	256	282	291	300
Financial account	268	812	-23	846	1,836	667	519	481	1,286	500	1,067	-367	-180
Direct investment	110	-4,171	995	1,056	1,326	1,547	1,424	1,533	2,149	1,981	2,017	1,423	1,088
Portfolio investment	274	487	-94	351	471	0	-145	-273	0	-500	-167	-745	-540
Trade credits, net	-302	-101	-45	-80	-28	-45	-85	-106	-78	-71	-85	-78	-78
Currency and deposits, net	-233	-204	-886	-219	485	-663	-368	-198	-323	-285	-316	-281	-325
Loans, net	347	4,920	7	-261	-418	-171	-307	-475	-462	-625	-382	-685	-325
Other, net	72	-120	0	0	0	0	0	0	0	0	0	0	0
Errors and omissions	-181	-221	0	0	-76	0	0	-144	-150	-154	-149	-135	-146
Overall balance	-268	-18	-365	138	857	-220	-371	-254	226	-298	610	-215	398
Change in reserves 2/	-324	-27	395	622	1,715	823	615	583	1,168	197	856	17	398
Financing Gap	0	0	760	483	717	1,043	986	837	942	495	246	233	0.0
Fund credit	-3	0	113	113	113.5	134.7	134.7	134.7	141.8	35.5	0.0	0.0	n.a.
Donor support			647	370	603	908	852	703	800	460	246	233	n.a.
Memorandum items:													
Current account balance (in percent of GDP)	-4.0	-6.3	-4.4	-7.0	-8.8	-9.5	-8.6	-6.4	-8.3	-6.0	-3.6	0.0	2.0
Gross official reserves (end-period) 3/	1,324	1,297	1,692	1,919	3,012	2,515	2,534	3,595	4,762	4,959	5,815	5,832	6,230
(In months of next year's imports of goods and services)	2.8	2.4	3.4	3.5	5.2	4.4	4.1	5.5	7.3	7.3	8.5	8.3	8.2
Copper price (in U.S. dollars per ton)	5,510	4,868	5,722	6,030	6,170	5,733	6,430	7,075	7,156	7,177	7,178	7,178	7,178
Oil price (in U.S. dollars per barrel)	51	43	55	50	53	56	50	65	61	58	57	56	56
Gold price (in U.S. dollars per troy oz.)	1,160	1,248	1,212	1,254	1,257	1,225	1,291	1,344	1,378	1,418	1,449	1,482	1,482

Sources: Mongolian authorities; and Fund staff projections.

1/ Structural break in series: 2013-2015 reported on the basis on BPM5, while 2016 onwards in on BPM6.

2/ Changes in reserves reflect valuation adjustments.

3/ Gross official reserves includes drawings from swap line.

Table 4. Mongolia: External Financing Requirements and Sources, 2015–23
(In millions of U.S. dollars)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
			Projections						
Gross financing requirements	935	2,057	3,538	3,161	3,929	3,131	3,333	3,013	2,506
External current account deficit (excl. official transfers)	497	756	1,005	868	1,209	969	668	44	-385
Amortization	427	689	1,268	1,437	1,178	1,653	1,483	2,689	2,182
Public sector	64	62	260	666	633	737	1,252	1,744	1,830
o/w bonds	0	0	0	273	0	0	500	1,000	1,073
o/w loans	58	62	260	393	633	737	752	744	757
Private sector	363	627	1,008	771	545	916	230	946	352
Repayment of arrears	0	0	0	0	0	0	0	0	0
Gross reserves accumulation (increase = +)	-324	-27	1,715	583	1,168	197	856	17	398
IMF repurchases and repayments	3	0	0	0	0	0	0	0	0
Other net capital outflows 1/	332	638	-451	273	374	312	327	263	311
Available financing	935	2,057	2,821	2,324	2,987	2,636	3,088	2,781	2,506
Grants	28	56	25	65	64	70	77	40	41
Disbursements to public sector	255	1,133	745	223	255	61	458	773	843
o/w bonds		500	433	0	0	0	333	667	533
o/w loans		467	312	223	255	61	125	106	309
Disbursements to private sector	543	5,039	725	503	519	524	535	546	535
Foreign direct investment	110	-4,171	1,326	1,533	2,149	1,981	2,017	1,423	1,088
Financing need	0	0	717	837	942	495	246	233	0
Financing	0	0	717	837	942	495	246	233	0
IMF 2/	0	0	113	135	142	35	0	0	0
Other IFI	0	0	320	418	472	290	0	0	0
Identified bilateral support	0	0	283	284	328	170	246	233	0
PBOC swap (additional drawing)	0	0	0	0	0	0	0	0	0
PBOC swap rollover (net zero)			1,805			1,805			

Sources: Mongolian authorities; and Fund staff projections.

1/ Includes all other net financial flows, and errors and omissions.
2/ SDR/USD = 0.73924 exchange rate was used.

Table 5. Mongolia: Capacity to Repay Indicators, 2017–23

(In millions of SDR, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023
Exposure and Repayments from Existing and Prospective Fund Arrangements							
GRA credit to Mongolia	83.87	183.45	288.29	314.51	312.18	294.27	259.33
In percent of quota	116.00	253.74	398.75	435.00	431.78	407.01	358.68
Debt service on GRA credit	0.20	2.47	5.88	8.97	11.65	27.04	44.56
Principal (repayments/repurchases)					2.33	17.91	34.94
Charges and interest	0.20	2.47	5.88	8.97	9.32	9.13	9.62
Debt and debt service ratios (In percent of GDP)							
Public and publicly-guaranteed debt	84.60	81.66	78.72	73.79	67.90	60.89	55.19
Excluding proposed IMF	83.59	79.69	75.92	70.99	65.38	58.79	53.54
GRA credit to Mongolia	1.01	1.97	2.81	2.80	2.52	2.10	1.66
Public and publicly-guaranteed debt service	5.71	15.44	12.36	10.56	13.11	16.34	17.21
Excluding proposed IMF	5.71	15.41	12.30	10.48	13.01	16.15	16.92
GRA debt service	0.00	0.03	0.06	0.08	0.09	0.19	0.28
Debt and debt service ratios (In percent of exports of goods and services)							
Public and publicly-guaranteed debt	137.73	139.93	141.79	140.70	133.16	126.92	120.90
Excluding proposed IMF	136.08	136.56	136.73	135.35	128.21	122.54	117.27
GRA credit to Mongolia	1.65	3.37	5.05	5.35	4.95	4.38	3.63
Public and publicly-guaranteed debt service	9.30	26.46	22.25	20.14	25.70	34.06	37.70
Excluding proposed IMF	9.29	26.41	22.15	19.99	25.52	33.66	37.07
GRA debt service	0.00	0.05	0.10	0.15	0.18	0.40	0.62

Sources: IMF Finance Department; and Fund staff estimates and projections.

Table 6. Mongolia: Indicators of Fund Credit, 2017–23

(In millions of SDR, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023
Existing and prospective Fund arrangements							
Disbursements	83.87	99.59	104.84	26.21			
Stock 1/	83.87	183.45	288.29	314.51	312.18	294.27	259.33
Obligations 2/	0.20	2.47	5.88	8.97	11.65	27.04	44.56
Principal (repayments/repurchases)					2.33	17.91	34.94
Charges and interest	0.20	2.47	5.88	8.97	9.32	9.13	9.62
Stock of existing and prospective Fund credit 1/	83.87	183.45	288.29	314.51	312.18	294.27	259.33
In percent of quota	116.00	253.74	398.75	435.00	431.78	407.01	358.68
In percent of GDP	1.01	1.97	2.81	2.80	2.52	2.10	1.66
In percent of exports of goods and services	1.65	3.37	5.05	5.35	4.95	4.38	3.63
In percent of gross usable reserves	2.78	5.10	6.05	6.34	5.37	5.05	4.16
Obligations to the Fund from existing and prospective Fund arrangements	0.20	2.47	5.88	8.97	11.65	27.04	44.56
In percent of quota	0.27	3.42	8.13	12.41	16.11	37.40	61.63
In percent of GDP	0.00	0.03	0.06	0.08	0.09	0.19	0.28
In percent of exports of goods and services	0.00	0.05	0.10	0.15	0.18	0.40	0.62
In percent of gross usable reserves	0.01	0.07	0.12	0.18	0.20	0.46	0.72

1/ End of period.

2/ Repayment schedule based on scheduled debt service obligations.

Table 7. Mongolia: Access and Phasing Under the Extended Fund Facility (EFF)

Availability Date		Purchase Million SDR	Purchase Million USD	Purchase Percent of Quota
May 24, 2017	Board Approval of extended arrangement	27.9560	37.82	38.67
September 15, 2017	Observance of end-June 2017 performance criteria, completion of first review 1/	27.9560	37.82	38.67
December 15, 2017	Observance of end-September 2017 performance criteria, completion of second review 1/	27.9560	37.82	38.67
March 15, 2018	Observance of end-December 2017 performance criteria, completion of third review	20.9598	28.35	28.99
June 15, 2018	Observance of end-March 2018 performance criteria, completion of fourth review	26.2088	35.45	36.25
September 15, 2018	Observance of end-June 2018 performance criteria, completion of fifth review	26.2088	35.45	36.25
December 15, 2018	Observance of end-September 2018 performance criteria, completion of sixth review	26.2088	35.45	36.25
March 15, 2019	Observance of end-December 2018 performance criteria, completion of seventh review	26.2088	35.45	36.25
June 15, 2019	Observance of end-March 2019 performance criteria, completion of eight review	26.2106	35.46	36.25
September 15, 2019	Observance of end-June 2019 performance criteria, completion of ninth review	26.2106	35.46	36.25
December 15, 2019	Observance of end-September 2019 performance criteria, completion of tenth review	26.2106	35.46	36.25
March 15, 2020	Observance of end-December 2019 performance criteria, completion of eleventh review	26.2106	35.46	36.25
		314.5054	**425.44**	**435.00**

1/ The first and second review were combined.

Table 8. Mongolia: Monetary Aggregates, 2015–23

	2015	2016	2017			2018			2019	2020	2021	2022	2023
			EFF	1st/2nd review	Proj.	EFF	1st/2nd review	Proj.			Proj.		
	(In billions of togrog, end of period)												
Monetary survey													
Broad money	10,008	12,113	13,967	14,930	15,799	15,822	17,127	19,127	22,309	25,111	29,443	33,560	39,394
Currency	461	565	656	696	615	743	799	745	869	978	1,146	1,307	1,534
Deposits	9,547	11,548	13,311	14,234	15,184	15,079	16,328	18,382	21,440	24,133	28,296	32,254	37,860
Net foreign assets	-4,151	-5,010	-4,176	-3,346	-1,252	-2,037	-1,818	-92	2,486	2,895	6,044	6,049	7,112
Net domestic assets	14,158	17,123	18,143	18,276	17,051	17,859	18,945	19,219	19,823	22,216	23,398	27,512	32,282
Domestic credit	14,344	16,358	18,252	16,702	15,988	19,640	18,291	18,351	19,906	22,490	25,872	29,787	33,697
Net credit to government	683	1,868	2,044	688	-76	1,770	248	100	-691	-643	-24	107	691
Credit to the private sector 1/	13,660	14,490	16,208	16,014	16,065	17,870	18,043	18,251	20,597	23,134	25,897	29,680	33,006
Other items, net	-185	764	-109	1,574	1,063	-1,780	654	868	-83	-274	-2,474	-2,275	-1,415
Monetary authorities													
Reserve money	2,462	3,067	3,734	3,472	4,001	4,457	4,137	4,782	5,577	6,278	7,361	8,390	9,849
Net foreign assets	-1,270	-1,690	-731	-460	2,283	1,072	813	3,512	6,145	6,628	9,882	9,991	11,078
Net domestic assets	3,732	4,757	4,466	3,932	1,718	3,385	3,324	1,270	-568	-350	-2,521	-1,601	-1,229
Net credit to government	-474	-332	-332	-13	-1,111	-332	-13	-1,191	-1,191	-1,191	-1,191	-1,191	-1,191
Claims on deposit money banks	1,686	1,471	1,097	1,794	1,270	837	1,997	1,490	1,688	1,808	445	425	425
Minus: Central bank bills (net)	1,025	573	979	3,595	3,426	2,535	4,861	4,267	6,628	6,433	7,040	5,896	6,381
Other items, net	3,544	4,191	4,680	5,745	4,985	5,415	6,200	5,238	5,563	5,466	5,264	5,060	5,918
Memorandum items:	(In percent, unless otherwise indicated)												
Annual broad money growth	-5.9	21.0	16.1	23.3	30.4	13.3	14.7	21.1	16.6	12.6	17.3	14.0	17.4
Annual reserve money growth	-28.2	24.6	21.8	13.2	30.5	19.3	19.1	19.5	16.6	12.6	17.3	14.0	17.4
Velocity	2.3	2.0	1.9	1.9	1.7	1.8	1.8	1.6	1.5	1.5	1.4	1.4	1.4
Credit growth (percent)	2.9	6.1	9.0	10.5	10.9	10.3	12.7	13.6	12.9	12.3	11.9	14.6	11.2

1/Includes mortgage-backed securities.

Sources: Mongolian authorities; and Fund staff projections.

Table 9. Mongolia: Summary of Financial Stability Indicators, 2010–17

	2010	2011	2012	2013	2014	2015	2016	2017	2017	2017	2017	2017	2017
				Dec	Dec	Dec	Dec	Jun	Jul	Aug	Sep	Oct	Nov
Capital (in percent)													
Risk Weighted CAR	16.2	15.9	15.5	16.0	17.7	17.9	18.6	18.0	17.8	17.6	17.5	17.4	18.0
Asset quality													
Asset Growth (percent change from start of year)	43.0	46.5	50.5	68.2	11.7	-3.6	21.3	1.7	5.4	8.5	10.8	9.5	9.2
Loan Growth (Net) (percent change from start of year)	26.4	34.0	37.8	52.4	17.5	-8.6	4.7	3.6	4.6	6.4	7.7	7.3	8.3
Loan share in total assets (in percent)	47.9	49.6	49.6	53.1	55.9	53.0	46.0	46.8	45.7	45.1	44.7	45.1	45.6
Non Performing Loan (in percent)													
NPL to gross loans	6.7	6.0	5.8	2.5	3.1	7.3	7.2	7.3	7.3	7.4	7.5	7.5	7.2
Past-due to gross loans	3.0	3.3	3.5	0.0	2.2	5.6	7.1	6.2	6.9	7.1	6.3	8.5	6.8
NPL + Past due to gross loans	9.7	9.2	9.3	3.6	5.3	12.9	14.2	13.5	14.2	14.5	13.8	16.0	14.0
Provision/NPLs	62.4	65.2	65.4	71.6	70.2	61.6	72.2	74.3	75.2	74.7	73.3	74.6	76.5
Provision/NPL+Past due	43.2	42.2	40.9	49.7	41.5	34.8	36.4	40.1	38.8	38.0	39.9	35.1	39.3
NPLs net of provision /Capital	12.5	10.6	10.5	4.3	5.0	12.7	7.9	7.4	7.2	7.6	8.0	7.6	6.8
NPLs+Past due net of provision /Capital	27.2	27.3	28.6	11.1	16.5	38.2	35.7	32.0	34.4	36.4	33.3	41.3	34.0
FX lending to total lending	33.7	33.2	34.4	27.5	23.5	24.5	20.2	21.4	21.9	21.6	21.4	21.9	21.8
Interest Rate (in percent)													
Average lending rate	17.4	17.4	17.0	14.0	14.3	15.2	15.8	16.5	16.4	16.4	15.6	16.8	16.8
Earnings and Profitability (in percent)													
Return on assets	1.8	2.7	1.8	2.7	1.8	1.2	0.8	1.0	0.9	1.0	1.0	0.9	1.0
Return on equity	11.2	24.2	14.6	20.4	13.5	9.1	6.9	9.0	8.3	9.0	9.6	8.2	9.0
Interest income to gross income	34.2	30.5	34.6	49.3	54.6	64.5	60.9	85.2	85.8	86.0	86.0	86.4	86.8
Interest expenses to gross income	21.3	19.2	22.5	30.2	34.7	41.1	42.2	59.9	59.9	60.2	59.8	60.3	60.3
Non-interest expenses to gross income	72.7	72.7	71.2	57.9	55.4	51.4	53.3	32.2	32.7	31.6	31.3	31.9	31.2
Personnel expenses to Non-interest expenses	7.2	6.5	7.7	10.2	11.2	13.9	11.8	24.4	24.7	25.2	25.1	24.7	25.0
Liquidity (in percent)													
Liquid assets to Total assets	44.1	43.3	43.4	30.9	25.2	22.0	24.0	23.7	24.5	26.0	26.8	25.9	26.5
Liquid assets to Short-term liabilities	53.3	52.1	52.1	32.0	29.7	30.6	35.8	34.6	35.4	37.2	38.0	36.7	37.8
FX deposit to total Deposits	32.4	29.9	30.9	21.6	26.8	26.1	31.7	24.9	27.0	25.9	27.6	25.4	25.3

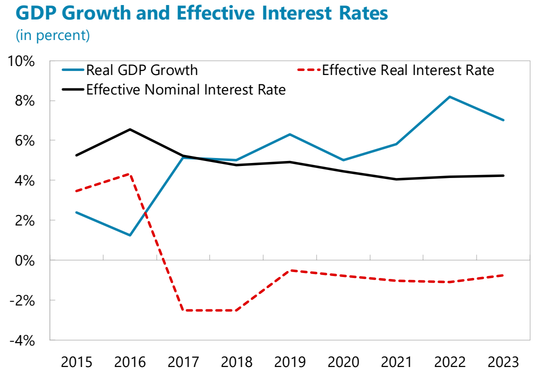
Source: Mongolian authorities.

Annex I. Public Debt Sustainability Analysis

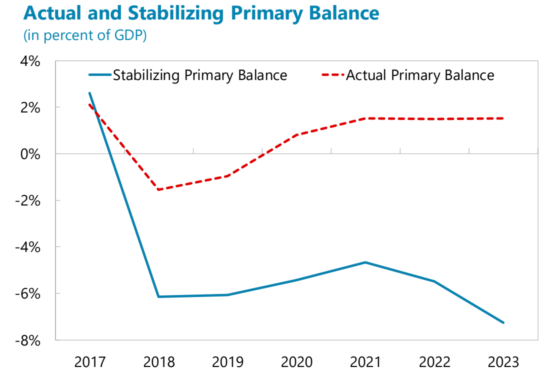
Gross public debt as a share of GDP declined in 2017 by 3 percentage points. Nominal gross public debt was 84.6 percent of GDP at end-2017. This definition comprises debt of central and local government, including debt guaranteed by the government, and debt of the Development Bank of Mongolia (DBM). In addition, gross public debt includes 1.5 percent of GDP as a contingent liability to be used in the event that public sector funds are needed to recapitalize the banking sector. This item has been reduced from 3.5 percent of GDP included in the 2017 Article IV Staff Report and First and Second Review under the EFF. The debt stock also includes the disbursed tranches of the IMF loan at 1.1 percent of GDP even though it is held at the BOM which is technically outside of the general government. Liabilities of state-owned enterprises and committed concessions for construction projects are not included in the debt stock. The latter amounted to 6.6 percent of GDP at end-2017 and will be added gradually to the debt stock as projects are being completed and payments are coming due.

Significant shares of public debt are denominated in foreign currency and reflect official sector loans, which has contributed to lower interest rates. Of the total debt stock at end-2017, 84 percent were denominated in foreign currency and 86 percent were held by non-residents with 10 percent of domestic bonds being held by non-residents. Short-term debt (defined on remaining maturity) was 16 percent of the total stock of debt. DBM's debt accounts for 10 percent of the total debt stock, while less than 1 percent are other guarantees with the remainder belonging directly to the government. Debt held by the official sector amounted to about 41 percent of GDP. The effective interest for 2018 is estimated at 4.8 percent, with domestic bonds carrying the highest interest at 10.2 percent, followed by external securities at 6.7 percent. The effective interest rate on external loans is significantly lower at only 1.3 percent. The government's stock of deposits was 5 percent of GDP at the end of 2017.

Public debt to GDP is forecasted to decline further on account of strong growth, favorable interest rate conditions and primary surpluses. The decline in the debt-to-GDP ratio in 2017 was driven by four main developments including (i) a primary surplus of 2.1 percent of GDP, (ii) strong real GDP growth, (iii) an appreciation in the togrog by 2.5 percent and (iv) a drop in the average real interest rate from 4.3 percent to -2.5 percent. The latter was driven by increased market confidence, a shift to concessional borrowing and a strong increase in inflation. Gross public debt is projected to decline further to 81.7 percent of GDP in 2018 as a further improvement in the interest-rate-growth differential is expected to offset a primary deficit of 1.5 percent of GDP and a depreciation in the togrog. In the medium-term, the public-debt-to-GDP ratio is expected to decline significantly to around 55 percent in 2023, driven by strong growth, primary surpluses and favorable interest rate conditions.

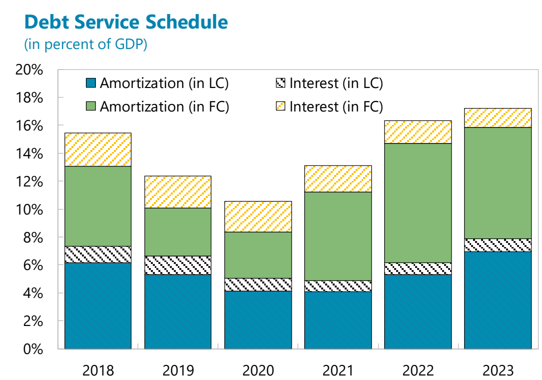


Sources: MOF, Staff estimates.



Sources: MOF, Staff estimates.

The debt service schedule is expected to decline in the short-term due to improved market confidence and a shift towards concessional borrowing. Total amortization and interest payments are projected to amount to 15 percent of GDP in 2018 and drop to around 11 percent in 2020 while increasing thereafter. Amortization of domestic bonds will reach about 6 percent of GDP in 2018 and is projected to decline until 2021 as it is largely being refinanced through long-term external concessional borrowing. The amortization of foreign-currency denominated debt at 5.7 percent of GDP in 2018 is largely on account of external loans (3 percent of GDP) and external bonds (2.2 percent of GDP) maturing in 2018. The latter have already been pre-financed in 2017 through the issuance of bonds that will mature in 2023 and 2024. Amortization coming due in 2019 and 2020 is lower as external bonds will only mature starting in 2021 and budget support under the program has grace periods ranging from 3 to 6 years.



Sources: MOF, staff estimates.

The main risk for the debt forecast is a negative growth shock that could put pressure on the primary balance and exchange rate. The considerable improvement in the public-debt-to-GDP ratio critically depends on persistent strong growth and primary surpluses. In the event of a negative growth shock, gross public debt would likely rise due to it directly reducing the denominator and its impact on other key parameters. First, it will likely decrease the primary balance as lower growth would weaken fiscal revenues and raise pressure for compensatory expenditures. Second, if the growth shock plays out in the external sector it could put downward pressure on the togrog. Given the large amount of debt denominated in foreign-currency this could result in significant increases in gross public debt.

Mongolia Public DSA–Baseline Scenario

(percent of GDP, unless otherwise indicated)

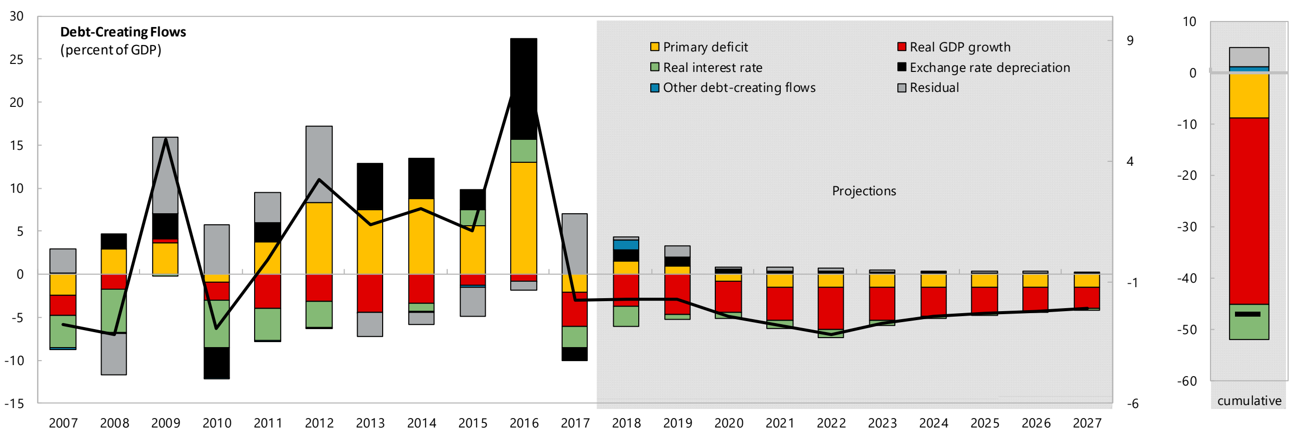
Debt, Economic and Market Indicators 1/

	Actual			Projections									
	2007–2015 2/	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Nominal gross public debt	40.3	87.6	84.6	81.7	78.7	73.8	67.9	60.9	55.2	50.3	45.7	41.4	37.4
Public gross financing needs	5.7	18.0	3.6	18.5	13.3	9.7	11.6	14.8	15.7	15.3	12.4	13.4	14.2
Real GDP growth (percent)	8.1	1.2	5.1	5.0	6.3	5.0	5.8	8.2	7.0	7.0	6.9	6.8	6.8
Inflation (GDP deflator, percent)	10.9	2.1	7.9	7.5	5.5	5.3	5.2	5.3	5.0	4.9	4.9	5.0	5.1
Nominal GDP growth (percent)	20.2	3.4	13.5	12.9	12.1	10.6	11.3	14.0	12.4	12.2	12.1	12.1	12.2
Effective interest rate (percent) 4/	2.7	6.6	5.2	4.8	4.9	4.5	4.1	4.2	4.2	4.9	4.7	4.9	5.0

As of February 22, 2018		
Sovereign Spreads		
EMBIG (bp) 3/		291
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	B3	B3
S&Ps	B-	B-
Fitch	B-	B-

Contribution to Changes in Public Debt

	Actual			Projections											
	2007–2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	Cumulative	Debt-stabilizing primary balance 9/
Change in gross public sector debt	3.1	25.5	-3.0	-2.9	-2.9	-4.9	-5.9	-7.0	-5.7	-4.9	-4.6	-4.3	-4.0	-47.2	-2.6
Identified debt-creating flows	1.1	26.7	-10.0	-3.3	-4.3	-5.2	-6.3	-7.3	-5.9	-5.1	-4.8	-4.5	-4.1	-50.9	
Primary deficit	4.1	13.0	-2.1	1.5	1.0	-0.8	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-8.8	
Primary (noninterest) revenue and grants	28.4	23.5	29.2	27.0	27.3	27.3	27.2	27.2	27.1	26.8	26.6	26.3	26.0	268.8	
Primary (noninterest) expenditure	32.6	36.6	27.1	28.6	28.3	26.5	25.7	25.7	25.6	25.3	25.1	24.8	24.6	260.0	
Automatic debt dynamics 5/	-2.9	13.6	-7.9	-6.1	-5.2	-4.3	-4.8	-5.8	-4.4	-3.6	-3.3	-3.0	-2.6	-43.2	
Interest rate/growth differential 6/	-4.7	1.9	-6.4	-6.1	-5.2	-4.3	-4.8	-5.8	-4.4	-3.6	-3.3	-3.0	-2.6	-43.2	
Of which: real interest rate	-2.2	2.7	-2.4	-2.3	-0.6	-0.8	-0.9	-0.9	-0.6	-0.2	-0.2	-0.2	-0.1	-7.0	
Of which: real GDP growth	-2.4	-0.7	-4.0	-3.8	-4.6	-3.6	-3.8	-4.9	-3.8	-3.4	-3.1	-2.8	-2.5	-36.2	
Exchange rate depreciation 7/	1.8	11.7	-1.5	...	...	...	...	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.1	0.0	0.0	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.2	
Net privatization proceeds	-0.1	0.0	0.0	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.3	
Contingent liabilities	0.0	0.0	0.0	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.5	
Other liabilities (bank recap. and PSI sweetner)	0.0	0.0	0.0	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 8/	2.0	-1.2	7.0	0.4	1.4	0.2	0.4	0.3	0.2	0.2	0.2	0.2	0.1	3.7	

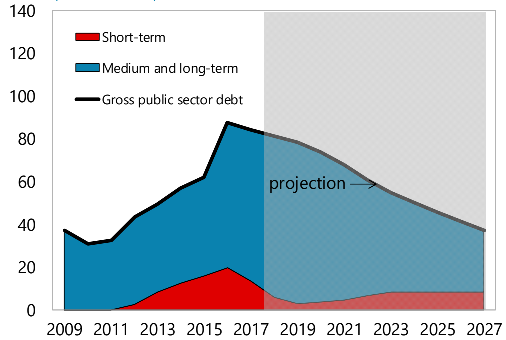


Source: IMF staff
1/ Public sector is defined as general government
2/ Based on available data
3/ Bond Spread over U.S. Bonds.
4/ Defined as interest payments divided by debt stock at the end of previous year
5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation
6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g
7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year

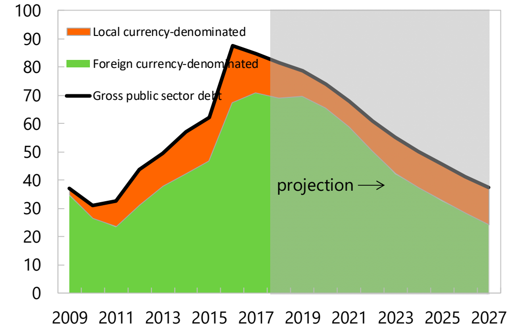
Mongolia Public DSA–Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(Percent of GDP)



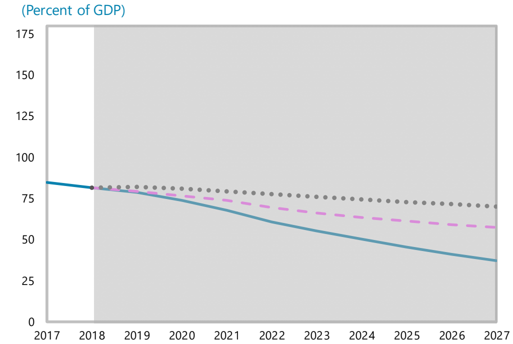
By Currency
(Percent of GDP)



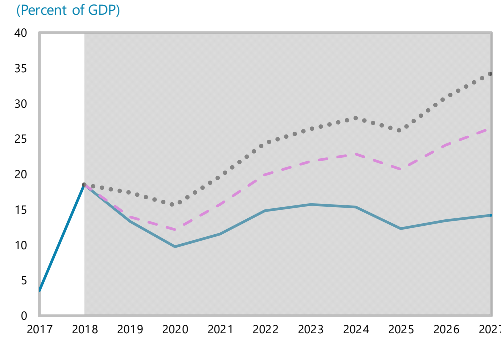
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(Percent of GDP)



Public Gross Financing Needs
(Percent of GDP)



Underlying Assumptions
(Percent)

Baseline scenario	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Real GDP growth	5.0	6.3	5.0	5.8	8.2	7.0	7.0	6.9	6.8	6.8
Inflation	7.5	5.5	5.3	5.2	5.3	5.0	4.9	4.9	5.0	5.1
Primary balance	-1.5	-1.0	0.8	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Effective interest rate	4.8	4.9	4.5	5.5	4.2	4.2	4.9	4.7	4.9	5.0
Constant primary balance scenario										
Real GDP growth	5.0	6.3	5.0	5.8	8.2	7.0	7.0	6.9	6.8	6.8
Inflation	7.5	5.5	5.3	5.2	5.3	5.0	4.9	4.9	5.0	5.4
Primary balance	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5
Effective interest rate	4.8	4.9	4.3	4.1	4.3	4.4	5.0	4.9	5.0	5.2

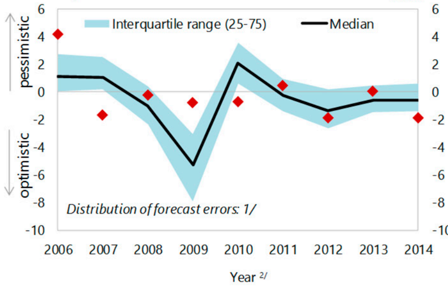
Historical scenario	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Real GDP growth	5.0	7.1	7.1	7.1	7.1	7.1	7.1	7.1	7.1	7.1
Inflation	7.5	5.5	5.3	5.2	5.3	5.0	4.9	4.9	5.0	5.1
Primary balance	-1.5	-5.1	-5.1	-5.1	-5.1	-5.1	-5.1	-5.1	-5.1	-5.1
Effective interest rate	4.8	4.9	3.5	2.9	2.7	2.2	2.4	2.1	1.2	1.1

Source: IMF staff

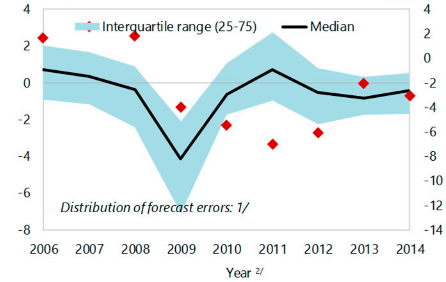
Mongolia Public DSA–Realism of Baseline Assumptions

Forecast Track Record, versus all countries

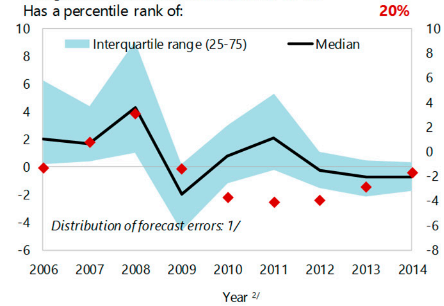
Real GDP Growth
(Percent, actual-projection)
Mongolia median forecast error, 2006-2014: **-0.70**
Has a percentile rank of: **29%**



Primary Balance
(Percent of GDP, actual-projection)
Mongolia median forecast error, 2006-2014: **-0.69**
Has a percentile rank of: **29%**

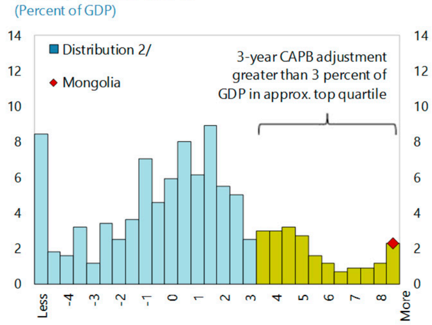


Inflation (Deflator)
(Percent, actual-projection)
Mongolia median forecast error, 2006-2014: **-0.41**
Has a percentile rank of: **20%**

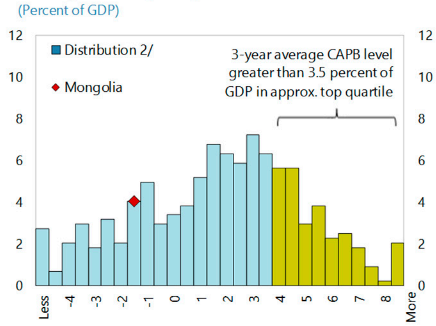


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

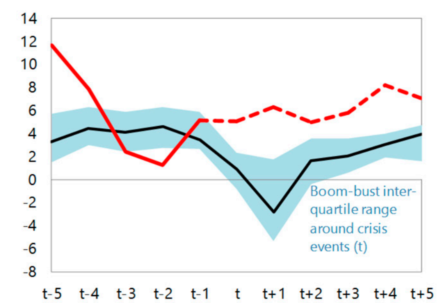


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis

Real GDP growth
(Percent)



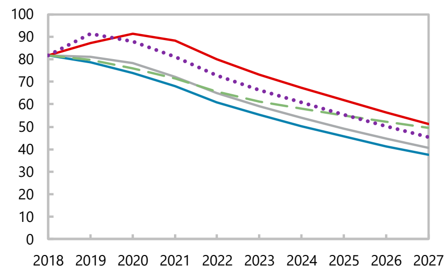
Source : IMF staff
1/ Plotted distribution includes all countries, percentile rank refers to all countries. Projections made in the spring WEO vintage of the preceding year
2/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis

Mongolia Public DSA–Stress Tests

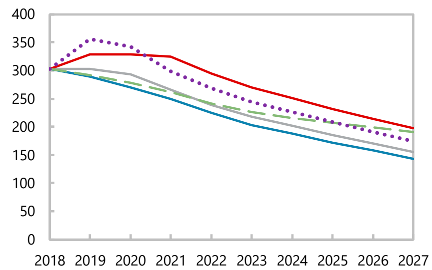
Macro-Fiscal Stress Tests

Baseline
Real GDP Growth Shock
Primary Balance Shock
Real Exchange Rate Shock
Real Interest Rate Shock

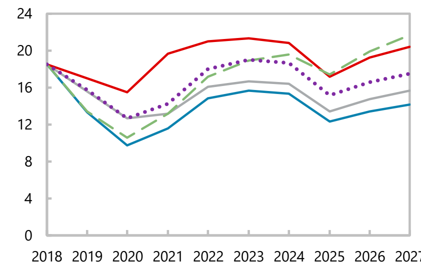
Gross Nominal Public Debt
(Percent of GDP)



Gross Nominal Public Debt
(Percent of Revenue)



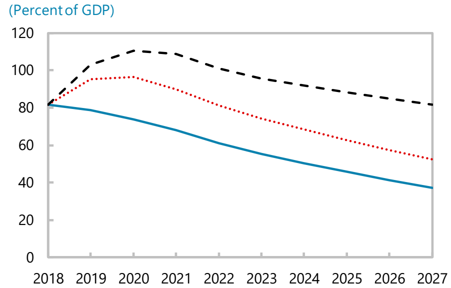
Public Gross Financing Needs
(Percent of GDP)



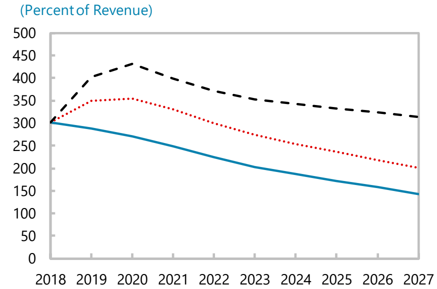
Additional Stress Tests

Baseline
Combined Macro-Fiscal Shock
Contingent Liability Shock

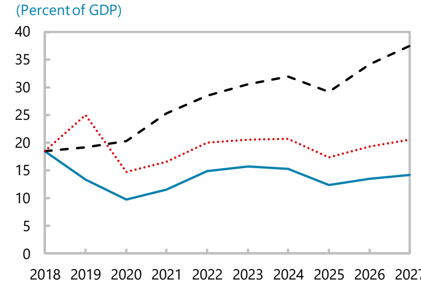
Gross Nominal Public Debt
(Percent of GDP)



Gross Nominal Public Debt
(Percent of Revenue)



Public Gross Financing Needs
(Percent of GDP)



Underlying Assumptions

(Percent)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Primary Balance Shock										
Real GDP growth	3.3	4.3	6.9	5.2	5.9	8.2	7.0	7.0	6.9	6.8
Inflation	11.0	6.2	6.2	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-3.4	-2.6	-1.0	0.8	1.5	1.5	1.7	1.7	1.7
Effective interest rate	5.1	6.0	6.0	5.6	4.9	4.4	4.6	4.8	4.8	5.0
Real Interest Rate Shock										
Real GDP growth	3.3	3.0	5.7	4.4	5.4	8.0	6.8	6.8	6.7	6.6
Inflation	11.0	6.2	6.2	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-2.6	-1.0	0.8	1.5	1.5	1.7	1.7	1.7	1.7
Effective interest rate	5.1	6.0	6.2	5.9	5.3	5.0	5.4	5.3	6.3	6.4
Combined Shock										
Real GDP growth	3.3	-1.5	1.0	4.4	5.4	8.0	6.8	6.8	6.7	6.6
Inflation	11.0	4.8	4.7	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-5.5	-5.6	-3.5	0.8	1.5	1.5	1.7	1.7	1.7
Effective interest rate	5.1	6.3	6.3	5.9	5.4	5.1	5.4	5.4	6.3	6.4
Real GDP Growth Shock										
Real GDP growth	3.3	-1.5	1.0	5.0	5.8	8.2	7.0	7.0	6.9	6.8
Inflation	11.0	4.8	4.7	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-5.5	-4.6	-3.1	1.5	1.5	1.7	1.7	1.7	1.7
Effective interest rate	5.1	6.0	6.0	5.4	4.7	4.2	4.3	4.1	4.6	4.7
Real Exchange Rate Shock										
Real GDP growth	3.3	3.7	6.5	5.0	5.8	8.2	7.0	7.0	6.9	6.8
Inflation	11.0	7.9	6.2	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-3.1	-1.5	0.8	1.5	1.5	1.7	1.7	1.7	1.7
Effective interest rate	5.1	6.3	5.9	5.3	4.6	4.2	4.3	4.1	4.7	4.7
Contingent Liability Shock										
Real GDP growth	3.3	-1.5	1.0	5.0	5.8	8.2	7.0	7.0	6.9	6.8
Inflation	11.0	4.8	4.7	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-2.6	-1.0	0.8	1.5	1.5	1.7	1.7	1.7	1.7
Effective interest rate	5.1	6.3	5.9	5.3	4.6	4.2	4.3	4.1	4.7	4.7

Source: IMF staff

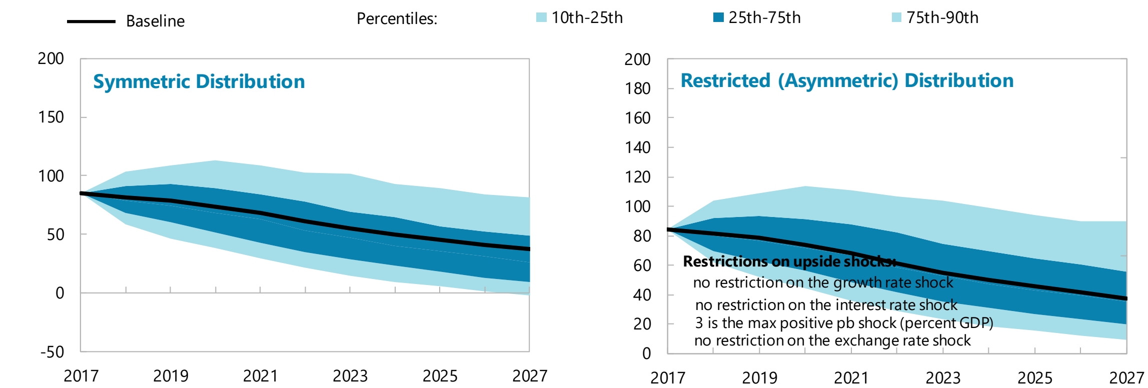
Mongolia Public DSA–Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

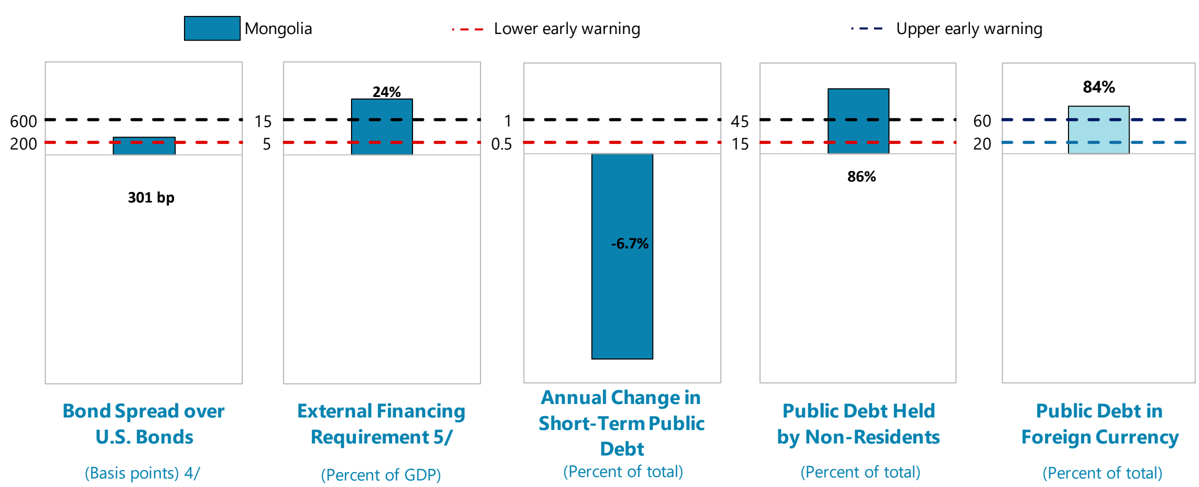
Evolution of Predictive Densities of Gross Nominal Public Debt

(Percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt

4/ Bond Spread over U.S. Bonds, an average over the last 3 months, 24-Nov-17 through 22-Feb-18.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Table 1. Country: External Debt Sustainability Framework, 2012-2022
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
Baseline: External debt	125.2	151.2	171.7	186.2	222.8			**232.9**	**207.2**	**190.3**	**169.5**	**151.0**	**126.6**	**-17.6**
Change in external debt	32.7	26.0	20.5	14.4	36.6			10.1	-25.7	-16.9	-20.8	-18.4	-24.4	
Identified external debt-creating flows (4+8+9)	-22.7	5.8	13.8	9.9	55.4			-14.5	-16.2	-19.2	-15.9	-17.5	-18.5	
Current account deficit, excluding interest payments	25.5	21.6	5.0	-3.7	-3.0			-2.0	-4	0	-2	-3	-6	
Deficit in balance of goods and services	-108.6	-100.1	-108.7	-87.8	-101.4			-2.4	-2.6	1.3	-0.2	-1.6	-4.1	
Exports	43.5	39.6	52.1	45.3	50.7			61.4	58.4	55.5	52.4	51.0	48.0	
Imports	-65.1	-60.5	-56.7	-42.5	-50.7			59.0	55.8	56.8	52.2	49.4	43.9	
Net non-debt creating capital inflows (negative)	-35.9	-16.7	-2.3	-0.9	37.7			-11.9	-12.2	-15.6	-13.2	-12.1	-7.6	
Automatic debt dynamics 1/	-12.3	0.9	11.1	14.6	20.7			-0.6	-0.4	-3.2	-0.8	-2.2	-5.2	
Contribution from nominal interest rate	1.9	3.8	6.3	7.7	9.3			10.8	10.0	8.7	7.9	6.7	5.7	
Contribution from real GDP growth	-9.6	-14.2	-12.3	-4.3	-2.5			-11.4	-10.4	-11.9	-8.7	-8.9	-10.9	
Contribution from price and exchange rate changes 2/	-4.5	11.4	17.1	11.1	13.8			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	55.3	20.2	6.7	4.5	-18.8			24.6	-9.4	2.3	-4.9	-1.0	-5.9	
External debt-to-exports ratio (in percent)	287.8	382.0	329.8	411.3	439.3			379.1	355.0	342.8	323.2	296.2	264.0	
Gross external financing need (in billions of US dollars) 4/	4.1	4.0	2.3	1.3	2.1			3.5	3.2	3.9	3.1	3.5	3.3	
in percent of GDP	33.2	32.0	19.1	11.5	18.8	10-Year	10-Year	31.9	25.9	28.4	20.3	20.9	17.5	
Scenario with key variables at their historical averages 5/								**232.9**	**217.0**	**206.0**	**188.8**	**176.5**	**160.4**	**-25.0**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	12.3	11.6	7.9	2.4	1.2	7.5	5.7	5.1	5.0	6.3	5.0	5.8	8.2	
GDP deflator in US dollars (change in percent)	5.1	-8.3	-10.2	-6.1	-6.9	4.4	16.0	-4.2	7.0	3.6	4.0	4.3	4.7	
Nominal external interest rate (in percent)	2.4	3.1	4.1	4.3	4.7	2.7	1.4	4.9	4.8	4.6	4.5	4.3	4.3	
Growth of exports (US dollar terms, in percent)	-1.7	-6.9	27.5	-16.4	5.6	13.6	27.4	22.0	6.8	4.8	3.1	7.3	6.5	
Growth of imports (US dollar terms, in percent)	5.4	-4.8	-9.3	-27.8	12.4	17.3	39.6	17.2	6.3	12.2	0.4	4.4	0.5	
Current account balance, excluding interest payments	-25.5	-21.6	-5.0	3.7	3.0	-9.4	11.7	2.0	3.6	0.4	1.9	3.1	5.7	
Net non-debt creating capital inflows	35.9	16.7	2.3	0.9	-37.7	11.4	22.2	11.9	12.2	15.6	13.2	12.1	7.6	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

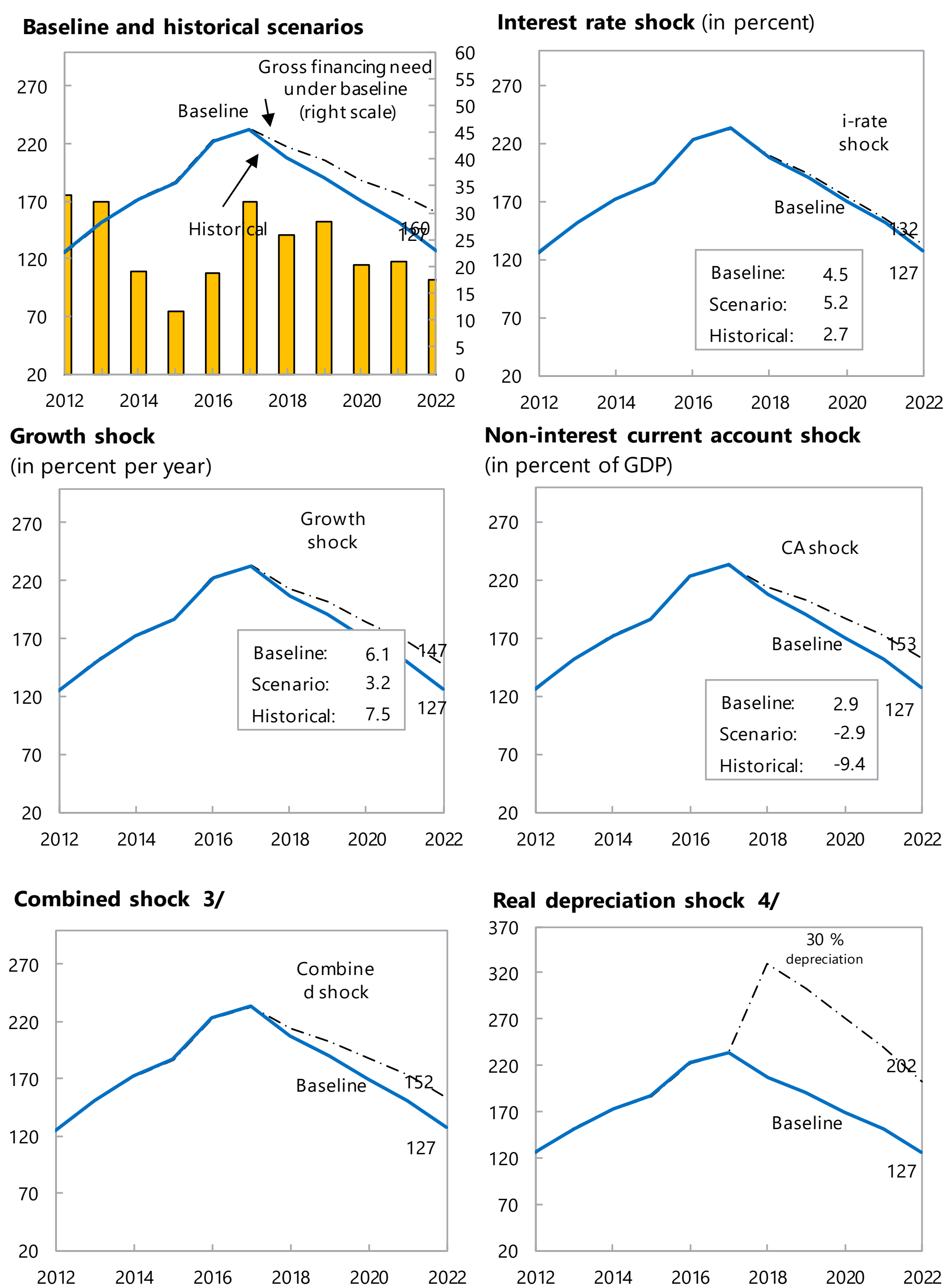
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 1. External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2017.

Appendix I. Letter of Intent

March 12, 2018
Ulaanbaatar

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde,

1. This letter serves as an update to our Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) of April 13, 2017, our supplementary LOI of May 17, 2017 and the LOI from the First and Second review of November 30, 2017. The policy commitments laid out in those documents remain valid, except as modified here.

Context

2. We are pleased to report that the Mongolian economy continues to re-bound, outperforming expectations. This recovery partly reflects strong external demand and benign global financial conditions. Our macro-policy mix and ongoing reform efforts have capitalized on this positive backdrop to rebuild needed buffers. Confidence is returning to the economy and the positive contribution of the mining sector has started to spread to other sectors. With the ongoing support of our partners in the donor community, we envision significant further progress ahead.

Program Performance

3. We have met all end-December 2017 quantitative targets under the program, in some cases by large margins. The primary balance in 2017 was 2.1 percent of GDP, which was 5.5 percentage points stronger than targeted at the time of the second review. Net international reserves rose by $1.8 billion in 2017 and exceeded the target by $1 billion. And we sterilized the impact on domestic liquidity from large foreign exchange accumulation allowing us to meet the monetary target.

4. Progress on structural reforms has also been strong:

- In the fiscal sector, we have started the implementation of 2018 tax compliance strategies; other tax administration reforms (a revised General Tax Law and simplified regime) will be submitted later than the end-February deadline to allow the incorporation of standards related to the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) and the Global Forum on Transparency and Information Exchange for Tax Purposes which we recently joined. The report of the Tax Working Group was submitted to the Ministry of Finance, providing a strategic outline of a possible tax reform going forward. We also passed a new parliamentary resolution establishing a Fiscal Council, noting that some provisions, particularly those related to independence and staffing, have been adapted from international best practice to fit the specific circumstances of our country. With respect to social protection, our 2018 budget limited the Child Money program to the poorest 60 percent as called for in the program, but we are working to increase coverage to 80 percent given the large increase in poverty in recent years.

- In the financial sector, we continue to make progress in strengthening our financial system. We have successfully completed the asset quality review of the banking sector and passed three pieces of legislation that strengthen our ability to respond to financial sector pressures going forward: amendments to the Central Bank law, Banking law, and deposit insurance law. However, there are two reforms that have not been completed. First, in agreement with the IMF, we decided not to set up a credit line for the deposit insurance fund because it has enough resources for small banks and is not designed to cover a crisis in systemic banks. And second, we have not yet passed a recapitalization law which will delineate when public sector funds should and should not be used in a financial crisis. Given that this is critical to protect the public-sector balance sheet and maintain financial stability, we remain committed to implementing this reform in coming months (see below).

5. Besides implementing these key program commitments, we have decided to adapt our program policies in three areas while maintaining the core program objective of stabilizing our economy and laying the groundwork for sustainable, inclusive growth. Specifically, we have reversed the introduction of progressivity in the personal income tax law, eliminated the excise tax on low octane gasoline, and dropped the planned 6-month-per-year increase in the minimum retirement age. While we understand that these steps, by themselves, are not in line with program goals, we note that these modifications are being made in the context of much faster-than-expected progress in restoring growth, reducing the deficit, and rebuilding reserves. While we remain committed to program goals, we consider that a somewhat more gradual pace of adjustment will help maintain consensus and support a larger transformation of the economy in the longer run. Nonetheless, we have outlined a series of complementary steps (see below) that will be taken to minimize the impact of these changes.

Fiscal Policy

6. We plan to continue the strong commitment to fiscal discipline demonstrated in 2017. Ongoing strength in the mining sector and a gradual broadening of growth throughout the economy will cause revenues again to over-perform previous projections. Meanwhile, we do not intend to bring a supplementary budget increasing expenditures above levels passed in the original 2018 budget. In the 2018 budget, we included measures worth about 3 percent of GDP. The recent changes noted in ¶5 in personal income tax rates, fuel excise rates, and pension retirement will cost

about a ½ percent of GDP. This loss in revenue will still allow fiscal over-performance relative to previous program targets. Nonetheless, we intend to take the following measures which underscore our commitment to program goals:

- On personal income tax, to support those in lower income groups and support progressivity, we have increased the tax credit from MNT84,000 to MNT160,000, with the credit fading out at higher incomes. We will increase this credit substantially to MNT240,000 in 2019.

- On pensions, we have increased the reference period for determining benefits from the current best 5 consecutive years to 7 years. While significant further work to ensure the sustainability of the pension system remains, this measure is a step in that direction.

- On the excise tax, we are committed to reforming the broader structure of retail fuel prices. By end-September, we will start to gradually increase excise tax rates to help raise revenue while reducing congestion and pollution. Once the excise tax is sufficiently high, we will explore the scope for adopting an automatic pricing mechanism which uses taxes to smooth (but not stabilize) retail prices. This process of gradual tax increase and price flexibility will require careful planning and we will work with the IMF regarding technical concerns.

7. This mix of stronger growth, previous fiscal measures, on-going expenditure restraint, and the above steps will still allow us to reduce the 2018 primary budget deficit close to -1.5 percent of GDP, considerably below the 2.6 percent of GDP deficit targeted in the second review. We intend to continue this over-performance after 2018 and have strengthened our targets in line with the better outlook. After two years of strict discipline in the public wage bill, we intend to raise civil service salaries from the 4th quarter of 2018 (while not changing the approved budget envelope) and in 2019 in line with inflation. Nonetheless, this will not cause us to deviate from our commitment to reach a primary surplus of 1.5 percent of GDP in the medium term, which is consistent with our Fiscal Stability Law.

8. With respect to public debt, a key priority of this government is to reduce our interest bill and extend the average maturity of obligations. To this end, we intend to use the stronger fiscal performance and ongoing donor support to reduce our stock of high-interest rate and short-term treasury bills. If market conditions allow, we will also selectively re-finance external bonds as we did in 2017. With better growth, stronger fiscal targets, and a lower interest bill, public debt is now projected to reach 82 percent at end-2018 and fall to 55 percent in the medium term, considerably lower than the 84 percent of GDP projected at the time of program approval.

9. We will also continue our progress with fiscal structural reforms. Governance reforms at the Development Bank of Mongolia (DBM) have helped keep the net lending balance low. With the assistance of the World Bank, we have started an audit to assess our progress in meeting our goal of managing DBM on a solely commercial basis. In tax administration, we will ensure that the General Department of Taxation has adequate resources to implement a series of tax compliance strategies also designed with the support of IMF technical assistance. In light of potential fiscal risks, we plan

to complete an audit of all outstanding concessions contracts, develop a repayment plan based on the recommendations of that audit, and incorporate this repayment plan in our Medium Term Financial Framework **(structural benchmark end-August 2018).** Finally, the MoF will approve a guideline on appraisal and selection of public investment projects, including specific methodology and evaluation criteria **(structural benchmark end-December 2018).**

Monetary and Exchange Rate Policy

10. We have recently reduced our policy rate by 100 basis points, reflecting the fact that inflation is in line with our target of 8 percent in 2018 and the balance of payments has continued to strengthen. In light of strong demand and surging household lending, the Bank of Mongolia sees its current monetary stance as appropriate to reach its inflation target and maintain macro-stability. A key element of our strategy to improve the well-being of the Mongolian people is to ensure that inflation does not erode their wages. In addition, it will be important to avoid excessive credit growth as this will put pressure on imports and undermine our goals of reserve accumulation.

11. This monetary policy, along with our broader macro-policy mix, ongoing support from international donors, and a favorable outlook for the commodity sector, will continue to support a recovery in the balance of payments. We intend to use this benign external environment to continue to re-build our reserve buffers. The sale of foreign exchange reserves will be limited to smoothing excessive volatility and preventing disorderly market conditions. To the degree the external environment does allow us to continue to purchase foreign exchange, we will remain vigilant about the resulting impact on domestic liquidity conditions, using Central Bank bills and other available tools to sterilize as necessary.

Financial Sector Policy

12. **We have recently completed the asset quality review (AQR)**. It concluded that the system-wide capital adequacy shortfall of the Mongolian banks was about 1.9 percent of GDP at end-2017. Following the adjustment of the AQR results, the capital adequacy ratio of the banking sector stood at 13.7 percent at end-2017. This revision has revealed some practices in the banking system (e.g. accounting policies and procedures, collateral valuation, and credit risk management framework) which led to an overstatement of balance sheet strength and hence need to be improved. Based on these findings, we are taking several steps. First, going forward, we will require banks to maintain a capital buffer above the regulatory minimum to ensure that all banks can continuously meet capital requirements in the coming years also under plausibly stressed conditions. Second, based on the AQR findings, we will issue new regulations on asset classification and provisioning reflecting advice provided by external experts **(structural benchmark end-September 2018)**. Third, we will conduct a review of related-party lending based on improved legislation **(structural benchmark end-December 2018)**. Fourth, the Bank of Mongolia will develop a new regulation for banks on collateral appraisal and valuation, and the MoF will prepare amendments to the Law on the Licensing of Appraisers; both will be completed no later than March

2018 in consultation with IMF technical experts and will be submitted to Parliament by end-October. And finally, the BoM will issue regulations, as mandated by legislation including the recently approved banking law, guidelines, and internal manuals aimed at strengthening banking supervision and improving risk management and internal controls at banks.

13. Our immediate priority is to ensure that banks' capital shortfall is addressed as quickly as possible. In March, informed by the results of a stress test exercise run on the whole system, we determined the needed capital buffer above regulatory minima that banks will need to maintain and communicated to each bank the total capital it must raise. We have also communicated to the public a summary of the AQR results, the key follow-up steps, and the other initiatives undertaken to reinforce the banking system. Looking ahead, banks will be required to complete the recapitalization process by end-December **(structural benchmark end-December 2018).** Banks will submit business plans by March and BoM will start a supervisory conversation to assess banks' viability in subsequent months.

14. We expect all banks to be able to address their shortfall, either via raising additional capital or asset sales. However, we are preparing for a scenario in which this is not the case. For systemic and viable banks, MoF will work with parliament to pass a recapitalization law or decree which outlines eligibility for support, governance of the process, burden sharing principles, supervision of the supported banks, the management of public equity holdings in banks, and the need for privatization in due time **(structural benchmark end-May 2018)**. This framework will be intended to guard financial stability at the lowest possible cost to the public-sector balance sheet. For non-systemic and non-viable banks, BOM will prepare an action plan with the help of Fund technical assistance by end-March 2018.

15. Faster progress in reducing the stock of non-performing loans on bank balance sheets will help the sector recover more quickly. By March 2018, we will decide whether a public asset management company (AMC) should play a role in this process, considering our past experience with AMCs as well as the nature of non-performing loans found in this AQR. Regardless of this decision, it is imperative that banks' ability to resolve non-performing loans is improved. To this end, a multi-agency working group (including members from BOM, MoF, MoJ, and the FSC) will develop and publish a NPL resolution strategy **(structural benchmark end-April 2018)** and implement the agreed reforms by end-2019.

16. Outside of the AQR process, we are exploring whether greater use of macro-prudential tools could help bolster financial stability. Two emerging concerns are household lending – which is growing at 23 percent y/y and is primarily for consumption—and FX loans—which account for a fifth of all loans and are largely unhedged. To address these, we are considering tighter debt-service to income ratios and higher risk weights on unhedged loans. We intend to proceed carefully to ensure that such regulatory changes are appropriately calibrated and do not put unnecessary pressure on individual banks.

17. Finally, a key priority in the months ahead is to improve our Anti-Money Laundering (AML) framework. At a 2017 meeting of the Asia Pacific Group (APG), Mongolia was given until October 2018 to strengthen legislation and procedures. As part of our effort to address the concerns raised, we are taking a number of steps. First, we will pass a new AML law in the next parliamentary session. Second, we will introduce risk-based supervision. And third, we will work with the FRC to ensure the specific concerns raised by the APG are addressed.

Conclusions

18. We believe that the policies set forth in this and previous Letters of Intent are adequate to achieve the objectives of our economic program. Nonetheless, the Government stands ready to take additional measures as appropriate to ensure the program is successful. We will continue to consult with Fund staff regarding any revisions to policies in this or previous Letters of Intent, in accordance with the IMF's policies on such consultations. We will also provide the Fund with information it requests for monitoring program implementation.

19. Against the background of our performance to date and our strong commitment going forward, we request completion of the third review of the extended arrangement under the Extended Fund Facility, following which we intend to draw one tranche amounting to SDR20.9598 million. In keeping with its policy of transparency, the Government has authorized the publication of this letter and its attachments as well as the associated staff report.

/s/

Ch. Khurelbaatar
Minister of Finance

/s/

N. Bayartsaikhan
Governor, Bank of Mongolia

Table 1. Mongolia: Quantitative Performance Criteria and Indicative Targets

	Actual Dec-16	Target Sep-17	Actual Sep-17	Target Dec-17	Adj. Target Dec-17	Preliminary Actual Dec-17	Target Mar-18	Revised Target Mar-18	Target Jun-18	Revised Target Jun-18	Target Sep-18	Revised Target Sep-18	Indicative Target Dec-18
Performance Criteria 1/ 2/ 3/ 4/													
Change in net international reserves (NIR) of the Bank of Mongolia (BOM) (floor, cumulative, change in eop stock, in million US$ at program exchange rate)		100	809	950	1,371	1,893	1,200	1,700	1,100	1,700	1,300	2,000	2,500
Net domestic assets (NDA) of the BOM (ceiling, eop stock, in billion togrog at program exchange rate)	4,774	4,900	4,146	4,400	3,352	2,011	3,850	2,400	3,900	2,800	3,700	2,300	1,800
Primary balance of the general government (floor, cumulative since the beginning of the fiscal year, in billion togrog)	-3,127	-1,050	585	-950		572	-425	-337	-650	-473	-850	-594	-475
New nonconcessional external debt maturing in one year or more, contracted and/or guaranteed by the government or the BOM (ceiling, eop stock, in million US$).		1,800	600	1,800		1,410	NA	NA	NA	NA	NA	NA	NA
Net nonconcessional external debt maturing in one year or more, contracted and/or guaranteed by the government or the BOM (ceiling, cumulative flow from November 15, 2017, in million US$). /5		NA	NA	20		0	NA	NA	20	20	NA	NA	20
Stock of guarantees on external debt extended by the government or BOM (ceiling, eop stock, in million US$)	1,385	850	688	750		685	750	750	750	750	750	750	750
Indicative Targets (IT)													
Reserve money (ceiling, in billion togrog)	3,067	3,900	3,280	3,650		3,980	3,600	4,000	3,800	4,300	4,000	4,600	4,900
Social protection spending (floor, cumulative since the beginning of the fiscal year, in billion togrog)								1,387		2,841		4,287	5,816
Continuous Performance Criteria													
New nonconcessional external debt maturing in less than one year, contracted and/or guaranteed by the government or the BOM (ceiling, eop stock, in million US$).	0	0	0	0		0	0	0	0	0	0	0	0
Accumulation of new external payment arrears (ceiling, eop, in million US$).	0	0	0	0		0	0	0	0	0	0	0	0
Memorandum items													
Budget support from bilateral and multilateral donors excluding Fund under the program baseline (eop stock, cumulative, in million US$)		427	100	320		603	682	703	717	753	849	753	1,195
Net nonconcessional borrowing received and repatriated by the general government (including the DBM) under the program baseline (eop stock, cumulative, in million US$)		20	20	295		433	295	306	150	160	150	160	160
Program exchange rate (togrog/U.S. dollar)	2,489	2,489	2,489	2,489		2,489	2,489	2,489	2,489	2,489	2,489	2,489	2,489
U.S. dollar per SDR	1.35	1.35	1.35	1.35		1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35
Monetary gold price (U.S. dollar/ounce)	1,142	1,142	1,142	1,142		1,142	1,142	1,142	1,142	1,142	1,142	1,142	1,142

1/ Evaluated at program exchange rates.
2/ Cumulative targets are all defined relative to 12/31/2016 except for the primary balance figures.
3/ Targets and actual from December 2017 on reflect the revised treatment of government forex deposits in the TMU.
4/ Additional new nonconssessional external debt inflows with the purpose of debt management do not affect the level of NDA as defined in the TMU.
5/ The net ceiling applies starting from the date of the completion of the second review. Prior to this date, the ceiling remains as specified in Table 10 of the May 31, 2017 Staff report and TMU.

Table 2. Mongolia: Structural Benchmarks

Structural Benchmark	Target Date	Status
Fiscal		
Finalization and commencement of implementation by the General Department of Taxation (GDT) and tax offices of compliance improvement strategies for large, medium, small, and micro businesses that will include baseline performance measures and an automated monitoring and evaluation framework.	end-April 2017	Met
Establishment of a working group to review the tax structure and make recommendations to improve efficiency and equity including review of the investment, VAT, personal income tax, and economic entity tax laws with a view to enhance revenue, reduce complexity, and introduce progressivity in personal income tax, in consultation with IMF staff.	end-August 2017	Met
Submission to Parliament of a revised general taxation law that consolidates the common administrative provisions that apply to all tax types, promotes consistent administration of the tax system, and achieves an appropriate balance between taxpayers' interest and the powers of the tax authorities.	end-February 2018	Not Met
Submission to Parliament of legislation to create a simplified tax regime for micro and small businesses within the scope of IMF technical assistance recommendations.	end-February 2018	Not Met
Passage of a 2018 budget in line with the program's fiscal path.	end-November 2017	Met
Revision of the Integrated Budget Law and other relevant laws to restrict, effective 2018 onward, Parliament from increasing the aggregate expenditure envelope reflected in the budget presented by the Minister of Finance (including through a PAYGO provision).	end-November 2017	Met
Revision of the relevant budget laws and/or introduction of a new law to establish a fiscal council, in line with international best practice and in consultation with Fund staff.	end-December 2017	Not met
Submission of the tax working group's report to the Ministry of Finance.	end-December 2017	Met
Start the implementation of the 2018 compliance improvement strategies for large, medium, small, and micro businesses based on a review of the results of the 2017 compliance strategies and taking into account IMF recommendations.	end-January 2018	Met
Complete an audit of all existing concessions contracts, develop a repayment plan based on audit recommendations, contractual obligations and fiscal path, and incorporate in the medium-term fiscal framework (MTFF) repayment plan to be paid by the budget i) for each year of the MTFF and ii) the nominal sum for future years not covered by the MTFF	end-August 2018	

Table 2. Mongolia: Structural Benchmarks (Concluded)

Structural Benchmark	Target Date	Status
The MoF to approve a Guideline on appraisal and selection of public investment projects, including specific methodology and evaluation criteria.	end-December 2018	
Social Protection		
In the 2018 budget, the Child Money Program will be targeted to the poorest 60 percent of children and the savings redirected gradually toward the better-targeted Food Stamps program.	end-December 2017	Met
Monetary		
Submission to Parliament of a new Bank of Mongolia Law, to clarify the BOM's mandate, strengthen autonomy and governance, and improve operations, in consultation with IMF staff.	end-November 2017	Met
Adoption of the new Bank of Mongolia Law.	end-March 2018	Met
Banking		
BOM to adopt an amendment to its regulation on asset classification and provisioning in consultation with IMF staff.	end-June 2017	Met
Approval of Amendment of the Banking Law to • improve the early intervention framework • bring the bank resolution legislation, funding and cooperation framework up to best international standards in cooperation with MoF, DICOM • ensure that BOM has adequate powers to request from banks additional capital and provisioning to enhance financial strength or to absorb existing and estimated future credit losses, including based on the diagnostic studies and the analysis of the business plans. • introduce power for BOM to apply levies on banks to cover the cost of supervision incl. AQRs • strengthen shareholders', board members', and senior management's fit and proper requirements • upgrade rules on banks' related party exposure and final beneficial owners.	end-November 2017	Not Met – but implemented in January
Completion of the Asset Quality Review of all Mongolian banks	end-December 2017	Met
Amendment of DICOM law to bring it in line with IADI Core Principles for Effective Deposit Insurance Systems.	end-February 2018	Met
Setting up of a backup funding to DICOM.	end-February 2018	Not met
Enact a law or an amendment of existing laws on the use of public funds.	end-May 2018	
Financial Stability Council (FSC) finalization and publication of an NPL resolution strategy.	end-April 2018	
Based on the AQR findings and advice provided by external experts, regulation on asset classification and provisioning to be further improved in consultation with IMF staff.	end-September 2018	
Completion of the recapitalization process for viable banks and of resolution for nonviable ones.	end-December 2018	
BOM to carry out a review of related party exposures based on improved legislation.	end-December 2018	

Attachment I. Technical Memorandum of Understanding

This Technical Memorandum of Understanding (TMU) sets out the understandings between the Mongolian authorities and IMF staff regarding the definition of quantitative performance criteria (QPC) for the extended arrangement under the Extended Fund Facility (EFF). It sets out the QPC adjusters and data reporting requirements for the duration of the extended arrangement, as described in the authorities' Letter of Intent (LOI) dated April 13, 2017, and the attached Memorandum of Economic and Financial Policies (MEFP). The TMU also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets.

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS: DEFINITION OF VARIABLES

Test Dates

1. Performance criteria for end-June 2017, end-September 2017, end-December 2017, end-March 2018, end-June 2018 and end-September 2018 have been established with respect to:

- Floors on the change in level of net international reserves of the Bank of Mongolia (BOM);
- Ceilings on the level of net domestic assets of the BOM;
- Floors on the level of primary balance of the general government;
- Ceilings on the contracting and/or guaranteeing by the general government or the BOM of new nonconcessional external debt maturing in one year or more; and

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

- Ceilings on the contracting and/or guaranteeing by the general government or the BOM of new nonconcessional external debt maturing in less than one year,
- Ceilings on the accumulation of new external payment arrears;

3. Indicative targets have been established for, end-June 2017, end-September 2017, end-December 2017, end-March 2018, end-June 2018 and end-September 2018, with respect to:

- Ceilings on the level of reserve money.
- A floor on social spending

Definitions

4. For the purposes of the program the following definitions will be used:

- The general government (GG) includes all units of budgetary central government, social security funds, extra-budgetary funds (including but not limited to the Stabilization Fund and the Future Development Heritage Fund), and local governments, and the Development

Bank of Mongolia (DBM). Debts of other legally autonomous state-owned enterprises (SOEs) and BOM liabilities including the swap line with the People's Bank of China (PBOC) are excluded.

- The domestic banking system is defined as the BOM and licensed commercial banks incorporated in Mongolia.

- The fiscal year is the calendar year, starting on January 1 and ending on December 31.

- For program purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "program accounting exchange rates" as defined below, with the exception of items affecting government fiscal balances, which will be measured at current exchange rates. Unless otherwise indicated, U.S. dollar denominated components of the balance sheet of the Bank of Mongolia (BOM) will be valued at the reference exchange rate of the Mongolian togrog to the U.S. dollar of 2489.4 announced by the BOM as of December 31, 2016. Amounts denominated Chinese Renminbi (RMB), SDR and gold will be converted for program purposes into U.S. dollar amounts using the following cross-rates as of December 31, 2016: Chinese Renminbi (RMB) valued at 0.14389 U.S. dollars, Special Drawing Right (SDR) valued at 1.344330 U.S. dollars, and official gold holdings at 1142.54 U.S. dollars per troy ounce.

- For program purposes nonconcessional external borrowing excludes (i) the use of IMF resources; (ii) lending from the Asian Development Bank, European Bank for Reconstruction and Development, Asian Infrastructure Investment Bank, and the World Bank Group, and; (iii) lending from governments and government agencies such as the Japan International Cooperation Agency, the Export-Import Banks of India, Korea, and Turkey, and the Development Bank of Germany; (iv) concessional debts; (v) any togrog-denominated treasury bill and government bond holdings by nonresidents.

- For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. [1]

- For debts carrying a variable interest rate in the form of a benchmark interest rate plus a fixed spread, the PV of the debt would be calculated using a program reference rate plus the fixed spread (in basis points) specified in the debt contract. The program reference rate for the six-month USD LIBOR is 3.18 percent and will remain fixed for the duration of the program. The spread of six-month Euro LIBOR over six-month USD LIBOR is -308 basis points. The spread of six-month JPY LIBOR over six-month USD LIBOR is -306 basis points.

[1] For debts with a grant element equal or below zero, the PV will be set equal to the nominal value of the debt. The discount rate used for this purpose is the unified discount rate of 5 percent set forth in Executive Board Decision No. 15248-(13/97).

5. The spread of six-month GBP LIBOR over six-month USD LIBOR is -231 basis points. For interest rates on currencies other than Euro, JPY, and GDP, the spread over six-month USD LIBOR is 0 basis points.[2]

A. Net International Reserves of the BOM

6. A floor applies to the change in level of net international reserves (NIR) of the BOM. The floor on the change in NIR will be adjusted upward (downward) by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in excess (short) of the programmed level as shown in Quantitative Performance Criteria table. The floor on the change in NIR will also be adjusted upward (downward) by the amount of net nonconcessional borrowing (excluding project financing) received and repatriated by the general government in excess (short) of the programmed level during the program period as shown in Quantitative Performance Criteria table.

7. NIR will be calculated as gross international reserves less international reserve liabilities. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the BOM shall be valued at program exchange rates and gold price as described in paragraph 5 above. Gross international reserves of the BOM are defined as the sum of:

- Monetary gold holdings of the BOM;
- Holdings of SDRs;
- Mongolia's reserve position in the IMF; and
- Foreign currency assets held abroad (plus such cash held in BOM's vault) that are under the direct and effective control of the BOM and readily available for intervention in the foreign exchange market, or the direct financing of balance of payments imbalances.

8. Excluded from the definition of gross reserves are any foreign currency claims on residents including MNT swaps with local banks, capital subscriptions in international institutions other than in the IMF, and gross reserves that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities. International reserve liabilities of the BOM are defined as the sum of:

- All outstanding liabilities of Mongolia to the IMF;
- Any foreign currency liabilities of the BOM to nonresidents with an original maturity of up to and including one year including any gold deposits by foreign banks;
- The liabilities to the People's Bank of China under the swap line; and
- Any foreign currency liabilities of any maturity of the BOM to residents including current accounts and deposits of the commercial banks. Government foreign currency deposits at

[2] Where the variable rate is linked to a benchmark interest rate other than the six-month USD LIBOR, a spread reflecting the difference between the benchmark rate and the six-month USD LIBOR (rounded to the nearest 50 bps) will be added.

the BOM will be treated as an international reserve liability; however, IMF liabilities already included under the first bullet above shall not be included again. Foreign currency owed to commercial banks with any maturity as part of the swap program will be treated as a reserve liability.

B. Reserve Money

9. An indicative ceiling applies to the level of reserve money. This consists of currency issued by the BOM (excluding BOM holdings of currency) and commercial banks' deposits held with the BOM (excluding foreign currency time deposits).

C. Social Spending

10. An indicative floor applies to the level of social spending. This consist of spending on health by the Ministry of Health, education by the Ministry of Education, Culture, Science, and Sports, and on social protection by the Ministry of Labor and Social Welfare. This indicative target on social spending covers both current and capital spending, including net lending by the government.

D. Net Domestic Assets of the BOM

11. A ceiling applies to the level of net domestic assets (NDA) of the BOM. The ceiling on NDA will be adjusted downward by the amount of external borrowing (both budget support from bilateral and multilateral donors and net nonconcessional borrowing excluding project financing except for debt management purposes) received by the general government in excess of the programmed level. The ceiling on NDA will be adjusted upward by 50 percent of the amount of external borrowing (both budget support from bilateral and multilateral donors and net nonconcessional borrowing excluding project financing except for debt management purposes) received by the general government in short of the programmed level.

- NDA will be calculated as the difference between reserve money and the sum of NIR and other net foreign assets (ONFA) of the BOM. For calculating the NDA, NIR will be adjusted for the swap program with commercial banks, foreign exchange demand deposits of commercial banks that are already part of the reserve money, and government foreign currency current accounts.

- ONFA is defined as other net foreign assets of the BOM, including the difference between accrued interest receivables on gross international reserves of the BOM and accrued interest payables on international reserve liabilities of the BOM and deposits of international financial institutions.

E. Primary Balance of the General Government

12. A floor applies to the primary balance of the general government excluding DBM plus net lending and net interest payments of DBM. This is measured on a cumulative basis over the course of the year. This definition includes three components:

- Overall balance of general government excluding DBM: This will be defined below the line as:

    - net bank credit to the general government—this includes net borrowing from BOM (ways and means advances, loans, holdings of treasury bills and government bonds, minus deposits) and commercial banks (loans, advances, and holdings of treasury bills and government bonds, minus deposits).

    - net nonbank financing—this would include tax prepayments and holdings of government by pension and insurance funds, as well as any changes to the net assets (negative financing flows) of Fiscal Stability Fund, Social Security Funds, and Future Heritage Fund.

    - net external financing—this would include program loans, project loans, nonconcessional borrowing or long term external debts such as sovereign bonds or commercial loans.

    - Privatization receipts

- Gross Interest payments of the general government on domestic and external debt excluding DBM. This will be measured above the line.

- DBM's net lending (loan disbursements less repayments) and net interest payments (DBM's interest payments less interest receipts excluding interest payments and receipts to other general government). This will be measured above the line.

F. Non-Concessional Medium- and Long-Term External Debt

13. Prior to the completion of the second review, there was a ceiling on the issuance of gross debt. The ceiling applied to the contracting and/or guaranteeing by the general government or the BOM or other agencies on behalf of the general government of new debt with nonresidents with original maturities one year or more. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received.

14. Starting from the completion of the second review, there will be a ceiling on net debt issuance rather than gross debt issuance. The ceiling applies to contracting and/or guaranteeing by the general government or the BOM or other agencies acting on behalf of the general government of debt with nonresidents with original maturities one year or more. The ceiling will apply end-June and end-December of every year, starting from end-December 2017. Such a ceiling allows the authorities to conduct debt liability management. When conducting such operations, and for the purpose of netting, there should be no more than 6 months between the contracting of new debt and the retirement of existing debt. During the 6 month window, gross issuance will be adjusted by subtracting the refinancing of existing debt of general government or the BOM or other agencies acting on behalf of the general government with nonresidents with original maturities of one year or more as well as any debt of general government or the BOM or other agencies acting on behalf of the general government with nonresidents with original maturity of less than one year that is being

refinanced by longer maturity debt. If a new issuance falls before the date of ceiling application, but the repayment is scheduled after that date, netting still applies as long as the 6 months limit is adhered to. The two GOM bonds maturing in January 2018 and June 2018 will be excluded from the netting since they are already in the process of being refinanced through the issuance of the US$800 million Eurobond in November 2017. The definition of debt, for the purposes of the program, is set out in Executive Board Decision No. 15688, Point 8, adopted December 5, 2014 (see Annex 1).

15. For program purposes, the guarantee of a debt arises from any explicit legal obligation of the general government, the BOM, or other agencies on behalf of the general government to service a loan in the event of nonpayment by the recipient (involving payments in cash or in kind). The stock of guarantees on external debt stood at $1,385 million at the end of 2016.

G. Stock of Guarantees on External Debt

16. For program purposes, the guarantee of a debt arises from any explicit legal obligation of the general government, the BOM, or other agencies on behalf of the general government to service a loan in the event of nonpayment by the recipient (involving payments in cash or in kind), or indirectly through any other obligation of the general government, the BOM, or other agencies on behalf of the general government to finance a shortfall incurred by the loan recipient. The stock of debt stood at $1,385 million at the end of 2016.

H. Short-Term External Debt

17. A ceiling applies to the contracting and guaranteeing by the general government, the BOM, or other agencies on behalf of the general government of new debt with nonresidents with original maturities of less than one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This is a continuous performance criterion. For program purposes, the definition of debt is set out in Executive Board Decision No. 15688, Point 8, adopted December 5, 2014 (see Annex I).

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

II. DATA PROVISION

19. Data required to monitor performance under the program, including those related to performance criteria and indicative target(s) will be provided electronically or in hard copy to the

Fund’s Resident Representative by the 20th day of each month, unless otherwise indicated. The data to be reported are listed below, and the reporting responsibilities are indicated in parentheses.

A. Monetary Data (BOM)

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

- Net international reserves and auctions of the BOM in the foreign exchange market on daily basis and full reporting of all interventions on a weekly basis.

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

- A detailed breakdown of net credit to government from the BOM (on a weekly basis) and the commercial banks. The latter will be reconciled with the MoF and sent monthly.

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

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

- A bank-by-bank list of required reserves and actual reserves on a biweekly basis.

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

- Data on the stock of BOM swaps with resident and non-resident commercial banks on a quarterly basis;

- Data on the stock of BOM guarantees issued on behalf of the government or any other third party on a quarterly basis;

- Data on BOM's foreign convertible currency liabilities reflecting long- and short- term maturities of debt on a quarterly basis.

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

- Monthly consolidated accounts of the central, local, and general government, including detailed data on tax, nontax, and capital revenues, current and capital expenditures, net lending, and financing. Financing components should be separated into foreign sources (cash, project, and program loans) and domestic sources (bank and nonbank).
- Classified transactions of all social insurance funds.
- Results of each treasury bills auction within five working days of each auction, including amount of bills offered, amount demanded, amount sold to each bank and nonbanks, and the average yield in percent per month.
- Monthly accounts of the DBM detailing new lending and repayment as well as the stock of outstanding loans on a cash basis.
- Outstanding balances of all deposit accounts of the general government in commercial banks, including those of the extrabudgetary funds on a quarterly basis.
- Outstanding balances of any new deposit accounts of the general government opened in addition to the existing ones for grants and loans received from multilateral or bilateral donors, including associated counterpart funds.
- Monthly report on the stock of outstanding debt of the general government including DBM, including domestic and external debt, promissory notes, tax pre-payments and guaranteed debt netting out any cross holdings between DBM and the GoM.

C. External Sector Data (BOM and MOF)

- Complete list of new contracts above $10 million for the execution of public investment projects, which have been signed or are under negotiation with foreign or domestic entities, including details on the amounts, terms, and conditions of current or future debt or nondebt obligations arising from these contracts on a quarterly basis by MoF.
- Outstanding stock, disbursements, amortization, and interest payments of short-term external debt contracted and/or guaranteed by the government or the BOM by creditor in original currency and U.S. dollars on a quarterly basis by BOM.
- Outstanding, disbursements, amortization, and interest payments of medium- and long-term external debt contracted and/or guaranteed by the government or the BOM by creditor in original currency and U.S. dollars on a quarterly basis by BOM.

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

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

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

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

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

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

Excerpt from Executive Board Decision No. *15688-(14/107), adopted December 5, 2014*

8.

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

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

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

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

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

Statement by Heenam Choi, Executive Director for Mongolia and Gantsogt Khurelbaatar, Senior Advisor to Executive Director
March 28, 2018

Our Mongolian authorities would like to thank the staff for their candid assessment and constructive engagement.

The EFF program, official sector support and a favorable external environment have supported a strong economic recovery in Mongolia. The authorities undertook extensive economic reforms that have strengthened macroeconomic fundamentals. As a result, the fiscal deficit and public debt are decreasing at a much faster pace than projected at the time the EFF was approved. Inflation is within the target range; the exchange rate has stabilized and foreign reserves have continued to rise. The authorities' commitment to the program objectives, fiscal discipline and prudent monetary policy have played a key role in the economic revival of the country.

Recent economic development

The economy has performed better than expected, fueled by an increase in demand for commodities and growth in FDI. Economic growth reached 5.1 percent in 2017 compared to initial projections of -0.2 percent of GDP. The non-mining sector is showing solid growth and contributing to the overall growth of the economy.

Near term growth prospects are positive, as global commodity prices are projected to remain high, alongside improved market sentiment and increased domestic demand.

Public debt is decreasing at a much faster pace than expected. With refinancing of sovereign bonds at much lower market rates, short term debt pressures have fallen and there are no outstanding major payments due until the end of the program. Based on stronger growth and improved macroeconomic management, public debt is projected to decrease to 55.2 percent of GDP by 2023 from 84.6 percent of GDP in 2017.

Program performance

Quantitative targets for the end of 2017 were exceeded by considerable margins. Most structural benchmarks were either met or, in the case of the revised taxation laws and bank recapitalization law, will be implemented with a short delay. Some policy measures were revised after widespread public objection.

The structural benchmark related to the submission of revisions to the taxation laws, originally due in February, is delayed by one month. Revision of the main tax law happens only infrequently and, considering its importance to the economy, the authorities have initiated country wide consultations with the public, tax payers, scholars and professional organizations in February. These consultations will end in March and the revised general taxation, corporate income tax, personal income tax laws will be submitted to the Parliament for approval.

Submission of the recapitalization law, originally planned for January, has been delayed as it could have negatively affected the stability of the financial sector. As market sensitivity lowers, following the Asset Quality Review (AQR), the authorities are planning to pass the recapitalization law in May.

Some policy measures under the EFF program were not enacted. There was a growing discontent from the population about the introduction of the progressive personal income tax and the increase in pension age, given a still-modest recovery in household incomes. To maintain social cohesion and maintain momentum for reforms, the authorities felt they had to unwind these measures.

Mongolia is fully dependent on imported fuel. The excise tax on fuel is used to smooth global oil price movements. However, the recent increase in global oil prices made it difficult to keep the current arrangement, and the excise tax on certain types of gasoline has been temporarily removed. However, the authorities, with assistance from the Fund, will introduce fuel price formulas to reflect the global oil price movements and reintroduce excise tax on fuel in 6 months.

The fiscal costs of these policy changes will have a 0.5 percent of GDP impact on the fiscal balance and, to offset this, the authorities are committed to maintaining a tight expenditure policy.

Fiscal Policy

Driven by a strong economic performance, fiscal revenues outperformed projections by nearly 24 percent in 2017. Tight fiscal expenditure control and revenue overperformance resulted in an improvement in the fiscal balance of 8.7 percent of GDP, with an overall deficit of 1.9 percent of GDP in 2017.

Revenue projections for this year are positive and the authorities expect further reductions in the fiscal deficit. In the first two months of this year, fiscal revenues increased 23.5 percent. Despite this increase in fiscal revenues, the authorities do not intend to submit a supplementary budget to increase expenditure.

Thanks to revenue outperformance and official sector budget support, the authorities are reducing domestic borrowing. Over the four years to 2017, the stock of domestic government bonds reached 22.9 percent of GDP with the coupon rate peaking at 18 percent. This year, the authorities are planning to limit issuance of domestic bonds and reduce total interest payments to 3.7 percent of GDP, with a further reduction to 2.2 percent of GDP by 2023.

Monetary and financial sector policies

The exchange rate has remained stable and gross national reserves have more than doubled, reaching the equivalent of 5.2 months of imports. The policy of the Bank of Mongolia is to use every opportunity to continue building reserves.

Inflation is currently at 6.9 percent, below the Bank of Mongolia's target rate of 8 percent. In the medium term, the authorities expect that inflationary pressures will decline and inflation will be contained within the target range.

The banking sector AQR provided a good analysis of the health of the banking sector. AQR results showed that the required capital of the banking system needs to be increased by at least an amount equivalent to 1.9 percent of the 2017 GDP, to meet the capital adequacy ratio requirement. This is consistent with the estimates of the Bank of Mongolia and the recapitalization process will not undermine the banking sector stability.

Major legislation changes to strengthen financial sector stability have been approved this year. Amendments to the central bank law, banking law, and deposit insurance law were passed by the Parliament.

Conclusion

The authorities are aware that there is no room for complacency. They are committed to pursuing a tight fiscal policy and prudent monetary policy, together with implementation of reforms under the program to strengthen macroeconomic stability, build buffers and promote inclusive growth.

The Fund's continued engagement through the EFF program and support from development partners are vital in achieving macroeconomic stability. In this regard, the Mongolian authorities would like to thank the Fund, the Asian Development Bank, the World Bank, Korea, Japan and China for their continued support of the program.