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2017 ARTICLE IV CONSULTATION AND REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MONGOLIA

In the context of the combined 2017 Article IV Consultation and Request for an Extended Arrangement Under the Extended Fund Facility, the following documents have been released and are included in this package:

- **Press Releases** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its May 24, 2017, consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 24, 2017, following discussions that ended on February 19, 2017, with the officials of Mongolia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 23, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- 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.

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Press Release No. 17/193
FOR IMMEDIATE RELEASE
May 24, 2017

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves Financial Arrangement for Mongolia

The Executive Board of the International Monetary Fund (IMF) today approved a three-year extended arrangement under Extended Fund Facility (EFF) for Mongolia in a total amount of SDR 314.5054 million (about US$434.3 million, or 435 percent of quota) to support the country's economic reform program.[1] Other financing partners, including the Asian Development Bank, the World Bank, Japan, and Korea, have also committed to provide budgetary and project support, and the People's Bank of China has agreed to extend its swap line with the Bank of Mongolia. In sum, the total financing package amounts to about $5.5 billion. The Board's approval of the arrangement enables the immediate disbursement of an amount equivalent to SDR 27.9560 million (about $38.6 million).

The authorities' program aims to stabilize the economy, restore confidence, and pave the way to economic recovery. A critical pillar of the program is fiscal consolidation, to reduce the pressure on domestic financial markets, stabilize the external position, and restore debt sustainability. The program includes important safeguards to protect the most vulnerable during this period of adjustment as well as institutional reforms to make sure the fiscal adjustment is durable. Another pillar of the program is a comprehensive effort to rehabilitate the banking system and strengthen the Bank of Mongolia. A broad set of structural reforms is designed to support private-sector led growth.

The Executive Board also concluded the 2017 Article IV consultation with Mongolia today. A separate press release will be issued shortly.

Following the Executive Board's discussion, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, issued the following statement:

"Mongolia was hit hard by the sharp decline of commodity prices and the slowdown in key export markets. Efforts to mitigate these shocks through expansionary policies were unsuccessful and resulted in unsustainable public debt, falling international reserves, and lower growth.

"Against this background, the Mongolian authorities are implementing a program to maintain macroeconomic stability, pave the way to economic recovery, and protect the most vulnerable during the adjustment process. Fiscal consolidation is a critical element of this

[1] The dollar amount is calculated based on the SDR-dollar rate of May 24, 2017

program, including cuts of non-essential expenditures, a move to progressive taxation, pension and public financial management reforms, and steps to strengthen and better target the social safety net. A number of structural fiscal reforms, including an independent fiscal council, will help to bolster budget discipline. Sizable fiscal adjustment, coordinated concessional external financing from development partners, and continued engagement with private creditors will help restore debt sustainability and rebuild international reserves. The commitment to a market-determined exchange rate will strengthen the economy's resilience to external shocks, supported by prudent monetary policy and the program's favorable impact on confidence and private sector capital flows. A new central bank law is envisaged to strengthen the governance and independence of the Bank of Mongolia. In addition, implementation of a comprehensive strategy would rehabilitate the banking sector, improve the supervisory and regulatory framework, and strengthen the AML/CFT regime. The program also includes structural reforms to achieve sustainable and inclusive growth. These reforms aim to improve the business environment, promote economic diversification, and encourage foreign direct investment.

"Determined implementation will be critical to the success of the program. Together with Mongolia's development partners, the IMF will assist the authorities in their effort with an arrangement under the Extended Fund Facility."

ANNEX

Recent Economic Developments

With minerals accounting for up to 90 percent of total exports, the sharp drop in commodity prices from 2011 onward severely affected the balance of payments and fiscal position. Macroeconomic policy easing to buffer the economy from external shocks supported growth for a while, but at the cost of increasing public debt, weakening the balance of payments, and reducing banks' asset quality. By end-2016, the large fiscal deficit and the depreciation of the currency together pushed general government debt up to nearly 90 percent of GDP.

The authorities recognized these economic difficulties and prepared an "Economic Recovery Program" that would largely reverse past policies. They also approached the Fund for assistance.

Program Summary

The authorities' program supported by the extended arrangement aims to stabilize the economy, restore confidence, and pave the way to economic recovery. A critical pillar of the program is fiscal consolidation to reduce the pressure on domestic financial markets, stabilize the external position, and restore debt sustainability.

The program also lays the foundation for sustainable, inclusive growth in the future. To end the boom-bust cycles of the past, the reform program will: (i) discipline fiscal policy; (ii) improve the central bank's independence, governance, and focus on core responsibilities; (iii) strengthen the financial sector; (iv) foster economic diversification and inclusive growth; and (v) protect the most vulnerable in society.

Fiscal Policy. The fiscal adjustment, combined with the projected growth recovery, a gradual normalization of domestic yields, and the authorities' access to concessional financing under the program, is expected to restore debt sustainability.

Monetary and Exchange Rate Policies. A new Bank of Mongolia (BOM) law will be adopted to clarify the BoM's mandate and strengthen its governance and autonomy. The monetary stance will need to remain tight for the time being, and the exchange rate flexible.

Financial Sector reforms. As a first step, the authorities will undertake a comprehensive diagnosis of the banking system to assess institutions' financial soundness and resilience. This will be followed by recapitalization and restructuring as needed. The regulatory and supervisory framework will be strengthened.

Growth-enhancing structural reforms. Given the country's large mineral resources, mining will always be a key sector for the economy, but agribusiness and tourism have strong potential as well. The program includes structural reforms to promote economic diversification and improve competitiveness.

Social protection. The program includes important safeguards to protect the vulnerable groups, and gives priority to health and education. For instance, the savings from better targeting the Child Money Program will be used entirely to increase spending on the food stamp program for the most vulnerable.

Program financing. Other international partners also plan to support the government's program: the Asian Development Bank (ADB), World Bank, and bilateral partners including Japan and Korea are together expected to provide up to $3 billion in budget and project support; and the People's Bank of China is expected to extend its RMB 15 billion swap line with the Bank of Mongolia for at least another three years.

Press Release No. 17/198
FOR IMMEDIATE RELEASE
May 31, 2017

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

IMF Executive Board Concludes 2017 Article IV Consultation for Mongolia

On May 24, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the 2017 Article IV Consultation[1] with Mongolia.

Mongolia's longer-term prospects are promising given its large natural resources. In recent years, however, the economy has faced substantial challenges, as external shocks and expansionary fiscal and monetary policies have compounded structural weaknesses. The new government that took office in 2016 has expressed a strong commitment to strengthen macro policies and implement structural reforms in order to stabilize the economy and lay the basis for sustainable, inclusive growth in the future.

Mongolia remains heavily exposed to external shocks, given its export profile, and a key challenge will be to avoid the boom-bust cycles of the past. The discussions thus focused on improving the fiscal framework and strengthening policy discipline, complemented by structural reforms to boost diversification and competitiveness and by efforts to strengthen and better target the social safety net.

Executive Board Assessment[2]

Executive Directors noted that Mongolia had been hit hard by the fall in commodity prices and a slowdown in key export markets. Efforts to offset the impact of these external shocks through expansionary policies had proved unsustainable, leading to large fiscal deficits, high and rising debt and a fall in international reserves. Directors commended the new government for a strong commitment to restore stability and lay the foundations for sustained, rapid, and inclusive growth through sound macroeconomic policies and structural reforms, as reflected in its Economic Recovery Plan. Coordinated financial assistance from development partners, sizeable fiscal adjustment and continued engagement with private creditors will help restore debt sustainability as envisaged under the program to be supported by the IMF's Extended Fund Facility Arrangement.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors stressed that fiscal consolidation and discipline are central to regaining durable debt sustainability. They supported plans to reduce non-essential expenditures, and increase tax revenues and pension contributions. Directors supported the commitment to implement the rules-based fiscal framework, including an end to quasi-fiscal operations of the Bank of Mongolia and the Development Bank of Mongolia, and the establishment of an independent fiscal council. They welcomed plans to strengthen public financial management and tax administration, and tighten the framework for public-private partnerships. Directors underlined the need to enhance the social safety net, strengthen the pension system, and improve program targeting to protect the most vulnerable sections of society.

Directors underscored that monetary policy should remain appropriately tight to contain inflationary pressures, even as there will be room to lower the policy rate from the current high level if inflation remains low and confidence is restored. The exchange rate should remain flexible and market-determined with intervention limited to addressing disorderly market conditions.

Directors stressed the need to strengthen the banking system through special audits and recapitalization of banks as well as upgrades to the regulatory and supervisory framework. Directors welcomed steps, including the new Bank of Mongolia law, to strengthen the independence and governance of the central bank. The renewed focus on implementing an effective anti-money laundering framework would help attract foreign investment.
Directors emphasized the need to promote inclusive growth through a focus on sustainable mining, economic diversification, and further regional integration. In addition, structural reforms should aim to improve the business climate, address supply-side bottlenecks, and deepen access to finance.

Table 1. Mongolia: Selected Economic and Financial Indicators, 2013-22

	2013	2014	2015	2016 Est.	2017	2018	2019	2020	2021	2022
	(In percent of GDP, unless otherwise indicated)									
Real sector										
Nominal GDP (in billions of togrogs)	19,174	22,227	23,134	23,886	26,048	27,688	31,390	35,023	39,306	45,181
Real GDP growth (percent change)	11.6	7.9	2.4	1.0	-0.2	1.8	8.1	5.3	6.1	8.5
Mineral real GDP growth	18.5	19.4	14.1	0.7	0.5	4.5	13.6	15.1	13.7	18.9
Non-mineral real GDP growth	10.0	5.0	-1.0	1.1	-0.5	0.9	6.1	1.7	2.9	3.7
GDP deflator (percent change)	2.9	7.4	1.7	2.3	9.3	4.4	4.9	5.9	5.8	5.9
Consumer prices	11.2	10.7	1.1	0.5	6.1	6.1	6.9	6.5	6.5	6.5
(End-period; percent change)										
Gross national saving	26.3	23.4	21.1	26.5	30.3	30.1	32.4	36.4	38.2	41.4
Public	7.4	3.7	0.4	-4.6	-3.4	-1.5	1.3	3.7	5.5	6.1
Private	18.9	19.7	20.7	31.1	33.8	31.6	31.2	32.7	32.7	35.3
Gross capital formation	51.7	34.9	25.1	30.6	34.8	39.6	46.1	46.9	46.6	47.6
Public	16.4	15.0	9.2	12.8	7.7	7.5	7.6	8.0	8.0	8.0
Private	35.3	19.9	15.9	17.8	27.1	32.2	38.5	38.9	38.6	39.6
General government accounts										
Total revenue and grants	31.2	27.8	25.1	23.7	24.7	26.3	26.8	27.0	27.1	27.2
Total expenditure and net lending 1/	40.1	39.1	33.6	40.7	35.3	34.8	32.7	31.0	29.1	28.7
Overall balance (IMF definition) 2/	-8.9	-11.3	-8.5	-17.0	-10.6	-8.5	-5.9	-4.0	-2.0	-1.5
Primary balance (IMF definition)	-7.5	-8.8	-5.6	-13.1	-5.5	-3.1	-1.0	0.3	1.5	1.6
				(In percent of GDP, unless indicated otherwise)						
Monetary sector										
Credit growth (percent change)	57.9	23.5	0.5	8.5	9.0	10.3	10.6	11.1	11.9	15.6
Reserve money growth (percent change)	54.0	2.7	-28.2	24.6	21.8	19.3	16.0	15.3	15.1	16.1
Balance of payments										
Current account balance	-25.4	-11.5	-4.0	-4.1	-4.4	-9.5	-13.6	-10.6	-8.4	-6.2
Gross official reserves (in millions of US$) 3/	2,242	1,648	1,324	1,297	1,692	2,515	3,583	4,032	4,257	4,304
(In months of imports)	3.9	4.0	2.9	2.9	3.4	4.4	6.1	6.5	6.8	7.2
Debt indicators 4/										
General government debt	46.0	57.1	59.5	87.6	94.9	101.3	100.0	97.5	92.3	84.7
Domestic	13.5	14.7	14.6	19.8	21.4	19.4	15.1	11.7	12.9	11.6
External	32.5	42.3	44.9	67.8	73.4	81.9	84.9	85.7	79.5	73.1
General government debt in NPV terms	…	…	55.0	69.1	86.3	89.6	86.5	84.0	79.6	74.3
GFN	9.8	13.3	10.7	18.1	22.4	21.5	18.5	13.8	13.9	17.5
Memorandum items:										
Copper prices (US$ per ton)	7331	6,863	5,510	4,868	5,722	5,733	5,721	5,708	5,704	5,704
Gold prices (US$ per ounce)	1411	1,266	1,160	1,248	1,212	1,225	1,251	1,274	1,299	1,325

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

INTERNATIONAL MONETARY FUND

MONGOLIA

April 13, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION AND REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY

KEY ISSUES

Context. Mongolia's longer-term prospects are promising given its large natural resources. In recent years, however, the economy has faced substantial challenges, as external shocks and policy errors have compounded structural weaknesses. The new government that took office in 2016 has expressed a strong commitment to strengthen macro policies and implement structural reforms, so as to stabilize the economy and lay the foundation for sustainable, inclusive growth in the future.

Recent Developments and Outlook. Fiscal policy was loosened substantially last year, and the deficit spiked to 17 percent of GDP. Nevertheless, the economy remained anemic, with growth falling to just 1 percent and inflation below 1 percent, a historical low. Although weak activity has kept imports subdued, the balance of payments has remained under pressure. Banks face a number of challenges, including declining asset quality. Looking ahead, growth should recover with the development of some major mines, and the policy adjustment and financing under the program should help restore debt sustainability and boost FX reserves.

Article IV Discussions. Mongolia is heavily exposed to external shocks, given its export profile, and a key challenge will be to avoid the boom-bust cycles of the past. The discussions thus focused on improving the fiscal framework and strengthening policy discipline, complemented by structural reforms to boost diversification and competitiveness and by efforts to strengthen and better target the social safety net.

Extended Fund Facility. In support of the authorities' program, a three-year extended arrangement in the equivalent of 435 percent of quota (SDR 314.5054 million, or about $425 million) is proposed, supplemented by substantial donor support, for a total financing package of about $5½ billion. The proposed program addresses the key issues discussed in the Article IV consultation. Key policy pillars include: strong fiscal adjustment backed by substantial reforms intended to improve fiscal discipline; prudent monetary policy and a new central bank law to strengthen its independence and governance; a flexible exchange rate; a comprehensive strategy to strengthen the banking sector, starting with an independent Asset Quality Review; and measures to protect the most vulnerable and to diversify the economy.

Approved By
Markus Rodlauer (APD) and Daria Zakharova (SPR)

Discussions took place during October 24–November 5, 2016, and February 1–19, 2017. The team included Koshy Mathai (head), Neil Saker (resident representative), Ozgur Demirkol, Manuk Ghazanchyan, Rui Mano (all APD), Keiko Utsunomiya (COM), Baoping Shang (FAD), Laszlo Butt, Pierpaolo Grippa, Peter Lohmus, Guilherme Pedras (all MCM), Itai Agur, Pragyan Deb, and Yi Xiong (all SPR). The team was supported by Mmes. Selenge, Ardak, and Khulan (all economists in the res rep office), Mr. Paroutzoglou, and Ms. Tolentino (all APD). Messrs. H. Choi, K. Choi, Park, and Khurelbaatar (OED) participated in the discussions, as did Mr. Rodlauer (APD). The Fund team met with Speaker of the Parliament M. Enkhbold, Prime Minister J. Erdenebat, Finance Minister B. Choijilsuren, Bank of Mongolia Governor N. Bayartsaikhan, and other senior officials.

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CONTEXT

1. Mongolia has a bright future but faces serious economic challenges. The country has large deposits of copper, gold, coal, and other minerals, and many of these are either under development or already in production. The economy also has good potential for diversification into agribusiness—dairy, meat, and cashmere, in particular—as well as tourism. Finally, with its strategic location, Mongolia is likely to benefit as countries in the region integrate more closely. For these reasons, economic prospects are strong. At this juncture, however, the country faces depressed growth, low foreign-exchange reserves, a large fiscal deficit and rising debt, and a fragile banking system.

2. External shocks hit the vulnerable economy hard. With minerals accounting for up to 90 percent of total exports, the sharp drop in commodity prices from 2011 onward severely affected the balance of payments and fiscal position. Slow global growth and rebalancing in China contributed to this and weak export volumes. In addition, FDI dropped to almost zero in 2015 as the first-phase development of the Oyu Tolgoi (OT) copper and gold mine came to an end and the second phase was delayed on account of a shareholder dispute.

3. Expansionary policies compounded these shocks. Macroeconomic policy easing to buffer the economy from external shocks supported growth for a while, but at the cost of increasing public debt, weakening the balance of payments (BOP), and reducing banks' asset quality. The on-budget deficit was, until 2016, generally kept under control, but substantial additional spending (on infrastructure projects and subsidized lending programs) was channeled through the Development Bank of Mongolia (DBM) and the Bank of Mongolia (BOM) from 2012 onward. The overall fiscal stance was thus expansionary, and Mongolia eroded its (insufficient) buffers built during good times. The expansionary monetary stance fostered a credit boom and fueled imports; this in turn led to a substantial loss of reserves and sharp depreciation, as well as a spike in inflation. Regulatory forbearance in the financial sector was pervasive, allowing bank vulnerabilities to grow.

4. Against this background, the then-opposition Mongolian People's Party (MPP) won a landslide victory in the June 2016 general election. The MPP won 65 of 76 seats in Parliament, putting an end to a long period of coalition governments. A new Minister of Finance was appointed in late July, as was a new Bank of Mongolia Governor. The authorities openly acknowledged the extent of Mongolia's economic difficulties, prepared an "Economic Recovery Program" that would largely reverse past policies, and approached the Fund for assistance.

RECENT DEVELOPMENTS AND OUTLOOK

5. Economic activity has been weak. Growth slowed from almost 8 percent in 2014 to 1 percent in 2016. Mining was relatively weak throughout most of the year, with temporary geological factors continuing to depress output from the first phase of OT, but there was a large increase in coal output and prices in the fourth quarter on account of supply disruptions in China, as well as China's policy shift away from coal production. Nonmining growth was supported by construction on the second phase of OT, which ramped up in the second half of 2016, and also by a sharp increase in fiscal spending. Nonetheless, growth remained sluggish as private consumption weakened. Inflation had already fallen sharply in 2015 with the weak economy and moved to an historical low in 2016, despite substantial depreciation of the currency in the second half of the year.

6. **The fiscal position worsened substantially in 2016.** The deficit reached a historical high of 17 percent of GDP (on the Fund's definition), more than double the level in 2015, on account of a sharp fall in revenues, higher interest payments, pre-election spending programs, the clearance of some arrears on infrastructure spending, and a judicial settlement with a mining company. The large fiscal deficit and the depreciation of the currency together pushed general government debt up from 55 percent of GDP (Fund definition, and in present-value terms) at end-2015 to nearly 70 percent of GDP a year later.

Fiscal Accounts, 2015-26 (Percent of GDP)

	2011-15 avg.	2015	2016
Revenue	29.6	25.1	23.7
Expenditure	37.9	33.6	40.7
Current	24.7	24.4	27.9
Capital	13.3	9.2	12.8
Overall balance	-8.4	-8.5	-17.0
General government debt			
Nominal	...	59.5	87.6
Present value	...	55.0	69.1
Memorandum items:			
Primary expenditure	36.4	30.7	36.8
pre-election programs	...	...	2.3
judicial settlement	...	...	0.6
arrears clearance	...	...	1.2
underlying primary expenditure	36.4	30.7	32.7
Primary balance	-6.8	-5.6	-13.1
P.b. excluding one-off spending	-6.8	-5.6	-9.0
P.b. excluding one-off spending and rev. shortfall rel. to 2011-15 avg.	-6.8	-1.2	-3.1
Cyclically adjusted primary balance	-7.6	-6.5	-12.8
CAPB excluding one-off spending	-7.6	-6.5	-8.7
Nonmineral primary balance	-12.2	-10.0	-15.6

7. **The balance of payments has remained under pressure.** Exports recovered with the help of better-than-expected commodity prices and the sharp pickup in coal exports toward the end of the year. At the same time, imports were weak, reflecting the soft economy, and the trade balance stayed in surplus. The overall current account, however, registered a deficit of around 4 percent of GDP, and given market uncertainties about the state of the economy and upcoming bond repayments, as well as a single large FX transaction in June,[1] the togrog came under substantial pressure, depreciating by more than 25 percent in the second half of the year. Gross reserves were broadly stable at $1.3 billion (3 months of imports), supported by the issuance (at a high yield) of a $500 million sovereign bond, the contracting of a $250 million international syndicated loan, and drawings under the PBOC swap line. Mongolia's credit rating was downgraded twice toward the end of the year (to Caa1 by Moody's).

8. **Monetary conditions have been subdued.** Loan growth has been weak and driven mainly by subsidized credit schemes. Despite very low inflation, interest rates are high with the weighted average lending rate now near 20 percent, reflecting, *inter alia,* fiscal pressure and the risky environment. In August, the Bank of Mongolia (BOM) hiked the policy rate by 450 bps to defend the

[1] The purchase by a local company of Russian-owned shares in the Erdenet copper mine required several hundred million dollars, which put pressure on the exchange rate.

exchange rate; in December, the rate was lowered by 100 bps to 14 percent, in light of weak economic activity and low inflation. In addition, the BOM stopped its lending to government in the second half of 2016 and limited new mortgage financing to the total amount of principal and interest payments received on existing mortgage assets.

9. The banking sector faces major challenges. The sector is relatively small, with total assets at 90 percent of GDP and loans at just 50 percent of GDP. Asset quality has declined on account of the weak economy and depreciation of the currency, with the reported NPL ratio at around 7 percent (excluding restructured loans and loans in early arrears), putting pressure on capital adequacy ratios. NPLs are high for foreign-currency loans, reflecting the impact of currency depreciation on unhedged borrowers and weakness in the mining sector. Forbearance continues to mask vulnerabilities in the banking sector. The BOM is slowly moving to a more risk-based supervisory approach and working to improve its capacity.

10. Mongolia's medium-term outlook is favorable provided that the authorities can maintain policy discipline. A continuation of the policies of the past few years would lead to continued stagnation, an unsustainable buildup of debt, continued pressure on the balance of payments, and growing bank vulnerabilities. But with the strengthening of policies advocated by the new authorities and incorporated into the Fund-supported program, the outlook should be much stronger. In particular:

- Growth is expected to remain mildly negative in 2017, reflecting the impact of fiscal consolidation,[2] but should pick up in 2018 and reach 8 percent in 2019, when development / rehabilitation of the Tavan Tolgoi coal mine is expected to start. In addition, FDI flows related to development of the second-phase of OT will be around $1 billion in FDI annually for the next few years. Spillovers from these large mining investments, as well as rising agricultural production, are expected to support nonmining growth over the medium term.
- Inflation should return to 6 percent by end-2017, reflecting the pass-through from depreciation in 2016 as well as excise increases under the program, and stabilize around 6½ percent as the economy normalizes.
- The envisaged fiscal consolidation and substantial external financing on concessional terms should restore debt sustainability, with debt declining from 2019 onward, and bring international reserves to a healthy $4 billion by 2020, or about 6½ months of imports.[3]

[2] That a sharper contraction is not forecast despite the large fiscal consolidation can be explained by a number of factors. Most important, without consolidation, growth would likely have picked up substantially, given construction and manufacturing spillovers from OT-2 development, as well as a general improvement in confidence reflecting the policy adjustment and financing under the program. In addition, the reduction in the deficit overstates the contractionary impulse since it partly reflects the elimination of some one-off items—like the payment of a judicial settlement to a foreign entity—that did not stimulate the economy.

[3] This level of reserves will be sufficient to pay off the PBOC swap line if needed and still leave Mongolia with an adequate level of reserves.

Authorities' views

11. The authorities agreed on the critical importance of changing policy direction and had similar views on the outlook. They emphasized that they had opposed many of the previous government's economic policies and had come to power with a mandate for change. They shared staff's economic projections but noted that there were substantial upside risks to growth, particularly since Tavan Tolgoi was a high priority for the government, and they thus expected that development could start well before 2019.

ARTICLE IV DISCUSSIONS

12. Mongolia faces important risks. The country is highly exposed to global commodity markets. Moreover, it is subject to regional spillovers—slowing growth in China could imply less demand for Mongolian commodities, as could a shift away from coal-fired power generation, but these effects could be offset to the extent that China continues to reduce its own coal supply (by closing mines for environmental reasons), and moreover, rising Chinese household income and consumption could support demand for Mongolian tourism, dairy, meat, and cashmere. (Annex I discusses the global and domestic risks that the economy faces.)

13. Mongolia's fundamental economic problems have been its lack of diversification and its proclivity to boom-bust cycles. Diversification has been a longstanding goal, and the country does have substantial potential in agriculture and tourism. But given the extent of its mineral endowments, Mongolia will remain a mining economy for many decades. (See Box 1 for a description of Mongolia's mineral wealth.) And like many other commodity exporters, it has tended to spend excessively in good times, when prices are high, and not save enough for bad times, when extreme cuts are then required because of a lack of buffers. Mongolia's fiscal framework is designed to prevent such procyclicality, but it was essentially set aside in recent years. What is needed now is a strategy to help the country realize its potential—reforms have to be sequenced and prioritized properly, a robust fiscal framework is critical, and policy initiatives will need steady implementation. Many of these themes were taken up in the last Fund-supported program (the 2009 Stand-by Arrangement (SBA)) and recent Article IV Consultations, with mixed uptake (see Box 2). The last program was generally successful in stabilizing the economy but there was limited commitment to lock in reforms achieved under the program.[4]

[4] See "Mongolia: Ex Post Evaluation of Exceptional Access Under the 2009 Stand-By Arrangement," March 2011, IMF Country Report 11/77.

Box 1. Mongolia's Mineral Wealth

Mongolia has substantial mineral wealth, and if this can be exploited successfully, the country should have strong prospects for sustained, rapid growth over the medium to long term.

- Mongolia has huge potential in many key commodities (see map) and is one of the lowest-cost producers globally. It has one of the top copper and gold mines in the world (Oyu Tolgoi, whose first phase is already in production and whose second phase will begin production in 2018) and also one of the largest coal deposits, at Tavan Tolgoi (the redevelopment of which is expected to begin in 2019). Overall, current proven reserves are estimated at around $1 trillion and much of the country has yet to be prospected—the ultimate value could be much higher. Keys to leveraging this potential are better infrastructure and a more market-friendly investment environment. While these are key constraints currently, the new administration has announced a series of measures to accelerate the development of mega-projects, including new railways and power stations, and these should help to drive the commodity sector over the coming years, despite uncertain global conditions. As a consequence, GDP growth will be boosted and exports will more than double.
- Importantly, better connectivity to the main market in China will allow Mongolia to benefit from the spatial rebalancing of the Chinese economy, especially development away from the coast. Its coal and other energy production can fuel growth in the western provinces where competition from other shipborne imports such as cheap Australian coal is less relevant. In addition, Mongolia has competitive advantages in high-income-elasticity goods and services such as organic foodstuffs and high-end tourism and so can gain from rising consumption activities in China.

Copper

- OT is one of the top copper mines in the world. It is the flagship of Rio Tinto which is utilizing state-of-art mining techniques with indications that production can last for up to 100 years. Surveys indicate that the current OT site covers only a fraction of the potential copper deposit contained in a ridge of a former volcano. The rest of the potential ore bearing area has yet to be explored, and some observers suggest that there could be another ten OTs in this area alone. In addition, the Erdenet mine that has been in production for around 40 years could also significantly improve its efficiency with extra capital expenditure and management efficiencies.
- Copper is a good mineral to be concentrated in, as prices should rise in the 2020s on account of: (i) supply issues in Latin America; and (ii) demand pickup due to factors such as higher usage in electric cars and continued electrification in Asia (e.g., Myanmar and India).

Coal

- Mongolia has some of the largest coal deposits in the world, with both high-grade coking coal for the Chinese steel market and thermal coal for domestic and export use. Tavan Tolgoi (TT) is reportedly one of the largest single deposits in the world (estimated at around 7½ billion tons), and there are a number of smaller private-sector mines coming on stream.
- The future of the coal sector is intimately connected with developments in China. One scenario is that China downsizes its own coal industry for environmental reasons and either imports coal or coal-powered electricity from Mongolia.
- Key to increasing coal exports will be developing adequate infrastructure, especially railways. These include the TT railway that connects with the Chinese network but has been stalled for some time and Aspire's Northern Railways that aims to connect the Ovoot mine with the Russian network via Erdenet. China Development Bank is involved in talks regarding this project as part of the Northern Rail Corridor linking Chinese ports with Siberia.
- Building new coal power stations is another option to supply China and domestic market. The new government has indicated that it wants to speed up progress in building new plants, including the TT power plant.

Box 1. Mongolia's Mineral Wealth (concluded)

Gold

- Mongolia is on an important ore-bearing belt that extends across Central Asia. It has substantial deposits that are amongst the shallowest in the world (less than 500 meters, versus 3 km in South Africa) and so mining costs are relatively low.
- Industry experts highlight that much of the country has yet to be prospected. However, there are already significant deposits at OT which are mined in conjunction with the copper. In addition, the Gatsuurt mine with 1.6 million ounces in probable reserves is slated to be finalized this year.

Uranium and other rare metals

- Mongolia also has sizable uranium deposits, which have seen increasing demand given the renaissance in the global nuclear industry.

Renewables

- Mongolia has huge potential in terms of solar and wind energy production, given its terrain. There is growing interest in this sector, with FDI starting to materialize ($50 million from SoftBank recently, and the EBRD and IFC have been investing in projects). Hydroelectric power is also being explored with a $1 billion dam project in consideration with China.

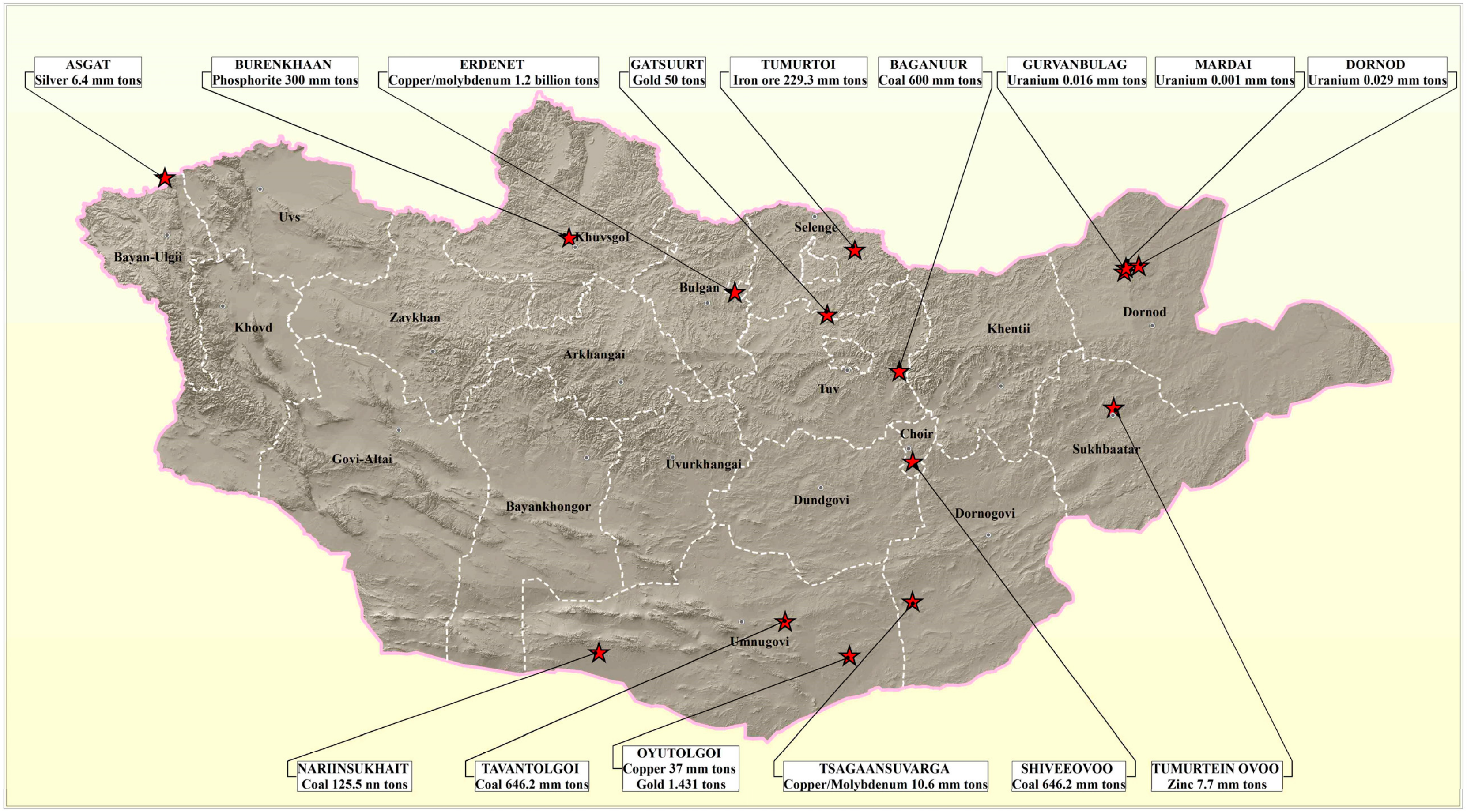
Diversification into other commodities

- Mongolia also has a large agricultural sector with around 60 million head of livestock and access to large markets in China and Russia as well as the Middle East. Meat and dairy exports, especially to parts of northern China, would benefit substantially with better husbandry techniques and disease control. Despite the harsh winter, there is also potential for increased grain and vegetable production and export with the use of modern farming techniques. Better agribusiness could go hand in hand with sustainable tourism in bringing income into rural areas.

Overcoming constraints

- Mongolia has been less proactive than other peers such as Mozambique and Peru in monetizing deposits, and no exploration licenses have been issued since 2012, meaning that FDI in the sector other than OT has fallen sharply. However, the start of OT-2 has boosted investor confidence, and smaller mining companies are returning. The judicial settlement of a dispute with a Canadian mining company has also boosted investor confidence. Encouragingly, a new Foreign Investment Protection Agreement has just been signed with Canada, and this should further raise investor confidence. Enhancing the anti-money laundering (AML) and anti-corruption frameworks would also increase transparency of the natural resources sector. In particular, progress on tackling AML issues could help credit raising by mining companies and other multinationals, as this would lower the compliance costs of investing in Mongolia.
- An appropriate tax regime for mining is also important, with the aim being to continue to incentivize participation by foreign companies, with their specialized expertise, while allowing Mongolia to gain the benefits from its resource endowment. Mining is a relatively capital-intensive sector with limited spillovers, and it will principally be by channeling tax revenues from the sector into the economy that the country will be able to make progress. While existing agreements will be respected, the mining tax regime for future projects will be considered as part of a comprehensive review of the tax system that the authorities are undertaking.
- With the right tax and regulatory environment, as well as progress on infrastructure, including transport links and power stations, there is substantial scope to harness Mongolia's large commodity reserves for decades to come.

Figure 1. Known Mineral Deposits in Mongolia



Source: Ministry of Mining.

Box 2. Response to Past Fund Policy Advice

The authorities generally agreed on the need for policy adjustment and responded to some of the recommendations made in past Article IV consultations. Implementation, however, was weak and deteriorated further ahead of parliamentary elections in mid-2016.

Key recommendation	Implementation
Fiscal Policy	
Tighten fiscal policy to bring deficits and debt gradually down to FSL/debt law limits.	Poor. The budget set out appropriate targets, but implementation was weak and deteriorated further before the parliamentary elections. Revenues undershot and spending control was substantially loosened. Debt has also risen sharply. A sovereign wealth fund law was passed to promote savings in the medium term but has yet to be operationalized.
Consolidate spending by various public sector bodies such as the DBM and BoM into the annual budget.	Partially done. BOM retains the mortgage subsidy program for now, though spending is restricted to the amount of principal and interest inflows from existing mortgage assets. DBM's commercial spending remains unconsolidated but will be included in the program's fiscal targets.
Monetary Policy	
Tighten monetary policy	Uneven policies. Large expansion (including quasifiscal activity), against Fund advice. BOM cut the policy rate twice citing very low inflationary pressures. However, bank rates did not follow and excess liquidity and weak confidence subsequently undermined the exchange rate. Policy has tightened recently with 450 bps hike in the policy rate and the introduction of improved liquidity management tools. This has stabilized the market for now.
Maintain exchange rate flexibility	Some progress. The BOM's intervention has, however, at times been larger than would be justified solely by the need to address disorderly market conditions.
Financial Policy	
Strengthen bank supervision, improve the crisis management framework including legal and operational changes, and end forbearance.	Limited progress. Fund TA on bank supervision provided specific recommendations on bank supervision, which the BOM welcomed. New regulations on provisioning were introduced but need improvement. Limited progress has been made on improving the crisis management framework. Regulatory forbearance continues.

14. Despite the negative output gap, the immediate priority is a tightening of macro policies. This should include significant revenue and especially expenditure measures to reduce the deficit and put debt on a sustainable path, combined with structural fiscal reforms to bolster fiscal discipline. (See debt sustainability analysis in Annex II, as well as discussion of structural measures in next section.) Monetary policy should remain prudent—i.e., the stance should remain appropriately tight for the time being, with policy rate cuts considered only carefully, as the economy normalizes—and the central bank should avoid quasifiscal activity. External policies should focus on building up reserves—the exchange rate (which is judged to be slightly undervalued—see Box 3) should be allowed to move flexibly, with intervention limited to addressing disorderly market conditions. Finally, financial-sector policies should focus on safeguarding stability and improving bank soundness—the BOM should end forbearance, adopt a well-defined early-intervention framework in the form of a progressive ladder of intervention, and deal proactively with banks that do not meet prudential norms. These points are all taken up in the authorities' program (see below).

15. The authorities should also move ahead on the structural agenda to boost longer-term growth prospects. This includes governance and other reforms to strengthen institutions, improve the business environment, and encourage foreign investment, especially in mining, agribusiness, and the financial sector. These policies should feed into a diversification strategy that should focus on the institutional and operational reforms needed to stimulate those sectors, like agriculture and tourism, where Mongolia does have real competitive advantage. These reforms also are pursued in the program.

16. Enhancing social safety nets and promoting inclusive growth is critical, alongside the adjustment and structural reform agenda. Mongolia has many programs to help the needy, but the efficiency of these programs could be further increased. This would entail a fresh look at existing social safety nets and better targeting them to the most vulnerable. The authorities could also take this opportunity to develop programs to address Mongolia's substantial income inequality and promote more inclusive growth.

Authorities' views

17. The authorities largely agreed with staff recommendations and underlined that these were already incorporated in their own program. They pointed out that their "Economic Recovery Program" envisaged immediate stabilization measures as well as structural reforms to help diversify the economy and lay the basis for sustainable growth. They highlighted their actions, immediately upon taking office, to tighten monetary policy and to stop quasifiscal activities of BOM and DBM as signs of their commitment to prudent economic policymaking. They also recognized the need for reforms in the banking sector to support growth. They were committed to reforming the social safety net in Mongolia while protecting the most vulnerable in the society.

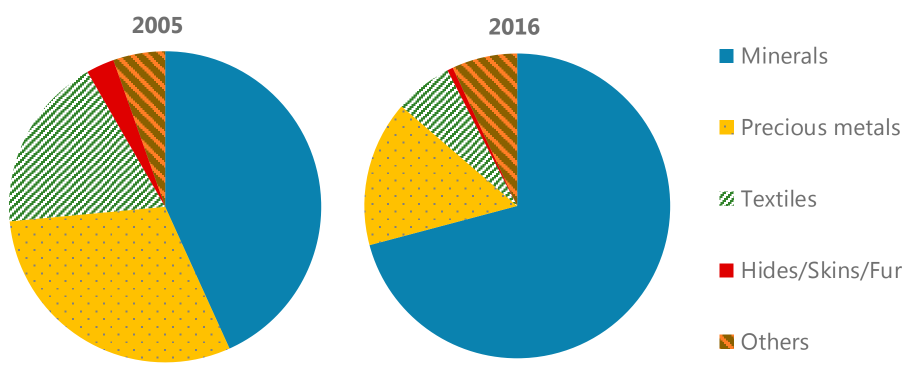
Box 3. External Sector and Exchange Rate Assessment

Mongolia's external position remains weak but, with the program in place, it is expected to move to a sustainable path. The currency depreciated substantially in 2016 reflecting expansionary policies in the first half of the year and market uncertainties about the state of the economy.

The trade balance improved during 2016, with exports picking up on the back of higher coal demand from China and the rebound in commodity prices late in the year. Imports remained depressed reflecting soft economic activity. The current account deficit narrowed slightly in 2016, and gross reserves were unchanged from end-2015, supported by large public sector external borrowing in the first half of the year. The REER was relatively stable from late 2014 until mid-2016, when it started to depreciate markedly, reflecting market uncertainties.

Given its vast mineral wealth, Mongolia's trade prospects are bright, but the economy's lack of diversification makes it vulnerable to shocks. Minerals accounted for over 70 percent of exports (in some recent years, this has touched 90 percent), up from roughly 40 percent in 2005, leaving Mongolia highly exposed to the commodity price cycle. While part of this is explained by new mining projects coming onstream and capacity expansion, it also reflects lackluster growth in Mongolia's other areas of strength such as cashmere and other textiles, as well as traditional hides, skins, and furs. Geographical concentration of exports also adds to the vulnerability. Going forward, it would be important for Mongolia to diversify its exports, both in terms of products as well as geographically.

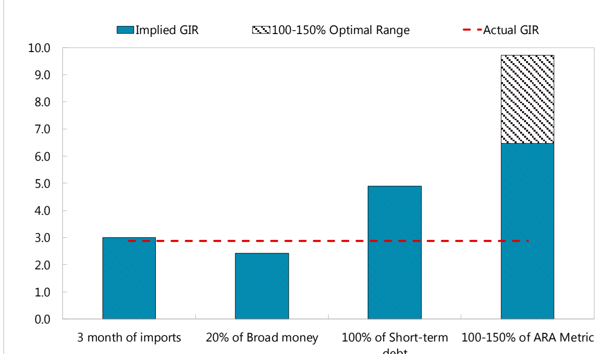
Mongolia: Exports by Commodity Groups



Sources: National Statistical Office of Mongolia; and IMF staff calculations.

By almost all indicators, gross reserves are low—just below the traditional 3-months of-imports benchmark, below the Greenspan-Guidotti rule suggesting 100-percent coverage of short-term debt, and only slightly above 20 percent of broad money. The metrics indicated in the chart suggest that 3 to 6 months of imports would be appropriate coverage. Given the economy's vulnerability to shocks, as well as the substantial deposit dollarization and need to protect against bank runs, it would be appropriate to aim for the upper end of this range, from which current reserves fall far short. Accordingly, under the program, gross reserves are expected to reach a healthy 6½ months of imports by 2020—similar to levels seen in 2012, before external shocks hit Mongolia. Excluding drawings from the PBOC swap, reserves would amount to a still-adequate 4¼ months of import cover in 2022.

Reserves Adequacy Under Different Approaches 1/
(in months of total imports)



Source: IMF staff calculations.
1/ For convenience, all figures are expressed in months of imports. The red line shows actual reserve coverage at end-2016 (2.9 months) and the bars show the targets suggested by different metrics.

Box 3. External Sector and Exchange Rate Assessment (concluded)

In the EBA-lite framework, all three approaches (macrobalance, equilibrium REER, and external stability) indicate that the current account is somewhat stronger than the norm and the currency somewhat undervalued, as of end-2016, following the 25-percent depreciation of the togrog in 2016. Given the low level of reserves, however, as well as the prospective widening of the current account deficit as FDI picks up, staff assess the overall external position to be weak. With the buildup of reserves during the program, the external position will return to a sustainable path.

Mongolia has a very high negative NIIP of about 239 percent of GDP (as of end 2016). Its liabilities are largely denominated in US dollars and are mostly composed of FDI (about 118 percent of GDP) and foreign debt (about 132 percent of GDP). It is natural, in an FDI-dependent mining economy to have a negative NIIP at first, and indeed for many years thereafter, but as mines come into production and the balance of payments improves over the long term, NIIP should improve steadily. The banking sector's net foreign liability poision is not fully hedged, which may pose additional risk to external vulnerability. (See Annex II for a discussion of external debt dynamics.)

Mongolia Exchange Rate Assessment

	2016		
	MB	ES	REER
Underlying CA balance	-4.1	-4.1	-4.1
CA norm	-4.5	-6.4	-4.8
Required change in the CA	0.5	2.3	…
Implied over (+) / under (-) valuation 1/	-1.4	-7.2	-6.8

1/ Using the elasticity of -0.32 estimated in the EBA-Lite framework.

PROGRAM

A. Strategy

18. **The proposed Fund-supported program aims to stabilize the economy, strengthen the banking sector, boost growth prospects, and restore debt sustainability.** Stabilization is an urgent priority. As described in the Letter of Intent and Memorandum of Economic and Financial Policies (LOI and MEFP, both in Appendix I), fiscal consolidation is a key priority to restore debt sustainability, keep deficits financeable, and strengthen BOM reserves. The monetary stance will need to remain tight, at least for the time being, and the exchange rate flexible. The banking sector will be subject to a comprehensive diagnosis, followed by recapitalization and restructuring as needed, and actions will also be taken to enhance the regulatory and supervisory framework.

19. **The program also lays the foundation for sustainable and inclusive growth by addressing long-standing structural weaknesses in the economy**. Since the transition to a market economy in 1990, Mongolia has come to the Fund on five earlier occasions, while at other times—e.g., when commodity prices are high—it has been among the world's fastest-growing economies. Ending this boom-bust cycle and putting the country on a sustainable and inclusive growth path remains a key objective. While previous programs have tried to do this, implementation and follow through were weak, particuilarly regarding fiscal discipline and strengthening the banking sector and its regulatory framework. Further reforms are needed to: (i) discipline fiscal policy and make it less procyclical; (ii) improve the central bank's governance and its focus on core

responsibilities; (iii) strengthen the financial sector; (iv) foster economic diversification and inclusive growth; and (v) protect the most vulnerable in society. The program has benefited importantly from the expertise of the World Bank and ADB, who have taken the lead in several of these areas.

20. Given the needed structural elements, a three-year arrangement under the Extended Fund Facility (EFF) is proposed. This will allow underlying challenges to be addressed, besides offering additional time to reverse debt dynamics and build up reserves. An SBA—the other possible alternative for Mongolia—would normally be shorter in duration and hence less well suited to deal with the country's structural problems.[5] The EFF would help avoid the implementation problems that limited sustainable progress of agreed reforms under the 2009 SBA.

21. Fund financing under the extended arrangement will be complemented by substantial concessional lending from other financing partners. This concessional finance, along with fiscal adjustment, will reduce Mongolia's reliance on expensive, short-term borrowing and thus help restore debt sustainability. Assistance from the World Bank and Asian Development Bank (ADB) will be delivered through budget support linked to policy commitments, as well as project financing directed, to the extent possible, toward spending already in the budget. Japan is offering budget support, backed by its own policy matrix, while Korea's financing will be in the form of project aid, and the People's Bank of China (PBOC) has agreed to extend its swap line with the BOM. All partners have collaborated closely to ensure consistency and minimal overlap of the policy content of their lending.

22. The program also envisages the continued engagement of Mongolia's private-sector creditors.

- **External creditors.** Soon after the announcement of staff-level agreement on the program, the authorities went to market and successfully exchanged the $580 million DBM bond maturing in March 2017 for a new, seven-year government bond with a coupon of 8.75 percent. There was substantial market interest in the deal, which also included a new-money component, and by limiting the total amount raised to $600 million—as against an order book that exceeded $3½ billion—the authorities were able to issue above par and push the yield on the new tranche down to 7.625 percent. The authorities' program envisages that they will return to the market to pre-finance the two bonds maturing in 2018.
- **Domestic creditors.** The authorities are also committed to guiding and engaging with their domestic creditors—mostly the commercial banks—to ensure that they continue to finance the government during the program period on terms consistent with debt sustainability. Domestic yields are currently high on account of heavy government borrowing, the high monetary policy rate, weak bank balance sheets, and also possibly the structure of the market (narrow investor base, limited custodian capacity, *et cetera*). Over time, many of these factors are expected to change as the economy stabilizes and as the government makes efforts to deepen the debt

[5] The longer repayment period of the EFF also allows repayments to be made at a time when OT exports will have risen substantially, and it avoids a bunching of maturities in 2021 and 2022, when Mongolia already has some large obligations due.

market. These changes, along with the authorities' active engagement with creditors, should allow government to fund itself at rates substantially lower than those prevailing today.

B. Fiscal Policy

23. The program envisages large fiscal adjustment (MEFP ¶13). Given the country's indebtedness, the fiscal anchor will be the primary balance, which should turn from a deficit of 13 percent of GDP in 2016 to a surplus of ¼ percent of GDP by 2020. This is a very large consolidation, but it should be achievable and realistic since a portion of it reflects the disappearance of various one-off factors (such as arrears clearance and some pre-election programs) that bloated the 2016 outturn. The fiscal adjustment, combined with the projected growth recovery, a gradual normalization of domestic yields, and the authorities' access to concessional financing under the program, is expected to restore debt sustainability.[6] For the next two years, deficits will still be high and growth low, and debt is expected to rise, reaching nearly 90 percent of GDP in present-value terms by end-2018; after that, however, it should fall, dropping to 74 percent by 2022 and continuing to decline thereafter, as OT production ramps up during the 2020s and both mining and nonmining GDP growth is sustained.

Fiscal Measures

	Estimated Savings 2017-2019 (percent of GDP)
Expenditure measures	**9.0**
Reducing capital spending	5.2
Streamlining and better targeting of social transfers and reforming public pensions	1.5
Containing public wage bill	1.4
Reducing expenditure on goods and services	0.9
Revenue measures	**2.2**
Improving revenue administration	0.1
Partly reversing cut in petroleum excise	0.8
Introducing a progressive income tax	0.2
Raising social security contribution	0.6
Increasing excise on vehicles, alcohol and tobacco	0.3
Eliminating the threshold for withholding tax on interest earnings	0.2
Increasing customs duty on tobacco	0.1
Total	**11.2**

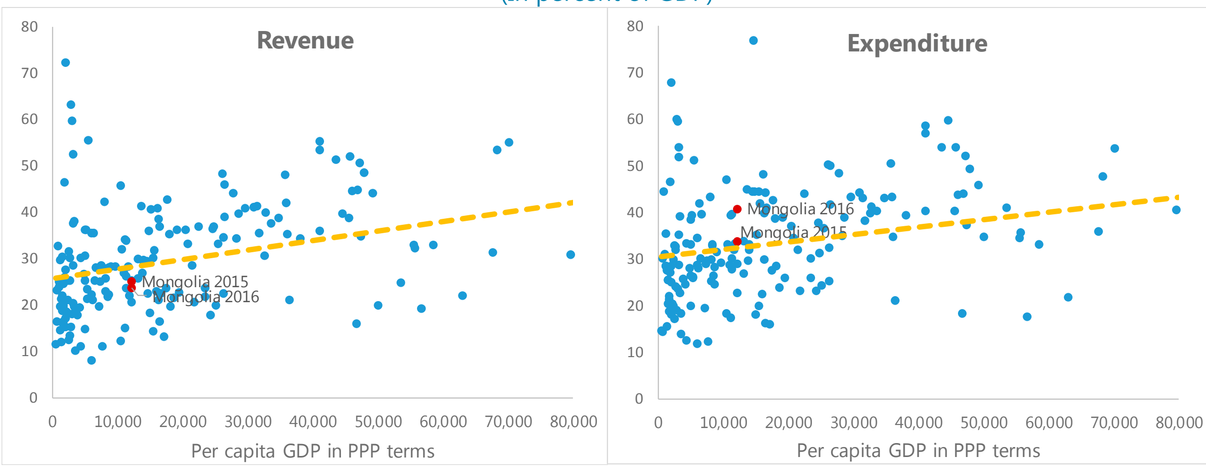
24. Fiscal consolidation is based on a broad set of revenue and expenditure measures (MEFP ¶¶14–15, 19). These measures include a rationalization of capital expenditures, steps to contain wages and pensions, and increases in excises and a number of other taxes.[7] (Approval of the 2017 supplementary budget and supporting measures, consistent with program parameters, is a

[6] While fiscal consolidation is expected to weigh on growth (staff conservatively assume a short-term multiplier somewhat above 1), with the development of mining projects and improvements in geological factors described above, a sharp contraction is avoided and growth recovers by 2019.

[7] A set of contingent fiscal measures will be developed in the first review, given the risks facing the program.

prior action for program approval.) The authorities will also embark on a comprehensive review of the tax system and will continue to pursue revenue administration reforms. Over the program period, expenditure measures yield fiscal savings of about 9 percent of GDP and revenue measures 2¼ percent, reflecting mostly the reversal of one-off spending items and also staff's assessment that Mongolia stands out more, in international comparison, for high expenditures than for low revenues.

International Comparison of Revenue and Expenditure
(In percent of GDP)



Source: WEO.
Note: Data for other countries are for 2015.

25. The program also addresses key risks that derailed fiscal policy in the past and strengthens fiscal discipline at every stage of the budget process (MEFP ¶18). Most importantly, a new DBM law has been passed that makes the institution more independent and commercially-oriented, and the BOM has committed to provide no new net financing for the subsidized mortgage program or any other quasifiscal activity.[8] In addition: government ministers will now need Ministry of Finance (MOF) approval to table proposals for Cabinet discussion; Parliament will no longer be able to increase the budget's aggregate spending envelope; a fiscal council will be set up to provide independent budget forecasts and macro projections; the framework for public-private partnerships will be tightened considerably; and the public investment program will be better aligned with national development priorities. Moreover, existing provisions of the budget law—e.g., on accountability and on supplementary budgets—will be followed strictly.

C. Monetary and Exchange Rate Policies

26. The BOM is committed to keeping monetary policy appropriately tight (MEFP ¶21). Inflation is starting to pick up (from less than 1 percent at end-2016) and is expected to reach 6 percent this year, but with the policy rate currently at 14 percent, real rates are substantially positive and higher than in the past, suggesting that there could be room to ease in the future as the economy stabilizes, and assuming BOP and inflation indicators permit. The BOM and MOF will,

[8] The authorities intend then to transfer the program to government and eventually convert it into a private-sector undertaking.

however, need to coordinate closely to manage liquidity conditions under the program, particularly given the substantial (and likely lumpy) external financing that should flow into the country under the program.

27. An important step under the program will be the adoption of a new central bank law in line with international best practice (MEFP ¶¶22-23). The new law will clarify the BOM's mandate and strengthen its governance and autonomy. Members of the Monetary Policy Committee will now have a vote on policy decisions, and bank supervisory issues will be decided in a collective manner. The BOM will also take steps to modernize its structure and in particular to reorganize its administration, with a focus on improvements in human resources and IT. The BOM will continue to be subject to annual external audit, and the authorities are committed to developing a strategy to address the BOM's negative capital position (including an end to lossmaking quasifiscal activities and a plan for recapitalization that also takes into consideration the fiscal/debt implications).

28. The exchange rate will be allowed to move flexibly under the program (MEFP ¶24). Intervention will be limited to addressing disorderly market conditions and opportunistic market purchases when needed to build reserves. Given the policy adjustment and financing under the program, the BOM should be able, by the end of the program, to build reserves to a healthy 6½ months of imports—an appropriate level, according to reserve adequacy metrics (see Box 3), and similar to levels seen in 2012, before external shocks hit Mongolia. (As noted earlier, excluding drawings from the PBOC swap line, reserve coverage would be a still-adequate 4¼ months of imports.)

D. Financial Sector Policy

29. Financial sector reforms will aim at creating a sound and stable financial system. While Mongolian banks' reported financial soundness indicators suggest that the system is generally healthy, some problems are likely masked by banks' practices and supervisory forbearance with respect to asset classification and provisioning. Thus, a critical first step to strengthening the system is undertaking a comprehensive diagnosis of banks' balance sheets. This will be followed by a process of recapitalization, restructuring, and resolution of banks, as needed. In parallel, the authorities will take action to bring bank regulations up to international best practice, strengthen bank supervision, and improve the monitoring and support of bank liquidity. They also intend to improve the framework for resolving problem loans and are taking important steps to strengthen the AML/CFT regime. Importantly, the DBM has been brought under BOM supervision.

30. Every bank will be subject to an independent Asset Quality Review (AQR) (MEFP ¶27). The Bank of Mongolia has already developed terms of reference, in consultation with Fund staff, and (as a prior action) published a Request for Proposals from auditing/consulting firms that could perform the AQR. The firms will be chosen shortly and will be expected to complete the AQR by end-October. Following this, banks will be required to present business and recapitalization plans, covering any shortfalls identified by the AQR, as well as their expected capitalization and profit and loss until 2019. The BOM will challenge banks' business plans based on its own internal stress testing model (to account for further possible losses within the program period) and approve (or reject) banks' business and capital plans by end-December 2017. In case of a capital shortfall revealed by either the AQR or the business-plan analyses, banks will raise capital from existing and/or new shareholders and must complete recapitalization by June 2018. Current estimates suggest that bank capital needs could amount to 7 percent of GDP.

31. The authorities will first seek full recapitalization of banks by their shareholders without recourse to public funds (MEFP ¶¶28-32) . Should the banks not be able to raise capital fully from their shareholders and the private sector, public funds could be used, if financial stability is at risk, subject to strict criteria that will be developed in consultation with Fund staff.[9] The recapitalization effort will rely, in the first instance, on efforts to raise private capital, but this may not be sufficient—a contingency of up to 3½ percent of GDP has thus been included in the DSA. Banks using public funds will have to undergo business restructuring and changes in governance and possibly management. The authorities are committed to managing any state ownership in these banks at arms length. Banks that do not pose systemic risk and do not manage to raise capital fully from private sources should be subject to resolution.

32. The regulatory and supervisory framework will be upgraded (MEFP ¶33). The authorities will introduce amendments to the Banking Law and Bank of Mongolia Law and related secondary legislation to: (i) improve asset classification, provisoning, and colateral valuation; (ii) strengthen fit and proper requirements for shareholders and management and upgrade rules on related party exposures and final beneficial owners; (iii) improve the early-intervention framework; (iv) strengthen bank resolution; (v) upgrade liquidity requirements; and (vi) enhance the BOM's powers to request additional capital and provisioning and to apply levies on banks to cover the cost of supervision. The authorities will also bring the Deposit Insurance Company (DICOM) law in line with international best practice. Finally, the new DBM law ensures that DBM will now be supervised by the BOM.

33. The authorities are committed to facilitating effective debt resolution (MEFP ¶35). The authorities will review banks' current operating environment, analyze and identify any impediments related to insolvency and enforcement laws, taxation issues, and legal and regulatory obstacles to NPL sales and outsourcing, and develop an NPL resolution strategy including milestones and a timetable to remove the identified impediments. The Financial Stability Board will approve this strategy by end-January 2018. The authorities intend to request technical assistance in this regard. The BOM will also request banks to have adequate NPL resolution policies, strategies and resources, and to improve their reporting on NPLs. In conjunction with the Fund and other partners, the authorities will further evaluate the potential role of a public-sector-led asset management company should the banks prove unable to manage their NPL problems individually.

34. The nonbank financial sector is small but needs to be monitored regularly. With a share of less than 5 percent of Mongolia's total financial assets, the sector does not appear to pose a

[9] Changes to the banking law and a new law on the use of public funds will likely be needed.

threat to financial stability, but it poses challenges to supervision. Capacity in this area at the Financial Regulatory Commission needs to be improved.

35. The authorities are committed to strengthening their AML/CFT regime (MEFP ¶¶36–37). They intend to adopt amendments to the legal framework to support anti-corruption efforts, including amendments to the AML/CFT law, the anti-corruption law, and the criminal code by end-March 2018. They are committed to further strengthening the resources and expertise of competent AML/CFT and anti-corruption authorities in the country. They are also benefiting from technical assistance from the Fund and other multilateral partners including the ADB, Asia Pacific Group, and World Bank.

E. Social Protection and Competitiveness/Diversification

36. Strengthening social safety nets is an important priority of the program (MEFP ¶20). Mongolia has to undertake substantial macroeconomic adjustment, and ensuring that the most vulnerable in society are adequately protected is therefore vital. The authorities will target the Child Money Program to the poorest 40 percent of households, and all savings from this targeting will be directed toward increasing spending on food stamps for the poorest—in this way, diffuse social protection spending will be made more efficient and effective. In addition, Mongolia has more than 70 social transfer programs, many of which serve overlapping groups. These programs will be consolidated (without cuts in benefits), thus generating some small net administrative savings. Finally, the World Bank and the ADB have been working on a number of other initiatives with the authorities to make social safety nets more effective.

37. The authorities are taking action to diversify the economy and improve its competitiveness (MEFP ¶38). Given the country's abundant mineral resources, mining will always be a key sector for the economy, but agribusiness and tourism have good potential too. The authorities plan to improve the animal health framework, securing higher phytosanitary standards and thus facilitating meat exports to Russia and China; with more than 60 million head of livestock in the country, the potential is large. The authorities are also working on the WTO Trade Facilitation Agreement, and the law on permits will be revised to improve the business climate. Finally, the authorities will boost their efforts to promote Mongolia as an attractive tourism destination.

F. Program Financing, Modalities, and Risks

38. Access is proposed at 435 percent of quota (SDR 314.5054 million, or about $425 million). This level of access (the maximum under normal access limits) is based on staff's assessment of the outlook, the strength of the envisaged reforms, and the estimated gross external financing requirements during the program period.

39. Multilateral and bilateral donors will provide substantial additional financial support, bringing the total package to $5½ billion. The Asian Development Bank is committing $900 million over the program period, including $600 million in budget support and $300 million in project financing. The World Bank has committed to provide $400 million in budget support over the program period, and there are good prospects that it can provide an additional $200 million, most likely in the form of project aid. Japan's contribution will be $850 million, entirely in the form of budget support. Korea is offering $700 million of project financing over the period 2017–22 (including $200 million previously committed). Absent this concessional support and the private-sector creditor engagement strategy (which significantly reduces gross financing needs over the medium term), sovereign debt would be on an unsustainable trajectory. The PBOC has already extended its RMB 15 billion ($2.2 billion) swap line with the BOM, which was to expire in August 2017, until 2020; furthermore, the PBOC has indicated that if the Mongolian authorities' policies under the program remain on track, it is reasonable to expect that the swap would be extended again in 2020. Finally, it is expected that the program will catalyze private-sector portfolio and FDI inflows, as validated by the recent successful bond exchange.

Mongolia: Program Financing (2017-2022)
(In millions of U.S. dollars)

	Total Financing 2017-2022
Financing	5,650
IMF	425
Other IFIs	1,500
World Bank 1/	600
o/w project financing	175
ADB	900
o/w project financing	300
Bilateral donors	1,550
Japan	850
Korea	700
o/w project financing	700
PBOC swap line	2,175

Sources: Fund staff projections.
1/ The World Bank has committed to provide $400 million in budget support over the program period, and there are good prospects that it can provide an additional $200 million, most likely in the form of project aid.

40. The program is fully financed. There are firm commitments from donors to fill the entire financing gap for the first 12 months of the arrangement, and good prospects that there will be adequate multilateral and bilateral financing for the remainder of the program as well. Moreover, proposed project financing has been matched against existing spending items in Mongolia's budget for the first year, thus transforming this assistance into quasi-budget support that helps to fill the financing gap.[10] Finally, as discussed above, the program incorporates continued engagement of private-sector creditors.

41. Capacity to repay. Mongolia is expected to be able to meet its obligations under the proposed arrangement. The country currently has zero Fund credit outstanding and an unblemished repayment history with the Fund. Total Fund exposure would be limited to at most 3½ percent of GDP, or about 10 percent of gross reserves. Thus, staff assess that Mongolia will maintain sufficient

[10] For the later years of the program, some additional discussion between the Mongolian authorities and the donors will be needed to allocate project financing fully.

capacity to repay its exposure to the Fund. Mongolia has some arrears to China (CHF 5.6 million) dating back to 1986–91; the two countries are in discussion on how to resolve the issue, and China has given its consent for the Board to consider Mongolia's request for an extended arrangement.

Mongolia: Phasing of Program Financing
(In millions of U.S. dollars)

	2017Q2	2017Q3	2017Q4	2018Q1
Financing	313	198	248	278
IMF	57	28	28	28
Other IFIs and bilateral donors	257	170	220	249

Sources: Fund staff projections.

42. The program faces significant risks. The authorities are firmly committed to their program, but there are still substantial risks of domestic policy slippages, given the sensitive nature of many of the policy commitments, and also given the electoral cycle (with Presidential elections in June 2017 and parliamentary elections in 2020). Implementation capacity is backed by very strong political support but will be taxed by the broad reform agenda; the Fund will thus support the authorities with technical assistance in a number of areas. The program is subject to many possible external shocks, including lower commodity prices, weaker FDI, less supportive global and regional growth, delays in major mining projects, and less favorable borrowing conditions. These factors could pose risks to growth as well as debt sustainability.

43. Given these risks, there will be quarterly program reviews. Test dates for the first and second sets of performance criteria will be end-April and end-June 2017, respectively. The program will be monitored with quarterly quantitative performance criteria on the primary balance of the general government, net official international reserves and net domestic assets of the BOM, nonconcessional medium- and long-term external debt, and the stock of guarantees on external debt by the government or BOM (ceiling). A continuous performance criterion (a zero ceiling) will be applied to nonconcessional short-term external debt and accumulation of external payment arrears. There is also an indicative target on reserve money. Structural benchmarks have been established to gauge progress in key reform measures discussed above.

44. Prior actions. The following prior actions are to be taken by the authorities ahead of the Executive Board meeting. All have now been completed:

a. Passage of a 2017 supplementary budget and a medium-term budget framework (2018-2020) consistent with program targets, and passage of all fiscal measures needed to support 2017 targets. *This was completed on April 13.*

b. Launch the procurement procedure for the AQR by reputable firms based on terms of reference developed in consultation with Fund staff. *This was completed on March 31.*

c. Discontinuation of net BOM financing of the mortgage program as well as any other quasifiscal BOM lending (e.g., to companies). *The BOM sent staff a letter on April 13 verifying that this had been done.*

45. Safeguards assessment. An updated safeguards assessment of the BOM is in progress and is expected to be completed by the first review. A safeguards mission was completed in early April. The BOM continues to be audited by leading external accounting firms, and its financial statements are published. The updated assessment will evaluate the central bank's control, governance, and legal framework against leading practices and safeguards requirements. The program already incorporates measures to address preliminary safeguards concerns—e.g., the need for legal reforms at the BOM and limiting quasifiscal activities.

STAFF APPRAISAL

46. Policy discipline is essential in a country as subject to external shocks as Mongolia. Mongolia has vast mineral resources, but its heavy dependence on this sector and on a single export market means that it is highly vulnerable to external shocks. Without a prudent policy framework, such a country can easily fall into boom-bust cycles, and that is exactly what happened over the past few years. The 2008-09 program was implemented successfully, and a state-of-the-art fiscal framework for resource-rich economies was introduced. But there was a lack of political will to adhere to the framework, and when commodity prices rebounded, so too did spending. Later, when external conditions again deteriorated, the authorities resorted to large-scale stimulus that resulted in serious fiscal, external, and financial vulnerabilities.

47. Macro policies now urgently need to be tightened to stabilize the economy. The fiscal deficit must be brought down sharply to help put debt on a sustainable trajectory. The availability of concessional finance under the program will facilitate adjustment and help restore debt sustainability. Monetary policy should be kept tight, though some easing may become possible as the economy stabilizes, and the exchange rate, which is currently somewhat undervalued following the sharp depreciation in 2016, should be allowed to remain flexible, as a buffer against external shocks. Mongolia's external position is currently weak but, with the program in place, it is expected to move to a sustainable path.

48. Structural reforms are another key element, to ensure that the adjustment is durable and to help prevent a repeat of past boom-bust cycles. The program contains a raft of measures to bolster fiscal discipline (including measures to remove DBM and BOM from fiscal activity), improve central bank independence and governance, strengthen the banking sector, and diversify the economy. The program also strengthens and better targets Mongolia's social safety net, to ensure that the most vulnerable are protected.

49. The authorities have strong program ownership, but this is nonetheless a high-risk program. Program policies are drawn almost entirely from the "Economic Recovery Program" that the government drew up soon after taking office last summer, and the government has a large majority in parliament. Nonetheless, many measures may be difficult and politically controversial, and there could be risks of policy slippage in many areas, particularly over time, as reform fatigue could set in. In addition, the economy will remain subject to external shocks, and a weakening of commodity prices, an economic slowdown in key trading partners, delays in major mining projects, or adverse changes in global market conditions could all have serious implications for Mongolia's projected economic recovery, which in turn could have implications for debt sustainability. To help address these risks, the program includes a number of prior actions for approval, policy commitments are frontloaded to the extent possible, and reviews will be conducted on a quarterly basis.

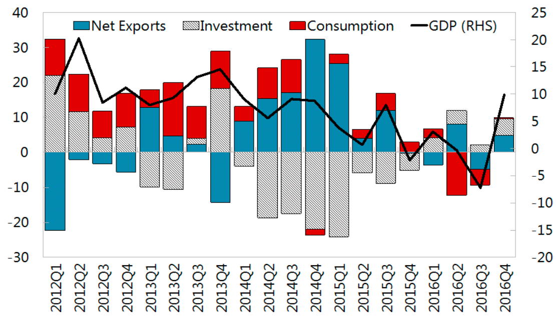
50. Staff support the authorities' request for an extended arrangement. In view of Mongolia's balance of payments need, the policy actions already taken, and the authorities' commitment to implement far-reaching reforms over the program period, staff support the authorities' request for an extended arrangement in the equivalent of SDR 314.5054 million.

51. Following approval of the proposed arrangement, Mongolia will be placed on a 24-month Article IV Consultation cycle, in line with Decision No. 14747-(10/96), adopted on September 28, 2010, as amended.

Figure 2. Real Sector Developments

Growth picked up in 2016Q4 on the back of a large increase in coal output.

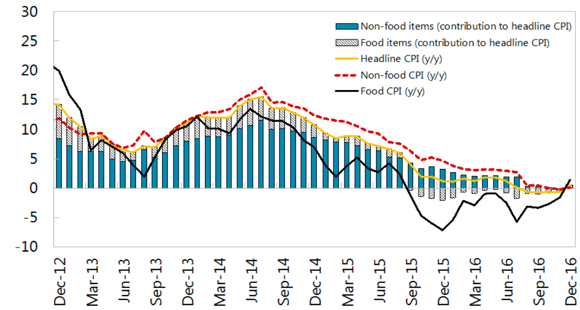
Real GDP Growth
(Contribution; Year-on-year percentage change, RHS)



Source: Mongolian authorities.

Inflation remained subdued in 2016 reflecting weak economic activity.

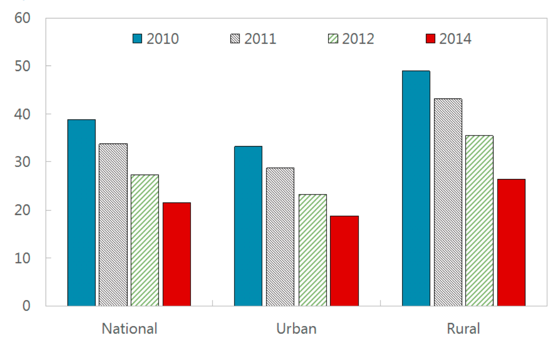
Consumer Price Inflation
(In percent)



Sources: Mongolian authorities; and IMF staff calculations.

Poverty has been going down steadily, in both urban and rural areas.

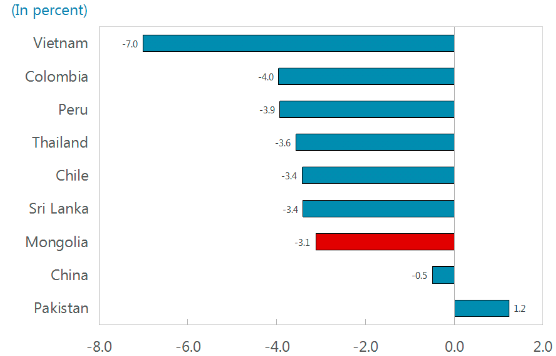
Poverty Headcount
(In percent)



Source: World Banks, *World Development Indicators (WDI)*.

Employment generation decelerated as the economy slowed down.

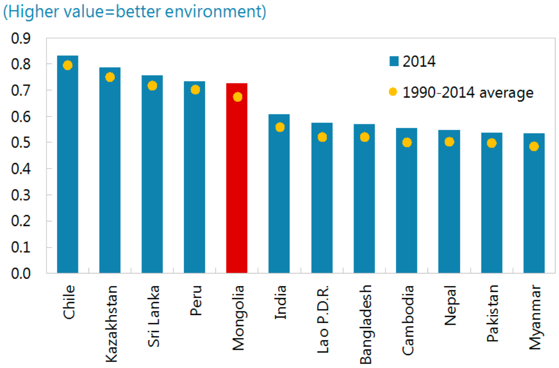
Change in Unemployment Rate, Average of 2011-2016
(In percent)



Source: IMF, *World Economic Outlook (WEO)*.

While Mongolia looks relatively good on the Human Development Index…

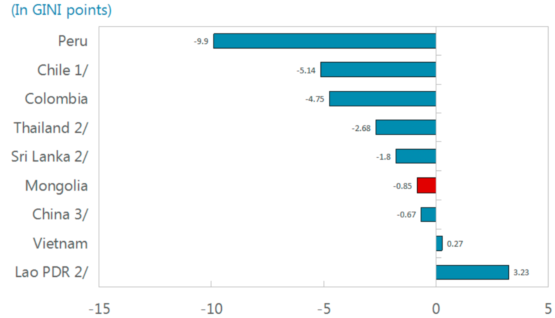
Human Development Index (HDI)
(Higher value=better environment)



Source: United Nations Development Programme, *Human Development Report 2015*.

… progress in reducing income inequality has been limited.

Change in GINI Index, 2002-2014
(In GINI points)

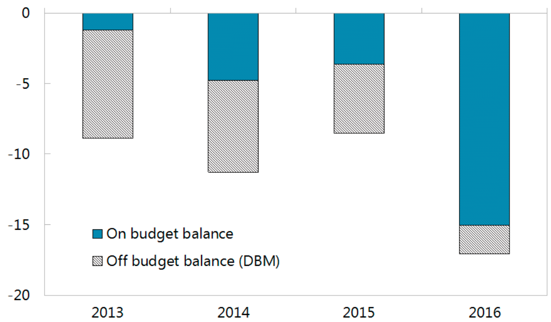


Source: World Bank, *World Development Indicators (WDI)*.
1/ GINI metric for Chile is from 2000-2013
2/ GINI metric for Thailand, Sri Lanka, Lao PDR, is from 2002-2012
3/ GINI metric for China is from 2008-2012

Figure 3. Fiscal and Monetary Sector Developments

The fiscal deficit ballooned as revenues stagnated and one-off spending spiked in the run-up to the 2016 election.

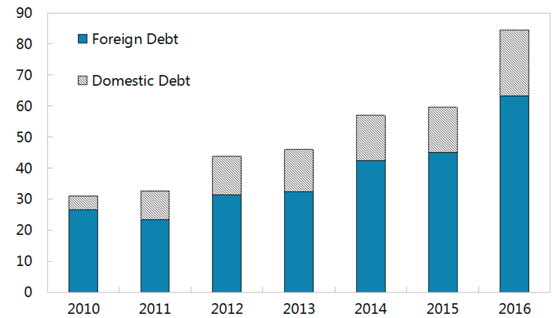
Fiscal Balance
(In percent of GDP)



Sources: Mongolian authorities; and IMF staff calculations.

As a result, general government debt rose markedly.

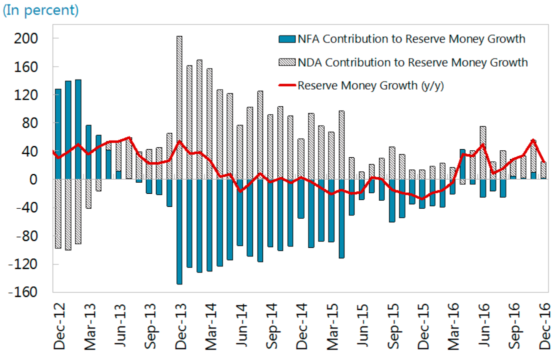
External and Domestic Debt
(In percent of GDP)



Sources: Mongolian authorities; and IMF staff estimates.

Monetary policy was accommodative early in 2016…

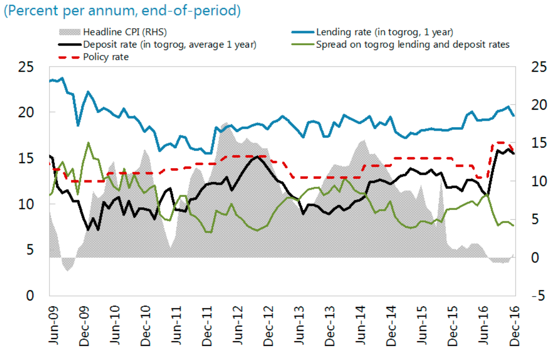
Reserve Money Growth and Contribution
(In percent)



Sources: Mongolian authorities; and IMF staff calculations.

…but the authorities raised the policy rate sharply in August to stem pressures on the exchange rate.

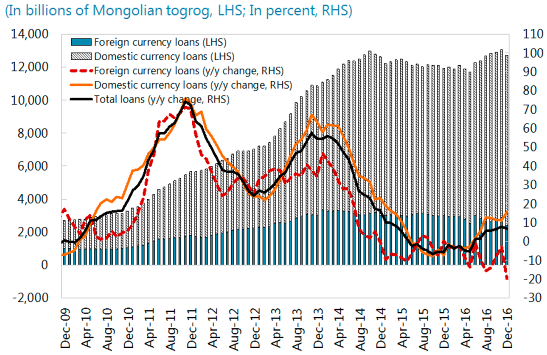
Policy Rate and Commercial Banks' Interest Rates
(Percent per annum, end-of-period)



Sources: Mongolian authorities; and IMF staff calculations.

Loan growth was driven by subsidized lending under the mortgage program.

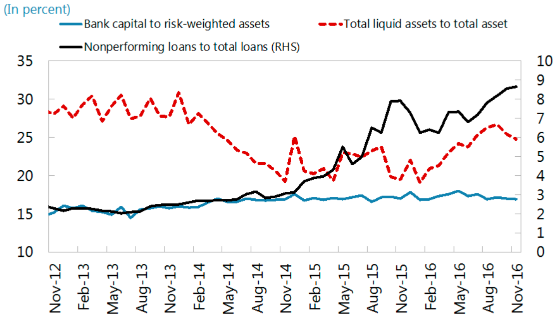
Bank Lending
(In billions of Mongolian togrog, LHS; In percent, RHS)



Sources: Mongolian authorities; and IMF staff calculations.

NPLs continued to rise, given the weak economy.

Bank Capitalization, Asset Quality and Liquidity
(In percent)



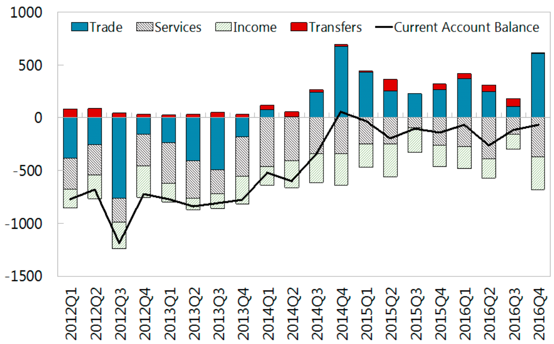
Sources: Mongolian authorities; and IMF staff calculations.
Note: Caution is needed in interpreting FSI indicators given pervasive forbearance and rapid credit growth.

Figure 4. External Sector Developments

The trade balance has stayed in surplus given the weak economy, but the current account remains in deficit.

Current Account Balance

(In millions of US dollars)

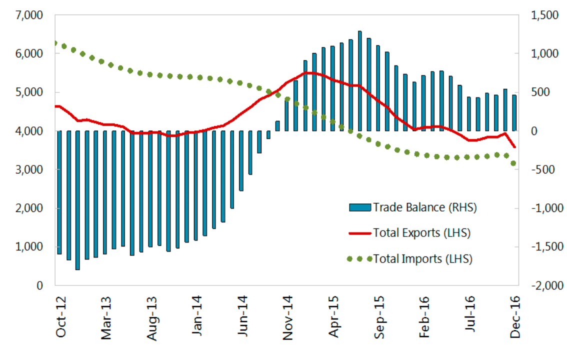


Source: Mongolian authorities.

Exports fell with commodity prices but imports have fallen even faster given the economic slowdown.

Trade Balance

(12-month rolling sums, in millions of US dollars)

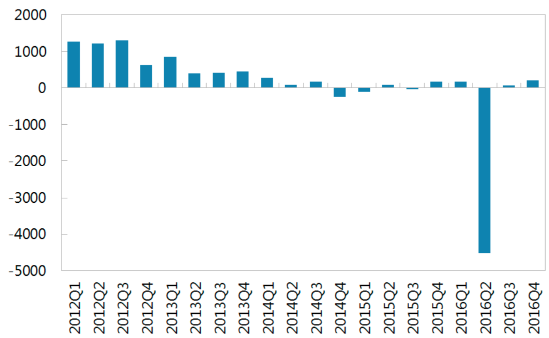


Sources: Mongolian authorities; and IMF staff calculations.

FDI remains weak (with the recent large drop reflecting an accounting change related to OT-2).

Foreign Direct Investment

(In millions of US dollars)

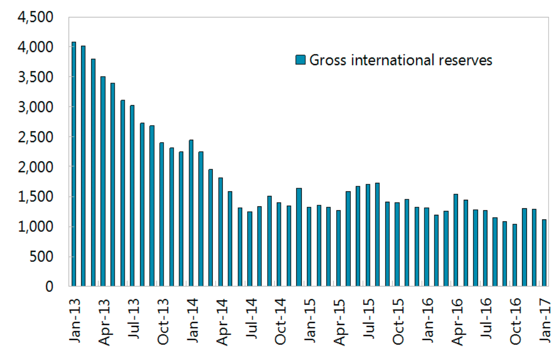


Source: Mongolian authorities.

Gross international reserves have remained stable, supported by international borrowing…

International Reserves

(In millions of US dollars)

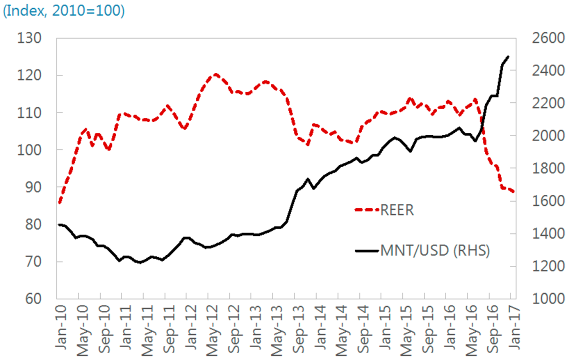


Sources: Mongolian authorities; and IMF staff calculations.

…but the currency depreciated markedly in the second half of last year before stabilizing in the first quarter of 2017.

Exchange Rates of the Togrog

(Index, 2010=100)

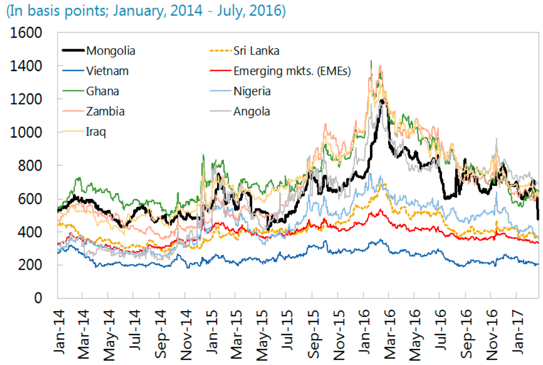


Sources: IMF, *Information Notice System*; and IMF staff calculations.

Spreads have been volatile but tightened in February after staff-level agreement on a program was reached.

JP Morgan EMBI Global Sovereign Spreads

(In basis points; January, 2014 - July, 2016)



Source: Bloomberg LP.

Table 1. Mongolia: Selected Economic and Financial Indicators, 2013-22

	2013	2014	2015	2016 Est.	2017	2018	2019	2020	2021	2022
	(In percent of GDP, unless otherwise indicated)									
Real sector										
Nominal GDP (in billions of togrogs)	19,174	22,227	23,134	23,886	26,048	27,688	31,390	35,023	39,306	45,181
Real GDP growth (percent change)	11.6	7.9	2.4	1.0	-0.2	1.8	8.1	5.3	6.1	8.5
Mineral real GDP growth	18.5	19.4	14.1	0.7	0.5	4.5	13.6	15.1	13.7	18.9
Non-mineral real GDP growth	10.0	5.0	-1.0	1.1	-0.5	0.9	6.1	1.7	2.9	3.7
GDP deflator (percent change)	2.9	7.4	1.7	2.3	9.3	4.4	4.9	5.9	5.8	5.9
Consumer prices (End-period; percent change)	11.2	10.7	1.1	0.5	6.1	6.1	6.9	6.5	6.5	6.5
Gross national saving	26.3	23.4	21.1	26.5	30.3	30.1	32.4	36.4	38.2	41.4
Public	7.4	3.7	0.4	-4.6	-3.4	-1.5	1.3	3.7	5.5	6.1
Private	18.9	19.7	20.7	31.1	33.8	31.6	31.2	32.7	32.7	35.3
Gross capital formation	51.7	34.9	25.1	30.6	34.8	39.6	46.1	46.9	46.6	47.6
Public	16.4	15.0	9.2	12.8	7.7	7.5	7.6	8.0	8.0	8.0
Private	35.3	19.9	15.9	17.8	27.1	32.2	38.5	38.9	38.6	39.6
General government accounts										
Total revenue and grants	31.2	27.8	25.1	23.7	24.7	26.3	26.8	27.0	27.1	27.2
Total expenditure and net lending 1/	40.1	39.1	33.6	40.7	35.3	34.8	32.7	31.0	29.1	28.7
Overall balance (IMF definition) 2/	-8.9	-11.3	-8.5	-17.0	-10.6	-8.5	-5.9	-4.0	-2.0	-1.5
Primary balance (IMF definition)	-7.5	-8.8	-5.6	-13.1	-5.5	-3.1	-1.0	0.3	1.5	1.6
	(In percent of GDP, unless indicated otherwise)									
Monetary sector										
Credit growth (percent change)	57.9	23.5	0.5	8.5	9.0	10.3	10.6	11.1	11.9	15.6
Reserve money growth (percent change)	54.0	2.7	-28.2	24.6	21.8	19.3	16.0	15.3	15.1	16.1
Balance of payments										
Current account balance	-25.4	-11.5	-4.0	-4.1	-4.4	-9.5	-13.6	-10.6	-8.4	-6.2
Gross official reserves (in millions of US$) 3/	2,242	1,648	1,324	1,297	1,692	2,515	3,583	4,032	4,257	4,304
(In months of imports)	3.9	4.0	2.9	2.9	3.4	4.4	6.1	6.5	6.8	7.2
Debt indicators 4/										
General government debt	46.0	57.1	59.5	87.6	94.9	101.3	100.0	97.5	92.3	84.7
Domestic	13.5	14.7	14.6	19.8	21.4	19.4	15.1	11.7	12.9	11.6
External	32.5	42.3	44.9	67.8	73.4	81.9	84.9	85.7	79.5	73.1
General government debt in NPV terms	…	…	55.0	69.1	86.3	89.6	86.5	84.0	79.6	74.3
GFN	9.8	13.3	10.7	18.1	22.4	21.5	18.5	13.8	13.9	17.5
Memorandum items:										
Copper prices (US$ per ton)	7331	6,863	5,510	4,868	5,722	5,733	5,721	5,708	5,704	5,704
Gold prices (US$ per ounce)	1411	1,266	1,160	1,248	1,212	1,225	1,251	1,274	1,299	1,325

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 from swap line.

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

Table 2a. Mongolia: Summary Operations of the General Government, 2014–22

	2014	2015	2016	2017		2018	2019	2020	2021	2022
	Actual	Actual	Prelim	Budget	Proj.					
				(In billions of togrogs)						
Total revenue and grants 1/	6,175	5,807	5,652	5,848	6,431	7,279	8,399	9,445	10,653	12,292
Current revenue	6,173	5,752	5,580	5,702	6,285	7,169	8,274	9,305	10,496	12,111
Tax revenue and social security contributions	5,197	5,121	4,921	4,984	5,523	6,346	7,368	8,316	9,403	10,877
Income taxes	1,101	1,171	1,021	1,056	1,120	1,292	1,441	1,610	1,838	2,215
CIT	621	688	511	495	520	556	641	744	864	1,049
PIT	480	482	510	561	600	735	801	866	974	1,166
Social security contributions	918	1,018	1,100	1,174	1,199	1,410	1,621	2,002	2,309	2,765
VAT	1,372	1,050	1,143	1,274	1,279	1,434	1,714	1,842	2,035	2,205
Excise taxes	454	592	627	547	487	659	752	798	880	985
Customs duties and export taxes	355	321	328	396	417	476	589	627	690	730
Other taxes	997	970	701	536	1,020	1,076	1,251	1,436	1,651	1,978
Non-tax revenue	976	631	660	718	762	823	906	989	1,094	1,234
Capital revenue and grants	2	54	71	146	146	110	125	140	157	180
Total expenditure and net lending	8,682	7,781	9,724	8,720	9,183	9,640	10,257	10,842	11,453	12,958
Current expenditure	5,344	5,656	6,671	6,949	7,178	7,574	7,872	8,025	8,324	9,356
Wages and salaries	1,586	1,710	1,742	1,736	1,764	1,796	1,863	1,910	2,014	2,315
Purchase of goods and services	1,066	1,092	1,421	1,307	1,426	1,497	1,578	1,683	1,792	2,060
Subsidies	167	110	224	191	233	245	258	272	290	333
Transfers	1,973	2,075	2,338	2,368	2,431	2,522	2,633	2,669	2,832	3,256
Interest payments	551	668	945	1,347	1,324	1,514	1,541	1,491	1,396	1,393
Capital expenditure and net lending 2/	3,338	2,126	3,053	1,771	2,005	2,066	2,384	2,817	3,129	3,602
Capital expenditure	2,413	1,397	2,305	1,484	1,607	1,623	1,875	2,261	2,531	2,924
Domestically-financed	2,160	1,151	1,699	949	949	816	915	1,490	1,672	1,972
o/w DBM noncommercial spending	642	431	240	173	173	0	0	0	0	0
Foreign-financed	253	246	606	535	658	807	960	771	858	952
Net lending	925	729	748	287	398	443	510	556	598	677
o/w DBM commercial spending	845	706	247	150	150	159	181	202	226	260
o/w Mortgage program net lending	0	0	0	0	111	120	129	140	151	163
Overall balance (Authorities' definition)	-828	-1,155	-3,668	-2,179	-2,330	-2,126	-1,677	-1,196	-573	-406
Structural overall balance (Authorities' definition)	-868	-1,157	-3,668	-2,409	-2,321	-2,126	-1,677	-1,196	-573	-406
DBM spending	1,487	1,137	487	323	323	159	181	202	226	260
Overall balance (IMF definition)	-2,507	-1,975	-4,072	-2,872	-2,753	-2,361	-1,858	-1,398	-800	-666
Primary balance (IMF definition)	-1,956	-1,306	-3,127	-1,525	-1,428	-846	-317	93	596	727
Financing	2,507	1,975	4,072	2,872	2,753	2,361	1,858	1,398	800	666
External	1,653	384	1,209	1,991	2,024	2,560	2,547	2,097	-94	446
Disbursement	1,770	505	1,345	2,162	2,646	3,268	3,413	2,806	2,067	4,425
Amortization	-116	-121	-136	-172	-622	-708	-866	-709	-2,161	-3,979
Domestic (net)	854	1,591	2,863	881	729	-199	-689	-700	893	220
Government bonds	1,051	366	2,454	1,086	1,069	-274	-689	-700	893	220
Privatization	23	54	0	177	100	75	0	0	0	0
Other	-220	1,170	409	-382	-440	0	0	0	0	0
Memorandum items:										
Mineral revenue (in percent of GDP)	4.6	4.4	2.5	…	3.7	3.7	3.9	4.1	4.3	4.6
Non-mineral revenue (in percent of GDP)	23.2	20.7	21.2	…	20.9	22.6	22.9	22.9	22.8	22.6
Total expenditure (in percent of non-mineral GDP)	46.8	40.6	50.9	…	46.4	45.9	43.6	42.5	40.9	41.9
Non-mineral overall balance (in percent of non-mineral GDP)	-19.0	-15.6	-24.4	…	-18.8	-16.2	-13.1	-11.1	-8.9	-8.9
Primary spending (change in percent)	6.2	-12.5	23.4	-16.0	-10.5	3.4	7.3	7.3	7.5	15.0

Sources: Mongolian authorities; and Fund staff projections.

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

2/ Includes DBM spending.

Table 2b. Mongolia: Summary Operations of the General Government, 2014–22

	2014	2015	2016	2017		2018	2019	2020	2021	2022
	Actual	Actual	Prelim	Budget	Proj.					
	(In percent of GDP)									
Total revenue and grants 1/	27.8	25.1	23.7	22.1	24.7	26.3	26.8	27.0	27.1	27.2
Current revenue	27.8	24.9	23.4	21.5	24.1	25.9	26.4	26.6	26.7	26.8
Tax revenue and social security contributions	23.4	22.1	20.6	18.8	21.2	22.9	23.5	23.7	23.9	24.1
Income taxes	5.0	5.1	4.3	4.0	4.3	4.7	4.6	4.6	4.7	4.9
CIT	2.8	3.0	2.1	1.9	2.0	2.0	2.0	2.1	2.2	2.3
PIT	2.2	2.1	2.1	2.1	2.3	2.7	2.6	2.5	2.5	2.6
Social security contributions	4.1	4.4	4.6	4.4	4.6	5.1	5.2	5.7	5.9	6.1
VAT	6.2	4.5	4.8	4.8	4.9	5.2	5.5	5.3	5.2	4.9
Excise taxes	2.0	2.6	2.6	2.1	1.9	2.4	2.4	2.3	2.2	2.2
Customs duties and export taxes	1.6	1.4	1.4	1.5	1.6	1.7	1.9	1.8	1.8	1.6
Other taxes	4.5	4.2	2.9	2.0	3.9	3.9	4.0	4.1	4.2	4.4
Non-tax revenue	4.4	2.7	2.8	2.7	2.9	3.0	2.9	2.8	2.8	2.7
Capital revenue and grants	0.0	0.2	0.3	0.5	0.6	0.4	0.4	0.4	0.4	0.4
Total expenditure and net lending	39.1	33.6	40.7	32.9	35.3	34.8	32.7	31.0	29.1	28.7
Current expenditure	24.0	24.4	27.9	26.2	27.6	27.4	25.1	22.9	21.2	20.7
Wages and salaries	7.1	7.4	7.3	6.6	6.8	6.5	5.9	5.5	5.1	5.1
Purchase of goods and services	4.8	4.7	6.0	4.9	5.5	5.4	5.0	4.8	4.6	4.6
Subsidies	0.8	0.5	0.9	0.7	0.9	0.9	0.8	0.8	0.7	0.7
Transfers	8.9	9.0	9.8	8.9	9.3	9.1	8.4	7.6	7.2	7.2
Interest payments	2.5	2.9	4.0	5.1	5.1	5.5	4.9	4.3	3.6	3.1
Capital expenditure and net lending 2/	15.0	9.2	12.8	6.7	7.7	7.5	7.6	8.0	8.0	8.0
Capital expenditure	10.9	6.0	9.6	5.6	6.2	5.9	6.0	6.5	6.4	6.5
Domestically-financed	9.7	5.0	7.1	3.6	3.6	2.9	2.9	4.3	4.3	4.4
o/w DBM noncommercial spending	2.9	1.9	1.0	0.7	0.7	0.0	0.0	0.0	0.0	0.0
Foreign-financed	1.1	1.1	2.5	2.0	2.5	2.9	3.1	2.2	2.2	2.1
Net lending	4.2	3.2	3.1	1.1	1.5	1.6	1.6	1.6	1.5	1.5
o/w DBM commercial spending	3.8	3.1	1.0	0.6	0.6	0.6	0.6	0.6	0.6	0.6
o/w Mortgage program net lending	0.0	0.0	0.0	0.0	0.4	0.4	0.4	0.4	0.4	0.4
Overall balance (Authorities' definition)	-3.7	-5.0	-15.4	-8.2	-8.9	-7.7	-5.3	-3.4	-1.5	-0.9
Structural overall balance (Authorities' definition)	-3.9	-5.0	-15.4	-9.1	-8.9	-7.7	-5.3	-3.4	-1.5	-0.9
DBM spending	6.7	4.9	2.0	1.2	1.2	0.6	0.6	0.6	0.6	0.6
Overall balance (IMF definition)	-11.3	-8.5	-17.0	-10.8	-10.6	-8.5	-5.9	-4.0	-2.0	-1.5
Primary balance (IMF definition)	-8.8	-5.6	-13.1	-5.8	-5.5	-3.1	-1.0	0.3	1.5	1.6
Financing	11.3	8.5	17.0	10.8	10.6	8.5	5.9	4.0	2.0	1.5
External	7.4	1.7	5.1	7.5	7.8	9.2	8.1	6.0	-0.2	1.0
Disbursement	8.0	2.2	5.6	8.2	10.2	11.8	10.9	8.0	5.3	9.8
Amortization	-0.5	-0.5	-0.6	-0.6	-2.4	-2.6	-2.8	-2.0	-5.5	-8.8
Domestic (net)	3.8	6.9	12.0	3.3	2.8	-0.7	-2.2	-2.0	2.3	0.5
Government bonds	4.7	1.6	10.3	4.1	4.1	-1.0	-2.2	-2.0	2.3	0.5
Privatization	0.1	0.2	0.0	0.7	0.4	0.3	0.0	0.0	0.0	0.0
Other	-1.0	5.1	1.7	-1.4	-1.7	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Mineral revenue (in percent of GDP)	4.6	4.4	2.5	…	3.7	3.7	3.9	4.1	4.3	4.6
Non-mineral revenue (in percent of GDP)	23.2	20.7	21.2	…	20.9	22.6	22.9	22.9	22.8	22.6
Total expenditure (in percent of non-mineral GDP)	46.8	40.6	50.9	…	46.4	45.9	43.6	42.5	40.9	41.9
Non-mineral overall balance (in percent of non-mineral GDP)	-19.0	-15.6	-24.4	…	-18.8	-16.2	-13.1	-11.1	-8.9	-8.9
Primary spending (change in percent)	6.2	-12.5	23.4	-16.0	-10.5	3.4	7.3	7.3	7.5	15.0

Sources: Mongolian authorities; and Fund staff projections.

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

2/ Includes DBM spending.

Table 3. Mongolia: Balance of Payments, 2013–22

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Projections					
	(In millions of U.S. dollars, unless otherwise indicated) 1/									
Current account balance (including official grants)	-3,192	-1,405	-469	-449	-456	-1,004	-1,568	-1,301	-1,110	-905
Trade balance	-1,321	994	1,178	1,330	1,266	968	709	1,002	1,267	1,626
Exports	4,269	5,776	4,616	4,803	4,898	4,943	5,440	5,827	6,348	6,777
Mineral export	4,050	4,762	4,099	4,125	4,314	4,351	4,825	5,195	5,691	6,103
Non-mineral export	219	1,014	517	678	584	592	615	633	656	675
Imports	-5,590	-4,783	-3,438	-3,473	-3,632	-3,975	-4,731	-4,825	-5,081	-5,151
Services, net	-1,314	-1,553	-857	-1,142	-1,017	-1,174	-1,328	-1,333	-1,405	-1,423
Income, net	-699	-989	-966	-832	-937	-1,033	-1,196	-1,229	-1,243	-1,374
Current transfers	140	168	175	191	231	234	248	259	272	266
General government	22	27	27	29	31	32	35	37	40	21
Other sectors	118	142	148	162	200	202	212	221	231	245
Of which: Workers remittances	26	55	76	108	88	88	96	103	110	121
Capital and financial account	1,438	1,112	382	707	91	785	1,589	1,325	1,185	902
Capital account	126	100	114	92	114	117	128	137	147	152
Financial account	1,312	1,012	268	615	-23	667	1,461	1,188	1,038	751
Direct investment	2,098	276	110	-4,081	995	1,547	2,385	2,036	2,081	1,456
Portfolio investment	-156	277	274	469	-94	0	0	-260	-319	0
Trade credits, net	9	-136	-302	-201	-45	-45	-45	-45	-45	-45
Currency and deposits, net	-1,376	-210	-233	-497	-886	-663	-791	-652	-751	-755
Loans, net	737	758	347	5,045	7	-171	-88	108	72	95
Other, net	0	48	72	-120	0	0	0	0	0	0
Errors and omissions	-113	-128	-181	-277	0	0	0	0	0	0
Overall balance	-1,867	-421	-268	-18	-365	-220	21	24	75	-3
Financing Gap	0	0	0	0	760	1,043	1,047	425	150	50
Fund credit	-93	-61	-3	0	113.5	134.7	141.8	35.5	0.0	0.0
Donor support					647	908	905	390	150	50
Memorandum items:										
Current account balance (in percent of GDP)	-25.4	-11.5	-4.0	-4.1	-4.4	-9.5	-13.6	-10.6	-8.4	-6.2
Gross official reserves (end-period) 2/	2,242	1,648	1,324	1,297	1,692	2,515	3,583	4,032	4,257	4,304
(In months of next year's imports of goods and services)	3.9	4.0	2.9	2.9	3.4	4.4	6.1	6.5	6.8	7.2
Change in reserves 3/	-1,885	-594	-324	-27	395	823	1,068	449	225	47
Copper price (in U.S. dollars per ton)	7,331	6,863	5,510	4,868	5,722	5,733	5,721	5,708	5,704	5,704
Oil price (in U.S. dollars per barrel)	104	96	51	43	55	56	56	56	56	57
Gold price (in U.S. dollars per troy oz.)	1,411	1,266	1,160	1,248	1,212	1,225	1,251	1,274	1,299	1,325

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/ Gross official reserves includes drawings from swap line.

3/ Changes in reserves reflect valuation adjustments.

Table 4. Mongolia: Monetary Aggregates, 2013–22

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
							Projections			
	(In billions of togrog, end of period)									
Monetary survey										
Broad money	9,449	10,635	10,008	12,031	13,967	15,822	18,465	21,356	24,721	28,777
Currency	582	499	461	565	656	743	867	1,003	1,161	1,351
Deposits	8,867	10,135	9,547	11,466	13,311	15,079	17,597	20,353	23,560	27,426
Net foreign assets	760	-2,021	-4,166	-5,028	-4,176	-2,037	710	2,057	3,951	4,184
Net domestic assets	8,689	12,656	14,174	17,058	18,143	17,859	17,754	19,298	20,769	24,594
Domestic credit	9,974	13,738	14,386	16,760	18,252	19,640	20,846	22,339	25,840	28,284
Net credit to government	-1,061	106	683	1,886	2,044	1,770	1,081	381	1,274	-112
Credit to the private sector 1/	11,034	13,632	13,703	14,874	16,208	17,870	19,765	21,958	24,566	28,396
Other items, net	-1,285	-1,082	-212	298	-109	-1,780	-3,092	-3,040	-5,071	-3,690
Monetary authorities										
Reserve money	3,335	3,427	2,462	3,067	3,734	4,457	5,172	5,965	6,867	7,972
Net foreign assets	1,941	120	-1,286	-1,708	-731	1,072	3,797	5,206	7,341	7,830
Net domestic assets	1,394	3,307	3,748	4,774	4,466	3,385	1,375	759	-475	142
Net credit to government	-1,685	-570	-474	-332	-332	-332	-332	-332	-332	-332
Claims on deposit money banks	4,297	2,608	1,686	1,471	1,097	837	677	567	445	495
Minus: Central bank bills (net)	1,627	854	1,025	577	979	2,535	5,041	6,469	8,418	8,706
Other items, net	410	2,123	3,559	4,212	4,680	5,415	6,071	6,993	7,830	8,684
Memorandum items:	(In percent, unless otherwise indicated)									
Annual broad money growth	24.1	12.5	-5.9	20.2	16.1	13.3	16.7	15.7	15.8	16.4
Annual reserve money growth	54.0	2.7	-28.2	24.6	21.8	19.3	16.0	15.3	15.1	16.1
Velocity	2.0	2.1	2.3	2.0	1.9	1.8	1.7	1.6	1.6	1.6
Credit growth (percent)	57.9	23.5	0.5	8.5	9.0	10.3	10.6	11.1	11.9	15.6

Sources: Mongolian authorities; and Fund staff projections.
1/ Includes mortgage-backed securities.

Table 5. Mongolia: Summary of Financial Stability Indicators

	2010	2011	2012	2013	2014	2015	2016	2017
				Dec	Dec	Dec	Dec	Feb
Capital (in percent)								
Risk Weighted CAR	16.2	15.9	15.5	16.0	17.7	17.9	18.6	18.5
Risk Weighted CAR (excluding Anod and Zoos)	16.2	15.9	15.5	16.0	17.6	17.8	18.3	18.2
Asset quality								
Asset Growth (percent change from start of year)	43.0	46.5	50.5	68.2	11.7	-3.6	21.3	-0.8
Loan Growth (Net) (percent change from start of year)	26.4	34.0	37.8	52.4	17.5	-8.6	4.7	1.3
Loan share in total assets (in percent)	47.9	49.6	49.6	53.1	55.9	53.0	46.0	47.0
Non Performing Loan (in percent)								
NPL to gross loans	6.7	6.0	5.8	2.5	3.1	7.3	7.2	6.9
Past-due to gross loans	3.0	3.3	3.5	0.0	2.2	5.6	7.1	8.4
NPL(old) to gross loans	9.7	9.2	9.3	3.6	5.3	12.9	14.2	15.3
Provision	9.7	9.2	9.3	3.6	5.3	12.9	14.0	15.1
Provision/NPL*s	62.4	65.2	65.4	71.6	70.2	61.6	72.2	75.0
Provision/NPL(old)s	43.2	42.2	40.9	49.7	41.5	34.8	36.4	34.0
NPL*s net of provision /Capital	12.5	10.6	10.5	4.3	5.0	12.7	7.9	6.6
NPL(old) net of provision /Capital	27.2	27.3	28.6	11.1	16.5	38.2	35.7	38.4
FX loans to total loans	33.7	33.2	34.4	27.5	23.5	24.5	20.2	20.4
Interest Rate (in percent)								
Average lending rate	17.4	17.4	17.0	14.0	14.3	15.2	16.7	18.6
Earnings and Profitability (in percent)								
Return on assets	1.8	2.7	1.8	2.7	1.8	1.2	0.8	1.6
Return on equity	11.2	24.2	14.6	20.4	13.5	9.1	6.9	14.7
Interest income to gross income	34.2	30.5	34.6	49.3	54.6	64.5	60.9	69.0
Interest expenses to gross income	21.3	19.2	22.5	30.2	34.7	41.1	42.2	49.2
Non-interest expenses to gross income	72.7	72.7	71.2	57.9	55.4	51.4	53.3	40.2
Personal expenses to Non-interest expenses	7.2	6.5	7.7	10.2	11.2	13.9	11.8	16.2
Liquidity (in percent)								
Liquid assets to Total assets	44.1	43.3	43.4	30.9	25.2	22.0	24.0	22.2
Liquid assets to Short-term liabilities	53.3	52.1	52.1	32.0	29.7	30.6	35.8	33.4
FX deposit to total Deposits	32.4	29.9	30.9	21.6	26.8	26.1	31.7	29.3

Source: Mongolian authorities.

Table 6. Mongolia: External Financing Requirements and Sources, 2015–2022

(In millions of U.S. dollars)

	2015	2016	2017	2018	2019	2020	2021	2022
			Projections					
Gross financing requirements	935	2096	2719	3417	4279	3523	3183	3220
External current account deficit (excl. official trai	497	482	487	1037	1603	1338	1151	926
Amortization	427	559	1019	946	880	1162	1141	1582
Public sector	64	62	257	301	329	259	734	1174
o/w bonds		0	0	0	0	0	500	1000
o/w loans		75	257	301	329	259	234	174
Private sector	363	497	762	645	551	903	407	407
Repayment of arrears	0	0	0	0	0	0	0	0
Gross reserves accumulation (increase = +)	-324	-27	395	823	1068	449	225	47
IMF repurchases and repayments	3	0	0	0	0	0	0	0
Other net capital outflows 1/	332	1082	818	612	728	573	666	665
Available financing	935	2096	1959	2374	3232	3098	3033	3170
Grants	28	33	31	32	35	37	40	21
Disbursements to public sector	255	1133	396	335	344	549	444	1223
o/w bonds		500	20	0	0	240	181	1000
o/w loans		467	376	335	344	309	263	223
Disbursements to private sector	543	5011	535	460	467	475	467	470
Foreign direct investment	110	-4081	995	1547	2385	2036	2081	1456
Financing need	0	0	760	1043	1047	425	150	50
Financing	0	0	760	1043	1047	425	150	50
IMF	0	0	113.5	134.7	141.8	35.5	0	0
Other IFI	0	0	313	475	472	240	0	0
Identified bilateral support	0	0	333	433	433	150	150	50
PBOC swap (additional drawing)	0	0	0	0	0	0	0	0
PBOC swap rollover (net zero)			1725			1725		

Sources: Mongolian authorities; and Fund staff projections.

1/ Includes all other net financial flows, and errors and omissions.

Table 7. Mongolia: Capacity to Repay Indicators, 2017–22
(In millions of SDR, unless otherwise indicated)

	Projections					
	2017	2018	2019	2020	2021	2022
Exposure and Repayments from Existing and Prospective Fund Arrangements						
GRA credit to Mongolia	83.87	183.46	288.30	314.51	311.02	293.11
In percent of quota	116.00	253.75	398.75	435.00	430.17	405.40
Debt service on GRA credit	0.71	1.97	4.75	7.37	11.14	25.33
Principal (repayments/repurchases)					3.49	17.91
Charges and interest	0.71	1.97	4.75	7.37	7.65	7.42
Debt and debt service ratios (In percent of GDP)						
Public and publicly-guaranteed debt	94.86	101.34	100.00	97.46	92.31	84.70
Excluding proposed IMF	93.77	99.00	96.63	94.02	89.15	81.99
GRA credit to Mongolia	1.10	2.34	3.37	3.44	3.16	2.71
Public and publicly-guaranteed debt service	17.69	19.20	18.17	14.67	15.89	19.08
Excluding proposed IMF	17.68	19.17	18.11	14.59	15.77	18.84
GRA debt service	0.01	0.03	0.06	0.08	0.11	0.23
Debt and debt service ratios (In percent of exports of goods and services)						
Public and publicly-guaranteed debt	171.01	185.46	182.44	178.13	167.39	158.51
Excluding proposed IMF	169.03	181.18	176.30	171.84	161.66	153.45
GRA credit to Mongolia	1.98	4.28	6.14	6.28	5.74	5.07
Public and publicly-guaranteed debt service	31.89	35.13	33.14	26.81	28.81	35.70
Excluding proposed IMF	31.87	35.08	33.04	26.66	28.60	35.27
GRA debt service	0.02	0.05	0.10	0.15	0.21	0.44

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

Table 8. Mongolia: Indicators of Fund Credit, 2017-22
(In millions of SDR, unless otherwise indicated)

			Projections			
	2017	2018	2019	2020	2021	2022
Existing and prospective Fund arrangements						
Disbursements	83.87	99.59	104.84	26.21		
Stock 1/	83.87	183.46	288.30	314.51	311.02	293.11
Obligations 2/					11.14	25.33
Principal (repayments/repurchases)					3.49	17.91
Charges and interest	0.71	1.97	4.75	7.37	7.65	7.42
Stock of existing and prospective Fund credit 1/	83.87	183.46	288.30	314.51	311.02	293.11
In percent of quota	116.00	253.75	398.75	435.00	430.17	405.40
In percent of GDP	1.10	2.34	3.37	3.44	3.16	2.71
In percent of exports of goods and services	1.98	4.28	6.14	6.28	5.74	5.07
In percent of gross usable reserves	4.96	7.29	8.05	7.80	7.31	6.81
Obligations to the Fund from existing and prospective Fund arrangements	0.71	1.97	4.75	7.37	11.14	25.33
In percent of quota	0.98	2.72	6.57	10.19	15.41	35.03
In percent of GDP	0.01	0.03	0.06	0.08	0.11	0.23
In percent of exports of goods and services	0.02	0.05	0.10	0.15	0.21	0.44
In percent of gross usable reserves	0.04	0.08	0.13	0.18	0.26	0.59

Sources: IMF Finance Department; and Fund staff estimates and projections.
1/ End of period.
2/ Repayment schedule based on scheduled debt service obligations.

Table 9. Mongolia: Proposed Access and Phasing Under the Extended Arrangement

Availability Date		Purchase		
		Million SDR	Million USD	Percent of Quota
April 28, 2017	Board approval of extended arrangement	20.9670	28.36	29.00
June 15, 2017	Observance of end-April 2017 performance criteria, completion of first review	20.9670	28.36	29.00
September 15, 2017	Observance of end-June 2017 performance criteria, completion of second review	20.9670	28.36	29.00
December 15, 2017	Observance of end-September 2017 performance criteria, completion of third review	20.9670	28.36	29.00
March 15, 2018	Observance of end-December 2017 performance criteria, completion of fourth review	20.9670	28.36	29.00
June 15, 2018	Observance of end-March 2018 performance criteria, completion of fifth review	26.2088	35.45	36.25
September 15, 2018	Observance of end-June 2018 performance criteria, completion of sixth review	26.2088	35.45	36.25
December 15, 2018	Observance of end-September 2018 performance criteria, completion of seventh review	26.2088	35.45	36.25
March 15, 2019	Observance of end-December 2018 performance criteria, completion of eight review	26.2088	35.45	36.25
June 15, 2019	Observance of end-March 2019 performance criteria, completion of ninth review	26.2088	35.45	36.25
September 15, 2019	Observance of end-June 2019 performance criteria, completion of tenth review	26.2088	35.45	36.25
December 15, 2019	Observance of end-September 2019 performance criteria, completion of eleventh review	26.2088	35.45	36.25
March 15, 2020	Observance of end-December 2019 performance criteria, completion of twelfth review	26.2088	35.45	36.25
		314.5054	**425.4**	**435.00**

Table 10. Mongolia: Quantitative Performance Criteria

	4/30/2017	6/30/2017	9/30/2017	12/31/2017	3/30/2018 Indicative targets
Performance Criteria 1/ 2/					
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)	-250	0	100	250	550
Net domestic assets (NDA) of the BOM (ceiling, eop stock, in billion togrog at program exchange rate)	5,400	5,100	4,900	4,600	4,000
Primary balance of the general government (floor, cumulative since the beginning of the fiscal year, in billion togrog)	-650	-850	-1,050	-1,500	-350
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$).	600	1,800	1,800	1,800	1,800
Stock of guarantees on external debt extended by the government or BOM (ceiling, eop stock, in million US$)	850	850	850	750	750
Indicative Targets (IT)					
Reserve money (ceiling, in billion togrog)	3,400	3,500	3,900	4,000	4,200
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$).	0	0	0	0	0
Accumulation of new external payment arrears (ceiling, eop, in million US$).	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$)	0	257	427	597	783
Net nonconcessional borrowing received and repatriated by the general government (including the DBM) under the program baseline (eop stock, cumulative, in million US$)	20	20	20	20	20
Program exchange rate (togrog/U.S. dollar)	2489.4	2489.4	2489.4	2489.4	2489.4
U.S. dollar per SDR	1.3	1.3	1.3	1.3	1.3
Monetary gold price (U.S. dollar/ounce)	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 in Q1 2018.

Annex I. Global Risk Assessment Matrix

Sources of Risks	Likelihood	Potential Impact	Recommendation
		External	
Significant further strengthening of the US dollar and/or higher rates.	**H**	**H:** Filling the large external financing gap could be more challenging and expensive if markets reassess Mongolia's sovereign risk.	Maintain exchange rate flexibility and tighten macro policies; improve investment climate to attract FDI.
Significant China slowdown and its spillovers.	**L-M**	**H:** Exports could decline further, intensifying BOP pressures and fiscal revenue shortfalls. More currency depreciation could be likely, adversely affecting the banks.	Medium term: maintain exchange rate flexibility to preserve FX reserves; tighten macro policies. Long term: build resilience against external shocks; realize inclusive growth via diversification of the economy.
		Domestic	
Expansionary fiscal policy.	**M**	**H:** Inability to tighten fiscal policy could further intensify BOP pressures and add to debt burdens.	Undertake fiscal consolidation in line with requirements of the FSL.
Loose monetary policy.	**M**	**H:** Loose monetary policy could worsen BOP pressure and raise banking-sector risks.	Monetary policy should remain tight and the unconventional policies followed in recent past remain discontinued.
Elevated banking fragilities.	**H**	**H:** Bank and/or currency run could emerge should confidence weaken. Given the high degree of dollarization in the economy, this could put further pressure on reserves.	Strengthen supervisory framework; phase out forbearance; enhance provisions and capital ratios.
Uncertain business climate.	**M-H**	**H:** Uncertain environment could impede FDI inflows and further weigh on investors' confidence.	Improve business climate, clarify tax issues, and enhance transparency.
Political constraints ahead of presidential election in mid 2017.	**M**	**H:** Political factors could constrain decisive action on appropriately tight policies and cleaning up the banking system.	Better public awareness of the seriousness of the current economic difficulties and developing consensus on the need for adjustment.

Annex II. Debt Sustainability Analysis

Public Sector DSA

Mongolia's public debt has risen very sharply in recent years and, absent the fiscal adjustment, concessional financing, and private-sector creditor engagement strategy under the program, debt would be on an unsustainable trajectory. These elements, however, help to restore debt sustainability (contingent on successful implementation of the program), and the envisaged growth recovery and normalization of borrowing costs further improve debt dynamics.

Staff see the programmed deficit reduction as realistic given the authorities' strong commitment and the program's substantial structural conditionality to strengthen fiscal discipline. The projected recovery of growth is justified by the development of large mining projects—the second phase of Oyu Tolgoi, the Tavan Tolgoi coal mine, and the Gatsuurt gold mine—as well as the rebound of mineral prices.

The heat map, fan charts, and stress tests all point to significant vulnerabilities. Although debt trends down rapidly in all scenarios, given Mongolia's projected fiscal adjustment and strong growth prospects, debt levels remain high for many years, and gross financing needs are subject to risks in certain shock scenarios.

This DSA focuses on the general government and presents projections over a 10-year period. The coverage of public debt in this DSA includes: (i) general government debt (including that of the DBM); (ii) government guaranteed debt; and (iii) liabilities to the Fund. The PBOC swap line is not included since—assuming successful program implementation and materialization of staff's reserves projections—BOM reserves would be strong enough to allow BOM to repay this liability without recourse to government coffers. SOE debt is also excluded.[1] As for the projection period, it is useful in Mongolia's case to look at a 10-year horizon, given the country's long-term growth potential (based on long-gestation mining projects currently under development) and its reliance on long-term concessional finance; nonetheless, attention is focused primarily on the first five years given the inherent uncertainty of longer-term projections.

Public debt in Mongolia is very high, but on a declining path toward the end of the projection period under the program scenario. Nominal debt increased substantially from 59.5 percent of GDP in 2015 to 87.6 percent by the end of 2016, mostly reflecting low commodity prices (and thus revenue shortfalls), loose fiscal policy exacerbated by one-off spending prior to the 2016 elections, an increase in interest payments, and currency depreciation. Debt is projected to increase further through 2018 before starting to decline from 2019 onward, falling to 84.7 percent of GDP by 2022 and 59.7 percent by 2026, given the rapid and sustained growth expected as OT-2 comes onstream. In the outer years, debt should continue to decline, given continued strong economic growth and low fiscal deficits.

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[1] Though the basis for monitoring is the general government, SOEs that receive subsidies amounting to more than 50 percent of their costs could be considered government units, and their debts could thus be included. No SOEs in Mongolia, however, meet this test.

Debt levels are vulnerable to shocks but remain on a sustainable path. The heat map indicates that Mongolia breaches various high-risk DSA benchmarks. Fan charts and stress tests both suggest that public debt could increase substantially in the event of a real GDP growth shock and, to a lesser extent, other shocks. In addition, GFN remains high in some years, particularly among those toward the end of the projection period when debt has dropped to much lower levels (less than 70 percent).

The high share of concessional financing implies that the present value of debt is significantly below the nominal level. Because of the high share of concessional financing in Mongolia's public debt—and in particular, the large amount of concessional financing under the program—it is appropriate to analyze PV debt as a major indicator for debt sustainability.[2] Concessional financing provides much more favorable terms with interest rates typically below 2 percent and maturities up to over 20 years. As a result, PV debt is at much lower levels, rising from 69.1 percent in 2016 to 86.3 percent in 2017, and is projected to increase further to 89.6 percent in 2018 before starting to decline from 2019 onward.

Staff assess Mongolia's public debt as sustainable, reflecting a number of factors:

At the core is the fiscal adjustment to bring the deficit to sustainable levels. The deficit will decline from 17 percent of GDP in 2016 to 10.6 percent in 2017, and further to around 1.5 percent of GDP by 2022, and the primary balance will move from a deficit of 13.1 percent of GDP in 2016 to a surplus of 1.6 percent of GDP in 2022. The proposed adjustment is ambitious but necessary—to put public debt on a sustainable path—and feasible, given that a large part of the consolidation in 2017 reflects the disappearance of one-off factors that had bloated the 2016 deficit. While the adjustments are large in cross-country comparisons (the 3-year adjustment in the cyclically-adjusted primary balance, or CAPB, is in the top quartile), fiscal deficits remain relatively high (3-year average CAPB level has a percentile rank of 57 percent).

The economic outlook is favorable. After a contraction in 2017 and still weak growth in 2018, growth is projected to be 8 percent in 2019 and strong thereafter, averaging nearly 7 percent from 2020 to 2026. This is mostly driven by development of major mines and production from these mines. The growth assumptions are consistent with the fiscal adjustment path, but could be on the conservative side as a short-term fiscal multiplier (from deficit reduction) of over 1.0 is assumed—substantially higher than suggested by the literature.[3]

The financing package helps restore debt sustainability. The total package of $5½ billion—largely concessional—helps reduce more expensive domestic public borrowing and lower PV debt. As this concessional financing is long term and domestic borrowing in Mongolia typically has very short maturities, this also helps lower GFN substantially, another key indicator in assessing debt sustainability. Absent this concessional support, debt would be on an unsustainable trajectory.

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[2]Also, Mongolia graduated from the PRGT only recently—in late 2015—and earlier DSAs were all centered around PV debt.

[3] It is worth noting that the sharp fiscal expansion in 2016 did not generate a corresponding economic boom., suggesting again that multipliers may be lower than envisaged.

Both external and domestic private creditors will continue to be engaged. The $580 million DBM bond was successfully exchanged in early 2017, and against this background, it is expected that the $500 million Chinggis bond and $161 million Dim Sum bond maturing in 2018 will also be refinanced in the market. The government will also guide and engage with its domestic creditors so that they continue financing the government on terms consistent with debt sustainability. It is anticipated that over time, yields should be substantially lower than those prevailing today.

Bank recapitalization needs could amount to 7 percent of GDP. Should the banks not be able to raise capital fully from their shareholders and the private sector, public funds could be used, if financial stability is at risk, subject to strict criteria that will be developed in consultation with Fund staff. The recapitalization framework will incentivize banks to raise as much private capital as possible, but a contingency of up to 3½ percent of GDP has been included in the DSA, in case such funding should be needed. Nonetheless, the banking sector is currently weak and could deteriorate further with fiscal tightening and exchange rate depreciation, potentially raising recapitalization needs. More information will be available after the AQR is completed.

Mongolia Public DSA–Baseline Scenario

(percent of GDP, unless otherwise indicated)

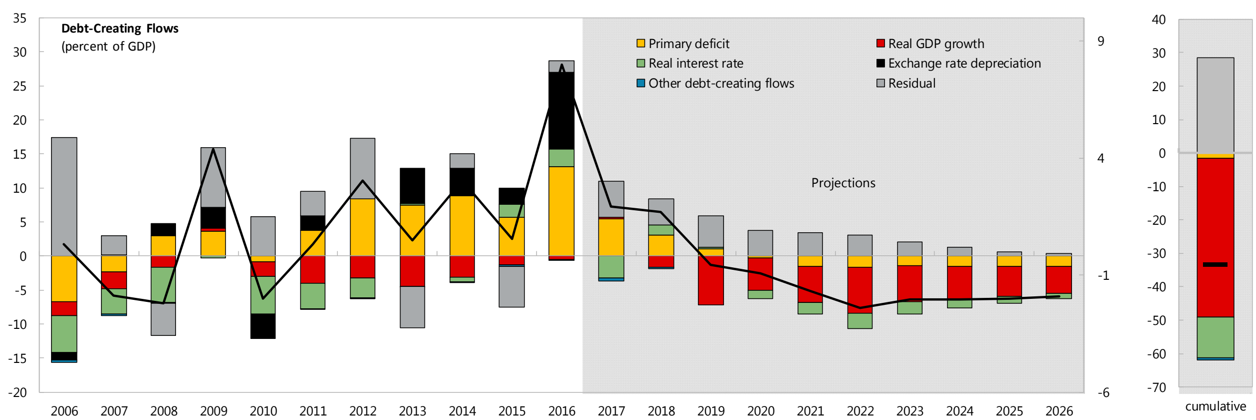
Debt, Economic and Market Indicators 1/

	Actual			Projections									
	2006–2014 2/	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	36.9	59.5	87.6	94.9	101.3	100.0	97.5	92.3	84.7	78.3	71.9	65.6	59.7
PV of public debt		55.0	69.1	86.3	89.6	86.5	84.0	79.6	74.3	70.0	65.6	61.0	56.5
Public gross financing needs	3.8	10.7	18.1	22.4	21.5	18.5	13.8	13.9	17.5	12.8	15.3	19.5	19.5
Real GDP growth (percent)	8.8	2.4	1.0	-0.2	1.8	8.1	5.3	6.1	8.5	7.0	7.0	6.8	6.7
Inflation (GDP deflator, percent)	13.1	1.7	2.3	9.3	4.4	4.9	5.9	5.8	5.9	5.8	5.6	5.7	5.7
Nominal GDP growth (percent)	23.8	4.1	3.3	9.0	6.3	13.4	11.6	12.2	14.9	13.2	13.0	12.9	12.8
Effective interest rate (percent) 4/	2.3	5.3	6.9	5.2	6.1	5.6	4.8	4.2	3.7	3.8	4.2	4.4	4.8

As of April 05, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		455
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	Caa1	Caa1
S&Ps	B-	B-
Fitch	B-	B-

Contribution to Changes in Public Debt

	Actual			Projections											
	2006–2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	Cumulative	Debt-stabilizing primary balance 9/
Change in gross public sector debt	2.7	2.5	28.1	7.3	6.5	-1.3	-2.5	-5.2	-7.6	-6.4	-6.4	-6.3	-5.9	-27.9	-3.1
Identified debt-creating flows	-1.6	8.4	26.4	4.4	5.1	-2.6	-2.8	-5.0	-7.5	-5.9	-5.3	-4.9	-4.7	-29.3	
Primary deficit	2.8	5.6	13.1	5.5	3.1	1.0	-0.3	-1.5	-1.6	-1.5	-1.6	-1.5	-1.6	0.0	
Primary (noninterest) revenue and grants	28.8	25.1	23.7	24.7	26.3	26.8	27.0	27.1	27.2	27.0	27.0	27.1	27.1	267.2	
Primary (noninterest) expenditure	31.6	30.7	36.8	30.2	29.3	27.8	26.7	25.6	25.6	25.5	25.5	25.5	25.5	267.2	
Automatic debt dynamics 5/	-4.2	3.0	13.3	-0.7	2.3	-3.7	-2.6	-3.5	-5.9	-4.4	-3.7	-3.4	-3.1	-28.7	
Interest rate/growth differential 6/	-5.5	0.7	2.1	-3.1	-0.2	-6.9	-6.0	-7.0	-9.1	-7.0	-6.1	-5.4	-4.7	-55.6	
Of which: real interest rate	-3.0	1.9	2.6	-3.3	1.4	0.3	-1.3	-1.7	-2.2	-1.8	-1.3	-1.0	-0.8	-11.6	
Of which: real GDP growth	-2.5	-1.3	-0.6	0.2	-1.6	-7.2	-4.8	-5.3	-6.8	-5.2	-4.8	-4.3	-3.9	-44.0	
Exchange rate depreciation 7/	1.3	2.3	11.3	…	…	…	…	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.1	-0.2	0.0	-0.4	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.7	
Net privatization proceeds	-0.1	-0.2	0.0	-0.4	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.7	
Contingent liabilities	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	
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/	4.3	-5.9	1.6	5.3	3.9	4.6	3.8	3.4	3.1	2.1	1.3	0.6	0.3	28.3	

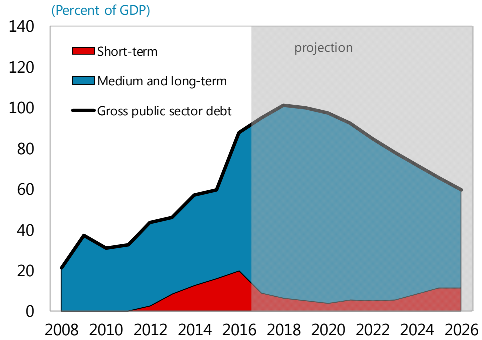


Source: IMF staff
1/ Public sector is defined as general government
2/ Based on available data
3/ Bond Spread over U.S. Bonds.
4/ Defined as interest payments divided by debt stock at the end of previous year
5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with 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 (measured by increase in local currency value of U.S. dollar)
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

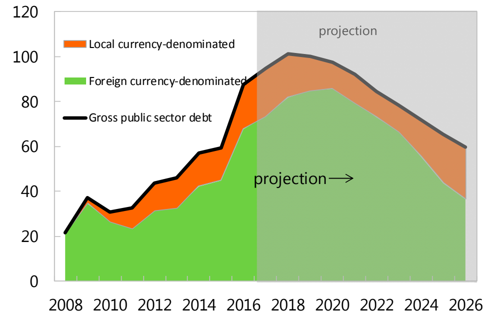
Mongolia Public DSA–Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(Percent of GDP)



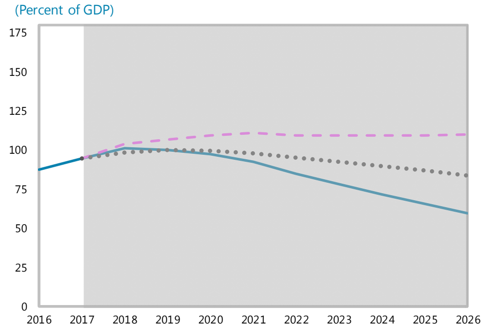
By Currency
(Percent of GDP)



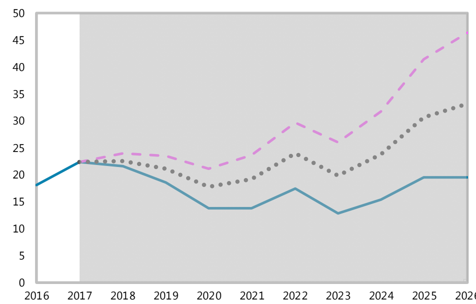
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(Percent of GDP)



Public Gross Financing Needs
(Percent of GDP)



Underlying Assumptions
(Percent)

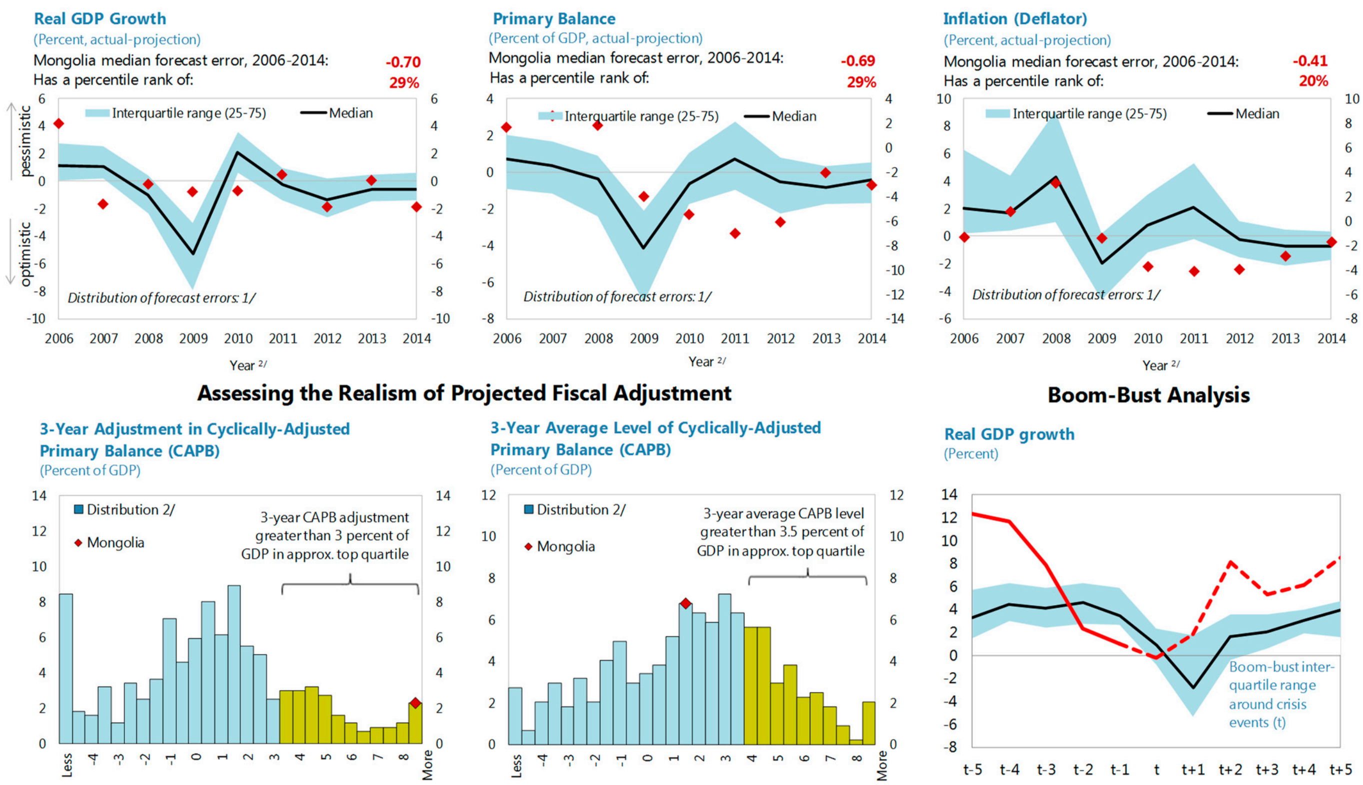
Baseline scenario	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Real GDP growth	-0.2	1.8	8.1	5.3	6.1	8.5	7.0	7.0	6.8	6.7
Inflation	9.3	4.4	4.9	5.9	5.8	5.9	5.8	5.6	5.7	5.7
Primary balance	-5.5	-3.1	-1.0	0.3	1.5	1.6	1.5	1.6	1.5	1.6
Effective interest rate	5.2	6.1	5.6	4.8	4.2	3.7	3.8	4.2	4.4	4.8
Constant primary balance scenario										
Real GDP growth	-0.2	1.8	8.1	5.3	6.1	8.5	7.0	7.0	6.8	6.7
Inflation	9.3	4.4	4.9	5.9	5.8	5.9	5.8	5.6	5.7	5.7
Primary balance	-5.5	-5.5	-5.5	-5.5	-5.5	-5.5	-5.5	-5.5	-5.5	-5.5
Effective interest rate	5.2	6.1	5.3	4.7	4.2	3.9	4.0	4.5	4.7	5.1

Historical scenario	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Real GDP growth	-0.2	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Inflation	9.3	4.4	4.9	5.9	5.8	5.9	5.8	5.6	5.7	5.7
Primary balance	-5.5	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0
Effective interest rate	5.2	6.1	4.2	2.9	2.0	1.2	0.8	0.9	0.8	0.9

Source: IMF staff

Mongolia Public DSA–Realism of Baseline Assumptions

Forecast Track Record, versus all countries



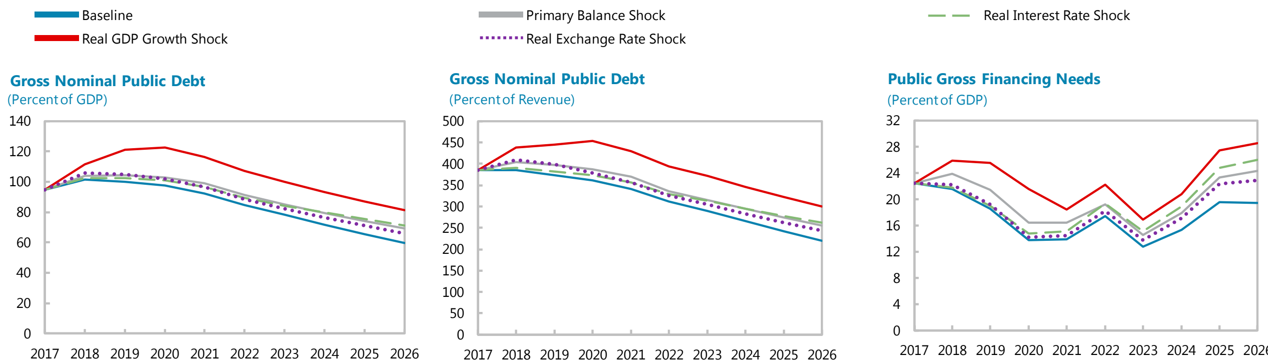
Source : IMF staff

1/ Plotted distribution includes all countries, percentile rank refers to all countries. Projections made in the spring WEO vintage of the preceding year

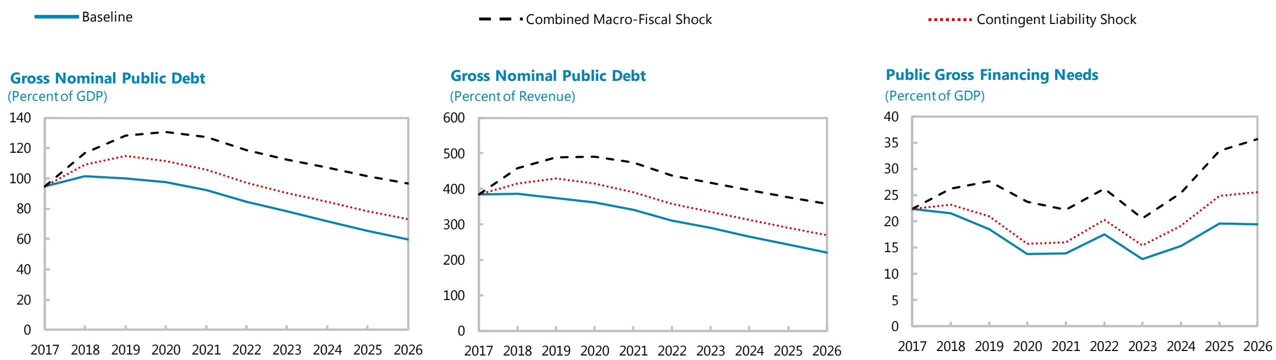
2/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis

Mongolia Public DSA–Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(Percent)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Primary Balance Shock										
Real GDP growth	-0.2	1.9	8.3	5.5	6.3	8.5	7.0	7.0	6.8	6.7
Inflation	9.3	4.4	4.9	5.9	5.8	5.9	5.8	5.6	5.7	5.7
Primary balance	-5.5	-5.5	-3.1	-1.0	0.3	1.5	1.5	1.5	1.5	1.5
Effective interest rate	5.2	6.1	5.8	5.1	4.4	4.0	4.1	4.5	4.7	5.1
Real Interest Rate Shock										
Real GDP growth	-0.2	0.6	7.1	4.7	5.7	8.3	6.8	6.8	6.6	6.5
Inflation	9.3	4.4	4.9	5.9	5.8	5.9	5.8	5.6	5.7	5.7
Primary balance	-5.5	-3.1	-1.0	0.3	1.5	1.6	1.5	1.6	1.5	1.6
Effective interest rate	5.2	6.1	5.8	5.4	4.9	4.6	5.0	5.5	5.9	6.3
Combined Shock										
Real GDP growth	-0.2	-3.9	2.3	4.7	5.7	8.3	6.8	6.8	6.6	6.5
Inflation	9.3	3.0	3.5	5.9	5.8	5.9	5.8	5.6	5.7	5.7
Primary balance	-5.5	-6.0	-5.7	-4.1	0.3	1.5	1.5	1.5	1.5	1.5
Effective interest rate	5.2	6.3	5.8	5.4	5.0	4.8	5.1	5.6	5.9	6.4

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Real GDP Growth Shock										
Real GDP growth	-0.2	-3.9	2.3	5.3	6.1	8.5	7.0	7.0	6.8	6.7
Inflation	9.3	3.0	3.5	5.9	5.8	5.9	5.8	5.6	5.7	5.7
Primary balance	-5.5	-6.0	-4.7	-3.8	1.5	1.6	1.5	1.6	1.5	1.6
Effective interest rate	5.2	6.1	5.4	4.8	4.3	3.7	3.8	4.2	4.4	4.7
Real Exchange Rate Shock										
Real GDP growth	-0.2	1.3	7.8	5.3	6.1	8.5	7.0	7.0	6.8	6.7
Inflation	9.3	6.1	4.9	5.9	5.8	5.9	5.8	5.6	5.7	5.7
Primary balance	-5.5	-3.6	-1.5	0.3	1.5	1.6	1.5	1.6	1.5	1.6
Effective interest rate	5.2	6.3	5.3	4.7	4.1	3.6	3.7	4.1	4.3	4.6
Contingent Liability Shock										
Real GDP growth	-0.2	-3.9	2.3	5.3	6.1	8.5	7.0	7.0	6.8	6.7
Inflation	9.3	3.0	3.5	5.9	5.8	5.9	5.8	5.6	5.7	5.7
Primary balance	-5.5	-3.1	-1.0	0.3	1.5	1.6	1.5	1.6	1.5	1.6
Effective interest rate	5.2	6.4	5.3	4.7	4.1	3.6	3.7	4.1	4.3	4.6

Source: IMF staff

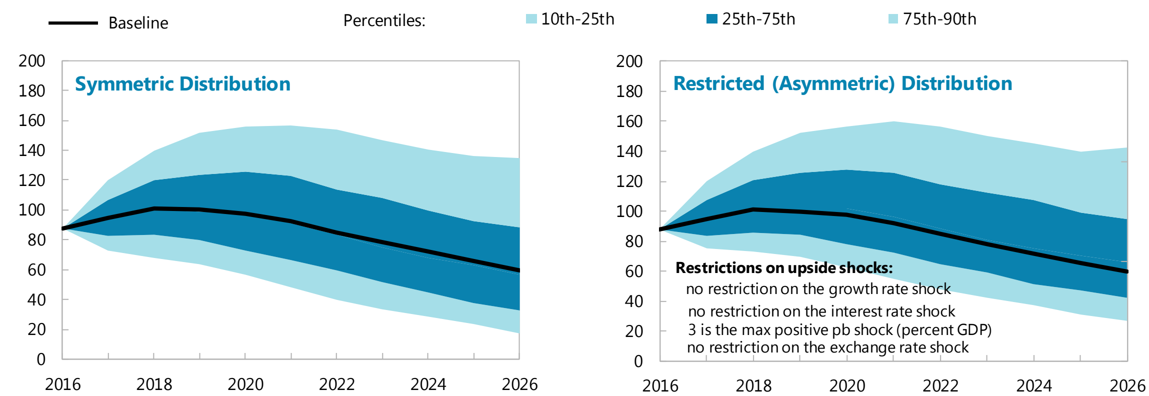
Mongolia Public DSA–Risk Assessment

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

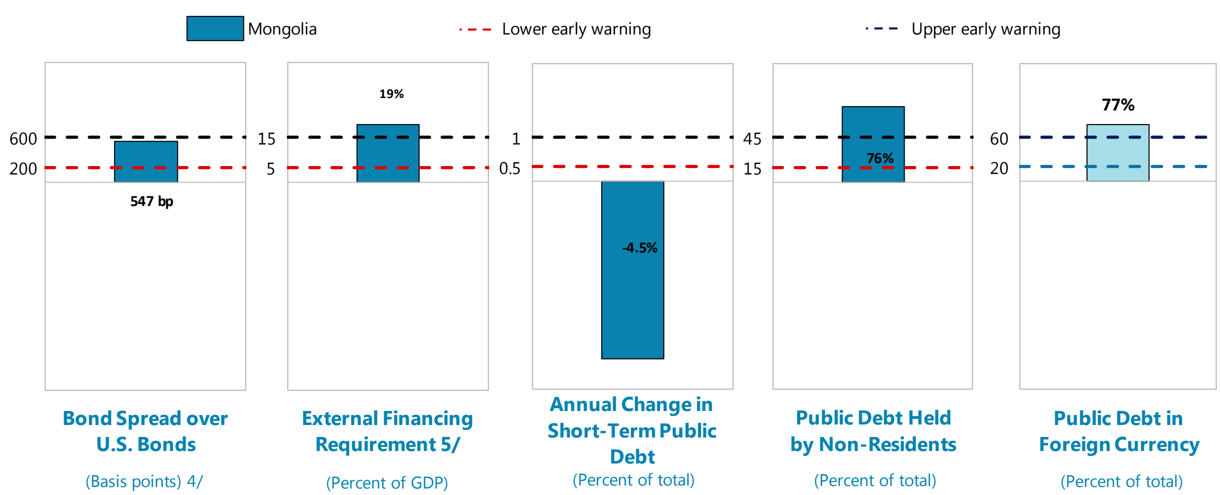
Evolution of Predictive Densities of Gross Nominal Public Debt

(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, 05-Jan-17 through 05-Apr-17.

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.

External DSA

External debt is defined according to the residency criterion, and its coverage in the DSA includes: (i) public and publicly guaranteed external debt, including swap lines and bilateral/multilateral loans on concessional terms; and (ii) external liabilities of the banking sector and private corporations. In Mongolia's case, mining-related intercompany loans form the bulk of private external debt. As of end-2016, intercompany lending comprised around 30 percent of total external debt.[4]

Mongolia's total external debt is extraordinarily high, but intercompany loans among foreign-owned companies inflate this number. External debt at end-2016 was 220 percent of GDP, or 155 percent excluding the $7.1 billion of intercompany loans. These loans qualify as part of external debt on the residency criterion, but the risks associated to them are less directly tied to Mongolia and its fiscal and economic performance than is the case for other forms of public and private external debt.

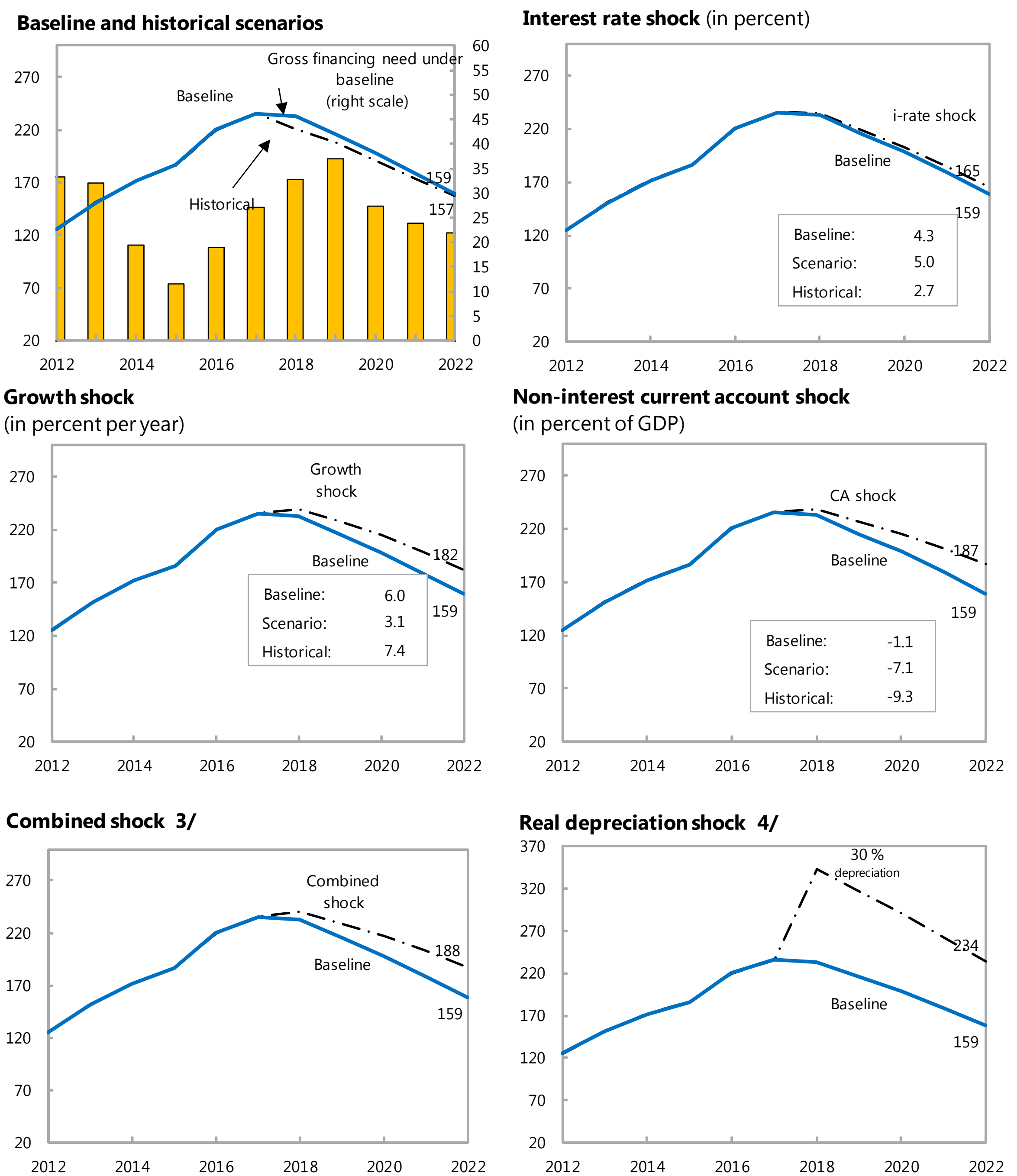
The sharp rise of external debt in 2016 was due to a combination of new external borrowing and large currency depreciation. External debt rose by over 30 percent of GDP from end-2015 to end-2016. External public debt increased by close to 7 percent on account of a new government loan of $250 million from Credit Suisse in March, followed by a $500 million bond issuance in April. Most of the remainder of the increase in 2016 stems from the nearly 25 percent nominal depreciation (relative to end-2015) of the togrog against the US dollar.

After peaking in 2017, external debt begins to decline quite rapidly from 2018, although the extent of this decline is sensitive to shocks. Mongolia successfully completed a market exchange of its $580mn bond and may return to the market later in the year to roll over bonds maturing in 2018. While the large concessional donor support as part of the program is expected to increase external debt in the short run, over time this inexpensive financing coupled with Mongolia's underlying medium-term fundamentals are favorable to external debt sustainability. Ongoing mining developments are expected to deliver significant FDI inflows (starting 2017) as well as favorable export and growth dynamics, especially toward the end of the forecast horizon. Debt dynamics are, however, subject to external shocks, particularly a steep depreciation (though the impact of this is overstated on account of intercompany lending since dollar-based revenues shield mining companies' debt repayment capacity).

[4] The figure was close to 50 percent at end-2015. The decline in 2016 was primarily due to conversion of $4.1 billion of intercompany FDI by Oyu Tolgoi into a long term external loan, which is no longer classified as intra-company lending.

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.

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

	Actual							Projections						
	2012	2013	2014	2015	2016	10-Year Historical Average	10-Year Standard Deviation	2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
Baseline: External debt	125.2	151.2	171.7	186.3	220.0			**235.5**	**232.7**	**215.3**	**198.4**	**178.9**	**159.1**	**-19.4**
Change in external debt	32.7	26.0	20.5	14.6	33.7			15.5	-2.8	-17.4	-16.9	-19.5	-19.9	
Identified external debt-creating flows (4+8+9)	-22.7	5.8	14.0	10.1	52.7			-4.7	-9.3	-24.3	-16.7	-18.6	-17.6	
Current account deficit, excluding interest payments	25.5	21.6	5.2	-3.7	-5.1			-6.9	-1.2	3.9	1.8	0.6	0.4	
Deficit in balance of goods and services	-108.6	-100.1	-108.7	-87.8	-99.8			-2.4	2.0	5.4	2.7	1.0	-1.4	
Exports	43.5	39.6	52.1	45.3	50.8			55.5	54.6	54.8	54.7	55.1	53.4	
Imports	-65.1	-60.5	-56.7	-42.6	-49.1			53.0	56.6	60.2	57.4	56.2	52.0	
Net non-debt creating capital inflows (negative)	-35.9	-16.7	-2.3	-0.9	37.0			-9.7	-14.7	-20.8	-16.6	-15.8	-10.0	
Automatic debt dynamics 1/	-12.3	0.9	11.1	14.7	20.8			11.9	6.6	-7.5	-2.0	-3.5	-8.0	
Contribution from nominal interest rate	1.9	3.8	6.3	7.7	9.2			11.3	10.8	9.8	8.8	7.8	5.9	
Contribution from real GDP growth	-9.6	-14.2	-12.3	-4.2	-1.9			0.5	-4.2	-17.2	-10.8	-11.3	-13.9	
Contribution from price and exchange rate changes 2/	-4.5	11.4	17.1	11.2	13.5			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	55.3	20.2	6.5	4.5	-19.0			20.3	6.6	6.9	-0.2	-0.8	-2.2	
External debt-to-exports ratio (in percent)	287.8	382.0	329.8	411.3	433.4			424.5	425.9	392.8	362.6	324.4	297.7	
Gross external financing need (in billions of US dollars) 4/	4.1	4.0	2.4	1.3	2.1			2.8	3.5	4.2	3.4	3.2	3.2	
in percent of GDP	33.2	32.0	19.3	11.5	19.0			27.0	32.8	37.0	27.4	23.9	21.9	
Scenario with key variables at their historical averages 5/								**235.5**	**221.0**	**208.2**	**190.9**	**174.0**	**157.4**	**-24.8**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	12.3	11.6	7.9	2.4	1.0	7.4	5.8	-0.2	1.8	8.1	5.3	6.1	8.5	
GDP deflator in US dollars (change in percent)	5.1	-8.3	-10.2	-6.1	-6.8	4.4	16.0	-6.7	0.7	0.9	1.5	1.3	1.4	
Nominal external interest rate (in percent)	2.4	3.1	4.1	4.3	4.6	2.7	1.4	4.8	4.7	4.6	4.4	4.2	3.6	
Growth of exports (US dollar terms, in percent)	-1.7	-6.9	27.5	-16.4	5.5	13.6	27.4	1.8	1.0	9.4	6.7	8.3	6.7	
Growth of imports (US dollar terms, in percent)	5.4	-4.8	-9.3	-27.8	8.5	16.9	39.6	0.7	9.4	16.0	1.9	5.2	1.9	
Current account balance, excluding interest payments	-25.5	-21.6	-5.2	3.7	5.1	-9.3	12.0	6.9	1.2	-3.9	-1.8	-0.6	-0.4	
Net non-debt creating capital inflows	35.9	16.7	2.3	0.9	-37.0	11.5	22.1	9.7	14.7	20.8	16.6	15.8	10.0	

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.

INTERNATIONAL MONETARY FUND 50

MONGOLIA

Appendix I. Letter of Intent

April 13, 2017
Ulaanbaatar

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

Dear Ms. Lagarde:

Mongolia is blessed with vast mineral resources, strong potential in agriculture and tourism, a talented workforce, and a vibrant democracy. Our long-run future is undoubtedly bright, but in recent years, we have been hit hard by the sharp decline of commodity prices and a collapse in foreign direct investment (FDI). Efforts to buffer the economy from these shocks succeeded in maintaining high growth for a while, but at the cost of higher public debt, a weaker external position, and declining asset quality at banks. As a result, market confidence waned and growth declined, leading to widespread hardship among the population and serious economic vulnerabilities.

The Mongolian People's Party won a landslide victory in the June 2016 parliamentary elections and came to power with a mandate to fix the economy and tackle legacy issues. We transparently acknowledged the magnitude of Mongolia's economic challenges, immediately prepared an "Economic Recovery Program" in consultation with international financial institutions and other key partners, and quickly took action under the plan. Among other actions, the Bank of Mongolia (BOM) hiked its policy rate by 450 basis points in August, and the parliament passed a budget in November designed to cut the fiscal deficit, on the IMF's definition, from 17 percent of GDP in 2016 to 10.6 percent this year.

We also jumpstarted discussions on key mining projects such as Tavan Tolgoi and began implementing a number of key structural reforms to ensure that, after a difficult phase of adjustment, the economy would be poised for sustainable long-run growth. We are planning important improvements to our fiscal framework as well as a completely revamped BOM law, both of which will help prevent a repeat of past policy mistakes. As for the financial sector, we plan to: (i) launch a comprehensive diagnosis of the banking system, followed by recapitalization and restructuring as needed; (ii) enhance regulation and supervision; (iii) improve governance; and (iv) support the resolution of poor-quality assets. Finally, we are taking important steps to diversify the economy and improve our competitiveness.

Our multilateral and bilateral partners have committed to providing concessional financing in support of our program of policy adjustment and structural reforms. This assistance is of critical importance in establishing overall financing assurances for our program. Moreover, by allowing us to reduce reliance on other, more expensive and shorter-term, debt, it will help us to improve our debt levels and gross financing needs and thus restore debt sustainability.

The attached Memorandum of Economic and Financial Policies (MEFP) presents the plans and policies of the authorities of Mongolia for 2017–2020. In support of these policies, we request a three-year extended arrangement under the IMF's Extended Fund Facility (EFF), with access equivalent to SDR 314.5054 million (435 percent of quota). Table A1 attached to the MEFP sets out quantitative targets that are to be observed under the extended arrangement, and the accompanying Technical Memorandum of Understanding (TMU) explains in detail how these targets are defined and monitored. Table A2 attached to the MEFP sets out proposed prior actions for approval of the extended arrangement and structural benchmarks on our key structural reforms. We agree to provide IMF staff, on a timely basis, with the information referred to in the TMU to assess progress made under the program.

We believe that the policies set forth in the MEFP are adequate to achieve the objectives of the program but are prepared to take further measures if necessary. We will consult with IMF staff on the implementation of the policies contained in the MEFP, and in advance of any revisions to these policies, in accordance with the IMF's policies on such consultation.

In keeping with our policy of transparency, we intend to make public the content of the IMF staff report, including this letter, the MEFP, the TMU, and the informational annex of the staff report. We therefore authorize IMF staff to publish these documents on the IMF website once the Executive Board has approved this EFF.

Sincerely yours,

/s/	/s/
B. Choijilsuren Minister of Finance	N. Bayartsaikhan Governor, Bank of Mongolia

Attachments
Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies
April 13, 2017

This Memorandum of Economic and Financial Policies (MEFP) provides context regarding Mongolia's economy, describes recent developments and the outlook, and then presents our program of policy adjustment and structural reforms, to be supported by an extended arrangement under the IMF's Extended Fund Facility (EFF).

I. Context

1. **Mongolia has strong economic potential but faces a number of difficulties.** We are blessed with large mineral reserves that are under active development, a well-educated population, and opportunities for economic diversification and greater regional integration in Asia. But when our new government took office in June, we inherited a very challenging economic situation, with stagnant growth, a weak balance of payments position, a large fiscal deficit and rising debt, and increasing vulnerabilities in the banking system.

2. **These difficulties were partly caused by major external shocks.** FDI fell from $4½ billion in 2011 (more than 40 percent of GDP) to nearly zero in 2015, reflecting the end of the first phase of the Oyu Tolgoi (OT) copper and gold mine, a dispute over the second phase of that project, and adverse changes to the investment regime, and coal and copper export prices fell sharply. The effect was to drive export earnings and fiscal revenues sharply downward.

3. **But policy errors also contributed.** Mongolia failed to build up buffers during good times. And when conditions worsened, stimulus policies temporarily helped maintain high growth while exacerbating economic vulnerabilities by building up public debt, weakening the BOP further, undermining bank asset quality, and damaging investor confidence:

- **Fiscal policy.** For several years up to 2015, quasifiscal spending at the Development Bank of Mongolia (DBM) pushed the consolidated deficit up to around 10 percent of GDP. In 2016, spending in the run-up to the elections helped push the annual deficit (as defined by the IMF) up even further, to 17 percent of GDP.
- **Monetary and exchange rate policy.** The BOM implemented expansionary policies during 2012–14: the policy rate was cut substantially, and several new quasifiscal lending programs injected about 25 percent of GDP in new liquidity into the economy. These policies fostered a credit boom and fueled imports. While the togrog was allowed to weaken, there were extended periods during which the Bank of Mongolia (BOM) attempted to defend the currency, and reserves, which stood at over $4 billion in 2012, fell to $1.3 billion by end-2015. Depreciation also led to an increase in inflation, which later diminished as the economy began to slump.
- **Financial sector policies.** Loans funded by the BOM's easing programs were zero-risk-weighted and exempted from limits on large exposures and industry concentration. In general, the supervisory framework was inadequate, with limited resources, frequent

recourse to forbearance, and weak enforcement. Banks' asset quality deteriorated as a result of the 2013-14 credit boom and the subsequent economic slowdown. In addition, the depreciation of the currency adversely affected dollar loans, many of which had been extended to unhedged borrowers.

4. **Our government came to power with a mandate to address Mongolia's economic challenges, supported by a strong majority of 65 out of 76 seats in Parliament.** We are determined to use that strength to improve governance, build institutions, and implement the tough measures needed to fix the economy. Soon after taking office, we announced our "Economic Recovery Program," which envisages immediate stabilization measures as well as structural reforms to help diversify the economy and lay the basis for sustainable growth. Moreover, we actively sought support from international financial institutions, including the IMF, and other development partners. We are confident that with policy adjustment and structural reform, as well as external support, we will get through this difficult period and return Mongolia to a sustainable growth trajectory.

II. Recent Economic Developments and Outlook

5. **The economy has slowed rapidly.** Growth decelerated from 17 percent in 2011 to 1 percent in 2016, and unemployment has risen markedly. Last year, temporary geological factors contributed to depress output from the first phase of Oyu Tolgoi (OT), but a sharp pickup in coal production and exports in the fourth quarter, driven by a revival in Chinese demand and a rebound in commodity prices, helped keep overall mining growth in positive territory. Nonmining growth was sluggish despite higher government expenditure and the ramp-up of second-phase development of OT—except agriculture and transportation, most sectors remained depressed, reflecting weakening confidence and uncertainties. With private investment and consumption declining, CPI inflation dropped to nearly zero despite the large currency depreciation, underlining the slowdown in economic activity.

6. **Looking ahead, the economy is likely to bottom out in 2017.** Fiscal consolidation and geological factors at OT-1 will weigh on growth, but higher commodity prices and a projected increase in coal production are positives, and the Gatsuurt gold mine should also begin production next year. OT-2 development will deliver about $1 billion in FDI annually for the next few years. Nonmining growth should be supported by spillovers from large mining investment and growing strength in agriculture. Overall growth is expected to be mildly negative in 2017 but should quickly recover, exceeding 8 percent in 2019 with investment in the Tavan Tolgoi mine, and remaining high thereafter as OT-2 production ramps up. Inflation should return to 6 percent by end-2017, reflecting the pass-through from depreciation in 2016, and stabilize around 6½ percent as the economy normalizes.

7. **The external position remains weak but has benefited from the recent rebound in global commodity prices.** The trade balance improved last year, with exports picking up while imports remained depressed reflecting soft activity. The current account improved on account of depreciation since 2015 but remained in deficit at about 4 percent of GDP. Portfolio flows rose,

given the previous government's (expensive) access to capital markets in April 2016. As a result of these factors, the overall balance was close to zero in 2016 and gross reserves were broadly stable at about $1.3 billion (3 months of imports), also helped by utilization of the swap line. But the external position remained under pressure. The currency depreciated by about 25 percent in the second half of the year, with sizable bond maturities approaching in 2017–2018.

8. **The fiscal position deteriorated sharply in 2016.** The deficit increased to 17 percent of GDP (IMF definition), more than double the level in 2015, on account of a sharp drop in revenues, increasing interest payments, and the clearance of some previously delayed capital expenditures, as well as pre-election spending. The large deficit, along with togrog depreciation, drove general government debt above 85 percent of GDP. Increasing borrowing needs and heightened risk perceptions pushed domestic treasury bill yields up to 17 percent in 2016. Likewise, Mongolia suffered ratings downgrades and higher costs of international borrowing.

9. **Monetary conditions have been subdued on account of the weak economy.** Loan growth remained very weak, supported only by subsidized credit schemes, which are winding down. After a series of policy rate cuts, the BOM hiked the rate by 450 basis points in August, to 15 percent, and introduced longer-term central bank bills to soak up excess liquidity that had undermined the exchange rate. Although inflation has been very low—and close to zero at the end of last year—interest rates are high, reflecting the risky environment and the structure of the banking sector. In December, the policy rate was lowered by 100 bps in light of the very sluggish economy and subdued inflation. The BOM stopped its lending to government in the second half of 2016 and limited new mortgage financing to the total amount of principal and interest payments received on existing mortgage assets.

10. **The banking sector is under pressure.** Asset quality has declined on account of the weak economy, with the reported NPL ratio rising to around 7 percent (excluding restructured loans and loans in early arrears). NPLs are highest for foreign-currency loans, many of which have been extended to unhedged borrowers. Provisioning for high NPLs is likely inadequate for certain cases, and this continues to put pressure on capital adequacy ratios. Some restructured loans are reportedly of uncertain quality.

III. Economic and Financial Policies for 2017–20

A. Overview

11. **Prudent macroeconomic and financial policies are at the core of our program, alongside a wide range of structural reforms.** As discussed below, we intend to pursue rapid fiscal consolidation while strengthening the social safety net, and also introduce a number of reforms to strengthen budget discipline. The just-passed new DBM law is an important element of this strategy. Monetary policy will be kept appropriately tight, and we plan to revamp the BOM law to reorient the central bank toward a traditional mandate of price and financial stability and away from the type of imprudent policies pursued in recent years; the law will also strengthen BOM governance and

improve its operations. We will keep the exchange rate flexible, as a shock-absorber for our commodity-dependent economy, and we will rebuild foreign-exchange reserves. We plan a comprehensive effort to analyze banks' resilience, and—depending on the results—to recapitalize and restructure them. In addition, we will strengthen banks' governance, as needed, and also improve regulation, supervision, and resolution by amending the Banking Law. Finally, we are pursuing a number of measures to diversify the economy and boost competitiveness.

12. **These initiatives, supported by financing from our multilateral and bilateral partners, should stabilize the economy and lay the basis for sustainable, long-run growth.** Growth will soon pick up to as much as 8 percent as the economy stabilizes and mining projects take off. Gross reserves should turn around from their downward path and rise to a healthy $4 billion (6½ months of imports) by the end of the program, similar to levels seen in 2012 before Mongolia was hit by external shocks. Government debt will start to decline by 2019 and will fall to 74 percent of GDP (IMF definition, and in present-value terms) by 2022. Fiscal consolidation also leaves room for the banking sector, over time, to extend more credit to the private sector, consistent with projected growth.

B. Fiscal policy

13. **Substantial fiscal consolidation is a key priority.** Deficits had been allowed to get too high for many years, and fiscal policy was undisciplined, with the government, DBM, and BOM essentially running parallel budgets. The deficit reached 17 percent of GDP on the IMF's definition (including DBM's commercial spending) last year, and we intend to reduce this to 10.6 percent of GDP in 2017. Adoption of a supplementary budget to this effect, along with passage of the corresponding fiscal measures, will be a ***prior action.*** This is an ambitious adjustment goal, but we see it as realistic since the 2016 outturn was inflated by a number of one-off factors. Looking ahead, we plan to continue reducing the deficit steadily, bringing it down to below 2 percent of GDP by 2022. (Passage of a 2018 budget consistent with the program's fiscal path will be a ***structural benchmark***.) By 2022, OT-2 production will be ramping up, and our intention will be eventually to move the fiscal balance into surplus. Given our high debt, the fiscal anchor of the program will be the primary balance, which should turn to surplus in 2020, and as discussed below, general government debt will be the medium-term target.

14. **To reduce the deficit, we will implement a wide range of measures in a supplementary budget, including the following initiatives to control spending (by about 9 percent of GDP during the program period)**:[15]

- **Capital expenditure**. Our vast terrain and low population density imply the need for substantial capital spending, and while capital spending is still robust (12 percent of GDP on average over the last three years), there is need for rationalization at both central- and local-government levels, in these difficult times.

[15] All measures affect 2017 onward, unless specifically noted otherwise.

- **Wage bill**. We also plan to institute a public-sector wage freeze through 2018, suspend civil servants' grade advancement through 2019, and restrict hiring through 2019 (a freeze in all sectors except the priority areas of health, education, emergency services, and police, where one new employee will be hired for every two who leave).
- **Pensions**. We intend to roll back recent steps that made pensions substantially more generous, and we will also raise the retirement age for both men and women by 6 months annually, to 65.
- **Social spending**. We are determined to protect priority social spending and make it more efficient and targeted to shield the most vulnerable parts of our population. We will make sure that social safety nets are in place and give priority to spending on education and health in the program period. The targeting of the Child Money Program will be extended indefinitely and tightened to the poorest 40 percent of Mongolian households, and the plan to offset the targeting retroactively by offering backpayments to the upper 40 percent in 2019 will be dropped. However, these savings will be used entirely to increase spending on the better-targeted food stamp program, to ensure that Mongolia's poorest citizens are shielded better. Separately, some small net savings of administrative costs will be achieved by consolidating existing, overlapping transfer programs (while maintaining total average benefits).
- **Other expenditure**. We will achieve cost savings by introducing a central procurement system for drugs and medical equipment. In addition, some bills that have been approved since the passage of the 2017 budget, and that have negative fiscal consequences, will be rolled back.

15. **We will also take important steps, alongside the supplementary budget, to boost revenue (by about 2¼ percent of GDP during the program period):**

- **Excises and duties**. We also intend: to reverse the last two cuts in the petroleum excise (from July 1, 2017 and October 1, 2017, respectively) while rationalizing the rates across different petroleum products; to increase the excises on vehicles and on alcohol and tobacco (from May 1, 2017 and January 1, 2018, respectively); and to raise duties on tobacco (from May 1, 2017).
- **Personal income tax**. The PIT will be made more progressive and will yield additional revenues, after the rates on upper brackets are increased (from January 1, 2018).
- **Withholding tax**. The threshold above which interest is subject to a withholding tax will be eliminated, so as to apply this tax more broadly.
- **Social security contributions**. These will be increased by 5 percentage points over 3 years (2 percent in 2018, 1 percent in 2019, and 2 percent in 2020), with employer and employee contributions each increased by 2.5 percentage points.

16. **The program restores debt sustainability partly through the mobilization of concessional financing.** Our fiscal adjustment alone does not suffice to put debt on a sustainable path, as deficits—albeit declining—will remain significant, requiring concessional financing to contain debt and gross financing needs. With $3 billion of concessional support expected from bilateral and multilateral donors, in connection with the IMF-supported program, we will be able to

reduce our reliance on short-term and expensive domestic borrowing. This will help reduce the present value of debt, which should start declining by 2019 and fall to 74 percent of GDP (IMF definition) by 2022.

17. **We are also making efforts to ensure the continued engagement of our private-sector creditors, both external and domestic, on terms consistent with debt sustainability.** Regarding external debt, last month we conducted a market-friendly exchange of the $580 million DBM bond maturing in March; our issue was oversubscribed many times, and we were able to extend maturities by seven years—well beyond the three-year program period—at a reasonable coupon and without any adverse market reaction. Given the positive response, we expect to return to the market to finance other debt obligations. On the domestic front, we will guide and engage with our creditors to ensure that they continue to finance the government during the program period on terms consistent with debt sustainability. With the improving macroeconomic outlook and fiscal situation, yields are expected to decrease, and the government should be able to fund itself at rates substantially lower than those prevailing today.

18. **We have also developed an ambitious agenda of fiscal structural reforms to ensure that past policy mistakes are not repeated and budget discipline is maintained:**

- **DBM law.** We have passed a new law governing the DBM that strengthens its independence substantially and restricts it to purely commercial activities. Key safeguards in the law include the following: neither government nor parliament will have any authority over project selection, beyond indicating broad priority areas; projects will be judged according to profitability; the DBM's board will include independent members required not to have held political positions in the recent past; senior management will be selected in an international, competitive process; and DBM will be subject to supervision by the BOM. Given these provisions, we expect that DBM will operate very differently from the past, but to be careful, we intend to monitor the fiscal deficit including DBM spending. We may, in the future, consider excluding DBM from fiscal monitoring if: (i) the institution builds up a track record of at least one year of operating in a purely commercial manner; (ii) a third-party audit is performed to assess which projects are truly commercial, and the other projects are all transferred to government; and (iii) the DBM's reliance on government funding and guarantees is substantially diminished (which will help establish the institution's independence). If DBM meets all these criteria and is excluded from the main fiscal target, however, a separate target on the DBM balance will be introduced.
- **Mortgage program.** We have already limited net BOM financing of the program—and, indeed, of any quasifiscal program (e.g., lending to companies)—to zero; new mortgage funding takes place only from the principal and interest inflows from existing mortgage assets ***(prior action)***. Moreover, starting with the 2017 supplementary budget, we now transparently reflect the interest-financed expansion of mortgages as government net lending. The government and BOM will sign a Memorandum of Understanding stating that BOM is involved in the mortgage program solely as an agent of government. We intend to transfer the program to the government next year and, with World Bank assistance, have already engaged an expert to study how best to do this. The Ministry of Finance may choose to expand the program, but only by making offsetting cuts elsewhere in the budget. Over

time, we intend to convert the mortgage program into a purely private-sector undertaking, in which case any guarantee or subsidy component will be transparently reflected in the budget.

- **PAYGO.** While the current Parliament has taken a tough line on fiscal consolidation, this has not always been the case in Mongolia. Indeed, there were several examples in the recent past in which Parliament loosened the overall fiscal stance. We intend by end-November 2017 to amend the Integrated Budget Law and other relevant laws to remove, effective 2018 onward, Parliament's ability to increase the overall spending envelope—any proposals for expenditure increases would need to be matched by offsetting, realistically costed measures ***(structural benchmark)***.
- **Supplementary budgets.** We intend to obey the Integrated Budget Law's requirement—sometimes ignored in the past—that a supplementary budget be passed before spending on any new program is committed.
- **Ministry of Finance powers.** A new Cabinet resolution will be issued to require the Ministry of Finance's prior approval before a proposal with substantial fiscal implications can be tabled at Cabinet.
- **Accountability framework.** Our new government intends to adhere strictly to provisions of the budget laws establishing the personal responsibility and liability of ministers and senior officials for any violations of these laws.
- **Fiscal council.** An independent fiscal council comprising former Prime Ministers, Ministers of Finance, and Governors of the Bank of Mongolia, and possibly other highly respected individuals, will be established under its own law by end-December 2017 ***(structural benchmark)***. The council will be nonpartisan, and while it will not be responsible for executing fiscal policy, it will prepare independent budget forecasts and costings of MPs' policy proposals, will seek to verify that off-budget vehicles are not being used to circumvent budget limits, and will monitor compliance with the FSL. International experience suggests that such an institution can improve fiscal discipline and performance. In addition, we will make efforts to strengthen the National Audit Office further.
- **Public-private partnerships (PPPs) / concessions.** In recent years, concessions have proliferated in Mongolia, undertaken by different units of government without sufficient central oversight. We have already restricted the ability of local governments to initiate such projects, and going forward we intend to assign the MOF a gatekeeper role over all PPPs. We intend to have an audit conducted of all existing concession contracts before making any further payments related to them. Furthermore, with assistance from the Asian Development Bank (ADB), we will work to revise the existing legal framework toward best international practice. Until this legislation is amended, we will contract no new concessions (except possibly some new BOT projects, and we may convert BTs into BOTs). Furthermore, we will attempt to cancel contracted projects that have not yet been launched.
- **Public investment program (PIP).** Serious questions have been raised about Mongolia's project selection criteria and its implementation of chosen projects. A Public Investment Management Assessment (PIMA) was recently undertaken to provide a detailed diagnosis and offer specific recommendations. We intend to rationalize the PIP, culling low-value-

added projects, and over time we aim, with World Bank assistance, to improve our processes for ensuring that the PIP is fully aligned with national development priorities.

- **Future Heritage Fund (FHF).** The law on the FHF entered into force on January 1, 2017, but transitional provisions have been passed such that actual savings will be delayed by a couple of years. In our view, the law should reinforce the importance of saving, but it should also be flexible enough not to require saving when this is unrealistic on account of high deficits. Until 2022, the FHF's revenues will be fully used to retire government debt and to transfer Human Development Fund expenditures (e.g., the Child Money Program) to the state budget smoothly.
- **Payment arrears.** We are committed to strengthening our control and monitoring system to prevent a buildup of arrears in the future.

19. **We are also envisaging a number of steps to strengthen Mongolia's tax system:**

- **Working group to review the tax system.** By end-August 2017, we will set up an independent working group of experts, aided by technical assistance from the IMF, to review the tax structure (including the VAT, as well as business—and in particular mining—taxation) and make revenue-neutral or revenue-enhancing recommendations to improve equity and efficiency ***(structural benchmark).*** The working group will be expected to submit its report by end-December 2017 (***structural benchmark***).
- **Tax expenditures.** We will review existing tax expenditures and report on, and reduce allocations for, these in the next budget, supported by World Bank technical assistance.
- **Revenue administration.** With active assistance from the IMF and US Treasury, we have been strengthening our revenue administration over the past few years. Efforts are ongoing and now focus mostly on simplified taxation for small businesses. By end-April 2017, we will finalize and begin implementing compliance strategies for different-sized businesses ***(structural benchmark)***. In addition, by end-October we will submit a revised general taxation law to Parliament ***(structural benchmark).*** Finally, by end-October 2017, we will submit legislation to create a simplified tax regime for micro businesses, in line with IMF TA recommendations ***(structural benchmark***).
- **Automatic revaluation**. We will ensure that fines, fees, stamp duties, and any other revenues fixed in togrog terms will automatically be revalued according to inflation each year, starting from 2019.

20. **Social protection will be made more efficient and effective.** As noted above, the Child Money Program will be targeted better, with savings used to increase spending on food stamps (***structural benchmark***), and other programs will be rationalized. A number of other initiatives—including parametric pension reform—will also be implemented, and these are described in detail by the World Bank for its development policy loan and the ADB for its policy-based loan.

C. Monetary and exchange rate policy

21. **Monetary policy will remain appropriately tight, given the objective of price stability.** The BOM will keep monetary policy tight in 2017, as warranted by economic fundamentals. Over

time, however, as the economy normalizes, the BOM may consider cutting the policy rate—currently at 14 percent, with inflation now around 2½ percent—if BOP and inflation indicators permit. Given the still-large fiscal deficit and substantial external financing (likely lumpy), keeping reserve money on the program path will require careful liquidity management and close coordination between the BOM and Treasury.

22. **A major priority will be the adoption of a new BOM law *(structural benchmarks*,** submission by end-November 2017 and adoption by end-March 2018)**.** This will clarify the BOM's mandate, strengthen governance, and improve independence. The powers of the Monetary Policy Committee will be enhanced, including by giving its members a vote on policy decisions. In the same way, supervisory decisions will be made in a collective manner. The decisionmaking body will meet on a regular basis to review and discuss the situation of individual banks and of the banking system as a whole, and to make supervisory decisions as necessary. The BOM will also be modernized and reorganized, with a focus on improvements in human resources and IT as well as on strengthening governance. In addition, we are committed to our statutory obligations to subject ourselves to annual external audit.

23. **We will work on a gradual strategy to address the BOM's negative capital position.** While this situation has persisted for many years without constraining the BOM's operations, it needs to be remedied to safeguard the BOM as a strong and operationally independent institution. Progress in this area will need to be gradual given already high public debt levels.

24. **We will continue to allow the exchange rate to move flexibly, with FX sales limited to smoothing excessive volatility and preventing disorderly market conditions.** Given the projected BOP surpluses under the program and the corresponding NIR targets, the BOM will build reserves. Gross reserves are expected to reach a healthy 6½ months of imports by the end of the program—similar to levels seen in 2012, before external shocks hit Mongolia.

25. **Other.** During the program we will not: impose or intensify restrictions on the making of payments and transfers for legitimate current international transactions; introduce or modify multiple currency practices; conclude bilateral payments agreements that are inconsistent with Article VIII of the IMF's Articles of Agreement; or impose or intensify import quota restrictions for balance of payments reasons.

D. Financial sector policies

26. **We are committed to ensuring that our financial system is sound and stable and can contribute to economic growth.** Our first priority is to undertake a comprehensive diagnosis of the banking system to assess institutions' financial soundness and resilience. With the results of this diagnostic in hand, we will embark on a process of bank restructuring and recapitalization, and—if needed—the safe and timely resolution of nonviable institutions. We will complement these actions by bringing bank regulations up to international best practice, strengthening bank supervision, and improving our monitoring and support of bank liquidity. We also intend to improve our framework

for facilitating the effective restructuring and resolution of problem loans. Finally, we are committed to strengthening our regime for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT). Our multilateral partners, including the ADB, APG, IMF, and World Bank, are providing relevant assistance.

Assessing financial resilience

27. **We intend to launch a comprehensive diagnosis of the banking system.** In order to assess the resilience, financial strength, and viability of our banks, we will require all of Mongolia's 14 banks to: (i) undergo independent studies of current asset valuations (Asset Quality Review, AQR); and (ii) submit business plans demonstrating their financial strength, including the effects of any necessary recapitalization and restructuring, through 2019. The overall process of the AQR and the review of business plans will be completed by end-December 2017. Details of the process will be as follows:

- The BOM will appoint a Steering Committee to oversee the diagnostic process for each of the banks to ensure consistency and to ensure that implementation meets the goals and modalities of the overall exercise. IMF staff will be observers in the entire process.
- On March 31, 2017, the BOM launched the procurement procedure to hire independent, internationally reputable expert company(ies) to carry out the AQR, on the basis of terms of reference developed by the BOM in consultation with IMF staff (***prior action***). The terms of reference specify that the selected audit company should not have any conflict of interest nor any contractual agreement with the banks in the last two years. The AQR will be completed by end-October 2017.
- Starting from the results of the AQR, banks will be required to submit to the BOM their business plans by end-November 2017. The business plans will be prepared according to requirements and a process developed in consultation with IMF staff, will provide detailed financial forecasts and an estimate of the capital needs through the period until end-2019, and will be assessed and validated using the stress test model of the BOM, in consultation with IMF staff. The AQR and business plans will allow assessment of whether banks' capital adequacy meets minimum Tier 1 and overall capital targets defined in consultation with IMF staff, both at end-2016 and until end-2019.
- The BOM will take a decision on the banks' business plans and will communicate it to them within one month of receipt, i.e., by end-December 2017. Where the AQR shows adequate capitalization and the business plan indicates a viable business and proper capitalization through 2019, no further steps will be required. Where the diagnostic studies reveal capital deficiencies or a nonviable business model, the bank will be required to submit recapitalization and restructuring plans. These plans should address the findings of the diagnostic studies and include a clear commitment to fill capital shortfalls and restructure business operations to achieve long-run profitability.

Bank recapitalization and restructuring process

28. **Bank shareholders are responsible for ensuring that their banks are fully capitalized, profitable, well managed, and able to contribute to economic growth.** If a shortfall exists—including prospectively, according to the agreed business plans—the institution in question will submit a time-bound, monitorable action plan for meeting capital adequacy and other financial milestones. These milestones will be reviewed by the BOM and necessary modifications agreed on a quarterly basis. Shareholders will be required to fully capitalize their institutions by June 2018, either by themselves or by bringing in new fit-and-proper shareholders, including possibly foreign investors as minority or majority shareholders. We will ensure that adequate backup funds are available and that financial stability can be maintained through the bank recapitalization and restructuring process.

29. **If banks' shareholders are unable to fully recapitalize their bank, we may facilitate an orderly restructuring using public funds to protect financial stability, subject to strict criteria.** These criteria will include that existing shareholders absorb any losses identified in the AQR before any public funds can be used, that the bank be restructured to ensure its long-term viability, that management be replaced as appropriate, and that public funds only be used in the public interest of maintaining financial stability. We will reach understandings with IMF staff on these criteria by end-October 2017 and will make the necessary legislative changes by end-December 2017 (***structural benchmark***). The government will seek budgetary authorization to provide financial support, subject to strict procedures developed in consultation with IMF staff, for the use of such support; in most cases, it is anticipated that such support would appropriately be shown below the line in the budget, as an exchange of financial assets, but this will have to be determined at the time. By end-September 2018 we will prepare an exit strategy for divesting our existing and potential public participation in banks.

30. **The Financial Stability Council will ensure proper governance regarding the use of public funds for bank recapitalization and restructuring.** In order to keep markets and depositors informed on a timely basis, the FSC—which will be enlarged to include the Deposit Insurance Corporation of Mongolia (DICOM)—will immediately appoint a spokesperson in charge of the communication strategy of the recapitalization process. This strategy will be developed in consultation with IMF staff.

31. **A specialized entity will be set up by end-December 2017 to manage government's participation in restructured banks, in consultation with IMF staff**. This entity will have a mandate to maximize the value of the State's holdings and interact with the respective banks on a purely commercial and arm's-length basis. We will ensure that members of the specialized entity, bank board members representing the state, and bank managers are fit and proper, independent, and professionally suitable, and take responsibility for key decisions regarding the government as a shareholder. To ensure no political interference in the banks' commercial business, a relationship framework agreement between this managing entity and each bank with state shareholding will be signed to govern the interaction between the two parties.

32. **Nonviable institutions will exit the financial system in a manner consistent with preserving depositor confidence and financial stability and minimizing economic costs.** We will bring the bank resolution legislation and cooperation framework up to best international standards, in consultation with IMF staff, by end-November 2017 ***(structural benchmark***). The legislative changes will ensure that the BOM has a full suite of resolution tools, and steps will be taken to ensure adequate staffing of the supervision department. The DICOM law will also be amended by end-November 2017 to ensure that it is in line with IADI Core Principles for Effective Deposit Insurance Systems ***(structural benchmark).*** By end-April 2017, we will put in place a backup financing facility to ensure that DICOM can meet its obligation to protect insured depositors. Operations of DICOM will be improved by end-November 2017, by, *inter alia,* facilitating data sharing with the BOM to ensure faster payout of deposits where this is appropriate. The BOM will ensure that banks can be resolved in an efficient and timely manner that minimizes economic costs.

Upgrading the regulatory and supervisory framework

33. To boost confidence in the banking system, we will enhance our regulatory and supervisory framework. To this end, we will:

- **Ensure conservative implementation of IFRS accounting and best international standards on asset classification, loan provisioning, and collateral valuation.** In this regard, the BOM will, by end-June 2017, adopt an amendment to its regulation on asset classification and provisioning, in consultation with IMF staff ***(structural benchmark).***
- **Introduce individual assessment of banks' risks and advance liquidity requirements.** By end-December 2018, we will initiate the introduction of a Pillar II process based on banks' internal capital and liquidity adequacy assessments (ICAAP and ILAAP) and supervisory review and evaluation (SREP). We will amend our BOM regulation on liquidity requirements and bring it in line with the Basel framework (Liquidity Capital Ratio, Principles for Sound Liquidity Risk Management and Supervision), no later than end-January 2019.
- **Improve governance of banks.** By end-November 2017, we will: (i) strengthen the fit and proper requirements of all board members, senior management, and shareholders of banks in line with international best practice, and in consultation with IMF staff; (ii) update the legislation and introduce regulation on related-party loans; and (iii) strengthen the ultimate beneficial owner requirements (***structural benchmark***). Based on the updated regulations, by end-September 2018, we will carry out a review of related-party exposures, to ensure that all transactions with related parties are not undertaken, restructured or resolved on more favorable terms than corresponding transactions with non-related counterparties***.***
- **Improve supervisory powers for early intervention and requesting additional capital.** By end-November 2017, we will also amend the Banking Law, in consultation with IMF staff, to: (i) improve the BOM's early intervention framework, including, *inter alia*, by introducing a capital buffer above the minimum and linking supervisory actions to its depletion; (ii) align rules on large exposures with international best practice; (iii) ensure that the BOM has

adequate powers to request from banks additional capital and provisioning to enhance financial strength or to absorb existing and estimate future credit losses, including based on the diagnostic studies and the analysis of the business plans; and (iv) introduce the power for the BOM to apply levies on banks to cover the costs of supervision, including AQRs ***(structural benchmark)***.

Monitoring and supporting bank liquidity

34. **We will monitor, and if needed provide, adequate liquidity to the banking system in a transparent and expeditious manner.** We will introduce full daily monitoring of liquid assets and liquidity flows, by improving reporting, and will expand our forecasting tools. We will update, as needed, our credit-granting rules to banks in line with international best practice. The BOM stands ready to take appropriate measures to maintain sufficient liquidity in banks in line with its rules.

Facilitating resolution of nonperforming loans (NPLs)

35. **We will take measures to facilitate effective debt resolution.** We will work on two fronts:

- **Improving banks' policies and procedures for loan workouts.** We will issue a regulation by end-December 2017 requesting banks to have strategies, policies, and internal capacity to resolve NPLs and also report on NPLs in a more detailed way from end-June 2018.
- **Identifying impediments to effective NPL resolution.** In consultation with other relevant ministries, we will review banks' current operating environment, analyze and identify any impediments related to insolvency and enforcement laws, taxation issues, and legal and regulatory obstacles to NPL sales and outsourcing, and develop an NPL resolution strategy including milestones and a timetable to remove the identified impediments. The Financial Stability Board will approve this strategy by end-January 2018 (***structural benchmark***). We intend to request technical assistance in this regard.

There has also been considerable work done toward setting up an Asset Management Company (AMC). AMCs have played a positive role in many countries, but there are questions still to be resolved, including how the AMC would fit with the AQR process. We will evaluate whether we will be in a position to move forward with a legislative initiative after further, careful study, in consultation with the ADB and IMF staff.

Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)

36. **We commit to enhancing our AML/CFT and anti-corruption frameworks in order to bring them into compliance with international standards.** Progress in these areas is important to enhance the business climate and facilitate capital inflows, and to increase transparency and soundness of key sectors, such as the financial and natural resources sectors.

37. **As a first step, by end-March 2018, we will adopt amendments to the legal framework to support anti-corruption efforts.** In particular, the AML/CFT law, the anti-corruption law, and the

criminal code will be amended to ensure that: (i) corruption offenses are criminalized in line with the UN convention against corruption, including with regard to illicit enrichment; (ii) domestic politically exposed persons are subject to due diligence requirements in line with the FATF standard; and (iii) senior officials are subject to a comprehensive asset disclosure requirement, covering assets beneficially owned, reporting to a single agency in charge of timely publication, and subject to dissuasive sanctions for absence or false declaration. Going forward, we will further strengthen the resources and expertise of competent AML/CFT and anti-corruption authorities.

E. Competitiveness and diversification

38. **Mongolia's economy will likely center around mining for many decades, but efforts to diversify and improve competitiveness can only improve our prospects.** To this end, we plan to develop and implement an animal health law: higher phytosanitary standards will help unlock Mongolia's potential—given its more than 60 million head of livestock—for meat exports. We will also work on the WTO Trade Facilitation Agreement. Finally, we will revise the law on permits, so as to improve the business climate. These issues are discussed in detail in the documentation for the World Bank's budget support loan.

F. Program risks, contingencies, and monitoring

39. **The program is subject to risks, but we stand ready to adjust our policies as needed, in close consultation with IMF staff.** The main risks include: (i) a weakening of commodity prices; (ii) an economic slowdown in our key trading partners; (iii) weaker than projected revenues; (iv) lower than expected growth; (v) lower than planned capital inflows; and (v) the realization of other contingent liabilities. These risks could destabilize the macroeconomic environment and further challenge public debt sustainability. Should such risks materialize, the government stands ready to adjust its policies promptly, in close consultation with IMF staff, to ensure that the program's goals continue to be achieved. Contingent fiscal measures will be developed during the first review.

40. **Our program will be subject to quarterly reviews.** The reviews will assess macroeconomic performance and also progress toward observance of the program's structural benchmarks. The first two reviews of the program will take place before June 30, 2017, and September 30, 2017, respectively.

41. **A safeguards assessment of the BOM will be conducted by the 1st review.** This is a standard exercise performed at the beginning of every IMF-supported program, to ensure that systems are adequate to safeguard IMF resources that will be disbursed during the program.

Table A1. Mongolia: Quantitative Performance Criteria

	4/30/2017	6/30/2017	9/30/2017	12/31/2017	3/30/2018 Indicative targets
Performance Criteria 1/ 2/					
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)	-250	0	100	250	550
Net domestic assets (NDA) of the BOM (ceiling, eop stock, in billion togrog at program exchange rate)	5,400	5,100	4,900	4,600	4,000
Primary balance of the general government (floor, cumulative since the beginning of the fiscal year, in billion togrog)	-650	-850	-1,050	-1,500	-350
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$).	600	1,800	1,800	1,800	1,800
Stock of guarantees on external debt extended by the government or BOM (ceiling, eop stock, in million US$)	850	850	850	750	750
Indicative Targets (IT)					
Reserve money (ceiling, in billion togrog)	3,400	3,500	3,900	4,000	4,200
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$).	0	0	0	0	0
Accumulation of new external payment arrears (ceiling, eop, in million US$).	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$)	0	257	427	597	783
Net nonconcessional borrowing received and repatriated by the general government (including the DBM) under the program baseline (eop stock, cumulative, in million US$)	20	20	20	20	20
Program exchange rate (togrog/U.S. dollar)	2489.4	2489.4	2489.4	2489.4	2489.4
U.S. dollar per SDR	1.3	1.3	1.3	1.3	1.3
Monetary gold price (U.S. dollar/ounce)	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 in Q1 2018.

Table A2. Mongolia: Proposed Prior Actions and Structural Benchmarks

	Completion Date
Prior actions (to be completed before Board approval of the new arrangement)	
Fiscal	
Passage of a 2017 supplementary budget and a medium-term budget framework (2018-2020) consistent with program targets, and passage of all fiscal measures needed to support 2017 targets	
Banking	
BOM to launch the procurement procedure for AQRs by internationally reputable firms on banks based on terms of reference developed in consultation with IMF staff.	
Monetary	
Authorities to communicate to staff the discontinuation of any net BOM financing of the mortgage program as well as any quasi- fiscal lending e.g. to companies	
Structural benchmarks	
Fiscal	end-August 2017
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.	
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
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-October 2017
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-October 2017
Passage of a 2018 budget in line with the program's fiscal path.	end-November 2017
Revision of the relevant budget laws and introduction of a new law to establish a fiscal council, in line with international best practice and IMF advice.	end-December 2017
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
Submission of the tax working group's report to the Ministry of Finance.	end-December 2017

Table A2. Mongolia: Proposed Prior Actions and Structural Benchmarks (concluded)

Social protection	
The Child Money Program will be targeted to the poorest 40 percent of Mongolian households and the savings redirected toward the better-targeted Food Stamps program.	end-December 2017
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
Adoption of the new Bank of Mongolia Law.	end-March 2018
Banking	
Amendment of the Banking Law and Bank of Mongolia Law and related secondary legislation, guided by IMF staff, to 1. improve the early intervention framework 2. bring the bank resolution legislation, funding and cooperation framework up to best international standards in cooperation with MoF, DICOM 3. 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 4. introduce power for BOM to apply levies on banks to cover the cost of supervision incl. AQRs 5. strengthen shareholders', board members', and senior management's fit and proper requirements 6. upgrade rules on banks' related party exposure and final beneficial owners	end-November 2017
Amendment of DICOM law to bring it in line with IADI Core Principles for Effective Deposit Insurance Systems.	end-November 2017
Financial Stability Board (FSB) approval of an NPL resolution strategy. In consultation with other relevant ministries, the FSB will first establish a working group, and that group will: (i) identify and analyze impediments to debt resolution, in particular related to insolvency and enforcement laws, taxation issues, and legal and regulatory obstacles to NPL sales and outsourcing; and (ii) develop an NPL resolution strategy including milestones and a timetable for removal of identified impediments.	end-January 2018
BOM to carry out a review of related party exposures based on improved legislation	end-September 2018
BOM to adopt an amendment to its regulation on asset classification and provisioning in consultation with IMF staff	end-June 2017
Enact a law on the use of public funds	end-December 2017

Attachment II. Technical Memorandum of Understanding

1. 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

2. Performance criteria for end-April 2017, end-June 2017, end-September 2017, and end-December 2017 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
- Ceilings on stock of guarantees on external debt by the general government or the BOM.

3. 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;

4. Indicative targets have been established for end-April 2017, end-June 2017, end-September 2017, end-December 2017, with respect to:

- Ceilings on the level of reserve money.

Definitions

5. 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 from the definition of the general government debt.

- The primary balance of the GG is calculated as the consolidated fiscal balance of the GG plus total interest payments of the GG.
- 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. 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]

[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).

[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.

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 by the amount of net nonconcessional borrowing (excluding project financing) received and repatriated by the general government in excess 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.

Excluded from the definition of gross reserves are any foreign currency claims on residents, capital subscriptions in international institutions, 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; and
- 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 deposits and current accounts of the commercial banks. 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

8. 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.

C. Net Domestic Assets of the BOM

9. 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) 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) 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.
- 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.

D. Primary Balance of the General Government

10. A floor applies to the primary balance of the general government, measured below the line. This is measured on a cumulative basis over the course of the year. The below the line sources of financing would include:

- Net bank credit to the general government which includes DBM—this includes net borrowing from BOM (ways and means advances, loans, holdings of treasury bills and government bonds, and the government liabilities to the IMF, 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 and DBM securities 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, and DBM external borrowing.
- Privatization receipts.

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

11. A ceiling applies 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. The definition of debt, for the purposes of the program, is set out in Executive Board Decision No. 12274, Point 9, as revised on August 24, 2000 (see Annex I).

F. Stock of Guarantees on External Debt

12. 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. Short-Term External Debt

13. 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.

14. 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).

15. 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

16. 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 IMF'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 (assets) as well as gold liabilities, 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 IMF staff. 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 IMF staff.

- Assets and liabilities held in Renminbi and in SDR, on a weekly basis.
- 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 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 I. Guidelines on Performance Criteria with Respect to Foreign Debt

Excerpt from Executive Board Decision No. 15688, adopted December 5, 2014

8.

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

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

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

iii. leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of these guidelines, 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) awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

INTERNATIONAL MONETARY FUND

MONGOLIA

April 13, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION AND REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FALICILITY—INFORMATIONAL ANNEX

Prepared By: Asia and Pacific Department (in collaboration with other departments)

CONTENTS

FUND RELATIONS

(As of March 31, 2017)

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

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	72.30	100.00
Fund Holdings of Currency	66.87	92.49
Reserve Position in Fund	5.44	7.52

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	48.76	100.00
Holdings	42.91	88.01

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
None		

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	04/01/2009	10/01/2010	153.30	122.64
ECF [1]	09/28/2001	07/31/2005	28.49	12.21
ECF [1]	07/30/1997	07/29/2000	33.39	17.44

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

	Forthcoming				
	2017	**2018**	**2019**	**2020**	**2021**
Principal					
Charges/interest	0.02	0.03	0.03	0.03	0.03
Total	0.02	0.03	0.03	0.03	0.03

Safeguards assessment: Safeguards assessments of the BOM were conducted in 2002, 2003, and 2009. The 2009 assessment found that the BOM financial reporting and audit practices generally complied with international standards. Recommendations were made to improve the external audit mechanism to grant auditors full access to central bank vaults, strengthen the central bank law, and strengthen the role of the supervisory board. An updated safeguards assessment of the BOM is in progress and is expected to be completed by the first review. A safeguards mission was conducted in late March / early April. The BOM continues to be audited by reputable firms, and its financial statements are published. The updated assessment will evaluate the central bank's control, governance, and legal framework against leading practices and safeguards requirements.

[1/] Formerly PRGF.

Exchange Arrangement:

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

Mongolia accepted the obligations of Article VIII, Sections 2, 3, and 4 on February 1, 1996. Mongolia maintains two multiple currency practices (MCPs) subject to Fund jurisdiction. First, the modalities of the multi-price auction system give rise to an MCP since there is no mechanism in place that ensures that exchange rates of accepted bids at the multi-price auction do not deviate by more than 2 percent. The Executive Board approved the multi-price auction MCP until June 22, 2010 (Decision No. 14365 of June 23, 2009), and its further extension until March 15, 2012 or the next Article IV consultation whichever is earlier (Decision No. 14669 of June 23, 2010 and Decision No. 14365 of March 16, 2011). The MCP, however, could not be resolved by March 15, 2012, and would be continued as long as the multiple price foreign exchange auction mechanism remains in place. Therefore, the MCP is unapproved, and since the criteria for approval of this MCP are not in place, staff do not recommend Executive Board approval of said measure. In addition, Mongolia has an official exchange rate (reference rate) that is mandatorily used for government transactions (as opposed to the commercial market rate). Therefore, by way of official action, the authorities have created market segmentation. While Order #699 of the BOM issued on December 3, 2010, sets forth that the reference rate is determined based on the weighted average of market rates used from 4 PM of the previous day to 4 PM of the current day, staff are of the view that this Order does not eliminate the market segmentation and the multiplicity of effective rates arising from it. Accordingly, in the absence of a mechanism to ensure that the commercial rates and the reference rate do not deviate by more than 2 percent, the way the reference rate is used in government transactions gives rise to an MCP subject to Fund approval. Since the criteria for approval of this MCP are not in place, it remains unapproved. Mongolia imposes exchange restrictions for security reasons in accordance with United Nations Security Council Resolution No. 92/757 concerning certain transactions with the Federal Republic of Yugoslavia (Serbia and Montenegro) that have been notified to the Fund under Decision 144 (11/4/94).

The BOM notes that hitherto there have been no cases where exchange rates of accepted bids at the multi-price auction deviate by more than 2 percent, and plans to introduce a mechanism to ensure the deviation would never exceed 2 percent. The BOM is also working on the development of an indicative spot exchange rate.

Article IV Consultation:

The 2015 Article IV consultation (IMF Country Report No. 15/109) was concluded by the Executive Board on April 3, 2015. Mongolia is on a 12–month cycle.

ROSC Assessments:

The following ROSC assessments have been undertaken: Data Dissemination (May 2001), Fiscal Transparency Module (November 2001), Fiscal Update (May 2005), Data Dissemination

(April 2008), Monetary and Fiscal Policy Transparency (September 2008), Banking Supervision (September 2008).

Recent Financial Arrangements:

An 18-month Stand-by Arrangement in an amount of equivalent to SDR 153.3 million (300 percent of quota) was approved on April 1, 2009. The Executive Board successfully completed the final review on September 8, 2010.

FSAP Participation:

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

Technical Assistance in 2015–2017:

Missions:

- Medium-Term Budget Framework (MTBF), (FAD), January 2015
- Systemic Oversight and Crisis Preparedness (MCM), January - February 2015
- Banking supervision (MCM), January - February 2015
- External Sector Statistics (STA), February 2015
- National Accounts (STA), March 2015
- Government Finance Statistics (FAD), March 2015
- Medium-Term Budget Framework (MTBF), (FAD), March-April 2015
- Natural Resource Revenue Pilot Study (FAD), March 2015
- Tax Administration (FAD), March 2015
- AML/CFT (LEG), September 2015
- Government Bond Secondary Market Development (MCM), September – October 2015
- Establishing Sovereign Wealth (MCM), September – October 2015
- Bank Supervision & Regulations (MCM), September – October 2015
- Government Finance Statistics (FAD/STA), October-November 2015
- External Sector Statistics (STA), November 2015
- Macro-Fiscal Issues (FAD), November- December, 2015
- National Accounts (STA), December 2015
- Macro-Fiscal Issues (FAD), March-April, 2016
- Strengthening Government Accounting and Financial Reporting (STA, FAD), April 2016
- Tax Administration (FAD), April 2016
- AML/CFT (LEG), April 2016
- National Accounts (STA), September 2016

- Public Accounting (STA), November - December 2016
- Mission on PIMA (FAD), November - December 2016
- Macro-fiscal issues (FAD), November - December 2016
- Monetary and Forex Operations (MCM), February, 2017
- VAT Gap Exercise as part of RMTF Project Development Activities (FAD), February 2017
- RMTF Project Development Activities (FAD), February 2017
- VAT Gap Exercise as part of RMTF Project Development Activities (FAD), February 2017
- Selected Issues and VAT Implementation (FAD), March 2017
- Compilation of Financial Soundness Indicators (FSIs) (STA), March 2017

Resident Representative:

Since April 2015, Mr. Neil Saker has been the resident representative based in Ulaanbaatar.

WORLD BANK-IMF COLLABORATION

1. **World Bank and IMF country teams maintain a close working relationship**. The teams, led by Mr. John Litwack (Lead Economist, GMFDR) and Mr. Koshy Mathai (Mission Chief, APD) collaborate on a range of macroeconomic and structural issues.

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

- **IMF surveillance**. World Bank staff comment on Fund documents and also participate in selected meetings of the Article IV and program mission team with the authorities. This facilitates the discussions, especially as regards policies in areas of mutual interest, such as bank restructuring, social welfare reform, and fiscal policy.

- **Development Policy Credits (DPC) and Country Partnership Strategy (CPS)**. In turn, Fund staff participated in the design and review of the Bank's DPCs and were kept informed about the development of the Bank's new CPS for FY13−17.

- **Banking system issues**. Both country teams have been active in this area, including by fielding technical assistance missions. The teams coordinate closely to provide the authorities with consistent advice while avoiding unnecessary duplication of efforts. The two teams also continue to educate the public and parliamentarians on banking sector issues in an effort to build support for reforms.

- **Structural reforms.** Staff of the IMF and the World Bank have worked together successfully to provide technical assistance in expenditure management, the Fiscal Stability Law, the Integrated Budget Law, the Social Welfare Law, the Investment Law, and taxation of the mineral sector, and on the Future Heritage Fund Law. Staff also actively collaborated on a series of assessment of Mongolia's PFM system, including the Public Expenditure and Financial Accountability (PEFA) framework and the PIMA report.

3. **Based on this close collaboration, the World Bank and the IMF share a common view about Mongolia's macroeconomic and structural reform priorities.** These include strengthening macroeconomic policies to stabilize the economy and avoid boom-bust cycles, pursuing structural reforms to diversify the economy and allow for sustainable medium-term growth, protecting the poor through improvements in the social welfare system, and strengthening the banking sector.

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

Table 1. Mongolia: Bank and Fund Planned Activities in Macro-Critical Structural Reform Areas

	Products	Expected Delivery Date
Bank Work Program	<u>Analytical and Advisory Services</u> • Semi-Annual Economic Update • Policy notes on selected economic topics • Financial Sector Monitoring and Policy Dialogue (banking supervision, deposit insurance, housing finance, payment system, financial capability and consumer protection, AML/ATF) • Capital Markets Strengthening and Development TA • Public Expenditure Review • TA on improving debt management system <u>Operational</u> • Supervision missions, multi-sectoral TA Credit (fiscal policy and public expenditure system, banking, social welfare) • Preparation of Development Policy Credit Operation • Preparation of the second phase of multi-sectoral TA loan.	 • Ongoing • Ongoing • Ongoing • Ongoing • August 2017 • Ongoing • Ongoing • Ongoing • Ongoing
Fund Work Program	• Article IV-Board Meetings • Missions	• November 2013, April 2015 • 2014: April, June, September, December; 2015: February, June, October; 2016: August, October; 2017: February

RELATIONS WITH THE ASIAN DEVELOPMENT BANK[2]

Mongolia became a member of the Asian Development Bank (ADB) in February 1991. The ADB has been Mongolia's largest source of multilateral development finance for more than two decades, and since Mongolia joined ADB, the country has received US$1.7 billion in loans for sovereign and nonsovereign operations, and US$177 million in grants, including from the Japan Fund for Poverty Reduction (JFPR), among other trust funds. Technical Assistance (TA) in the amount of US$147.7 million has been implemented during the same period. The ADB has supported trade through its Trade Finance Program, with a total value of US$185 million support trade transaction of small-and medium-enterprises (SMEs). In addition, non-sovereign operations in the amount of about $100 million have been provided to support on-lending to SMEs.

In 2011, Mongolia gained access to ADB's ordinary capital resources (OCR), alongside ADB's concessional lending (COL). However, Mongolia no longer has access to Asian Development Fund (ADF) grant financing. Access to OCR funding has allowed for a substantial scale-up of ADB's operations in Mongolia to better support its development needs in various areas, including financial sector reforms, technical, and policy support in urban infrastructure, agriculture, rural development, energy, financial sector reform, education, health, public finance, social protection, transport, regional cooperation, and climate change and environmental protection.

The Mongolia Country Partnership Strategy (CPS) 2012−2016 was approved by the ADB's Board of Directors in April 2012. The CPS prioritized transport, energy, and water supply infrastructure; access to education and health; and regional economic cooperation to support sustainable and inclusive growth. In 2014, reflecting changed government priorities two strategic adjustments was made through the Interim CPS 2014–2016: (i) the inclusion of two additional sectors (agriculture, natural resources and rural development; and finance); and (ii) scaling up OCR resource allocations to meet pressing development needs, from $50m annually to $200m. The Mongolia Country Partnership Strategy 2017-2020 is under preparation. Closely aligned with the government's priorities and ADB's corporate strategy, the overarching goal of the CPS will be to help Mongolia sustain inclusive growth in a period of economic difficulties. To that end, ADB's operations will promote economic and social stability; develop infrastructure to support economic diversification; and strengthen environmental sustainability.

Under the new CPS, ADB will help the government to diversify the country's economic structure and foster growth and job creation to facilitate economic and social stability. ADB will provide assistance to develop skills and encourage labor-intensive growth outside the mining sector, especially by SMEs engaged in agribusiness and tourism. To safeguard hard-won gains in poverty reduction and progress in human development from cyclical economic downturns and rapid internal migration, ADB will strengthen access to and government capacity to design and administer a broad range of essential social services. This will include efforts to improve social service delivery and coverage to strengthen the social safety net. Support will also be provided to increase the pace and impact of structural

[2] Data provided by Asian Development Bank staff.

reforms with a particular focus on ensuring the stability of the financial sector to support private sector development.

In addition, ADB operations will support deeper regional cooperation and integration through improved physical connectivity to strengthening Mongolia's competitiveness and diversify economic activity. The broader aim of ADB's support will be to secure Mongolia's place on northeast Asia's transport and trade routes. A more holistic approach to urbanization will increase living standards and boost the development of local economies fostering economic diversification and job creation.

To make economic growth more environmentally sustainable, ADB will seek to strengthen natural resource management, including by promoting environmental protection and sustainable resource use; foster climate change adaptation and mitigation by supporting Mongolia in attaining its national commitments to the Paris Agreement through provision of TA and capacity building of responsible agencies as well as through selected infrastructure investments. Efforts will be stepped up to strengthen disaster risk management in light of Mongolia's vulnerability to natural disasters.

STATISTICAL ISSUES

(As of March 29, 2017)

I. Assessment of Data Adequacy for Surveillance
General: Data provision to the Fund is broadly adequate for surveillance, but some shortcomings exist in the estimation of GDP and treatment of missing observations in price indices. The priority areas for improvement are national accounts and price statistics, and also the migration of government finance statistics to a new methodology.
National Accounts: The National Statistics Office (NSO) currently publishes annual and quarterly GDP using the production and expenditure approaches. Annual supply-use tables are compiled and represent a significant quality improvement as part of Mongolia's implementation of 2008 SNA. A recent mission (September 2016) recommended enhancements to source data used to compile natural resources in the national accounts.
Price Statistics: CPI estimates use a base year of 2010 using the 2010 household survey. The NSO publishes a producer price index (PPI and uses the imputation of missing prices. Also, NSO compiles Housing Price Index for Ulaanbaatar following a mix-adjustment by stratification methodology.
Government Finance Statistics: Currently, the concepts, classifications, and definitions used to compile sub-annual and annual fiscal statistics for the consolidated general government operations series used in APD generally follow the guidelines of the GFSM 1986. The authorities have indicated an intention to adopt a migration path to the GFSM 2001/2014 methodology. STA assists the authorities compile and disseminate monthly and annual (cash-based) general government series in the GFSM 2001/2014-based Statement of Sources and Uses of cash (Revenue, Expenditure, Transaction in Assets and Liabilities). A 2015 GFS TA mission compiled a complete annual balance sheet and integrated presentation of stock and flows for the consolidated general government sector using the accrual (IPSAS-based) accounts maintained by the Ministry of Finance. The mission also encouraged the reporting of public sector debt statistics (PSDS), as these were (and still are) not reported systematically to the World Bank for dissemination on the PSDS Website. In March 2017, STA conduct a GFS Workshop as well as provide additional TA to the authorities.
Monetary and Financial Statistics: BOM's monetary and financial statistics (MFS) conform to the concepts and definitions of the *Monetary and Financial Statistics Manual (MFSM)* and its *Compilation Guide*, as the authorities implemented recommendations of latest MFS missions. In particular, the BOM improved monetary data through the proper classification of repurchase agreements, accrued interest, and financial derivatives. The coverage of monetary statistics was expanded beginning in February 2010 to include data of Savings and Credit Cooperatives (SCCs) that collect deposits; and since May 2010 data for some other financial corporations (OFCIs) have been disseminated in the BOM's *Monthly Statistical Bulletin*. The July/August 2011 mission discussed the quality of data of the nonbank financial institutions (NBFIs), insurance companies, and securities companies that are reported to the Financial Regulatory Commission (FRC) and recommended compiling the other financial corporations (OFC) survey with data from these institutions. However, due to insufficient coordination among various agencies, this recommendation has not been implemented. The recommendation is particularly relevant in view of the introduction of the new Monetary and Financial Statistics Manual and Compilation Guide (2016).

Financial sector surveillance: With regard to financial soundness indicators (FSIs), Mongolia currently does not report data to the Fund for dissemination on the Fund website. The BoM is quite advanced in the compilation of their FSIs, but they still need to confirm their action plan commitment to submit their data and metadata to the IMF and allow for its posting in the http://fsi.imf.org website. STA conducted a technical assistance mission on FSIs for deposit takers in March 2017 that addressed the former.
External Sector Statistics: For compilation of external sector statistics (ESS), the Bank of Mongolia (BOM) follows the statistical framework of the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) from 2016. Information till 2015 is based on the fifth edition of the Balance of Payment Manual (BPM5). The coverage of the balance of payments statistics has been broadened by extending the International Transaction Reporting System (ITRS) to nonbank financial institutions and by increasing the number of direct reporting private enterprises. Since May 2014, BOM has produced 2012-annual international investment position data for submission to STA. Priorities for improvement are to (1) submit quarterly external debt statistics to the World Bank's Quarterly External Debt Statistics (QEDS) database in collaboration with the Ministry of Finance; and (2) assess the State Registry Office's database on all enterprises registered in Mongolia to determine whether all relevant enterprises with direct investment are included in the BOM's ESS surveys.

II. Data Standards and Quality	
Mongolia participates in the General Data Dissemination System (GDDS).	A data ROSC mission visited Mongolia in September 2007 to update the May 2000 assessment of the macroeconomic statistics. The report was published in April 2008.

Mongolia—Table 2. Common Indicators Required for Surveillance
(As of March 29, 2017)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]	Memo Items: Data Quality-Methodological soundness[7]	Memo Items: Data Quality – Accuracy and Reliability[8]
Exchange rates	02/28/17	02/28/17	D	D	D		
International reserve assets and reserve liabilities of the Monetary Authorities[1]	02/21/17	02/21/17	W	W	W		
Reserve/base money	12/31/16	12/31/16	W	W	W	O, LO, LO, LO	O, O, O, O, LNO
Broad money	12/31/16	12/31/16	W	W	W		
Central bank balance sheet	12/31/16	12/31/16	M	M	M		
Consolidated balance sheet of the banking system	12/31/16	12/31/16	M	M	M		
Interest rates[2]	02/21/17	02/21/17	W	W	W		
Consumer price index	12/31/17	12/31/17	M	M	M	O, LO, O, O	LO, LO, LO, O, O
Revenue, expenditure, balance and composition of financing[3] – general government[4]	12/31/16	1/16/17	M	M	M	LO, LNO, LO, O	LO, O, LO, LO, LNO
Stocks of general government and general government-guaranteed debt[5]	12/31/16	12/31/16	Q	Q	Q		
External current account balance	02/28/17	03/15/17	M	M	M	O, O, O, LO	LO, O, LO, LO, LO
Exports and imports of goods	02/28/17	03/15/17	M	M	M		
GDP/GNI	2016Q4	02/15/17	Q	Q	Q	O, LNO, O, LO	O, LO, LO, LO, LNO
Gross external debt	2016Q4	01/31/17	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, and rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I), Not Available (NA).
[7] Reflects the assessment provided in the data ROSC or the Substantive Update (published in April 2008, and based on the findings of the mission that took place during September 1–28) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[8] Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

MILLENNIUM DEVELOPMENT GOALS[1/]

	2004	2014	2015
Goal 1: Eradicate extreme poverty and hunger 2/			
Employment to population ratio, ages 15-24, total (%) (national estimate)	...	...	...
Employment to population ratio, 15+, total (%) (national estimate)	56.50	...	...
GDP per person employed (constant 2011 PPP $)	12,222.86	22,450.35	...
Income share held by lowest 20%	...	8.08	...
Prevalence of underweight, weight for age (% of children under 5)	4.80	...	...
Poverty headcount ratio at $1.90 a day (2011 PPP) (% of population)	...	0.22	...
Poverty gap at $1.90 a day (2011 PPP) (%)	...	0.03	...
Vulnerable employment, male (% of male employment)	...	...	...
Goal 2: Achieve universal primary education 3/			
Literacy rate, youth female (% of females ages 15-24)	...	...	98.98
Literacy rate, youth male (% of males ages 15-24)	...	...	98.05
Survival rate to Grade 5 of primary education, both sexes (%)	...	...	...
Primary completion rate, total (% of relevant age group)	97.78	109.85	...
Adjusted net enrollment rate, primary, female (% of primary school age children)	92.86	94.99	...
Adjusted net enrollment rate, primary, male (% of primary school age children)	92.82	96.24	...
Goal 3: Promote gender equality and empower women 4/			
Proportion of seats held by women in national parliaments (%)	6.80	14.90	14.50
Share of women in wage employment in the nonagricultural sector (% of total nonagricultural employment)	51.20	...	...
Ratio of female to male labor force participation rate (%) (national estimate)	96.31	...	...
Goal 4: Reduce child mortality 5/			
Immunization, measles (% of children ages 12-23 months)	99	98	98
Mortality rate, infant (per 1,000 live births)	37.30	19.90	19.00
Mortality rate, under-5 (per 1,000 live births)	46.80	23.50	22.40
Goal 5: Improve maternal health 6/			
Adolescent fertility rate (births per 1,000 women ages 15-19)	20.54	16.34	15.00
Births attended by skilled health staff (% of total)	99.70	98.90	...
Contraceptive prevalence, any methods (% of women ages 15-49)	...	54.60	...
Maternal mortality ratio (modeled estimate, per 100,000 live births)	105	46	44
Pregnant women receiving prenatal care (%)	...	98.70	...
Unmet need for contraception (% of married women ages 15-49)	...	...	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases 7/			
Condom use, population ages 15-24, female (% of females ages 15-24)	...	...	...
Condom use, population ages 15-24, male (% of males ages 15-24)	...	...	...
Incidence of tuberculosis (per 100,000 people)	428	428	428
Tuberculosis case detection rate (%, all forms)	42	36	37
Prevalence of HIV, total (% of population ages 15-49)	0.10	0.10	0.10
Prevalence of HIV, female (% ages 15-24)	0.10	0.10	0.10
Prevalence of HIV, male (% ages 15-24)	0.10	0.10	0.10
Goal 7: Ensure environmental sustainability 8/			
CO2 emissions (kg per 2011 PPP $ of GDP)	0.60	...	...
CO2 emissions (metric tons per capita)	3.43	...	...
Forest area (% of land area)	7.33	8.14	8.08
Improved sanitation facilities (% of population with access)	51.90	59.10	59.70
Improved water source (% of population with access)	59.60	64.20	64.40
Net ODA received per capita (current US$)	103.32	108.13	...
Goal 8: Develop a global partnership for development 9/			
Debt service (% of exports of goods, services and primary income)	2.93	...	...
Mobile cellular subscriptions (per 100 people)	17.17	105.06	104.96
Fixed telephone subscriptions (per 100 people)	5.85	7.92	8.75
Internet users (per 100 people)	...	19.94	21.44
Other			
Fertility rate, total (births per woman)	2.12	2.66	...
GNI per capita, Atlas method (current US$)	760	4260	3870
GNI, Atlas method (current US$, billion)	1.89	12.39	11.46
Gross capital formation (% of GDP)	31.18	35.18	27.02
Life expectancy at birth, total (years)	64.73	69.46	...
Adult literacy rate, population 15+ years, both sexes (%)	...	...	98.37
Population, total (millions)	2.50	2.91	2.96
Trade (% of GDP)	131.33	109.32	90.35

Source: World Bank, *World Development Indicators 2014* (October 2015 version) and Indian Ministry of Statistics and Programme Implementation.

1/ Years shown in table are those with data available for the most indicators.

2/ Halve, between 1990 and 2015, the proportion of people whose income is less than the poverty line. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

3/ Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

4/ Eliminate gender disparity in primary and secondary education preferably by 2005, and at all levels of education no later than 2015.

5/ Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

6/ Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

7/ Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

8/ Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

9/ Develop an open, rule-based, predictable, non-discriminatory trading and financial system. Address the Special Needs of Least Developed Countries and of landlocked countries and small island states. Deal with the debt problems of developing countries through national and international measures to make debt long term sustainable. In cooperation with developing countries, implement strategies for decent and productive work for youth. In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the benefits of technology.

MAIN DATA WEBSITES

National Statistics Office (www.nso.mn)
- National Accounts
- Consumer Price Inflation
- Agricultural and Industrial Production
- Petroleum Imports
- Electricity Production and Consumption
- Coal Production
- Retail Prices
- Employment
- Exports and Imports

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

Ministry of Finance (www.mof.gov.mn)
- Government Budgetary Operations

National Development and Innovation Committee (www.ndic.gov.mn)
- Long- and medium-term development strategy
- Economic and social policies
- Investment policy coordination
- Development Bank of Mongolia

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

INTERNATIONAL MONETARY FUND

MONGOLIA

May 18, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION AND REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—SUPPLEMENTARY INFORMATION AND SUPPLEMENTARY LETTER OF INTENT

Approved By
Markus Rodlauer (APD) and Daria Zakharova (SPR)

Prepared by the Asia and Pacific Department

This supplement provides information on developments since the issuance of the staff report for the 2017 Article IV Consultation and Request for an Extended Arrangement under the Extended Fund Facility (EBS/17/30) on April 14, 2017. The supplement does not change the thrust of the staff appraisal.

Recent economic developments

1. **Activity has begun picking up, suggesting possible upside risks to this year's economic outlook.** GDP growth registered 4.2 percent y/y in the first quarter, with strong private investment more than offsetting a contraction in government consumption. Inflation, which had fallen to nearly zero at end-2016 on account of soft activity (and despite the depreciation of the currency), rebounded to 3½ percent y/y in April reflecting higher food prices. Gross international reserves, though still weak, have risen somewhat with better commodity prices and stronger-than-expected exports. Finally, fiscal performance is on track, with the deficit through March amounting to around 1 percent of GDP, as against an annual target of 10½ percent.

Measure affecting FDI foreign-exchange transactions

2. **A measure on the foreign-exchange banking arrangements of foreign direct investment (FDI) projects risked undermining the macro framework of the program.** A Parliamentary resolution ratified on April 20 implementing key parts of the authorities' program included a clause requiring the foreign-exchange sales of major FDI projects to be channeled through the domestic banking system. There was a serious concern that the clause could affect the investment climate and undermine the macroeconomic projections

underpinning the program, in particular, the outlook for FDI, growth, and the balance of payments. Executive Board consideration of the Article IV Consultation and EFF request was thus postponed from the original date of April 28, pending resolution of this issue. Parliament passed a new version of the resolution that excluded the clause on May 4, paving the way to Board consideration on May 24.

3. **The postponement of Board consideration has required some modifications to program monitoring arrangements**. The first test date for the program's quantitative performance criteria will now be end-June instead of end-April., and the phasing of quarterly reviews and disbursements is modified accordingly. (See Tables 1-3.) The authorities' supplementary Letter of Intent (LOI) requesting these changes is attached, along with revised relevant staff report tables. An end-April structural benchmark on tax compliance improvement strategies was met on time and thus no longer remains in the program's structural agenda.

Staff Appraisal

4. **The thrust of the staff appraisal remains unchanged.** FDI is of critical importance to Mongolia, and continuing efforts to strengthen the investment climate will be a key priority.

Table 1. Mongolia: Quantitative Performance Criteria
(Revised Staff Report Table 10)

	6/30/2017	9/30/2017	12/31/2017	3/30/2018 Indicative targets
Performance Criteria 1/ 2/				
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)	0	100	250	550
Net domestic assets (NDA) of the BOM (ceiling, eop stock, in billion togrog at program exchange rate)	5,100	4,900	4,600	4,000
Primary balance of the general government (floor, cumulative since the beginning of the fiscal year, in billion togrog)	-850	-1,050	-1,500	-350
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$).	1,800	1,800	1,800	1,800
Stock of guarantees on external debt extended by the government or BOM (ceiling, eop stock, in million US$)	850	850	750	750
Indicative Targets (IT)				
Reserve money (ceiling, in billion togrog)	3,500	3,900	4,000	4,200
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$).	0	0	0	0
Accumulation of new external payment arrears (ceiling, eop, in million US$).	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$)	257	427	597	783
Net nonconcessional borrowing received and repatriated by the general government (including the DBM) under the program baseline (eop stock, cumulative, in million US$)	20	20	20	20
Program exchange rate (togrog/U.S. dollar)	2489.4	2489.4	2489.4	2489.4
U.S. dollar per SDR	1.3	1.3	1.3	1.3
Monetary gold price (U.S. dollar/ounce)	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 in Q1 2018.

Table 2. Mongolia: Proposed Access and Phasing Under the Extended Arrangement
(Revised Staff Report Table 9)

Availability Date		Purchase Million SDR	Purchase Million USD	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	27.9560	37.82	38.67
December 15, 2017	Observance of end-September 2017 performance criteria, completion of second review	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 eighth 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**

Table 3. Mongolia: Phasing of Program Financing
(Revised Staff Report Text Table)
(In millions of U.S. dollars)

	2017Q2	2017Q3	2017Q4	2018Q1
Financing	295	208	258	278
IMF	38	38	38	28
Other IFIs and bilateral donors	257	170	220	249

Sources: Fund staff projections.

Table 4. Mongolia: Indicators of Fund Credit, 2017-22
(Revised Staff Report Table 8)
(In millions of SDR, unless otherwise indicated)

	Projections					
	2017	2018	2019	2020	2021	2022
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
Obligations 2/					10.72	26.09
Principal (repayments/repurchases)					2.33	17.91
Charges and interest	0.68	2.21	5.25	8.07	8.39	8.18
Stock of existing and prospective Fund credit 1/	83.87	183.45	288.29	314.51	312.18	294.27
In percent of quota	116.00	253.74	398.75	435.00	431.78	407.01
In percent of GDP	1.10	2.34	3.37	3.44	3.17	2.72
In percent of exports of goods and services	1.98	4.28	6.14	6.28	5.76	5.09
In percent of gross usable reserves	4.96	7.29	8.05	7.80	7.33	6.84
Obligations to the Fund from existing and prospective Fund arrangements	0.68	2.21	5.25	8.07	10.72	26.09
In percent of quota	0.94	3.06	7.26	11.16	14.83	36.09
In percent of GDP	0.01	0.03	0.06	0.09	0.11	0.24
In percent of exports of goods and services	0.02	0.05	0.11	0.16	0.20	0.45
In percent of gross usable reserves	0.04	0.09	0.15	0.20	0.25	0.61

Sources: IMF Finance Department; and Fund staff estimates and projections.
1/ End of period.
2/ Repayment schedule based on scheduled debt service obligations.

Table 5. Mongolia: Capacity to Repay Indicators, 2017–22
(Revised Staff Report Table 7)
(In millions of SDR, unless otherwise indicated)

	Projections					
	2017	2018	2019	2020	2021	2022
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
In percent of quota	116.00	253.74	398.75	435.00	431.78	407.01
Debt service on GRA credit	0.68	2.21	5.25	8.07	10.72	26.09
Principal (repayments/repurchases)					2.33	17.91
Charges and interest	0.68	2.21	5.25	8.07	8.39	8.18
Debt and debt service ratios (In percent of GDP)						
Public and publicly-guaranteed debt	94.86	101.34	100.00	97.46	92.31	84.70
Excluding proposed IMF	93.77	99.00	96.63	94.02	89.14	81.98
GRA credit to Mongolia	1.10	2.34	3.37	3.44	3.17	2.72
Public and publicly-guaranteed debt service	17.69	19.20	18.17	14.67	15.89	19.08
Excluding proposed IMF	17.68	19.17	18.11	14.58	15.78	18.84
GRA debt service	0.01	0.03	0.06	0.09	0.11	0.24
Debt and debt service ratios (In percent of exports of goods and services)						
Public and publicly-guaranteed debt	171.01	185.46	182.44	178.13	167.39	158.51
Excluding proposed IMF	169.03	181.18	176.30	171.84	161.64	153.43
GRA credit to Mongolia	1.98	4.28	6.14	6.28	5.76	5.09
Public and publicly-guaranteed debt service	31.89	35.13	33.14	26.81	28.81	35.70
Excluding proposed IMF	31.87	35.08	33.03	26.65	28.61	35.25
GRA debt service	0.02	0.05	0.11	0.16	0.20	0.45

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

Supplementary Letter of Intent

May 17, 2017
Ulaanbaatar

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

Dear Ms. Lagarde:

We understand that Board consideration of Mongolia's request for an extended arrangement under the Extended Fund Facility was postponed pending clarification of a recent measure related to foreign-exchange banking arrangements of foreign direct investment projects. After careful consideration, Parliament decided to rescind this measure on May 4, and we look forward to Board consideration of our EFF request as rescheduled on May 24.

The postponement, however, necessitates some modifications to program monitoring arrangements. Specifically, we propose a rephasing of test dates, program reviews, and disbursements, as set out in attached Tables A1 and A2. The first two reviews of the program will take place before September 30, 2017, and December 31, 2017, respectively. We are happy to report that finalization of tax compliance improvement strategies, which was earlier intended as a structural benchmark for end-April, was completed on time.

Aside from these changes, our Letter of Intent (LOI), Memorandum of Economic and Financial Policies (MEFP), and Technical Memorandum of Understanding (TMU) of April 13, 2017 remain valid. We believe that the policies set forth therein are adequate to achieve the objectives of the program but we stand ready to take additional measures as needed. As is standard under all IMF arrangements, we will consult with the IMF before modifying measures contained in our MEFP or adopting new measures that would deviate from the goals of the program.

Sincerely yours,

/s/	/s/
B. Choijilsuren	N. Bayartsaikhan
Minister of Finance	Governor, Bank of Mongolia

Attachments

Revised – Table A1. Mongolia. Quantitative Performance Criteria

	6/30/2017	9/30/2017	12/31/2017	3/30/2018 Indicative targets
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Primary balance of the general government (floor, cumulative since the beginning of the fiscal year, in billion togrog)	-850	-1,050	-1,500	-350
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$).	1,800	1,800	1,800	1,800
Stock of guarantees on external debt extended by the government or BOM (ceiling, eop stock, in million US$)	850	850	750	750
Indicative Targets (IT)				
Reserve money (ceiling, in billion togrog)	3,500	3,900	4,000	4,200
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$).	0	0	0	0
Accumulation of new external payment arrears (ceiling, eop, in million US$).	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$)	257	427	597	783
Net nonconcessional borrowing received and repatriated by the general government (including the DBM) under the program baseline (eop stock, cumulative, in million US$)	20	20	20	20
Program exchange rate (togrog/U.S. dollar)	2489.4	2489.4	2489.4	2489.4
U.S. dollar per SDR	1.3	1.3	1.3	1.3
Monetary gold price (U.S. dollar/ounce)	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 in Q1 2018.

Revised - Table A2. Mongolia: Proposed Prior Actions and Structural Benchmarks

	Completion Date
Prior actions (to be completed before Board approval of the new arrangement)	
Fiscal	
Passage of a 2017 supplementary budget and a medium-term budget framework (2018-2020) consistent with program targets, and passage of all fiscal measures needed to support 2017 targets	
Banking	
BOM to launch the procurement procedure for AQRs by internationally reputable firms on banks based on terms of reference developed in consultation with IMF staff.	
Monetary	
Authorities to communicate to staff the discontinuation of any net BOM financing of the mortgage program as well as any quasi- fiscal lending e.g. to companies	
Structural benchmarks	
Fiscal	
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
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-October 2017
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-October 2017
Passage of a 2018 budget in line with the program's fiscal path.	end-November 2017
Revision of the relevant budget laws and introduction of a new law to establish a fiscal council, in line with international best practice and IMF advice.	end-December 2017
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
Submission of the tax working group's report to the Ministry of Finance.	end-December 2017
Social protection	
The Child Money Program will be targeted to the poorest 40 percent of Mongolian households and the savings redirected toward the better-targeted Food Stamps program.	end-December 2017

Revised - Table A2. Mongolia: Proposed Prior Actions and Structural Benchmarks (concluded)

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
Adoption of the new Bank of Mongolia Law.	end-March 2018
Banking	
Amendment of the Banking Law and Bank of Mongolia Law and related secondary legislation, guided by IMF staff, to 1. improve the early intervention framework 2. bring the bank resolution legislation, funding and cooperation framework up to best international standards in cooperation with MoF, DICOM 3. 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 4. introduce power for BOM to apply levies on banks to cover the cost of supervision incl. AQRs 5. strengthen shareholders', board members', and senior management's fit and proper requirements 6. upgrade rules on banks' related party exposure and final beneficial owners	end-November 2017
Amendment of DICOM law to bring it in line with IADI Core Principles for Effective Deposit Insurance Systems.	end-November 2017
Financial Stability Board (FSB) approval of an NPL resolution strategy. In consultation with other relevant ministries, the FSB will first establish a working group, and that group will: (i) identify and analyze impediments to debt resolution, in particular related to insolvency and enforcement laws, taxation issues, and legal and regulatory obstacles to NPL sales and outsourcing; and (ii) develop an NPL resolution strategy including milestones and a timetable for removal of identified impediments.	end-January 2018
BOM to carry out a review of related party exposures based on improved legislation	end-September 2018
BOM to adopt an amendment to its regulation on asset classification and provisioning in consultation with IMF staff	end-June 2017
Enact a law on the use of public funds	end-December 2017

Statement by Christine Barron, Alternate Executive Director for Mongolia,
Il Young Park, Senior Advisor to Executive Director,
Gantsogt Khurelbaatar, Advisor to Executive Director
May 24, 2017

Mongolia has significant potential for economic growth with its abundant natural resources and a young and dynamic population. But the large fall in commodity prices from 2011 and slower growth in China, exacerbated by loose fiscal discipline, resulted in economic growth falling from 17 percent in 2011 to 1 percent in 2016, the budget deficit soaring to 17 percent of GDP, unemployment rising to double digits, depleting international reserves and resulting in high public debt.

These were the economic conditions faced by the Government when it took office in July 2016. They have since embarked on an ambitious and challenging economic recovery program supported by a very constructive dialogue with the Fund on designing an economic recovery plan with policies to address Mongolia's economic difficulties. The Mongolian authorities thank staff for a very constructive and comprehensive dialogue during the program negotiation. Authorities are in broad agreement with the staff's well-balanced assessment of the economic situation and outlook and are firmly committed to implementing the policy recommendations.

Recent Economic Developments and Outlook

The economy will start to regain growth momentum after 2017. Mongolia's economic growth is expected to fall slightly in 2017, before modest growth of 1.8 percent in 2018 and stronger growth of 8.1 percent in 2019, driven by further mining investment. While the authorities broadly agree with staff's assessment of the outlook, they think there is some larger upside risk to economic growth from the mining sector. Growth in the first quarter of 2017 was 1.3 percent. We agree with staff that agriculture and tourism can potentially play a bigger role in the economy, but Mongolia's economy will remain heavily dependent on the mining sector with large potential reserves yet to be exploited.

Mongolia is rich in mineral resources including copper, coking coal, gold and other minerals. One of the largest copper and gold mines in the world, Oyu Tolgoi will have a second phase development of $US 6 billion investment and together with the coking coal mine Tavan Tolgoi's expanded production from 2018 they will contribute significantly to economic growth.

The long-term global copper and gold price outlook is stable. Coking coal market prices have tripled compared to last year, which gives a more positive outlook to near-term economic growth. Higher mineral prices will support a recovery in the trade balance and contribute to a tighter fiscal stance but inflation is expected to remain well within the program target.

A significant contribution to the better near-term and medium-term outlook for Mongolia is that it avoided default on foreign debt. The low level of foreign reserves and short-term bond payments due in 2017, 2018 and 2019 totaling around $US1.2 billion posed a risk that Mongolia could not meet its obligations to international creditors and so default on its foreign debt. However, with the announcement on February 16, 2017 that the authorities and Fund staff had reached an agreement on an Extended Fund Facility program, the Government successfully refinanced $US 580 million of Mongolian Government issued euro bonds maturing on 21st March, 2017. In line with staff's requirements, Mongolia exchanged 79 percent of the debt with existing bondholders to new 7 year bonds and raised the remaining amount from new private sector investors. Upcoming bond payments scheduled for January 2018 and 2019 will be refinanced from the market.

Fiscal Policy

The Medium Term Fiscal Framework's primary goals is to stabilize public debt. The Mongolian fiscal deficit was financed primarily by local and foreign borrowings which accumulated in high public debt. Over the last four years the Government borrowed heavily through issuance of domestic bonds. Current debt financing costs equal one fifth of the budget and average coupon rates on treasury notes are around 15 percent annually. As the Government still relies heavily on treasury notes to close the gap from revenue shortfalls, budget support lending from donors will be used towards reducing the public debt and debt financing costs. Frontloading of available liquid funds in the first year of the program could significantly reduce the pressure on the Government to issue treasury notes, reduce financing cost of debt from the budget and may effectively signal to the domestic debt market a lower interest rate period. Authorities are strongly committed to reduce public debt by lowering the fiscal deficit and efficient management of public debt.

The Fiscal deficit is expected to decline significantly. Fiscal expansion and quasi-fiscal activities contributed to a significant expansion of the fiscal deficit over the last four years. The fiscal deficit reached 17 percent of GDP in 2016, including quasi-fiscal activities by the Development Bank of Mongolia (DBM) and the Bank of Mongolia (BOM). The authorities are giving high importance to fiscal consolidation and the removal of quasi-fiscal activities. The Government has already significantly cut fiscal expenditures resulting in a decrease of the fiscal deficit by 7 percent of GDP to 10.4 percent of GDP in 2017. The program target is to reduce the fiscal deficit below 2 percent of GDP by 2021.

The Government has already taken significant steps to achieve this target.

On the expenditure side, the authorities have adopted a policy to move away from universal social spending to a policy more targeted to the most socially vulnerable sectors. This is expected to reduce expenditures by 1.5 percent of GDP over the next three years. Significant cuts are also being made to capital expenditures and in the coming years if budget revenue allows it will be spent on much needed infrastructure.

On 14 April, the Parliament approved a number of politically challenging tax increases despite strong opposition from the public**.** To alleviate fluctuations in fiscal revenue caused by commodity price cycles, the authorities introduced a set of tax policy measures. These include increasing taxes and excise on petroleum, vehicles, alcohol and tobacco, customs duty on tobacco, introducing a progressive personal income tax, raising social security contributions and eliminating the threshold for withholding tax on interest earned. These measures will bring a stable income stream to the budget. The Government's implementation of politically difficult and unpopular tax increases demonstrates strong commitment to economic reform and the Fund program.

Monetary and exchange rate policy

Monetary policy will remain appropriately tight to achieve the objective of price stability. The BOM will continue to allow the exchange rate to move flexibly consistent with macro fundamentals and will exploit any opportunities to enhance the level of foreign exchange reserves.

As indicated in the staff report for the 2017 Article IV consultation, BOP projection for 2017 and 2018 are under pressure, due to high level of current account deficit.

However, the recent trend shows that current account balance is recovering quicker than expected, due to a sharp pickup in coal exports, and it is expected to continue through the year. In addition, the Government of Mongolia is eager to start big projects such as Tavantolgoi (coking coal mine) and Gatsuurt (gold mine) in the near future. Thus, the BOP outlook could be better than the projection shown in the staff report for the 2017 Article IV consultation.

Due to previous expansionary monetary policy and quasi-fiscal activities by the BOM, foreign reserves decreased from $US 4.5 billion in 2012 to $US 1.3 billion at end of 2016. To avoid previous mistakes, the adoption of a new Central Bank law to clarify central bank's mandate, improve independence and most importantly to introduce collective decision making on policy issues will be vital. The proposed new Central Bank law will be submitted to Parliament by November this year and enacted by March next year.

Financial sector policies

Financial sector health check and assessment will be done. Financial sector stability is a cornerstone of future solid economic growth. Bank balance sheets deteriorated rapidly over the last few years. The major reasons were the negative impact of exchange rate devaluations on mostly US dollar denominated loans and the overall slowdown in the economy following the commodity price slump. Current NPL ratio stands at 8.2 percent and further detailed analysis and a complete review need to be done on banks' health. As one of the prior actions identified in the MEFP, the BOM has launched the procurement procedure to hire an independent, internationally reputable expert company to carry out the AQR in consultation with the IMF staff. The BOM announced the invitation for potential consultant companies to express their interest to carry out the AQR which was opened until April 21, 2017. The selection process of candidates may be completed by late June 2017. Depending on the AQR findings, banks will be required to fix their shortcomings and, most importantly, to recapitalize their capital deficiencies if they are found. Authorities will not intervene unless there is a clear systemic risk to the financial sector.

The Fund and the BOM staff have agreed to adopt an amendment to asset classification and provisioning regulation by end-June, 2017. This regulation was already revised based on the recommendations of a prior IMF Technical assistance mission team and has been implemented since December 2017. The BOM remains committed to implementing the amendments but will delay it until other amendments arising from the AQR are implemented. The BOM is concerned that amending the regulation that was introduced only a few months ago could be disruptive for the banks and affect BOM's credibility with the banks.

Conclusion

Mongolia has strong long-term economic potential due to its abundant natural resources. The Government of Mongolia has met all the prior actions set out in the program, namely discontinuation of quasi-fiscal activities, passage of the supplementary budget consistent with program targets and starting the procurement procedures for the banking sector AQR. The Government of Mongolia strongly believes that the improving economic outlook and sound macroeconomic policies under the Extended Fund Facility program will deliver positive outcomes and the country's economy will recover soon. The main challenges will be to put in place policy measures to build a diversified and resilient economy to avoid negative effects of future commodity cycles. Above all, the Government is committed to strict fiscal discipline and stringent monetary policy as key conditions for successful program implementation.

The authorities reaffirm their strong commitment to the policies and objectives under the IMF program.