INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/303

# MONGOLIA

November 2018

## FIFTH REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION AND WAIVER OF APPLICABILITY OF PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; STAFF SUPPLEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MONGOLIA

In the context of the Fifth Review Under the Extended Fund Facility Arrangement and Request for Modification and Waiver of Applicability of Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on October 31, 2018, following discussions that ended on August 6, 2018, with the officials of Mongolia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on October 16, 2018.
- 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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**International Monetary Fund**
**Washington, D.C.**

Press Release No. 18/404
FOR IMMEDIATE RELEASE
October 31, 2018

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Executive Board Completes Fifth Review under the Extended Arrangement for Mongolia and Approves US$ 36.22 Million Disbursement**

On October 31, 2018, the Executive Board of the International Monetary Fund (IMF) completed the fifth review of Mongolia's performance under the program supported by a three-year extended arrangement under the Extended Fund Facility (EFF). Completion of the review enables Mongolia to draw the equivalent of SDR 26.2088 million (about US$ 36.22 million), bringing total disbursements under the arrangement to SDR 157.2454 million (about US$ 217.33 million).

Mongolia continues to perform well under the program. The combination of strong policy implementation and a supportive external environment has helped the authorities meet all end-September 2018 quantitative targets under the program, with significant over-performance on fiscal targets. Progress has also been made on structural reforms, albeit with some delays.

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

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

"Mongolia continues to make good progress under the Fund-supported program. Helped by favorable commodity exports, a recovery in confidence, and strong program implementation, growth has accelerated further, leading to improvements in the fiscal position and debt dynamics. The fiscal accounts have posted a primary surplus, reflecting both a sharp increase in revenues and continued expenditure restraint. Meanwhile, past over-performance allowed the authorities to meet key reserve targets, despite a recent rise in balance of payments pressures.

“In the financial sector, the focus remains the follow-up to the Asset Quality Review (AQR). Select banks are in the process of booking the results of the AQR and subsequent on-site inspections. They are also now raising the needed capital to address identified shortfalls by the end-December 2018 deadline. The Bank of Mongolia will remain focused on ensuring financial sector stability throughout the process.

“Notwithstanding this progress, Mongolia remains vulnerable to external and domestic shocks. It is therefore crucial to take advantage of the still favorable economic environment to further bolster fiscal and external buffers, strengthen the banking sector, and improve the investment climate. In addition, the authorities should continue efforts to protect social spending, strengthen tax administration, and improve public financial management. A dedicated implementation of the authorities’ reform program is key to build resilience against shocks and ensure sustainable, inclusive growth.”

INTERNATIONAL MONETARY FUND

# MONGOLIA

October 16, 2018

## FIFTH REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION AND WAIVER OF APPLICABILITY OF PERFORMANCE CRITERIA

## EXECUTIVE SUMMARY


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

**Recent developments.** Economic growth remains strong at just above 6 percent for the last three quarters and the primary balance is on track to reach a surplus above 3 percent of GDP. However, there are rising pressures on the balance of payments with reserves declining for the first time since the start of the program—reflecting faster import growth, lower donor flows, and deteriorating terms of trade.

**Program performance.** All quantitative performance criteria (QPCs) for which data is available have been met. Data are not yet available for the QPC on primary balance of the general government for end-September, but it is expected to be met by a large margin. Of four structural benchmarks due, two are expected to be met by the Board date and two are expected to be completed in coming months. The authorities request, and staff supports, a waiver of applicability for the end-September QPC target on the primary balance of the general government as data for this item is unavailable, though it is expected to be met by a large margin. The authorities have also completed three of four prior actions for this review: two related to reining in strong credit growth and one to ensure banks book all additional provisions called for by the Asset Quality Review. The fourth prior action is pending and requires the submission of detailed updates regarding capital raised to date and how remaining shortfalls will be met by end December.

**Policies.** On fiscal policy, the authorities have submitted a budget for 2019 targeting a primary surplus of 1 percent of GDP. The proposal includes a 3 percent of GDP increase in expenditures which aims to recover investment from compressed levels and can be accommodated due to stronger revenues. The authorities have committed to save 100 percent of any further revenue over-performance, and to cut expenditures by mid-year if revenues disappoint. On monetary policy, the authorities have committed to further tightening the monetary stance in coming months if credit and import growth does not slow down. In the financial sector, banks are in the process of raising new capital as called for by the AQR, with a deadline of end-December.

**Program risks.** Despite substantial progress, significant risks remain. Increasing political pressure could result in overly loose fiscal and monetary policies which would weigh on the exchange rate and put reserve targets at risk. In addition, a fall in external demand could affect mining sector investment and exports.

| Approved By | |
| --- | --- |
| **Markus Rodlauer (APD) and Daria Zakharova (SPR)** | Discussions were held in Ulaanbaatar during July 25–August 6, 2018 and continued from headquarters after the mission. The team included Geoff Gottlieb (head), Neil Saker (resident representative), Ruchir Agarwal, Rui Xu (all APD), Wendell Daal (FAD), Pragyan Deb (SPR), and Laszlo Butt (MCM). The team was supported by Mmes. Selenge Sandagsuren, Ardak Bazarbai, and Khulan Buyankhishig (all economists in the res. rep. office), as well as Mmes. Medha Madhu Nair and Livia Tolentino (both APD). Mr. Gantsogt Khurelbaatar (OED) participated in some of the discussions. The mission met Finance Minister Ch. Khurelbaatar, Bank of Mongolia Governor N. Bayartsaikhan, and other senior officials as well as private sector representatives. |

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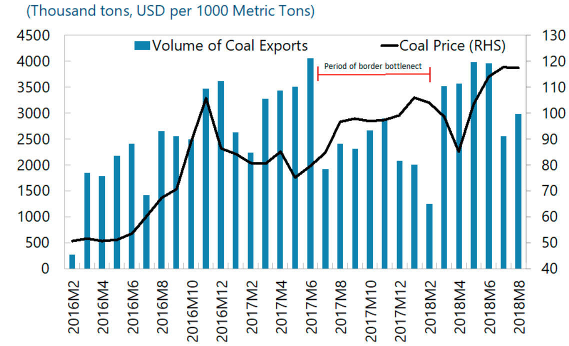
# CONTEXT

1. **The program has continued to outperform original targets by wide margins, though policy challenges are rising.** Due to strong external demand, improved confidence and rapid credit growth, economic growth remains very strong in 2018 at 6–7 percent. This recovery has translated into large revenue over-performance which the authorities intend again to save fully. The result is an expected second year of large fiscal surpluses and rapidly falling public debt, a primary goal of the IMF-supported program. However, loose monetary policy and deteriorating terms of trade have weighed on the balance of payments and put pressure on the exchange rate, triggering some foreign exchange intervention which has partially reversed key progress made with reserve accumulation under the program. With the authorities now looking to increase public expenditures in 2019 after two years of restraint, monetary and credit policies will need to tighten to support renewed reserve accumulation. Thus, in addition to completing the follow-up to the Asset Quality Review, the authorities' main challenge in coming months will be implementing a sufficiently tight macro policy mix.

# RECENT DEVELOPMENTS

2. **The strong economic recovery continues**. Since the start of the program, the economy has rebounded sharply, driven primarily by a resumption in OT-related investment, strong coal exports, and credit-financed private consumption. The recovery continued in Q2-2018 with real GDP growth slightly above 6 percent, for the third quarter in a row. Amid such strong growth and a positive non-mining output gap, inflation has continued to hover around the 8 percent informal target. Nonetheless, BOM halted the easing cycle in June (after cutting rates by 400 basis points since May 2017) and adopted a tightening bias in September, citing the rising pressure on the balance of payments.

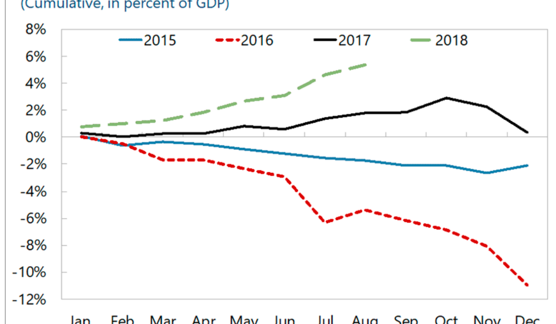
**Real Coal Exports and Prices**
(Thousand tons, USD per 1000 Metric Tons)




Sources: Haver Analytics and Bloomberg LLP

3. **Fiscal over-performance has continued, and a significant primary surplus is now expected by end-year**. The primary balance through August reached a surplus of 5.3 percent of GDP, up from 3.1 percent in June. The key driver was a 31-percent increase in revenues, which reflected strong mineral exports (via royalties and corporate income tax) and investment-related imports (via VAT). On the expenditure side, cash outlays year-to-date have been low but this reflects the back-loaded seasonal

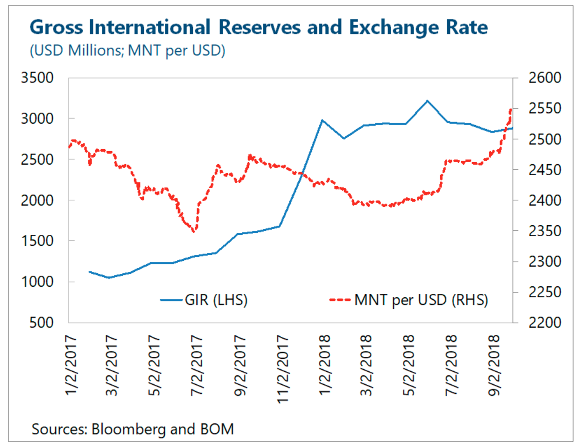
**Monthly Primary Balance**
(Cumulative, in percent of GDP)



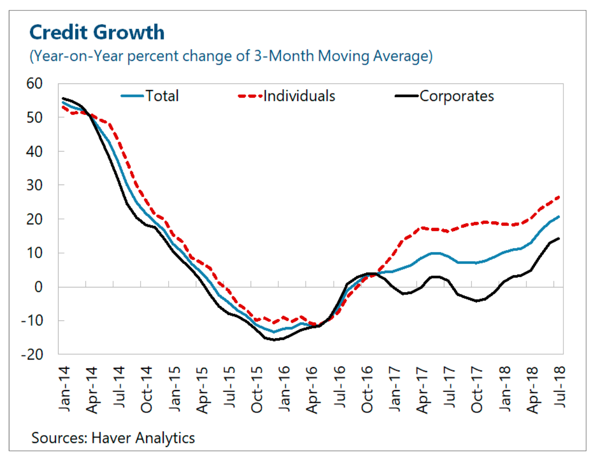

Sources: Mongolian authorities; and Fund staff estimates
Note: DBM net lending is excluded.

pattern in Mongolia and is in line with program projections. Discussions confirmed some over-commitments on donor-financed capital spending but these, at 1.3 percent of GDP, were less than expected and can be accommodated within the existing budget envelope via under-execution of other investment projects. The primary balance is now projected to reach a surplus of 3.2 percent of GDP, well above the 0.2 percent primary deficit target from the fourth review (-2.5 percent in the original program).

4. **Amid a weakening balance of payments, the Bank of Mongolia has intervened to limit pressure on the exchange rate**. Reserves increased in 2017 by $1.8 billion to reach $3 billion, or 74 percent of the ARA metric. This increase was driven roughly equally by FX intervention (both auction purchases from banks and direct gold purchases from domestic mining firms) and donor flows. By contrast, in 2018, this progress has stalled and recently started to reverse. Rising domestic demand, lower donor disbursements, and deteriorating terms of trade have weighed on the balance of payments. The exchange rate has depreciated by 5.4 percent and the Bank of Mongolia has sold $334 million of gross international reserves (10 percent of total) since end-May.




5. **Bank lending started to accelerate again sharply over the summer**. For most of 2017 and the first quarter of 2018, annual credit growth hovered around 10 percent, boosted mainly by household credit growth of 15-20 percent while corporate borrowing languished. Since then, total credit (excluding principal in arrears and non-performing loans) has accelerated, to 20 percent y/y in recent data, driven most recently by a recovery in lending to corporates (15 percent in May, up from 2 percent in February). The lending recovery appears to reflect a series of factors including the lagged response to lower policy rates, renewed confidence in the economy, and the reduction in uncertainty upon completion of the Asset Quality Review in January. While supporting the economic recovery, it also raised macro and financial stability concerns leading BOM to respond with three steps. First, in June, BOM announced a ceiling of 70 percent on debt service- to-income ratios for all new non-mortgage consumer loans (effective January 2019). Second, in September, BOM increased the risk weight on unhedged FX lending from 120 percent to 150 percent (over 50 percent of corporate FX loans are unhedged) and introduced a 30-month maturity limit on non-mortgage consumer loans to close a loophole on the debt service to income ceiling (**prior action** for this review). And third, BOM adopted a tightening bias in its September MPC (**prior action** for this review).



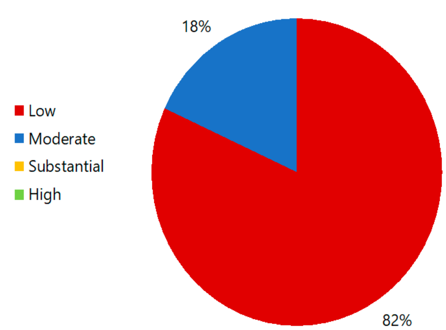
**6. After important progress early in the program, implementation of fiscal structural reforms has been limited this year.** In May, the authorities submitted two pieces of legislation to strengthen tax administration (completing a structural benchmark originally due in October 2017). The bills failed to come to a vote in the initial attempt and will be re-submitted in the fall session. Regarding social protection assistance, the authorities missed the end-June indicative floor on such spending but indicated that the full 2 percent of GDP of social protection spending (new definition) in the budget would be allocated by end-year. The authorities also indicated that the recently increased coverage of the Child Money Program (from 60 to 80 percent, at a cost of 0.1 percent of GDP) would be financed by cutting one of the two targeted social protection programs in the 2018 budget (the "Poverty Benefit Program"). And the audit of concessions contracts (infrastructure project commitments made off budget) was completed after the end-August due date. These developments follow several other important setbacks in reforms earlier this year, including reversing the increase in the pension age, eliminating excise taxes on fuel, reversing the increase in upper income personal tax rates, and establishing a Fiscal Council without sufficient independence. Notwithstanding these setbacks, the authorities' passage in 2017 of new laws for the Development Bank of Mongolia and the Bank of Mongolia—designed to prevent further quasi-fiscal spending – rank as one of the most important achievements in the program.

**7. While there have been delays, the authorities have now completed most of the major interim steps of the Asset Quality Review, the key financial structural reform under the program.** With the four key milestones below complete, what remains is monitoring banks' progress in meeting the end-December capital-raising deadline and being prepared to respond as needed if there are still shortfalls.

- In January, the third-party auditors completed the assessment and BOM informed banks of the respective capital needs based on Q3 2017 balance sheets, with a system-wide shortfall of 1.9 percent of GDP.
- In May, BOM informed banks that it had updated this assessment to reflect the projected capital need at end-2018, based on the higher NPLs found by the AQR and banks' business plans. This increased the amount of new capital that the banking system had to raise by end-December 2018 to 3.1 percent of GDP.
- In June, Parliament passed a Recapitalization Law (formally titled the Law on Ensuring Banking Sector Stability) which ensures public capital is available (subject to strict conditions) for systemic banks that are unable to raise sufficient capital from private means.
- In September, banks booked all additional provisions called for by the AQR, adjusted only by loans that were repaid, and are also required to submit detailed updates regarding capital raised to date and how remaining shortfalls would be met by end December (both **prior actions** for this review).
- Notwithstanding this progress, one key shortfall of recent months is that banks still have not re-classified their non-performing loans in line with the findings of the AQR (**structural benchmark end-June**). Ensuring progress in this area will be a focus of the next review (see ¶ 16 below).

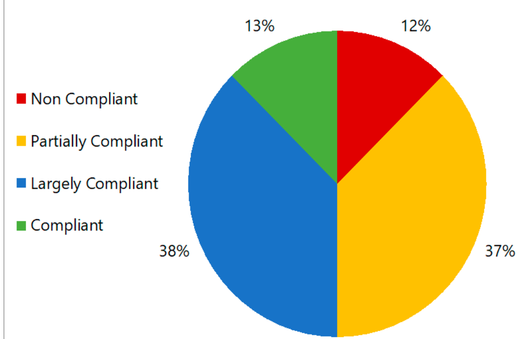
8. **The authorities have improved their AML-CFT framework but missed an opportunity to seek corresponding upgrades in their assessment ratings**. In mid-2017, the Asia Pacific Group on Money Laundering (APG) gave Mongolia very low ratings, primarily with respect to its effectiveness in mitigating risks but also on its technical compliance with the established standards (i.e. on having the appropriate legal and institutional framework). In recent months, the authorities passed amendments to the AML law and the Law on Infringements to address some of the concerns, but not in time to be reassessed at the annual APG plenary in July 2018. The low ratings have attracted scrutiny by the Financial Action Task Force (FATF) and, in the absence of substantial progress in addressing AML/CFT shortcomings, there is a risk that Mongolia would be publicly listed by FATF in October 2019 as a country with "strategic deficiencies". Several foreign banks have already withdrawn correspondent banking relationships with Mongolia. As of June 2018, there are no relationships with U.S. banks and all Mongolian banks must now access dollars via regional banks.

**Effectiveness Ratings**




Sources: IMF Staff Calculations

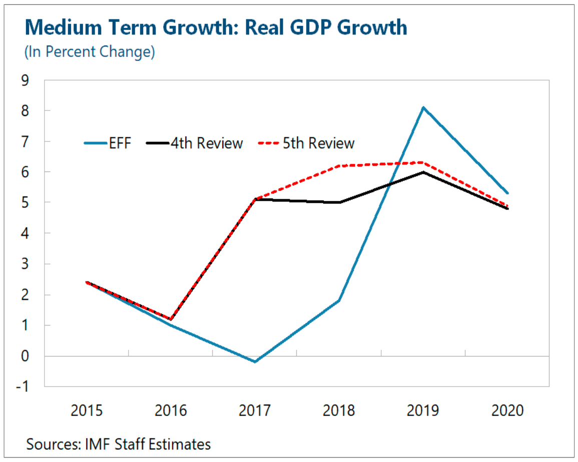
**Technical Compliance Ratings**

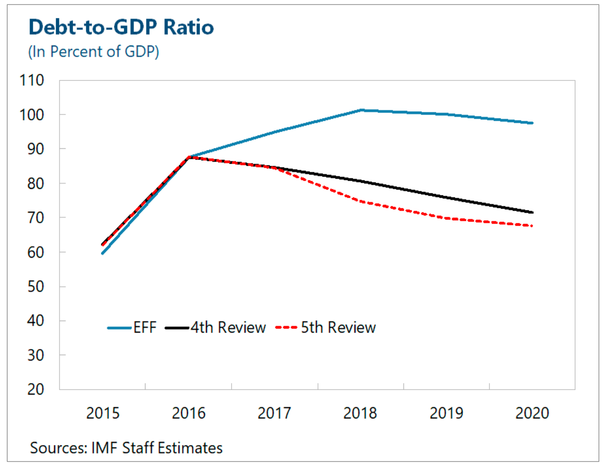



Sources: IMF Staff Calculations

# OUTLOOK AND RISKS

9. **The strong momentum of the economy justifies upgrading near-term growth forecasts.** Stronger coal exports and expanding credit support an increase in growth projections from 5 to 6.2 percent in 2018 and a smaller increase in 2019. Inflation, which does not always correlate well with broader macro-economic developments, is expected to remain around 8 percent. The recovery in private demand, as well as the forthcoming loosening in the fiscal stance (see below) and deteriorating terms of trade, is expected to weigh on the balance of payments going forward, resulting in a widening current account deficit in 2019. Nonetheless, with an expected move toward tighter credit policies going forward, FX purchases by BOM as well as donor disbursements are expected to resume in coming quarters, allowing reserves to reach 3.9 billion (5.5 months of imports and 99 percent of ARA) at end 2019.




**10. The program faces several important downside risks**. To date, upside risks have materialized more than downside ones. Global demand (both trade and investment) has exceeded expectations, growth has recovered faster, and the authorities have resisted pressures to spend the related upswing in revenues, resulting in significant fiscal over-performance. However, at this stage, two downside risks loom large:

- *Domestic Political Consensus* – There is ongoing political pressure for two types of policy changes that could put the program at risk. The first is for looser macro-policies, including higher public spending, more intervention to support the exchange rate, and lower interest rates. Given sizable external debt and still-insufficient reserves, a further loosening in the policy mix and loss of reserves would jeopardize the program. A second risk relates to the investment agreement underlying the OT mine. If discussions to modify the agreement were to become disorderly and trigger a stop in OT investment, the macro impact would be large and require a recalibration of program policies.

- *External Demand* –A potential slowdown in global growth, particularly if driven by developments in China, would reduce both prices and volumes of Mongolia's mineral exports. Prices on gold and copper, two of Mongolia's key exports, are already down 10-15 percent y.o.y. Even without a change in underlying growth, a reversal of China's recent move toward importing a higher share of its national coal demand would weigh significantly on Mongolia's balance of payments. Either development would require much tighter domestic policies or greater exchange rate depreciation for Mongolia to meet its reserve targets.

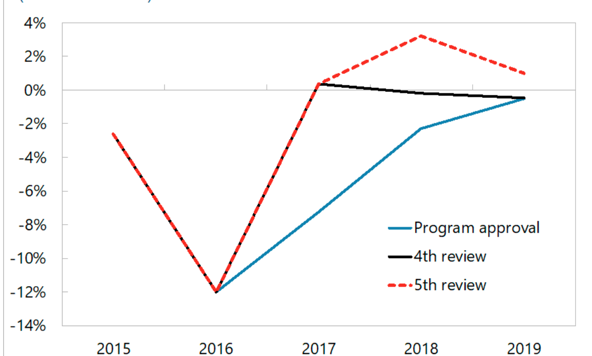
# PROGRAM POLICIES

*The program strategy has been i) securing macro stability by using strong global tailwinds, concessional donor support and fiscal adjustment to reduce public debt and build foreign exchange reserves, while keeping inflation contained; ii) improving the durability of the adjustment with structural reforms to strengthen the banking system and reduce quasi-fiscal risks; and iii) protecting spending on the most vulnerable and increasing its efficiency. While this strategy has been broadly successful, and the authorities remain ahead of original program projections, the pace of macro adjustment has slowed and there have been some significant reversals on structural reforms.*

## A. Macro Policies

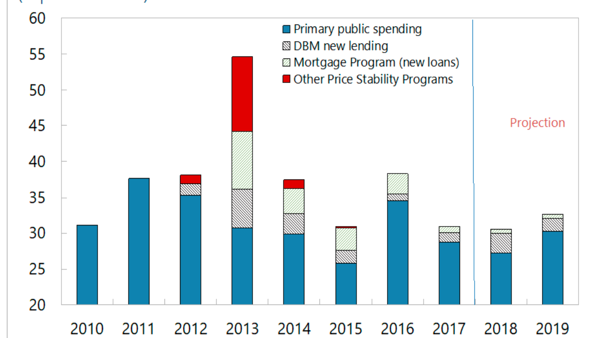
**11. The proposed 2019 fiscal stance represents a substantial loosening but still delivers a 1 percent of GDP primary balance surplus which is consistent with rapid debt reduction.** The draft 2019 budget proposes a roughly 3 percent of GDP increase in expenditures. Based on current forecasts, this will result in a primary fiscal surplus of 1 percent of GDP, down from a projected 3.2 percent surplus this year. This fiscal stance remains significantly stronger than the target at program approval (-0.4 percent of GDP) and the debt stabilizing level (-5.5 percent of GDP). Moreover, while public debt remains high, projections have improved further since the last review due to better dynamics more broadly (growth, fiscal, interest rate): debt is now projected to be 5 percentage points lower by end-2018 and 6.5 percentage points lower by end-2019 (See Annex II – Public DSA). Nonetheless, the authorities recognize that the fiscal loosening will put additional pressure on the balance of payments. To safeguard the target and increase the chance of over-performance, the authorities have committed to save 100 percent of any revenue over-performance and cut expenditures at mid-year if there is a revenue shortfall.

**Primary Balance Path (excl. DBM)**
(In Percent of GDP)




Sources: Mongolian Authorities and IMF Staff Estimates

**Primary Spending**
(In percent of GDP)




Source: Mongolian authorities; and Staff estimates
Note: In 2013, two additional price stability programs, i.e. deposits placed at banks and housing supply suppor resulted in large quasi-fiscal spending by BOM.

**12. The increase in spending reflects the authorities' desire to return key expenditures to more sustainable levels after two years of sharp compression and low execution.** The primary driver of the increase is public investment where the authorities are seeking a roughly 1 percent of GDP increase in Central Government spending (focused on reducing air pollution and building schools and hospitals), a 1.4 percent of GDP increase in infrastructure spending by Local Governments, and a 0.1 percentage point increase in the rate of clearing unpaid concessions. The authorities have also increased the public wage bill by 16 percent to help address a significant reduction in purchasing power of public employees over the last 5 years (see Box 1). Notwithstanding concerns mentioned about pressure on the balance of payments, Staff share the authorities' view that such increases can support long-term growth and are critical to maintaining the necessary social cohesion to

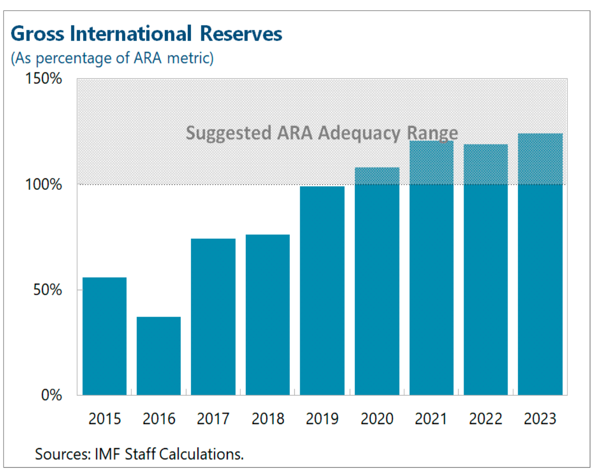
**Change in Primary Expenditure in 2019**
*(in percent of GDP)*

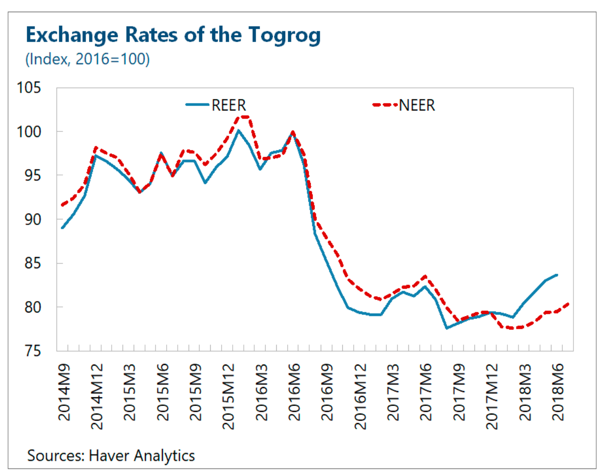
| | |
|---|---|
| Total | 3.1 |
| Wages and salaries | 0.1 |
| Other goods and services | 0.2 |
| Transfers and subsidies | 0.3 |
| Public Investment | 2.7 |
| Domestic sources | 2.7 |
| Central Government | 1.2 |
| Concession repayment | 0.1 |
| Local Gov. and Other | 1.4 |
| Foreign-financed | 0.0 |
| Net lending (excl. DBM) | -0.3 |

implement other reforms under the program. The authorities also noted that, even with these increases, the proposed expenditure level remains substantially below the outlays seen in pre-program years, particularly if one considers previous quasi-fiscal spending.

**13. To ensure that the fiscal easing is consistent with program goals, tighter monetary and credit policies will be needed going forward**. The authorities recognize the need for a shift in the composition of the domestic policy mix and, as shown with the announcements in the June and September Monetary Policy Committee meetings - are already moving toward tightening domestic financial conditions. Going forward, higher policy rates will likely be necessary to prevent over-heating and support the balance of payments. With respect to the use of macro-prudential tools, staff agree that such tools they can play a useful role in addressing current policy challenges, but two concerns remain. While recent macro-prudential measures are a step in the right direction, the 70 percent floor in the DSTI is still relatively accommodative and should be tightened further going forward. In addition, when facing balance of payments pressures (rather than just financial stability concerns), macro-prudential measures should be complements rather than substitutes for an appropriately tight monetary policy stance.

**14. In addition to tighter monetary policies, greater exchange rate flexibility will be necessary going forward to help address a still large external imbalance**. Recent foreign exchange interventions to stem togrog weakness reflect the authorities' concern that amid thin markets, larger exchange rate moves could trigger a disorderly depreciation. However, limiting depreciation against the dollar is particularly challenging when the dollar is appreciating against most currencies globally. Combined with Mongolia's higher inflation relative to trading partners, the real effective exchange rate has now appreciated by 7 percent in the year through July. As a result, Mongolia is now losing competitiveness on the export side (primarily relevant for the non-mining export sectors key to diversification such as agribusiness) as well as boosting demand for imports.



**15. This real appreciation undermines progress in addressing Mongolia's large current account deficit and large negative net international investment position (IIP)**. The weak IIP (-270 percent of GDP) primarily reflects large external debt for the private sector but also the significant foreign liabilities of the Central Bank. Staff assesses that the external position has changed from broadly in line to weaker than fundamentals (See Annex 1—External Sector Assessment). While Mongolia's large underground mineral wealth portends a solution to the external imbalance once OT and other mines come on line, tighter policies and greater exchange rate flexibility are important to contain risks in the interim. In light of these challenges, the authorities' commitment to consider regular and announced foreign exchange purchases to support reserve accumulation while preserving exchange rate flexibility is a welcome development. Going forward, the authorities agreed that sales of foreign exchange should be limited to disorderly market conditions.

## B. Structural Policies

**16. In the financial sector, the AQR process is now entering its final and most critical phase.**

- Banks have until December to raise new capital from private means in the amounts identified in the BOM's May communication. Systemic, viable institutions that are unable to meet this deadline will be eligible for public capital, subject to strict conditions, while other banks unable to address shortfalls will be resolved consistent with the Banking law. As a precaution, the authorities are advancing in their contingency planning to ensure that any regulatory response that is needed following the December deadline can move forward swiftly.

- As noted above, banks have not yet classified non-performing loans in line with the findings of the AQR. Correct classification would significantly increase NPL ratios from the current levels of 7-8 percent and thus necessitate a reduction of incurred interest income and hence capital positions. Addressing this classification will be a focus of the 6$^{th}$ review. The new capital called for in BOM's May communication already incorporates the additional capital need from the needed change in NPL classification.

- Once the recapitalization process is complete, the focus of the program in coming quarters will turn toward embedding the lessons from the AQR process in stronger supervision and regulation as well as a better NPL resolution framework (**several structural benchmarks throughout 2019**).

**17. The other major financial sector priority is making further improvements to the AML/CFT framework.** There is a risk that gains under the program could be undermined if Mongolia does not have sufficient correspondent banking relationships due to foreign bank concerns about money laundering issues. At this stage, the priority is promptly addressing the main deficiencies identified by the Asia Pacific group. Doing this will require further legal and regulatory improvements: introducing the implementing regulations for the recently passed AML laws and introducing a new legal framework to address proliferation financing (**structural benchmark end-**

**April 2019**)[1]. Equally important, the authorities need to demonstrate effectiveness in the enforcement of the AML/CFT laws. Partly to address this concern, the 2019 budget has increased the AML/CFT funding of the Financial Regulatory Commission (the key non-bank regulator) and other law enforcement agencies.

**18. The authorities have made progress on fiscal structural reforms but a large agenda remains.**

- *Fuel Prices* – There are two main concerns about regulated fuel prices in Mongolia. First, they do not adjust frequently enough to reflect prevailing world oil prices. This approach risks fuel shortages when suppliers can't recover costs. Second, excise taxes on fuel are now zero, which is inappropriate for both fiscal and environmental reasons. Staff discussed a three-phase plan with the authorities for addressing these concerns (See Box 2). Informed by this work, the authorities will develop a proposal by year's end and change the policy on fuel prices next year (**structural benchmark, end-June 2019**).
- *Mortgage Program* – The authorities feel that significant government involvement in the mortgage market remains necessary (80 percent of all mortgages are subsidized). Historically, this was done solely by the Central Bank which resulted in substantial pressure on the money supply. Under the Fund-supported program, this has stopped with BOM only making loans out of repayments while all net increase is on budget (0.4 percent of GDP). The next step is to reduce BOM's exposure to these assets and ensure that the program is completely on budget. This will be a focus of the next review.
- *Development Bank of Mongolia (DBM)* – The revised DBM law passed in the first year of the program strengthened its management and helped prevent a return to the quasi-fiscal spending of the past. As a next step, the board of DBM has hired an international auditing firm to review its 2012-17 operations which is expected to be completed by mid-December.
- *Social Spending* – Throughout the program, the authorities have supported preserving social protection assistance, leaving the total at roughly 2 percent of GDP (**indicative target**). However, they spend most of this on the Child Money Program (more than one-third), which now covers 80 percent of children, while means-tested targeted programs remain small (0.2 percent of GDP in 2019 budget). Staff believe that this approach, particularly when combined with a flat income tax, may not be optimal for reducing inequality but there is currently no political support for a different approach.
- *Unpaid Liabilities on Concessions* – In 2015-16, the previous government incurred roughly 5 percent of GDP in off-budget liabilities on build-transfer projects. The current government has effectively banned the practice and started a series of audits to determine the exact amount owed based on the extent of completion of the projects. As of end-2018, the authorities will have paid off 0.3 percent of GDP of these liabilities and plan to clear another 0.4 percent of GDP in 2019.

[1] Proliferation financing is short for the act of the financing of proliferation of weapons of mass destruction, as further detailed in the FATF Recommendations and relevant United Nations Security Council Resolutions.

- *Investment Guidelines* – IMF and World Bank technical assistance has found that domestically financed investment in Mongolia tends to be inefficient. One reason is that the public investment guidelines are inadequate to properly select and execute capital projects. Building on TA from donor partners, the authorities have committed to issuing a regulation on the appraisal and selection of investment projects (**structural benchmark, end-December 2018**).

# PROGRAM MODALITIES

**19. The authorities have made progress on key conditionality under the program.** All QPCs for which data is available have been met. The authorities request, and staff supports, a waiver of applicability for the end-September QPC target on the primary balance of the general government as data for this item is unavailable, though it is expected to be met by a large margin. On fiscal structural benchmarks, they are expected to finalize an audit of all completed concession projects and meet the operational guidance benchmark on tax compliance, both by the board date. In the financial sector, they have completed part of one benchmark—booking the necessary provisioning gaps from the AQR—but have not reclassified assets to the non-performing category in line with the AQR findings and domestic regulations. A second structural benchmark regarding improving asset classification regulations, due originally at end-September, will be completed in early 2019. In addition, in June, the authorities completed a structural benchmark due for the previous review regarding the finalization and publication of the NPL resolution strategy.

**20. Looking ahead, there is a need to modify several conditions and adjust the TMU.**

- *QPCs* - The mission proposes to i) adjust the primary balance target to reflect the strong outturns so far and new definitions in the TMU (see below), ii) introduce a new target for DBM net lending and iii) set QPCs for March 2019. No modifications to monetary, reserve, and external debt targets are proposed.
- *Indicative Target* - The mission proposes to adjust the quarterly path of the indicative spending floor on social spending starting end-December to better capture seasonal patterns and account for the change in definition in the TMU (see below).
- *Structural Benchmarks* - Reflecting the need for more technical work and time to build consensus, the authorities requested more time to meet some structural benchmarks: reforming fuel price setting, amendments to strengthen creditor rights, and adoption of new prudential regulations which incorporate select elements from Basel II.
- *TMU* - The mission proposes to change the primary balance QPC to exclude DBM net lending as it introduced noise that complicates the measurement of the fiscal stance. Since it remains important to monitor DBM, there will be a separate QPC explicitly on DBM net lending. The mission proposes to revise the definition of social spending in the indicative target to include only social protection, excluding social insurance, education, and health, as this facilitates monitoring.

**21. The program remains fully financed, despite some delays and reductions in donor commitments**. There are three changes. First, due to delays in meeting prior actions and reversals on previous commitments, the 2018 World Bank disbursement—and thus the 2018 disbursement from Japan which is linked to it—is currently expected in the first quarter of 2019 (instead of late 2018) resulting in a similar delay on the 2019 disbursement into 2020. Second, because Mongolia is no longer facing an acute crisis, the World Bank has moderated its total program commitment from $600 million to $450 million. And third, some Korea-related flows are now expected to occur after the program ends in 2020. Notwithstanding these changes, the program is fully financed for the next 12 months, with good prospects for financing thereafter. With the revised donor estimates, current policy commitments, and other balance of payments projections, gross reserves are expected to reach USD 3.9 billion in 2019 (5.5 months of imports, 99 percent of the ARA metric), above the $3.5 billion projected at program approval.

**22. Implementation of outstanding recommendations from the 2017 safeguards assessment has slowed.** Agreement on the timing and modalities for the transfer of the mortgage program from the BOM to the MOF has not yet been reached and discussions continue. While a new internal audit charter has been drafted, they have not yet been approved by management. Further, discussions with another central bank on conducting a peer review of internal audit and aspects of controls were initiated, but no firm agreements have been reached yet. Separately, an independent body to oversee the audit and control mechanisms as provided for in the revised BOM Law, has not yet been established. Staff continue to be engaged with the authorities on monitoring safeguards developments at the BOM.

# STAFF APPRAISAL

**23. The economic recovery continues to be robust, but significant challenges remain.** Due to strong external demand combined with expenditure restraint, macroeconomic outcomes have so far exceeded expectations. The fiscal and reserve targets under the program are expected to be met. While compliance with structural conditionality has been mixed, important progress has been made and going forward the authorities remain committed to implementing key reforms in banking and fiscal areas. However, risks to the program remain significant, including from lower external demand for commodities, rising domestic pressures to loosen fiscal and monetary policies, adverse changes to the investment climate, and resistance from vested interests.

**24. Policies to support further buildup of international reserves will be critical to help insulate the economy from external shocks.** After strong reserve accumulation in 2017, progress stalled and reversed in recent months, with international reserves of the BOM declining for the first time since the beginning of the program. In the recent monetary policy committee meeting, the authorities have committed to a monetary and financial policy stance that contains inflation and supports further improvement in the balance of payments. While gross reserves are significantly higher than expected, they remain at 76 percent of the ARA metric. The authorities should stand ready to raise policy rates and tighten credit conditions in the next MPC meeting if credit and import growth do not slow and pressure on reserves and the exchange rate continue. Greater exchange rate flexibility will be an important additional shock absorber and important also to preserve competitiveness especially in the context of a strong US dollar.

**25. Continued fiscal discipline and improving the structure of the budget to support sustained adjustment remain critical.** As the 2020 elections near, spending pressures are rising. With public debt still high (projected to reach around 75 percent of GDP at end-2018) and the economy exposed to global commodity developments, it is crucial that the authorities maintain the strong commitment to the program. On fiscal policy, continued expenditure restraint and strengthening of tax administration, while protecting social spending, are key. In addition, efforts must continue to improve public financial management, particularly with respect to concessions, public investment, and the operations of the DBM.

**26. The next few months will be critical for the successful completion of the bank recapitalization process.** Implementing the conclusions of the AQR itself and several related steps has been a major achievement; now comes the critical follow up to achieve the goal of a stronger banking system. Banks that are undercapitalized have until end-December to raise fresh capital to meet identified capital shortfalls. Ensuring that the banks are fully capitalized will be crucial to restore confidence in the financial sector. Sustaining this success going forward will require stronger banking supervision, legislative and regulatory changes to address non-performing loans, and strengthening the AML framework.

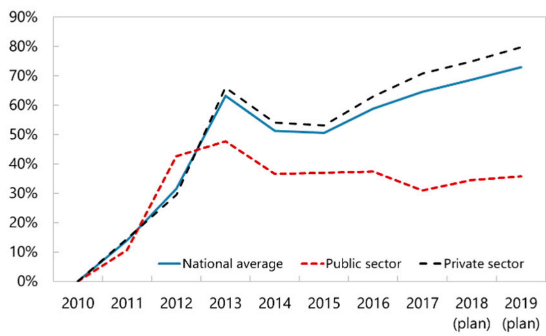
**27. On the basis of progress to date and the authorities' continuing commitment to the program, staff supports the request for waiver and modification of performance criteria (modification of the primary balance performance criterion, addition of the DBM net lending performance criterion, and modification of the social spending indicative target) and recommends completion of the fifth review.**

## Box 1. Wage Bill

### *Recent Developments*

Real wages of the public and private sector grew sharply in the early part of the decade rising by 48 percent in 2011–13. Since then, private sector wages have risen another 10 percent (cumulative 76 percent since 2010) while the civil service has seen its real wages contract by 15 percent through August 2018. During the same period, public employment has grown by a cumulative 25 percent, mainly due to a sharp increase in 2014 and reflecting a significant expansion of lower-wage support positions.

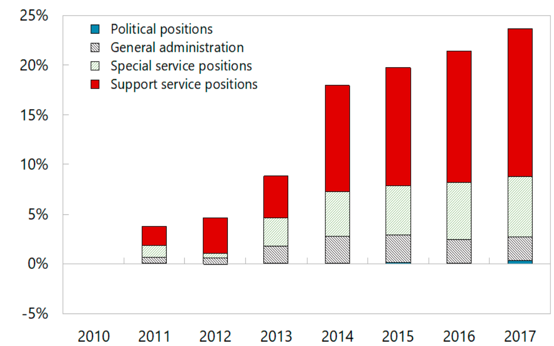
**Cumulative Real Wage Growth Since 2010**




Sources: NSO and staff estimates.

**Cumulative Growth of Public Sector Employment**

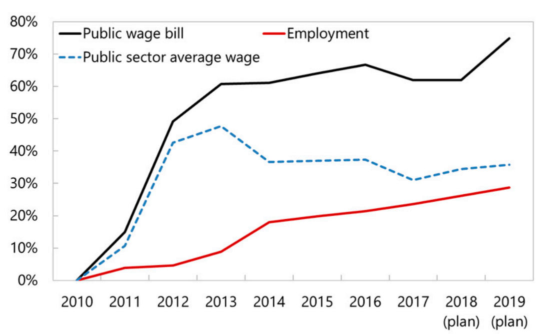
(Since 2010)




Sources: NSO and IMF Staff estimates

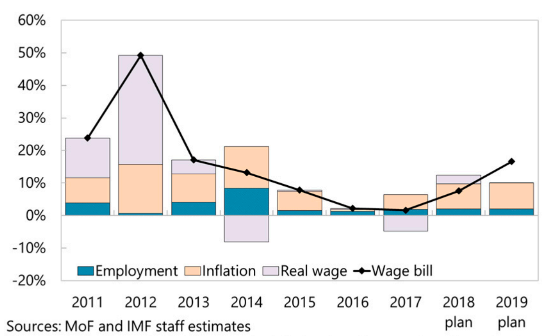
Putting these factors together, the real public-sector wage bill in 2018 is still 62 percent higher than it was in 2010. Almost all of this increase stems from the sharp rise in wages in the early part of the decade. Since then, the impact of steadily rising employment has been mostly offset by falling real wages particularly in 2014 and again in 2017-18.

**Cumulative Growth of GG Wage Bill in Real Terms**




Sources: NSO; and IMF Staff estimates

**Annual Contribution to Growth in GG Wage Bill**




Sources: MoF and IMF staff estimates

Note: the government raised civil servants' salaries by about 9 percent from September 1, 2018, and plans to make future wage adjustment in line with inflation.

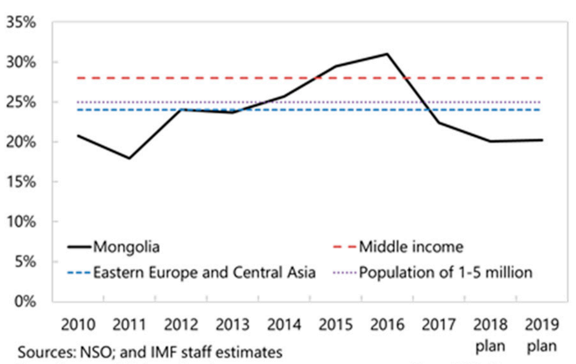
### *Planned Wage Adjustments*

As a result of the stagnation in real wages since 2013, labor unions have staged several protests in recent months, demanding a 50-percent wage increase for civil servants. After consultation with Fund staff, the government announced two salary adjustments: an average nominal raise of around 9 percent from September 1, 2018, and another nominal salary increase of roughly 8 percent in 2019. The adjustment will be larger for teachers, nurses, and other low-wage civil servants who have experienced the largest drop in purchasing power. Although much lower than the 50 percent demanded by the union, the current plan can reduce the salary gap between private and public sectors, and help relieve the shortage of civil servants, particularly to staff newly built hospitals and schools.

## Box 1. Wage Bill (Concluded)

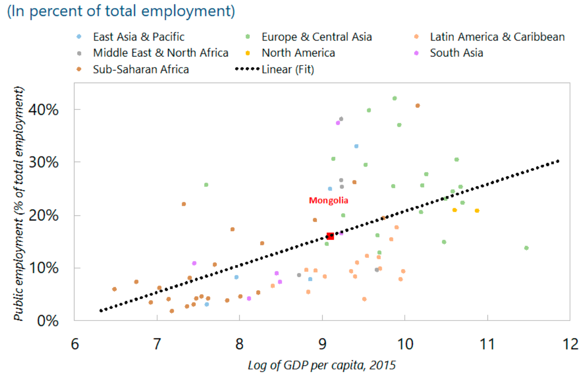
Adjustment under the program, together with the economic recovery and favorable external environment, brought down the wage bill from expensing more than 30 percent of revenues in 2016 to 22 percent in 2017. In light of the economic recovery, the proposed adjustments are not projected to raise the total wage bill as a percent of government revenues in 2018 and 2019. As a result, Mongolia's wage bill is expected to remain lower than peers. This is true regardless of whether it is measured as a percent of GDP, expenditure, or revenues. The current lower level is viewed as appropriate because revenues follow commodity cycles and are highly volatile. In addition, a lower average civil servant salary than peers may be appropriate if the Mongolian civil service requires a higher share of support service staff, such as teachers and medical workers, who typically receive lower wages than other civil servants.

**GG Wage Bill as % of Revenue: Mongolia vs. Peers**




Sources: NSO; and IMF staff estimates
Note: the wage bill shares in other country groups are averaged from 2000-13

**Public Employment**
(In percent of total employment)



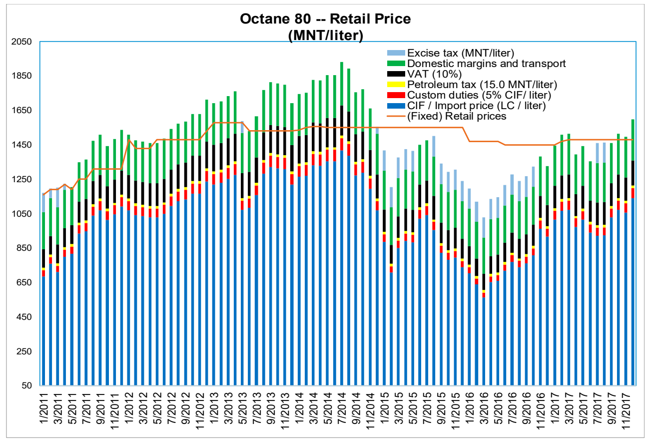

Source: The World Bank.

### *Future Challenges*

Expenditures on civil service have been contained at a sustainable level since 2017. Nonetheless, three challenges remain in further improving the effectiveness of the civil service in Mongolia. First, recurrent changes in leadership has led to frequent reorganization of key ministries, compromising meritocratic principles in recruitment and promotion. Second, a centralized personnel and payroll system is needed to improve monitoring, control and data collection by the Ministry of Finance. And third, the complex pay structure with various supplementary payments should be reviewed and simplified to improve grading and efficiency. The government has been pushing ahead on these fronts with the recent approval of the Civil Service Law in December 2017. Effective implementation of the new law is a key stepping stone for further reforms in civil service.

## Box 2. Fuel Pricing in Mongolia

*Current Status* – Retail fuel prices in Mongolia are set by a commission, consisting of the government, retailers, unions and civil society. The commission occasionally adjusts the retail price but not in the same frequency or magnitude as changes in supplier costs (e.g. import prices). Rather, the commission seeks to smooth retail prices by adjusting excise taxes. One consequence of this strategy has been that, during periods of particularly elevated import prices (e.g. 2014), the retail price can be too low for suppliers to cover costs. Increases in import prices in 2017 led the authorities to reduce taxes earlier this year, setting the excise tax at zero (there is still an import duty of 5 percent and VAT of 10 percent).




*Policy Concerns* – The current approach raises several concerns:

- Investment Climate/Growth – The lack of a transparent pricing system which preserves supplier margins can lead to fuel shortages, hurting economic growth.
- Tax Revenue – Given the low elasticity of fuel consumption, taxes on fuel are an important source of revenue, particularly for highly indebted governments.
- Administrative Burden – Given the frequency of changes in market conditions, an automatic pricing formula is preferred to price setting on an ad hoc basis by a committee.
- Environmental Costs – Below-cost recovery fuel prices, including low taxes, lead to over-consumption of fuel, which is particularly costly given the pollution and congestion in Ulan Bator.

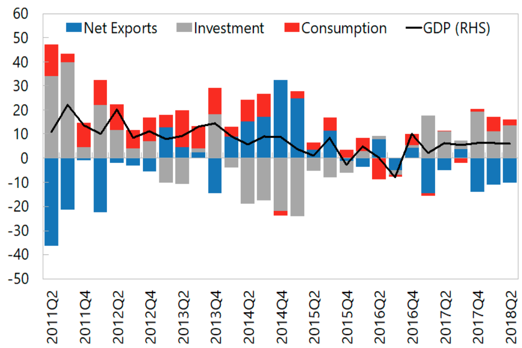
*Potential Solutions* – One way to address the above concerns and have the option of returning to a policy of smoothing consumer prices is to follow a three-phase approach.

- Phase I – Stop Smoothing – To avoid fuel shortages, retail prices should immediately be set equal to suppliers' cost recovery (import price plus fixed operational costs and profit margin) at current tax rates, automatically adjusting each month.
- Phase II – Gradually Close Tax Gap - The automatic formula above should be augmented to incorporate a gradual rise in excise tax rate, on a fixed schedule, from zero to a target rate that balances fiscal and environmental considerations.
- Phase III – Allow Full Passthrough or Resume Smoothing - Once the target tax rate has been reached, the authorities can either allow for a full pass through of costs without smoothing or resume smoothing but with an automatic mechanism to protect supplier margins and tax revenue. The most common automatic fuel price smoothing mechanism is the 3-percent price band mechanism which sets retail price changes to a maximum of 3 percent.

## Figure 1. Real Sector Developments

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

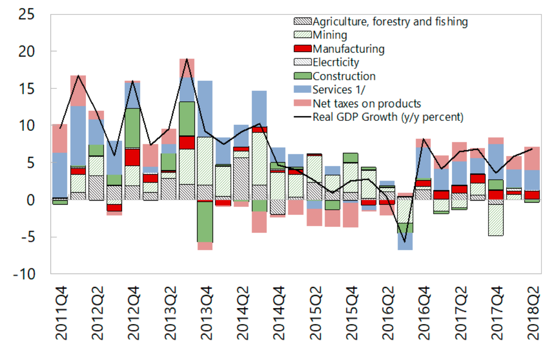
### Real GDP Growth: Expenditure Side
(Contribution; Year-on-Year Percentage Change)




Sources: IMF Staff Estimates

*On the supply side, mining contracted, but services sector growth reached almost 9 percent.*

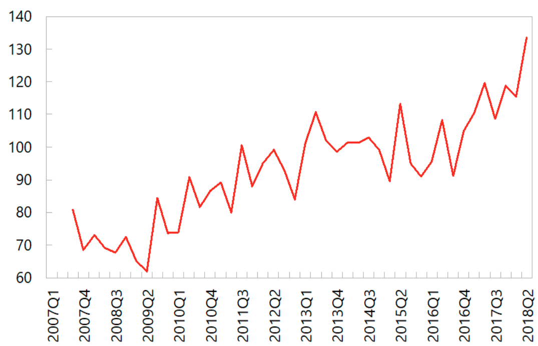
### Real GDP Growth: Supply Side
(Contribution; Year-on-Year Percentage Change)




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

*The recovery in 2017 was accompanied by improvement in employment*

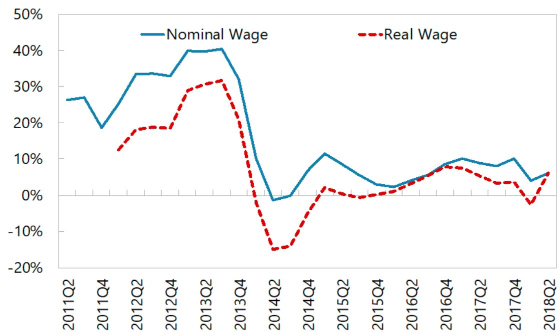
### Employment
(Index, 2016=100)



Sources: Haver Analytics

*...while real wage growth moderated due to stronger inflation.*

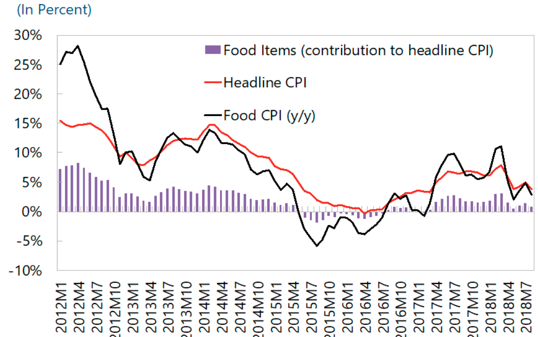
### Nominal and Real Wage Growth
(In Percent, Year-on-Year)




Sources: CEIC, Haver Analytics and IMF Staff Calculations

*After accelerating in most of 2017, inflation has begun to stabilize around the target of 8 percent...*

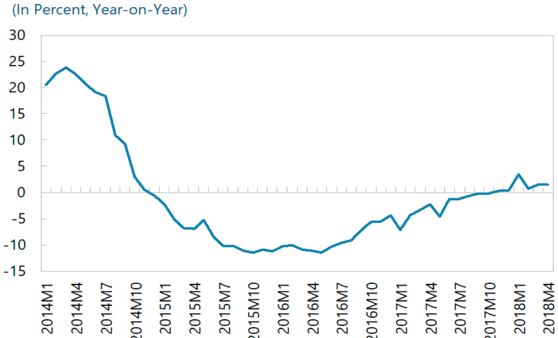
### National Consumer Price Inflation
(In Percent)




Sources: Mongolian Authorities; and IMF staff calculations

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

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

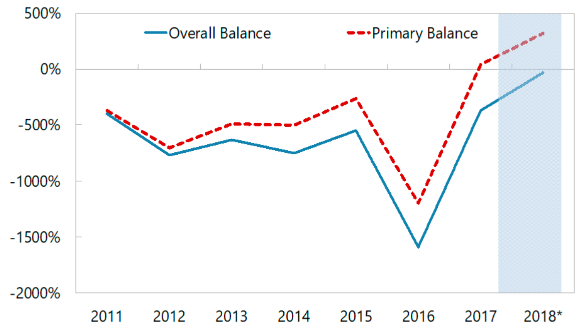


Sources: Haver Analytics; and IMF Staff Calculations

## Figure 2. Fiscal Sector Developments

*Fiscal performance improved substantially in 2017…*

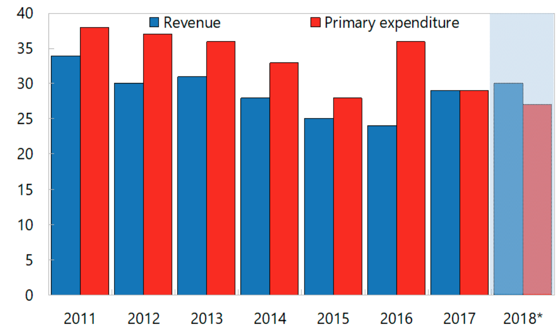
### Fiscal Balance
(In Percent of GDP)




Sources: Mongolian Authorities and IMF staff calculations
Note: The balance excludes DBM 2018 is an estimate

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

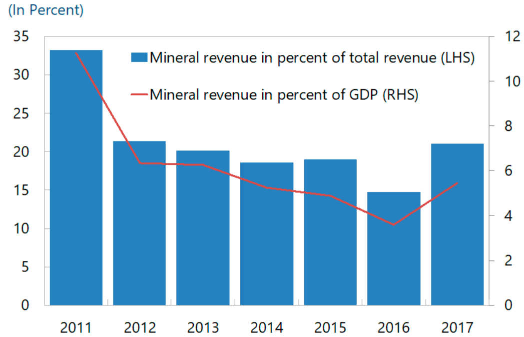
### Revenue and Primary Expenditure
(In Percent of GDP)




Sources: Haver Analytics; Staff Estimates
Note: The expenditure excludes DBM. 2018 is an estimate

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

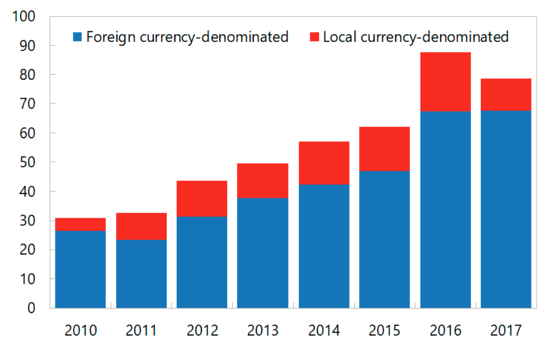
### Mining Revenues
(In Percent)




Sources: Mongolian Authorities; IMF staff estimates

*As a result of the strong outrun and growth, the public debt ratio has now started to decline…*

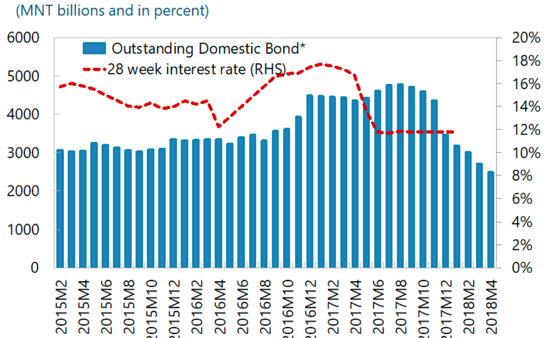
### Public Debt
(In Percent of GDP)




Sources: Mongolian Authorities, IMF Staff Estimates

*…with less high cost domestic debt.*

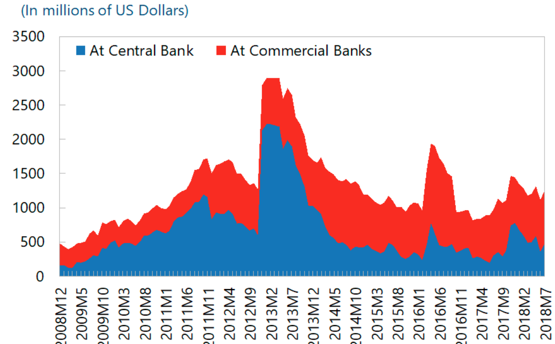
### Government Securities
(MNT billions and in percent)




Sources: Ministry of Finance
*These are primary market issuance

*The authorities have also been able to start rebuilding deposit buffers.*

### General Government Deposits
(In millions of US Dollars)



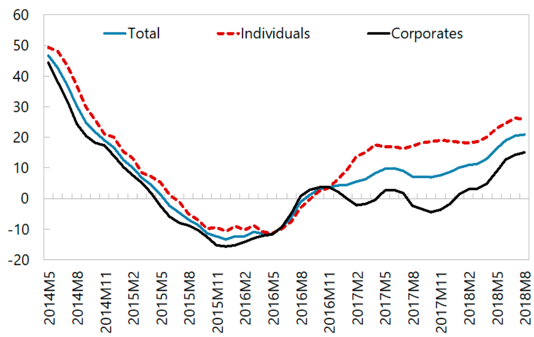

Sources: Haver Analytics

## Figure 3. Financial Sector Developments

*Private sector credit growth recovered in 2017, driven initially by strong lending to households and to firms.*

**Credit Growth**

(Year-on-Year Percent Change of 3 Month Moving Average)

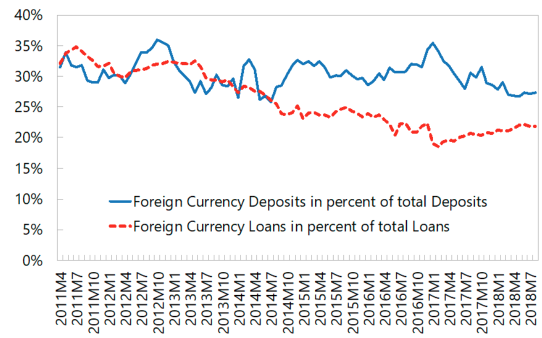



Sources: Haver Analytics and IMF staff calculations

*The share of foreign currency loans has risen since 2017, while the share of FX deposits has been falling.*

**Loans and Deposits in FX**

(In Percent)

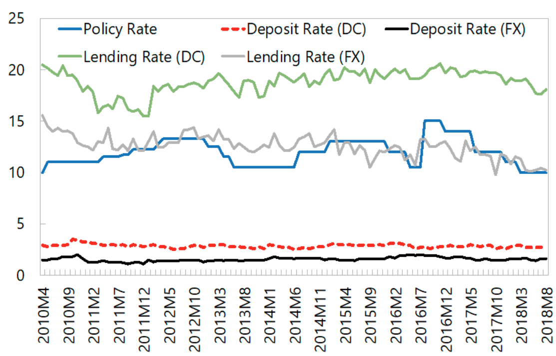



Sources: CEIC and IMF Staff Calculations

*Lending rates have fallen less than policy rates*

**Interest Rates**

(In Percent)

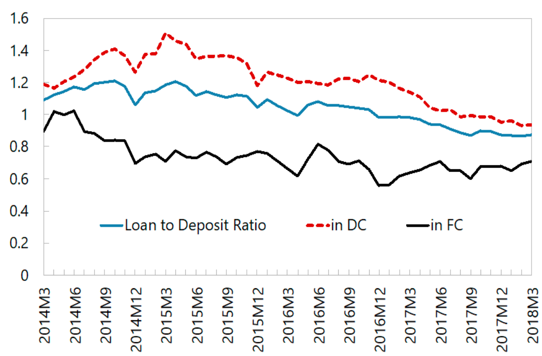



Sources: CEIC and Haver Analytics

*Loan-to-Deposit ratios continue to trend down.*

**Loan to Deposit**

(Ratio)

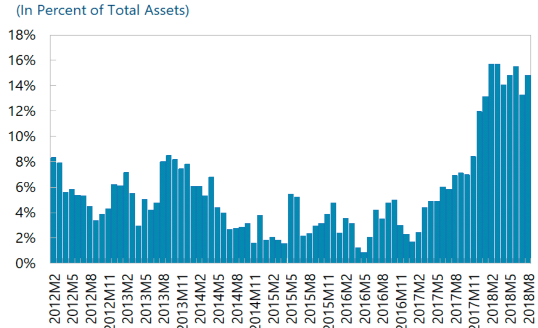



Sources: IMF Staff Calculation

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

**Central Bank Bills held by Banks**

(In Percent of Total Assets)

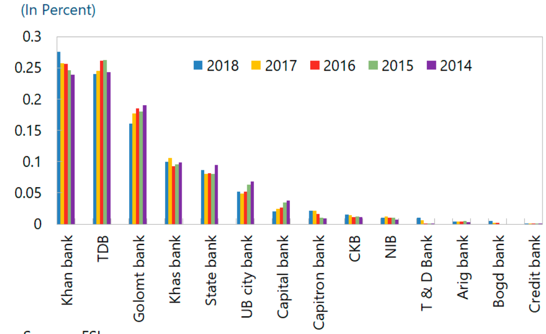



Sources: Haver Analytics

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

**Market Share by Bank**

(In Percent)



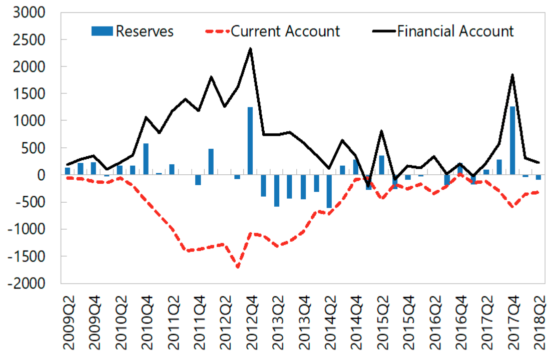

Sources: FSI

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

## Figure 4. External Sector Developments

*The external accounts have been less strong in 2018.*

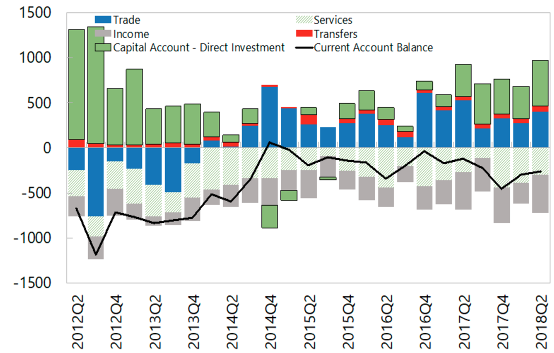
### Balance of Payments
(In millions of US dollars)




Sources: Haver Analytics

*The current account deficit has remained large…*

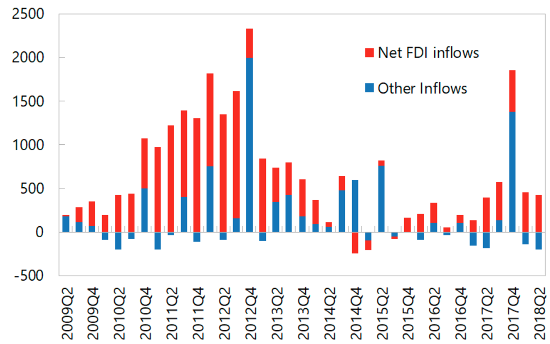
### Current Account Balance
(In millions of US dollars)




Sources: Haver Analytics

*…while capital inflows have moderated…*

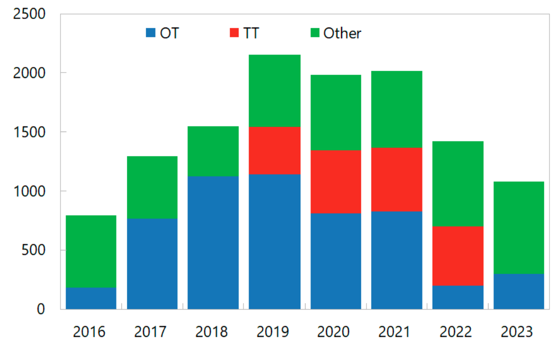
### Net Capital Inflows
(In millions of US dollars)




Sources: Haver Analytics

*…despite still strong FDI.*

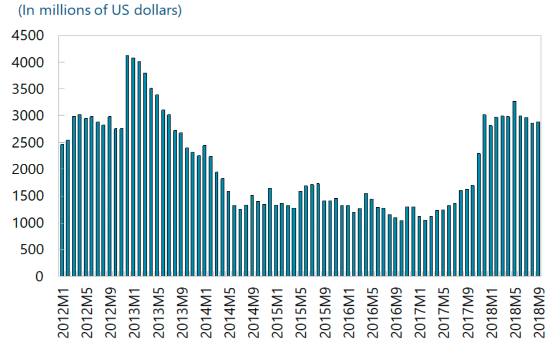
### FDI Inflows
(In millions of US dollars)




Sources: Haver Analytics, Staff Estimates

*Reserve accumulation has stalled and started to reverse…*

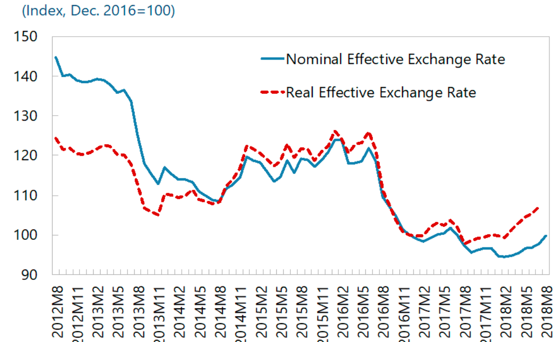
### Gross International Reserves
(In millions of US dollars)




Sources: Mongolian authorities

*…while effective exchange rates have appreciated.*

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

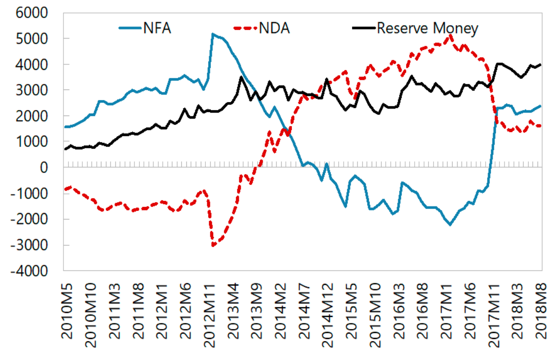



Sources: Haver Analytics

## Figure 5. Monetary Sector

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

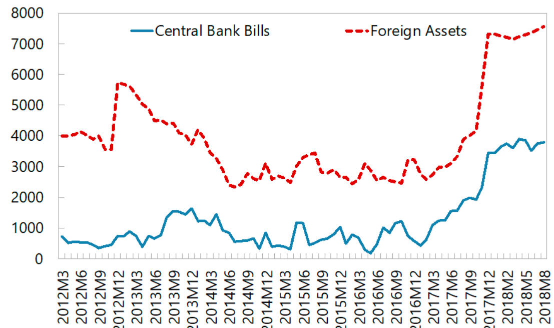
**BOM NFA, NDA and Reserve Money**
(In billions of tograg)




Sources: BOM

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

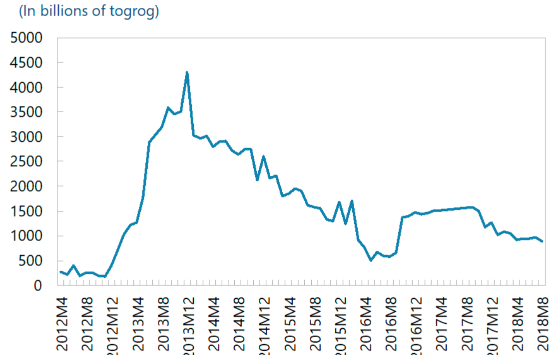
**BOM Foreign Assets and Central Bank Bills**
(In billions of togrog)




Sources: BOM

*BOM has halted the large scale direct lending to banks…*

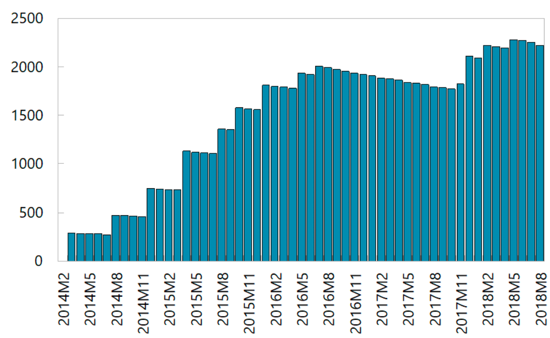
**BOM Claims on Banks**
(In billions of togrog)



Sources: BOM

*…but continues to have substantial mortgage exposure via holding Mortgage Backed Securities.*

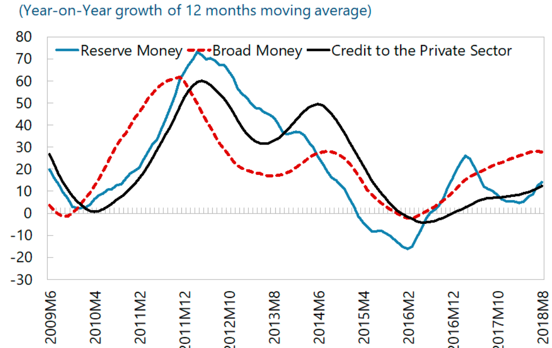
**Mortgage Backed Securities**
(In billions of MNT)



Sources: BOM

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

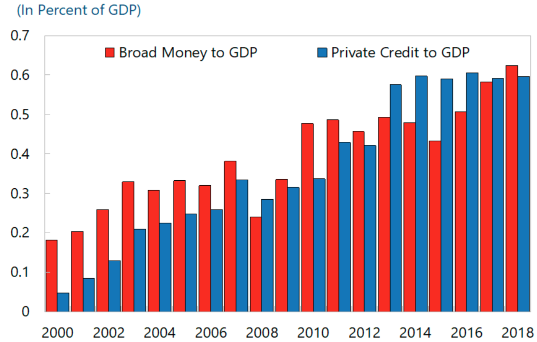
**Reserve Money, Broad Money and Private Credit**
(Year-on-Year growth of 12 months moving average)




Sources: BOM, Staff Calculations

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

**Broad Money and Private Credit**
(In Percent of GDP)

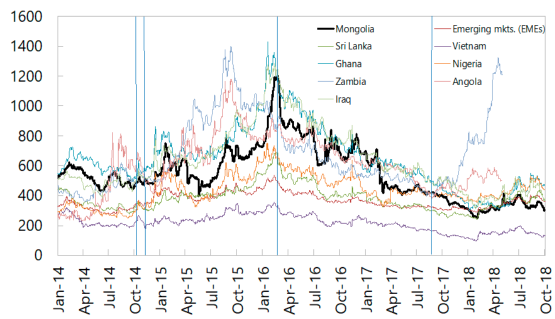



Sources: BOM Staff Calculations

## Figure 6. Markets

*Since the program, Mongolian sovereign spreads have narrowed faster than EM peers…*

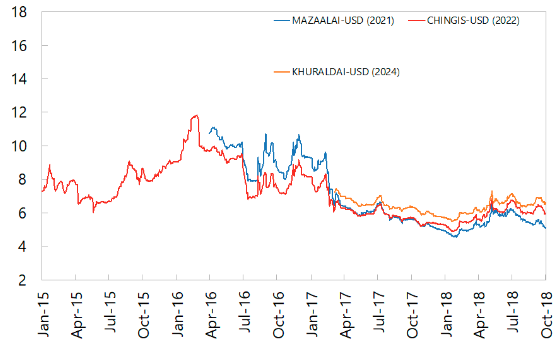
**EMBI Global Sovereign Spreads**
(In basis points)




Sources: Bloomberg L.P
Note: Vertical lines depict sovereign bond issuances.

*…but more recently widened marginally amid some risk aversion in EM.*

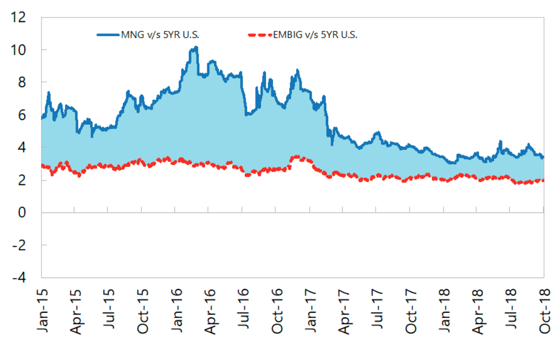
**Outstanding Govt. Bonds**
(Yield-to-Maturity)




Sources: Bloomberg LP

*There has been a move in the Mongolian spreads vis-à-vis the U.S. treasuries.*

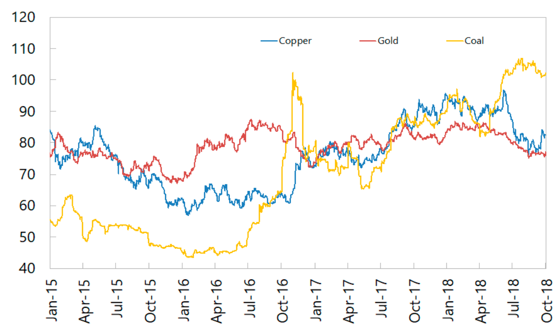
**Mongolia Spread Analysis**
(In percent)




Sources: Bloomberg LP

*After an increase in 2017, commodity prices of key Mongolian exports have fallen in recent months…*

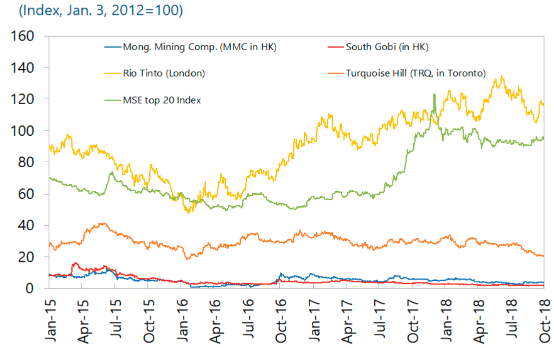
**Commodity Prices: Gold, Copper & Coal**
(Index, Jan. 2, 2012=100)




Sources: Bloomberg LP

*…while stock prices of mining companies have experienced some volatility.*

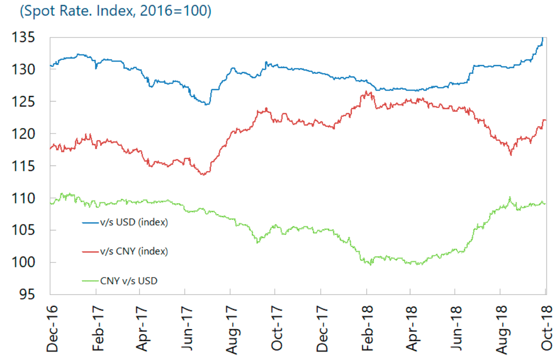
**Stock Prices: Mining Companies**
(Index, Jan. 3, 2012=100)




Sources: Bloomberg LP; IMF staff estimates

*The currency has resumed depreciation against the dollar while strengthening against the RMB.*

**Exchange Rate: Togrog**
(Spot Rate. Index, 2016=100)



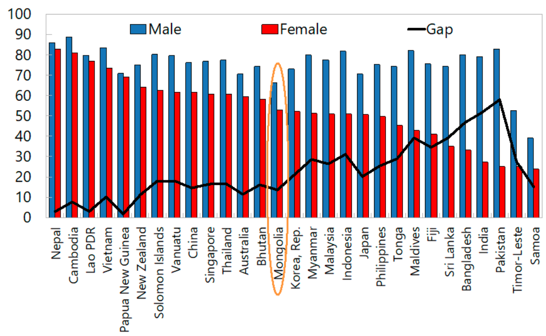

Sources: Bloomberg LP

## Figure 7. Gender

*Female labor force participation in Mongolia is in line with other countries in the region…*

**Labour Force Participation in Asia**

(In Percent of Male and Female Population Respectively)

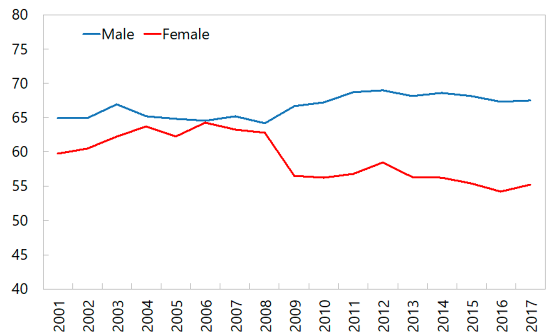



Sources: World Development Indicators

*…but has deteriorated over the past decade, particularly relative to male counterpart.*

**Labour Force Participation Rates**

(In Percent of Working Age Population)

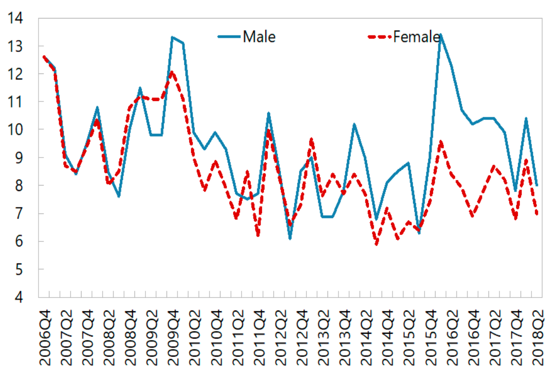



Sources: National Statistics Offfice and World Development Indicators

*The female unemployment rate is broadly in line with male unemployment*

**Unemployment**

(In Percent)

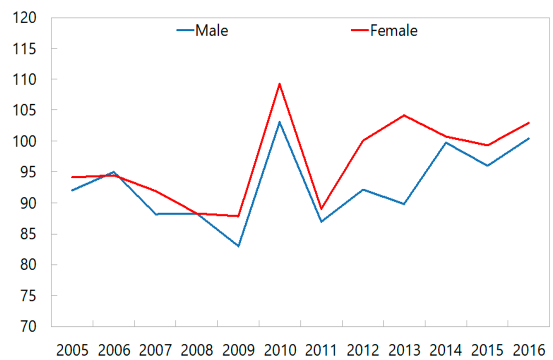



Sources: National Statistics Offfice and World Development Indicators

*The female enrollment ratio at the primary level has improved.*

**Gross Enrollment Ratio**

(Primary Level, In Pecent)




Sources: National Statistics Offfice and World Development Indicators

*Mongolia has relatively low gender inequality relative to regional peers…*

**Gender Inequality Index**

(Index)

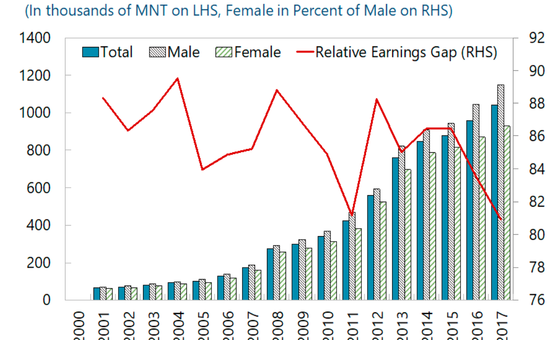

Sources: UNDP

Note: GII is an inequality index created by UNDP that measured three important aspects of human development- reproductive health, empowerment and economic status.

*…and the relative gender earnings gap has narrowed in recent years.*

**Monthly Average Real Earnings**

(In thousands of MNT on LHS, Female in Percent of Male on RHS)




Sources: National Statistics Offfice and World Development Indicators

Note: Relative Earnings Gap is calculated as female earnings as a percent of male earnings

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

| | 2015 | 2016 | 2017 | | 2018 | | | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Act. | | EFF | Act. | EFF | 4th review | Proj. | | | Proj. | | |
| | (In percent of GDP, unless otherwise indicated) | | | | | | | | | | | |
| ***Real sector*** | | | | | | | | | | | | |
| Nominal GDP (in billions of togrogs) | 23150 | 23943 | 26047 | 27167 | 27688 | 30830 | 31201 | 35331 | 39481 | 44109 | 49503 | 55625 |
| Real GDP growth (percent change) | 2.4 | 1.2 | -0.2 | 5.1 | 1.8 | 5.0 | 6.2 | 6.3 | 4.9 | 5.0 | 5.2 | 5.7 |
| GDP deflator (percent change) | 1.7 | 2.2 | 9.3 | 8.0 | 4.4 | 8.1 | 8.1 | 6.5 | 6.5 | 6.4 | 6.7 | 6.3 |
| Consumer prices (End-period; percent change) | 1.1 | 0.8 | 6.1 | 7.2 | 6.1 | 8.1 | 8.0 | 8.1 | 7.2 | 6.8 | 6.8 | 6.8 |
| Gross national saving | 20.7 | 26.0 | 30.3 | 26.9 | 30.1 | 29.2 | 28.9 | 29.2 | 31.8 | 34.5 | 38.8 | 43.0 |
| Public | 0.4 | -4.2 | -3.4 | 3.4 | -1.5 | 2.9 | 6.4 | 7.2 | 6.8 | 6.8 | 6.5 | 6.8 |
| Private | 20.3 | 30.3 | 33.8 | 23.5 | 31.6 | 26.4 | 22.5 | 22.0 | 25.0 | 27.7 | 32.3 | 36.2 |
| Gross capital formation | 26.4 | 29.4 | 34.8 | 37.3 | 39.6 | 37.2 | 37.2 | 39.9 | 41.4 | 41.2 | 42.1 | 42.6 |
| Public | 6.0 | 9.9 | 7.7 | 6.1 | 7.5 | 6.5 | 6.4 | 9.1 | 8.3 | 6.8 | 6.4 | 6.4 |
| Private | 20.4 | 19.5 | 27.1 | 31.2 | 32.2 | 30.7 | 30.8 | 30.8 | 33.2 | 34.4 | 35.8 | 36.1 |
| General government accounts | | | | | | | | | | | | |
| Total revenue and grants | 25.1 | 23.5 | 24.7 | 29.2 | 26.3 | 27.1 | 30.5 | 31.3 | 30.4 | 30.0 | 29.4 | 29.3 |
| Total expenditure and net lending 1/ | 33.6 | 40.5 | 35.3 | 31.1 | 34.8 | 32.1 | 30.3 | 32.9 | 31.0 | 28.9 | 28.3 | 28.0 |
| Overall balance (IMF definition) 2/ | -8.5 | -17.0 | -10.6 | -1.9 | -8.5 | -4.7 | -1.1 | -2.3 | -2.0 | -0.5 | -0.4 | -0.1 |
| Overall balance (IMF definition, excl. DBM) | -5.5 | -15.9 | -10.0 | -3.7 | -8.0 | -3.9 | -0.3 | -1.9 | -1.5 | 0.0 | 0.1 | 0.4 |
| Primary balance (IMF definition) | -5.6 | -13.0 | -5.5 | 2.1 | -3.1 | -1.0 | 2.4 | 0.5 | 0.3 | 1.5 | 1.5 | 1.5 |
| Primary balance (IMF definition, excl. DBM) | -2.6 | -12.0 | -4.9 | 0.4 | -2.5 | -0.2 | 3.2 | 1.0 | 0.8 | 2.0 | 2.0 | 2.0 |
| ***Monetary sector*** | | | | | | | | | | | | |
| Broad money growth (percent change) | -5.5 | 21.0 | 16.1 | 30.5 | 13.3 | 21.5 | 22.9 | 13.2 | 11.7 | 11.7 | 12.2 | 12.4 |
| Reserve money growth (percent change) | -28.2 | 24.6 | 21.8 | 30.5 | 19.3 | 19.5 | 19.5 | 16.6 | 12.6 | 17.3 | 14.0 | 17.4 |
| Credit growth (percent change) | 3.6 | 6.7 | 9.0 | 11.1 | 10.3 | 12.5 | 18.0 | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 |
| ***Balance of payments*** | | | | | | | | | | | | |
| Current account balance | -4.0 | -6.3 | -4.4 | -10.4 | -9.5 | -8.0 | -8.3 | -10.7 | -9.6 | -6.7 | -3.4 | 0.5 |
| Exports of goods (y/y percent change) | -20.1 | 4.1 | 2.0 | 21.4 | -15.3 | 10.4 | 17.6 | 0.2 | -0.3 | 7.3 | 7.6 | 13.2 |
| Imports of goods (y/y percent change) | -28.1 | 0.8 | 4.8 | 25.3 | -8.5 | 13.2 | 25.8 | 7.9 | 0.2 | 3.5 | 1.6 | 5.1 |
| Gross official reserves (in USD millions) 3/ | 1324 | 1297 | 1692 | 3012 | 2515 | 3150 | 3052 | 3885 | 4060 | 4412 | 4143 | 4195 |
| (In months of imports) | 2.8 | 2.4 | 3.4 | 4.6 | 4.4 | 4.9 | 4.4 | 5.5 | 5.6 | 6.0 | 5.4 | 5.1 |
| ***Debt indicators 4/*** | | | | | | | | | | | | |
| General government debt | 62.1 | 87.6 | 94.9 | 84.6 | 101.3 | 79.4 | 74.8 | 69.9 | 67.7 | 62.5 | 56.4 | 50.4 |
| Domestic | 15.2 | 20.2 | 21.4 | 13.6 | 19.4 | 13.6 | 11.1 | 5.2 | 3.6 | 3.2 | 2.0 | 1.4 |
| External | 46.9 | 67.5 | 73.4 | 71.0 | 81.9 | 65.8 | 63.8 | 64.6 | 64.1 | 59.4 | 54.4 | 49.0 |
| GFN | 10.7 | 18.0 | 22.4 | 3.6 | 21.5 | 13.6 | 9.8 | 3.8 | 7.8 | 1.9 | 10.3 | 3.2 |
| Exchange rate | | | | | | | | | | | | |
| Togrog per U.S. dollar (eop) | 1996 | 2490 | … | 2427 | … | … | … | … | … | … | … | … |
| Nominal Effective Exchange Rate 5/ | 101.9 | 85.4 | … | 82.7 | … | … | … | … | … | … | … | … |
| Real Effective Exchange Rate 5/ | 100.0 | 82.3 | … | 83.4 | … | … | … | … | … | … | … | … |
| ***Memorandum items:*** | | | | | | | | | | | | |
| Copper prices (US$ per ton) | 5510 | 4868 | 5722 | 6170 | 5733 | 7132 | 6608 | 6200 | 6244 | 6261 | 6263 | 6263 |
| Gold prices (US$ per ounce) | 1160 | 1248 | 1212 | 1257 | 1225 | 1340 | 1287 | 1276 | 1314 | 1363 | 1402 | 1441 |
| Oil price (in U.S. dollars per barrel) | 50.8 | 42.8 | 54.9 | 52.8 | 55.7 | 62.3 | 70.3 | 69.6 | 65.7 | 62.7 | 60.6 | 59.1 |
| Population in million (eop) | 3.1 | 3.1 | 3.1 | 3.2 | 3.2 | 3.2 | 3.2 | 3.3 | 3.4 | 3.4 | 3.5 | 3.6 |

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

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

5/ December 2014 =100

## Table 2a. Mongolia: Summary Operations of the General Government, 2015–23

(In billions of togrogs)

| | 2015 | 2016 | 2017 | | 2018 | | | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Act. | | EFF | Act. | EFF | 4th review | Proj. | Proj. | | | | |
| Total revenue and grants | 5807 | 5635 | 6431 | 7922 | 7279 | 8450 | 9515 | 11069 | 12007 | 13212 | 14533 | 16281 |
| Current revenue | 5752 | 5556 | 6285 | 7868 | 7169 | 8339 | 9404 | 10894 | 11811 | 12994 | 14288 | 16006 |
| Tax revenue and social security contributions | 5121 | 4875 | 5523 | 6986 | 6346 | 7486 | 8390 | 9616 | 10384 | 11399 | 12498 | 13994 |
| Income taxes | 1171 | 1043 | 1120 | 1610 | 1292 | 1693 | 1914 | 2286 | 2417 | 2674 | 2966 | 3391 |
| CIT | 688 | 520 | 520 | 962 | 556 | 977 | 1153 | 1374 | 1397 | 1534 | 1688 | 1954 |
| PIT | 482 | 523 | 600 | 648 | 735 | 716 | 762 | 912 | 1020 | 1139 | 1278 | 1436 |
| Social security contributions | 1018 | 1034 | 1199 | 1314 | 1410 | 1448 | 1464 | 1751 | 2054 | 2281 | 2544 | 2859 |
| VAT | 1050 | 1141 | 1279 | 1619 | 1434 | 1755 | 1955 | 2178 | 2299 | 2476 | 2641 | 2876 |
| Excise taxes | 592 | 630 | 487 | 520 | 659 | 664 | 683 | 772 | 865 | 965 | 1074 | 1207 |
| Customs duties and export taxes | 321 | 328 | 417 | 512 | 476 | 553 | 612 | 677 | 693 | 730 | 753 | 778 |
| Other taxes | 970 | 698 | 1020 | 1411 | 1076 | 1373 | 1762 | 1953 | 2056 | 2273 | 2519 | 2884 |
| Non-tax revenue | 631 | 682 | 762 | 882 | 823 | 853 | 1013 | 1278 | 1428 | 1595 | 1790 | 2011 |
| Capital revenue and grants | 54 | 78 | 146 | 54 | 110 | 111 | 111 | 175 | 195 | 218 | 245 | 275 |
| Total expenditure and net lending | 7781 | 9699 | 9183 | 8448 | 9640 | 9908 | 9864 | 11897 | 12809 | 13446 | 14742 | 16336 |
| Current expenditure | 5656 | 6571 | 7178 | 6948 | 7574 | 7454 | 7410 | 8364 | 9114 | 9976 | 11072 | 12204 |
| Wages and salaries | 1710 | 1747 | 1764 | 1775 | 1796 | 1853 | 1909 | 2215 | 2426 | 2710 | 3041 | 3417 |
| Purchase of goods and services | 1092 | 1386 | 1426 | 1337 | 1497 | 1455 | 1455 | 1726 | 1890 | 2112 | 2370 | 2663 |
| Subsidies | 110 | 229 | 233 | 261 | 245 | 236 | 236 | 262 | 294 | 316 | 355 | 399 |
| Transfers | 2075 | 2265 | 2431 | 2477 | 2522 | 2758 | 2702 | 3162 | 3583 | 3943 | 4354 | 4836 |
| Interest payments | 668 | 943 | 1324 | 1098 | 1514 | 1152 | 1108 | 999 | 921 | 895 | 952 | 889 |
| Capital expenditure and net lending 1/ | 2126 | 3128 | 2005 | 1500 | 2066 | 2454 | 2454 | 3532 | 3696 | 3470 | 3670 | 4132 |
| Capital expenditure | 1397 | 2360 | 1607 | 1646 | 1623 | 1991 | 1991 | 3215 | 3261 | 3008 | 3152 | 3576 |
| Domestically-financed | 1151 | 1664 | 949 | 1093 | 816 | 1184 | 1039 | 2142 | 2490 | 2150 | 2200 | 2779 |
| o/w DBM noncommercial spending | 431 | 240 | 173 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Foreign-financed | 246 | 696 | 658 | 553 | 807 | 807 | 952 | 1073 | 771 | 858 | 952 | 798 |
| Net lending | 729 | 768 | 398 | -146 | 443 | 463 | 463 | 317 | 435 | 462 | 518 | 555 |
| o/w DBM commercial spending 2/ | 706 | 247 | 150 | -475 | 159 | 253 | 253 | 173 | 194 | 216 | 243 | 273 |
| o/w Mortgage program net lending | 0 | 0 | 111 | 0 | 120 | 120 | 120 | 115 | 124 | 134 | 151 | 163 |
| Overall balance (IMF definition) | -1975 | -4065 | -2753 | -526 | -2361 | -1458 | -350 | -828 | -803 | -234 | -209 | -54 |
| Overall balance (IMF definition, excl. DBM) | -1269 | -3818 | -2603 | -1001 | -2201 | -1205 | -97 | -655 | -609 | -17 | 33 | 218 |
| Primary balance (IMF definition) | -1306 | -3121 | -1428 | 572 | -846 | -306 | 758 | 172 | 118 | 662 | 743 | 834 |
| Primary balance (IMF definition, excl. DBM) | -600 | -2875 | -1278 | 97 | -687 | -53 | 1011 | 345 | 312 | 878 | 985 | 1107 |
| Financing | 1975 | 4065 | 2753 | 168 | 2361 | 1463 | 350 | 828 | 803 | 234 | 209 | 54 |
| External | 384 | 1214 | 2024 | 1716 | 2560 | 845 | 467 | 2406 | 2043 | 389 | 346 | -99 |
| Disbursement | 505 | 1350 | 2646 | 1881 | 3268 | 1764 | 1383 | 2695 | 2442 | 2162 | 3496 | 2601 |
| Amortization | -121 | -136 | -622 | -165 | -708 | -919 | -915 | -289 | -399 | -1773 | -3150 | -2700 |
| Domestic (net) | 1591 | 2850 | 729 | -1548 | -199 | 618 | -118 | -1578 | -1240 | -155 | -136 | 153 |
| Government bonds (net issuance) | 366 | 2454 | 1069 | -1306 | -274 | 618 | -118 | -1578 | -340 | 45 | -236 | -147 |
| Privatization | 54 | 1 | 100 | 0 | 75 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other | 1170 | 396 | -440 | -242 | 0 | 0 | 0 | 0 | -900 | -200 | 100 | 300 |
| ***Memorandum items:*** | | | | | | | | | | | | |
| Mineral revenue (in percent of GDP) | 4.0 | 2.3 | 3.7 | 4.9 | 3.7 | 4.1 | 5.1 | 5.2 | 4.3 | 4.2 | 4.1 | 4.2 |
| Non-mineral revenue (in percent of GDP) | 21.1 | 21.2 | 20.9 | 24.2 | 22.6 | 23.3 | 25.4 | 26.1 | 26.1 | 25.7 | 25.2 | 25.0 |
| Total expenditure (in percent of non-mineral GDP) | 40.5 | 50.7 | 46.4 | 39.8 | 45.9 | 39.2 | 38.6 | 41.1 | 39.6 | 37.2 | 36.3 | 35.8 |
| Non-mineral overall balance (in percent of non-mineral G | -15.1 | -24.1 | -18.8 | -8.8 | -16.2 | -10.8 | -7.6 | -9.3 | -7.7 | -5.8 | -5.5 | -5.3 |
| Primary spending (change in percent) | -12.5 | 23.1 | -10.5 | -16.1 | 3.4 | 19.1 | 19.1 | 24.5 | 9.1 | 5.6 | 9.9 | 12.0 |

Sources: Mongolian authorities; and Fund staff projections.

1/ Includes DBM spending.

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

## Table 2b. Mongolia: Summary Operations of the General Government, 2015–23

(In percent of GDP)

| | 2015 | 2016 | 2017 | | 2018 | | | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Act. | | EFF | Act. | EFF | 4th review | Proj. | Proj. | | | | |
| Total revenue and grants | 25.1 | 23.5 | 24.7 | 29.2 | 26.3 | 27.4 | 30.5 | 31.3 | 30.4 | 30.0 | 29.4 | 29.3 |
| Current revenue 1/ | 24.8 | 23.2 | 24.1 | 29.0 | 25.9 | 27.0 | 30.1 | 30.8 | 29.9 | 29.5 | 28.9 | 28.8 |
| Tax revenue and social security contributions | 22.1 | 20.4 | 21.2 | 25.7 | 22.9 | 24.3 | 26.9 | 27.2 | 26.3 | 25.8 | 25.2 | 25.2 |
| Income taxes | 5.1 | 4.4 | 4.3 | 5.9 | 4.7 | 5.5 | 6.1 | 6.5 | 6.1 | 6.1 | 6.0 | 6.1 |
| CIT | 3.0 | 2.2 | 2.0 | 3.5 | 2.0 | 3.2 | 3.7 | 3.9 | 3.5 | 3.5 | 3.4 | 3.5 |
| PIT | 2.1 | 2.2 | 2.3 | 2.4 | 2.7 | 2.3 | 2.4 | 2.6 | 2.6 | 2.6 | 2.6 | 2.6 |
| Social security contributions | 4.4 | 4.3 | 4.6 | 4.8 | 5.1 | 4.7 | 4.7 | 5.0 | 5.2 | 5.2 | 5.1 | 5.1 |
| VAT | 4.5 | 4.8 | 4.9 | 6.0 | 5.2 | 5.7 | 6.3 | 6.2 | 5.8 | 5.6 | 5.3 | 5.2 |
| Excise taxes | 2.6 | 2.6 | 1.9 | 1.9 | 2.4 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 |
| Customs duties and export taxes | 1.4 | 1.4 | 1.6 | 1.9 | 1.7 | 1.8 | 2.0 | 1.9 | 1.8 | 1.7 | 1.5 | 1.4 |
| Other taxes | 4.2 | 2.9 | 3.9 | 5.2 | 3.9 | 4.5 | 5.6 | 5.5 | 5.2 | 5.2 | 5.1 | 5.2 |
| Non-tax revenue | 2.7 | 2.8 | 2.9 | 3.2 | 3.0 | 2.8 | 3.2 | 3.6 | 3.6 | 3.6 | 3.6 | 3.6 |
| Capital revenue and grants | 0.2 | 0.3 | 0.6 | 0.2 | 0.4 | 0.4 | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Total expenditure and net lending | 33.6 | 40.5 | 35.3 | 31.1 | 34.8 | 32.1 | 31.6 | 33.7 | 32.4 | 30.5 | 29.8 | 29.4 |
| Current expenditure | 24.4 | 27.4 | 27.6 | 25.6 | 27.4 | 24.2 | 23.7 | 23.7 | 23.1 | 22.6 | 22.4 | 21.9 |
| Wages and salaries | 7.4 | 7.3 | 6.8 | 6.5 | 6.5 | 6.0 | 6.1 | 6.3 | 6.1 | 6.1 | 6.1 | 6.1 |
| Purchase of goods and services | 4.7 | 5.8 | 5.5 | 4.9 | 5.4 | 4.7 | 4.7 | 4.9 | 4.8 | 4.8 | 4.8 | 4.8 |
| Subsidies | 0.5 | 1.0 | 0.9 | 1.0 | 0.9 | 0.8 | 0.8 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 |
| Transfers | 9.0 | 9.5 | 9.3 | 9.1 | 9.1 | 8.9 | 8.7 | 8.9 | 9.1 | 8.9 | 8.8 | 8.7 |
| Interest payments 2/ | 2.9 | 3.9 | 5.1 | 4.0 | 5.5 | 3.7 | 3.6 | 2.8 | 2.3 | 2.0 | 1.9 | 1.6 |
| Capital expenditure and net lending 3/ | 9.2 | 13.1 | 7.7 | 5.5 | 7.5 | 8.0 | 7.9 | 10.0 | 9.4 | 7.9 | 7.4 | 7.4 |
| Capital expenditure | 6.0 | 9.9 | 6.2 | 6.1 | 5.9 | 6.5 | 6.4 | 9.1 | 8.3 | 6.8 | 6.4 | 6.4 |
| Domestically-financed | 5.0 | 7.0 | 3.6 | 4.0 | 2.9 | 3.8 | 3.3 | 6.1 | 6.3 | 4.9 | 4.4 | 5.0 |
| o/w DBM noncommercial spending | 1.9 | 1.0 | 0.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Foreign-financed | 1.1 | 2.9 | 2.5 | 2.0 | 2.9 | 2.6 | 3.1 | 3.0 | 2.0 | 1.9 | 1.9 | 1.4 |
| Net lending | 3.1 | 3.2 | 1.5 | -0.5 | 1.6 | 1.5 | 1.5 | 0.9 | 1.1 | 1.0 | 1.0 | 1.0 |
| o/w DBM commercial spending 4/ | 3.1 | 1.0 | 0.6 | -1.7 | 0.6 | 0.8 | 0.8 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| o/w Mortgage program net lending | 0.0 | 0.0 | 0.4 | 0.0 | 0.4 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Overall balance (IMF definition) | -8.5 | -17.0 | -10.6 | -1.9 | -8.5 | -4.7 | -1.1 | -2.3 | -2.0 | -0.5 | -0.4 | -0.1 |
| Overall balance (IMF definition, excl. DBM) | -5.5 | -15.9 | -10.0 | -3.7 | -8.0 | -3.9 | -0.3 | -1.9 | -1.5 | 0.0 | 0.1 | 0.4 |
| Primary balance (IMF definition) | -5.6 | -13.0 | -5.5 | 2.1 | -3.1 | -1.0 | 2.4 | 0.5 | 0.3 | 1.5 | 1.5 | 1.5 |
| Primary balance (IMF definition, excl. DBM) | -2.6 | -12.0 | -4.9 | 0.4 | -2.5 | -0.2 | 3.2 | 1.0 | 0.8 | 2.0 | 2.0 | 2.0 |
| Financing | 8.5 | 17.0 | 10.6 | 0.6 | 8.5 | 4.7 | 1.1 | 2.3 | 2.0 | 0.5 | 0.4 | 0.1 |
| External | 1.7 | 5.1 | 7.8 | 6.3 | 9.2 | 2.7 | 1.5 | 6.8 | 5.2 | 0.9 | 0.7 | -0.2 |
| Disbursement | 2.2 | 5.6 | 10.2 | 6.9 | 11.8 | 5.7 | 4.4 | 7.6 | 6.2 | 4.9 | 7.1 | 4.7 |
| Amortization | -0.5 | -0.6 | -2.4 | -0.6 | -2.6 | -3.0 | -2.9 | -0.8 | -1.0 | -4.0 | -6.4 | -4.9 |
| Domestic (net) | 6.9 | 11.9 | 2.8 | -5.7 | -0.7 | 2.0 | -0.4 | -4.5 | -3.1 | -0.4 | -0.3 | 0.3 |
| Government bonds (net issuance) | 1.6 | 10.2 | 4.1 | -4.8 | -1.0 | 2.0 | -0.4 | -4.5 | -0.9 | 0.1 | -0.5 | -0.3 |
| Privatization | 0.2 | 0.0 | 0.4 | 0.0 | 0.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 5.1 | 1.7 | -1.7 | -0.9 | 0.0 | 0.0 | 0.0 | 0.0 | -2.3 | -0.5 | 0.2 | 0.5 |
| ***Memorandum items:*** | | | | | | | | | | | | |
| Mineral revenue (in percent of GDP) | 4.0 | 2.3 | 3.7 | 4.9 | 3.7 | 4.1 | 5.1 | 5.2 | 4.3 | 4.2 | 4.1 | 4.2 |
| Non-mineral revenue (in percent of GDP) | 21.1 | 21.2 | 20.9 | 24.2 | 22.6 | 23.3 | 25.4 | 26.1 | 26.1 | 25.7 | 25.2 | 25.0 |
| Total expenditure (in percent of non-mineral GDP) | 40.5 | 50.7 | 46.4 | 39.8 | 45.9 | 39.2 | 38.6 | 41.1 | 39.6 | 37.2 | 36.3 | 35.8 |
| Non-mineral overall balance (in percent of non-mineral GDP) | -15.1 | -24.1 | -18.8 | -8.8 | -16.2 | -10.8 | -7.6 | -9.3 | -7.7 | -5.8 | -5.5 | -5.3 |
| Primary spending (change in percent) | -12.5 | 23.1 | -10.5 | -16.1 | 3.4 | 19.1 | 19.1 | 24.5 | 9.1 | 5.6 | 9.9 | 12.0 |

Sources: Mongolian authorities; and Fund staff projections.
1/ Interest payments not in the budget, using instead USD IMF
2/ The 2017 budget revenue estimates are understated because
3/ Includes DBM spending.
4/ Not on the budget, using instead Fund projections.

## Table 3. Mongolia: Balance of Payments, 2015-23

| | 2015 | 2016 | 2017 | | 2018 | | | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Act. | | EFF | Act. | EFF | 4th review | Proj. | | | Proj. | | |
| | (In millions of U.S. dollars, unless otherwise indicated) 1/ | | | | | | | | | | | |
| Current account balance (including official grants) | -469 | -700 | -456 | -1155 | -1004 | -1000 | -1054 | -1508 | -1480 | -1135 | -630 | 99 |
| Trade balance | 1178 | 1338 | 1266 | 1490 | 968 | 1525 | 1398 | 976 | 939 | 1232 | 1697 | 2427 |
| Exports | 4616 | 4804 | 4898 | 5834 | 4943 | 6443 | 6862 | 6875 | 6852 | 7353 | 7913 | 8959 |
| Mineral export | 4099 | 3999 | 4314 | 5162 | 4351 | 5747 | 6154 | 6160 | 6136 | 6613 | 7149 | 8152 |
| Non-mineral export | 517 | 805 | 584 | 672 | 592 | 696 | 708 | 715 | 717 | 740 | 763 | 807 |
| Imports | -3438 | -3466 | -3632 | -4345 | -3975 | -4918 | -5465 | -5899 | -5913 | -6121 | -6216 | -6532 |
| Services, net | -857 | -1338 | -1017 | -1212 | -1174 | -1288 | -1292 | -1328 | -1302 | -1313 | -1295 | -1363 |
| Income, net | -966 | -911 | -937 | -1613 | -1033 | -1428 | -1382 | -1371 | -1349 | -1306 | -1285 | -1240 |
| Current transfers | 205 | 176 | 231 | 181 | 234 | 192 | 222 | 214 | 232 | 251 | 253 | 275 |
| General government | 56 | 20 | 31 | 22 | 32 | 26 | 50 | 28 | 30 | 33 | 17 | 17 |
| Other sectors | 148 | 156 | 200 | 159 | 202 | 166 | 172 | 187 | 201 | 218 | 236 | 258 |
| *Of which:* Workers remittances | 76 | 117 | 88 | 134 | 88 | 125 | 131 | 145 | 159 | 174 | 192 | 213 |
| Capital and financial account | 382 | 916 | 91 | 2068 | 785 | 839 | 795 | 1687 | 955 | 1384 | 255 | 93 |
| Capital account | 114 | 104 | 114 | 78 | 117 | 85 | 85 | 101 | 111 | 121 | 125 | 129 |
| Financial account | 268 | 812 | -23 | 1990 | 667 | 754 | 710 | 1586 | 844 | 1262 | 130 | -35 |
| Direct investment | 110 | -4171 | 995 | 1446 | 1547 | 1659 | 1665 | 2304 | 1996 | 2029 | 1551 | 1073 |
| Portfolio investment | 274 | 487 | -94 | 493 | 0 | -296 | -396 | -150 | -500 | 0 | -412 | -273 |
| Trade credits, net | -302 | -221 | -45 | -44 | -45 | -106 | 20 | -81 | -35 | -32 | -50 | -39 |
| Currency and deposits, net | -233 | -204 | -886 | 489 | -663 | -158 | -163 | -289 | -266 | -323 | -302 | -325 |
| Loans, net | 347 | 4920 | 7 | -394 | -171 | -345 | -416 | -197 | -351 | -412 | -657 | -471 |
| Other, net | 72 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Errors and omissions | -181 | -221 | 0 | -56 | 0 | -140 | -140 | -145 | -149 | -142 | -126 | -140 |
| Overall balance | -268 | -5 | -365 | 857 | -220 | -301 | -399 | 33 | -674 | 106 | -502 | 52 |
| Change in reserves 2/ | -324 | -27 | 395 | 1715 | 823 | 138 | 40 | 833 | 174 | 352 | -269 | 52 |
| Financing Gap | 0 | 0 | 760 | 717 | 1043 | 439 | 439 | 800 | 848 | 246 | 233 | 0 |
| Fund credit | n.a. | n.a. | 113 | 113 | 135 | 135 | 135 | 142 | 35 | 0 | 0 | 0 |
| Donor support | n.a. | n.a. | 647 | 603 | 908 | 305 | 305 | 658 | 813 | 246 | 233 | 0 |
| ***Memorandum items:*** | | | | | | | | | | | | |
| Current account balance (in percent of GDP) | -4.0 | -6.3 | -4.4 | -10.4 | -9.5 | -8.0 | -8.3 | -10.7 | -9.6 | -6.7 | -3.4 | 0.5 |
| Gross official reserves (end-period) 3/ | 1324 | 1297 | 1692 | 3012 | 2515 | 3150 | 3052 | 3885 | 4060 | 4412 | 4143 | 4195 |
| (In months of next year's imports of goods and services) | 2.8 | 2.4 | 3.4 | 4.6 | 4.4 | 4.9 | 4.4 | 5.5 | 5.6 | 6.0 | 5.4 | 5.1 |
| Copper price (in U.S. dollars per ton) | 5510 | 4868 | 5722 | 6170 | 5733 | 7132 | 6608 | 6200 | 6244 | 6261 | 6263 | 6263 |
| Oil price (in U.S. dollars per barrel) | 51 | 43 | 55 | 53 | 56 | 62 | 70 | 70 | 66 | 63 | 61 | 59 |
| Gold price (in U.S. dollars per troy oz.) | 1160 | 1248 | 1212 | 1257 | 1225 | 1340 | 1287 | 1276 | 1314 | 1363 | 1402 | 1441 |

Sources: Mongolian authorities; and Fund staff projections.

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

2/ Changes in reserves reflect valuation adjustments.

3/ Gross official reserves includes drawings from swap line.

## Table 4. Mongolia: Monetary Aggregates, 2015-23

| | 2015 | 2016 | 2017 | | 2018 | | | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Act. | | EFF | Act. | EFF | 4th review | Proj. | | | Proj. | | |
| | (In billions of togrog, end of period) | | | | | | | | | | | |
| Reserve Money | 2460 | 3064 | 3734 | 3939 | 4457 | 4793 | 4851 | 5493 | 6138 | 6858 | 7696 | 8648 |
| Broad money | 10049 | 12159 | 13967 | 15861 | 15822 | 19269 | 19501 | 22082 | 24675 | 27568 | 30939 | 34765 |
| Currency | 459 | 563 | 656 | 612 | 743 | 963 | 975 | 1104 | 1234 | 1378 | 1547 | 1738 |
| Deposits | 9590 | 11596 | 13311 | 15249 | 15079 | 18305 | 18526 | 20978 | 23442 | 26190 | 29392 | 33027 |
| Net foreign assets | -4158 | -4580 | -4176 | -1541 | -2037 | -293 | -1011 | -1488 | -2412 | -3563 | -4843 | -6366 |
| BOM | -1278 | -1260 | ... | 2283 | ... | 2777 | 2534 | 4838 | 5463 | 6596 | 6055 | 6370 |
| Other Depository Corporations | -2880 | -3320 | ... | -3824 | ... | -3070 | -3545 | -6326 | -7875 | -10159 | -10898 | -12735 |
| Net domestic assets | 14207 | 16739 | 18143 | 17402 | 17859 | 19562 | 20512 | 23570 | 27087 | 31131 | 35782 | 41131 |
| Net Domestic credit | 15129 | 17363 | 18252 | 16958 | 19640 | 19071 | 20022 | 23080 | 26596 | 30641 | 35292 | 40640 |
| Net claims on government | 661 | 1851 | 2044 | -366 | 1770 | -366 | -366 | -366 | -366 | -366 | -366 | -366 |
| BOM | -496 | -350 | ... | -1111 | ... | -1111 | -1111 | -1111 | -1111 | -1111 | -1111 | -1111 |
| Other Depository Corporations | 1157 | 2200 | ... | 745 | ... | 745 | 745 | 745 | 745 | 745 | 745 | 745 |
| Net claims on private sector | 11798 | 13014 | 16208 | 14217 | 17870 | 15994 | 16775 | 19292 | 22186 | 25513 | 29340 | 33742 |
| Net claims on other financial corporation | 2437 | 2437 | ... | 3061 | ... | 3443 | 3612 | 4153 | 4776 | 5493 | 6317 | 7264 |
| Other items, net | -689 | -563 | -109 | 491 | -1780 | 491 | 491 | 491 | 491 | 491 | 491 | 491 |
| ***Memorandum items:*** | | | | | | | | | | | | |
| Annual broad money growth | -5.5 | 21.0 | 16.1 | 30.5 | 13.3 | 21.5 | 22.9 | 13.2 | 11.7 | 11.7 | 12.2 | 12.4 |
| Velocity of Broad Money | 2.3 | 2.0 | 1.9 | 1.7 | 1.8 | 1.6 | 1.6 | 1.6 | 1.6 | 1.6 | 1.6 | 1.6 |
| Credit outstanding (Domestic credit+MBS) (In MNT bn) /1 | 13929 | 14866 | 16208 | 16521 | 17870 | 18586 | 19494 | 22419 | 25781 | 29649 | 34096 | 39210 |
| Credit to GDP ratio | 60.2 | 62.1 | 62.2 | 60.8 | 64.5 | 60.3 | 62.5 | 63.5 | 65.3 | 67.2 | 68.9 | 70.5 |
| Credit growth (percent) | 3.6 | 6.7 | 9.0 | 11.1 | 10.3 | 12.5 | 18.0 | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 |

1/Includes mortgage-backed securities.

Sources: Mongolian authorities; and Fund staff projections.

## Table 5. Mongolia: External Financing Requirements and Sources, 2015–23

(In millions of U.S. dollars)

| | | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
| Gross financing requirements | 935 | 2,067 | 3,628 | 2,917 | 3,980 | 3,524 | 3,444 | 3,449 | 2,610 |
| External current account deficit (excl. official transfers) | 497 | 756 | 1,176 | 1,104 | 1,536 | 1,510 | 1,168 | 647 | -82 |
| Amortization | 427 | 689 | 1,212 | 1,513 | 1,296 | 1,468 | 1,514 | 2,683 | 2,228 |
| Public sector | 64 | 62 | 259 | 603 | 296 | 156 | 724 | 1,231 | 1,574 |
| o/w bonds | 0 | 0 | 0 | 273 | 0 | 0 | 500 | 1,000 | 1,073 |
| o/w loans | 58 | 62 | 259 | 330 | 296 | 156 | 224 | 231 | 501 |
| Private sector | 363 | 627 | 952 | 910 | 1,001 | 1,312 | 790 | 1,452 | 654 |
| Repayment of arrears | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Gross reserves accumulation (increase = +) | -324 | -27 | 1,715 | 40 | 833 | 174 | 352 | -269 | 52 |
| IMF repurchases and repayments | 3 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other net capital outflows 1/ | 332 | 648 | -474 | 259 | 315 | 372 | 410 | 388 | 411 |
| | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Available financing | 935 | 2,067 | 2,911 | 2,477 | 3,180 | 2,676 | 3,198 | 3,217 | 2,610 |
| Grants | 28 | 56 | 20 | 50 | 28 | 30 | 33 | 17 | 17 |
| Disbursements to public sector | 255 | 1,133 | 755 | 370 | 455 | 154 | 627 | 1,129 | 1,265 |
| o/w bonds | 0 | 500 | 433 | 0 | 0 | 0 | 500 | 1,000 | 800 |
| o/w loans | 255 | 633 | 322 | 370 | 455 | 154 | 127 | 129 | 465 |
| Disbursements to private sector | 543 | 5,049 | 691 | 392 | 394 | 496 | 509 | 520 | 255 |
| Foreign direct investment | 110 | -4,171 | 1,446 | 1,665 | 2,304 | 1,996 | 2,029 | 1,551 | 1,073 |
| Financing need | 0 | 0 | 717 | 439 | 800 | 848 | 246 | 233 | 0 |
| Financing | 0 | 0 | 717 | 439 | 800 | 848 | 246 | 233 | 0 |
| IMF 2/ | 0 | 0 | 113 | 135 | 142 | 35 | 0 | 0 | 0 |
| Other IFI | 0 | 0 | 320 | 304 | 330 | 360 | 0 | 0 | 0 |
| Identified bilateral support | 0 | 0 | 283 | 1 | 328 | 453 | 246 | 233 | 0 |
| PBOC swap (additional drawing) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| PBOC swap rollover (net zero) | | | 1,805 | | | 1,805 | | | |

Sources: Mongolian authorities; and Fund staff projections.
1/ Includes all other net financial flows, and errors and omissions.
2/ SDR/USD = 0.73924 exchange rate was used.

## Table 6. Mongolia: Indicators of Fund Credit, 2017-23
(In millions of SDR, unless otherwise indicated)

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|
| Existing and prospective Fund arrangements | | | | | | | |
| Disbursements | 83.87 | 99.59 | 104.84 | 26.21 | | | |
| Stock 1/ | 83.87 | 183.45 | 288.29 | 314.51 | 312.18 | 294.27 | 259.32 |
| Obligations 2/ | 0.64 | 2.50 | 6.30 | 9.57 | 12.28 | 27.66 | 44.97 |
| Principal (repayments/repurchases) | | | | | 2.33 | 17.91 | 34.94 |
| Charges and interest | 0.64 | 2.50 | 6.30 | 9.57 | 9.95 | 9.75 | 10.03 |
| | | | | | | | |
| Stock of existing and prospective Fund credit 1/ | 83.87 | 183.45 | 288.29 | 314.51 | 312.18 | 294.27 | 259.32 |
| In percent of quota | 116.00 | 253.74 | 398.75 | 435.00 | 431.78 | 407.01 | 358.68 |
| In percent of GDP | 1.01 | 1.97 | 2.81 | 2.80 | 2.52 | 2.10 | 1.66 |
| In percent of exports of goods and services | 1.65 | 3.37 | 5.05 | 5.35 | 4.95 | 4.38 | 3.63 |
| In percent of gross usable reserves | 2.78 | 5.10 | 6.05 | 6.34 | 5.37 | 5.05 | 4.16 |
| | | | | | | | |
| Obligations to the Fund from existing and prospective Fund arrangements | 0.64 | 2.50 | 6.30 | 9.57 | 12.28 | 27.66 | 44.97 |
| In percent of quota | 0.89 | 3.46 | 8.71 | 13.24 | 16.98 | 38.26 | 62.20 |
| In percent of GDP | 0.00 | 0.03 | 0.06 | 0.08 | 0.09 | 0.19 | 0.28 |
| In percent of exports of goods and services | 0.00 | 0.05 | 0.10 | 0.15 | 0.18 | 0.40 | 0.62 |
| In percent of gross usable reserves | 0.01 | 0.07 | 0.12 | 0.18 | 0.20 | 0.46 | 0.72 |

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

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

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

1/ The first and second reviews were combined.

## Table 8. Mongolia: Selected Economic and Financial Stability Indicators, 2010-18

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 Mar | 2017 Jun | 2017 Sep | 2017 Dec | 2018 Mar |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Capital** (in percent) | | | | | | | | | | | | |
| Risk Weighted CAR | 16.2 | 15.0 | 16.1 | 16.0 | 17.7 | 17.9 | 18.6 | 18.5 | 18.0 | 17.5 | 17.4 | 16.7 |
| **Asset quality** | | | | | | | | | | | | |
| Asset Growth (percent change from start of year) | 43.0 | 48.4 | 24.2 | 68.2 | 11.7 | -3.6 | 21.3 | -0.6 | 1.7 | 10.8 | 13.4 | 0.6 |
| Loan Growth (Net) (percent change from start of year) | 26.4 | 79.2 | 25.9 | 52.4 | 17.5 | -8.6 | 4.7 | 2.1 | 3.6 | 7.7 | 8.3 | 3.8 |
| Loan share in total assets (in percent) | 47.9 | 57.9 | 58.6 | 53.1 | 55.9 | 53.0 | 46.0 | 47.3 | 46.8 | 44.7 | 43.9 | 45.3 |
| **Non Performing Loan** (in percent) | | | | | | | | | | | | |
| NPL to gross loans | 6.7 | 3.1 | 2.2 | 2.5 | 3.1 | 7.3 | 7.2 | 6.6 | 7.3 | 7.5 | 7.3 | 7.6 |
| Past-due to gross loans | 3.0 | 1.3 | 1.6 | 0.0 | 2.2 | 5.6 | 7.1 | 7.9 | 6.2 | 6.3 | 6.2 | 6.7 |
| NPL + Past due to gross loans | 9.7 | 4.4 | 3.8 | 3.6 | 5.3 | 12.9 | 14.2 | 14.5 | 13.5 | 13.8 | 13.5 | 14.3 |
| Provision/NPLs | 62.4 | 69.1 | 75.2 | 71.6 | 70.2 | 61.6 | 72.2 | 77.3 | 74.3 | 73.3 | 86.3 | 84.4 |
| Provision/NPL+Past due | 43.2 | 48.2 | 43.2 | 49.7 | 41.5 | 34.8 | 36.4 | 35.3 | 40.1 | 39.9 | 46.8 | 44.9 |
| NPLs net of provision /Capital | 12.5 | 5.5 | 2.9 | 4.3 | 5.0 | 12.7 | 7.9 | 5.8 | 7.4 | 8.0 | 4.1 | 5.0 |
| NPLs+Past due net of provision /Capital | 27.2 | 13.1 | 11.5 | 11.1 | 16.5 | 38.2 | 35.7 | 36.1 | 32.0 | 33.3 | 29.4 | 33.5 |
| FX lending to total lending | 33.7 | 32.3 | 32.6 | 27.5 | 23.5 | 24.5 | 20.2 | 20.7 | 21.4 | 21.4 | 22.3 | 22.5 |
| **Interest Rate** (in percent) | | | | | | | | | | | | |
| Average lending rate | 20.7 | 16.8 | 16.6 | 16.9 | 16.4 | 17.1 | 16.4 | 16.6 | 16.7 | 16.5 | 16.7 | 16.8 |
| **Earnings and Profitability** (in percent) | | | | | | | | | | | | |
| Return on assets | 3.0 | 4.1 | 3.5 | 3.8 | 2.6 | 2.6 | 1.8 | 2.1 | 2.1 | 2.0 | 2.0 | 2.1 |
| Return on equity | 20.5 | 23.6 | 21.0 | 24.6 | 16.5 | 15.3 | 15.0 | 18.3 | 18.2 | 16.7 | 16.7 | 18.3 |
| Interest income to gross income | 87.2 | 82.2 | 85.9 | 39.9 | 38.6 | 76.6 | 76.3 | 91.6 | 90.3 | 90.4 | 89.9 | 88.6 |
| Interest expenses to gross income | 41.4 | 36.1 | 41.7 | 22.4 | 22.2 | 43.5 | 48.4 | 57.5 | 56.2 | 55.8 | 55.1 | 54.8 |
| Non-interest expenses to gross income | 36.8 | 33.8 | 30.8 | 66.0 | 68.4 | 39.3 | 40.0 | 28.9 | 29.1 | 29.7 | 30.1 | 26.4 |
| Personnel expenses to Non-interest expenses | 51.7 | 52.3 | 56.3 | 9.3 | 8.0 | 26.9 | 23.0 | 30.5 | 29.3 | 28.2 | 27.9 | 32.5 |
| **Liquidity** (in percent) | | | | | | | | | | | | |
| Liquid assets to Total assets | 45.5 | 33.3 | 31.1 | 36.7 | 22.1 | 18.9 | 22.2 | 22.0 | 25.6 | 24.3 | 28.6 | 35.6 |
| Liquid assets to Short-term liabilities | 52.3 | 38.9 | 37.1 | 41.2 | 27.8 | 27.5 | 28.5 | 28.1 | 32.5 | 30.6 | 35.7 | 44.5 |
| FX deposit to total Deposits | 25.1 | 23.3 | 20.9 | 17.1 | 18.3 | 18.4 | 24.5 | 19.8 | 17.8 | 19.3 | 18.9 | 18.1 |

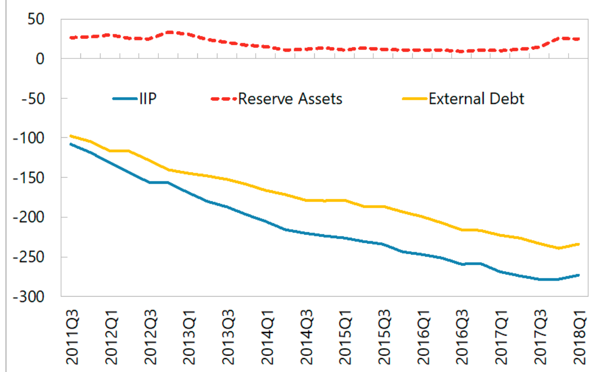
Source: Mongolian authorities.

# Annex I. External Sector Assessment

*Staff judge the external position to be weaker than fundamentals. On top of a weak underlying international investment position, Mongolia is facing a deterioration in the current account resulting from rising imports, delays in donor disbursements due to weaker program performance, and increased pressure on the investment climate amid ongoing investigations into OT.*

1. **Mongolia's net international investment position is weak** at -270 percent of GDP, primarily reflecting limited foreign assets at the Central Bank (gross FX reserves are only 25 percent of GDP) and very high external debt (240 percent of GDP). Such large external leverage could still be consistent with external solvency and a broadly stable exchange rate over the long-term if Mongolia can maintain an adequate investment climate and sufficiently tight macro policies to turn its physical commodity wealth into foreign financial assets. However, despite significant underground reserves, there is only one major mining project in the country (OT) and even that is increasingly at risk due to ongoing investment disputes.

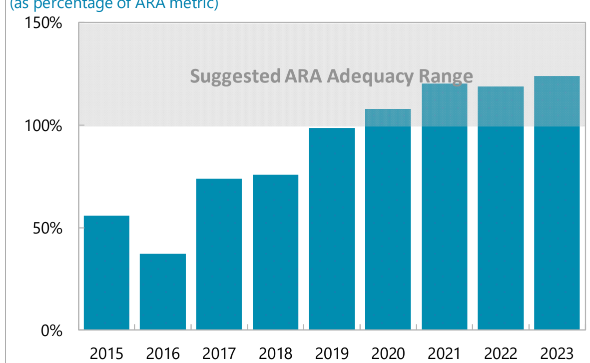
**International Investment Position**
(In Percent of GDP)




Sources: IMF Staff Calculations

2. **Gross official reserves stand at around USD 3 billion.** While well above levels projected at the time of program approval, at less than 5 months of imports, gross reserves are still below 100 percent of the Funds ARA metric and partly reflect large foreign liabilities including expensive swap agreements from China that have been rolled over during the program. Furthermore, reserve accumulation has stalled and partially reversed in 2018 due to delays in donor disbursements stemming from weak program performance and weakness in the current account amid strong imports and declining terms of trade. Although the current account deficit primarily reflects FDI-related imports, it is widening at the margin due to an acceleration in consumer imports (funded by 25 percent y.o.y. consumer credit growth).

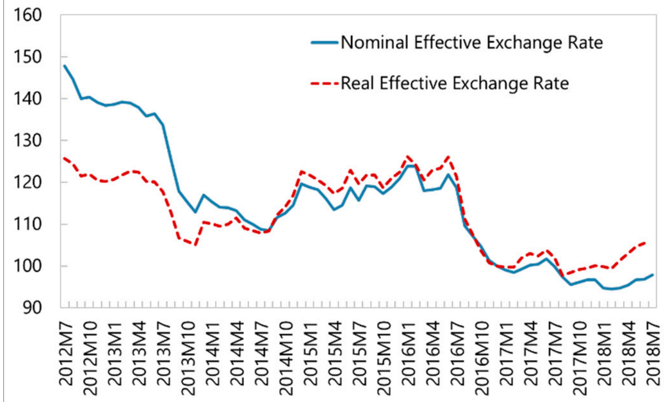
**Gross International Reserves**
(as percentage of ARA metric)




Sources: IMF Staff Calculations.

**3. The external position in 2017 is assessed to be weaker than implied by fundamentals.** The macro balance approach of the External Balance Assessment Lite (EBA-lite) shows that the current account in 2017 (10 percent of GDP deficit) was weaker than the norm, and hence the exchange rate was stronger than what fundamentals would suggest. The identified policy gaps are admittedly small and the large current account deficit is partly overstated as it includes mining related imports which will improve the long-run trade balance. However, in 2018, the current account deficit has continued to widen and the recent deterioration reflects other factors including loose monetary policy and deteriorating terms of trade. On the back of the nearly 25 percent depreciation of the togrog in 2016, direct estimates of the REER using the EBA-lite methodology however finds that the exchange rate is weaker than fundamentals. The large price adjustment has not helped reduce the current account deficit as expected because of the increase in FDI related imports and the large increase in household credit which helped maintain purchasing power.

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




Sources: Haver Analytics

**Mongolia: EBA-lite Assessments, 2017**

| | CA model | REER model |
|---|---|---|
| Actual CA | -10.4% | ... |
| CA Norm | -5.6% | ... |
| CA gap (model) | -4.8% | ... |
| o/w policy gap | 2.7% | ... |
| CA gap (staff-assessed) 1/ | -3.9% | ... |
| Elasticity | -0.44 | ... |
| REER gap | 8.9% | -10.0% |

1/ Adjustment of -0.9% is included to account for higher imports due to the drought.

# Annex II. Public Debt Sustainability Analysis

*While projected to remain high at around 75 percent of GDP at end-2018, the public debt ratio is expected to improve significantly under the baseline. This improvement reflects projections of high nominal growth, concessional financing, and strong fiscal performance under the program. However, this trajectory is particularly vulnerable to changes in the path of growth and the exchange rate.*

1. **The baseline scenario assumes strong economic growth, a stable exchange rate, and continued access to concessional budget support under the program.** The assumptions are:

- Real GDP growth is expected to remain anchored around 5-6 percent
- Inflation is expected to remain at or below the target of 8 percent
- The exchange rate is assessed to be broadly in line with fundamentals and is expected to remain broadly stable over the forecast horizon
- Financing assumes concessional budget support and project loans in line with current commitments (see para ¶20 of staff report).
- And lastly, the primary balance is projected to remain in surplus between 2018 and 2023.

2. **The improving debt outlook is mainly shaped by the projected path of the interest rate-growth differential.** The public debt-to-GDP ratio is forecast to decline by about 32 percentage points between end-2017 and end-2023. This decline is almost entirely due to automatic debt dynamics given the projected low interest rates and high economic growth. With respect to the former, at present, 40 percent of public debt is on concessional terms and this is expected to rise to about 60 by the end of the program. The average effective interest rate of public debt is currently 5.2 percent and projected to fall to about 4 percent by 2020.

3. **Historically, Fund staff forecasts have been broadly reasonable on growth and inflation but too optimistic on the primary balance.** The forecast track record is not systematically biased for growth or inflation, as reflected in projection errors generally being in line with other countries. However, the forecast error for primary balance has been significant—with actual primary deficits being much higher than projected. While the continuation of the program can mitigate the risk of a sizable deviation of the primary balance from baseline projections in the near term, this remains a material risk beyond the program horizon. Correspondingly, our primary balance shock scenario envisions a significant increase in the primary deficit to reflect this risk. In addition, the boom-bust analysis suggests that our growth forecast is not optimistic.

4. **The public debt and financing needs projections are particularly sensitive to growth, exchange rate, and primary balance shocks.**

- *Growth shock*. Slower growth remains a key risk to debt sustainability, given the high volatility and commodity-dependence of the Mongolian economy. Assuming a decline in growth by one standard deviation in 2019 and 2020, the debt-to-GDP-ratio is forecast to reach above 80 percent in 2020, reversing the improvements in debt dynamics in the preceding three years. It would also sizably increase gross financing needs in 2020 to almost 15 percent of GDP compared to about 9 percent of GDP in the baseline.

- *Exchange rate shock*. An exchange rate depreciation also poses significant risk to the public debt, given that roughly 84 percent of the debt is foreign-currency denominated. A real exchange rate depreciation of 25 percent in 2019, would increase debt to above 80 percent of GDP, compared to about 70 percent projected under the baseline.

- *Primary balance shock*. The DSA considers a large primary balance shock—a 15 percentage points of GDP worsening in the primary balance relative to the baseline in 2021. Under this scenario, public debt reaches about 70 percent in 2021, and gross financing needs reaches almost 14 percent of GDP.

**5. The fan charts show significant uncertainty around the baseline.** The width of the symmetric fan chart, estimated at about 60 percent of GDP, illustrates the degree of uncertainty for equal-probability upside and downside risks. In light of downside risks associated with loosening of the fiscal stance, an upside shock to primary balance is restricted to zero in the asymmetric fan chart, resulting in a more upward-sloping debt path. This reflects a balance of risks skewed to the downside.

**6. Mongolia's debt profile reveals some weaknesses.** External financing needs are above the upper-risk assessment benchmark driven by Mongolia's large current account deficit—but not due to high general government financing needs (as there are no large amortizations of public debt due until 2021). In addition, public debt in foreign currency is also above the upper-risk assessment benchmark (84 percent vs. 60 percent).

**7. However, risks to debt sustainability need to be weighed against some mitigating factors.** The macro performance under the program continues to be strong. The authorities have rolled-over external bonds maturing in 2017 and 2018 at much lower interest rates than before, private and official inflows have boosted gross reserves significantly, and the authorities face no external maturities on international bonds until 2021.

## Figure 1. Mongolia Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

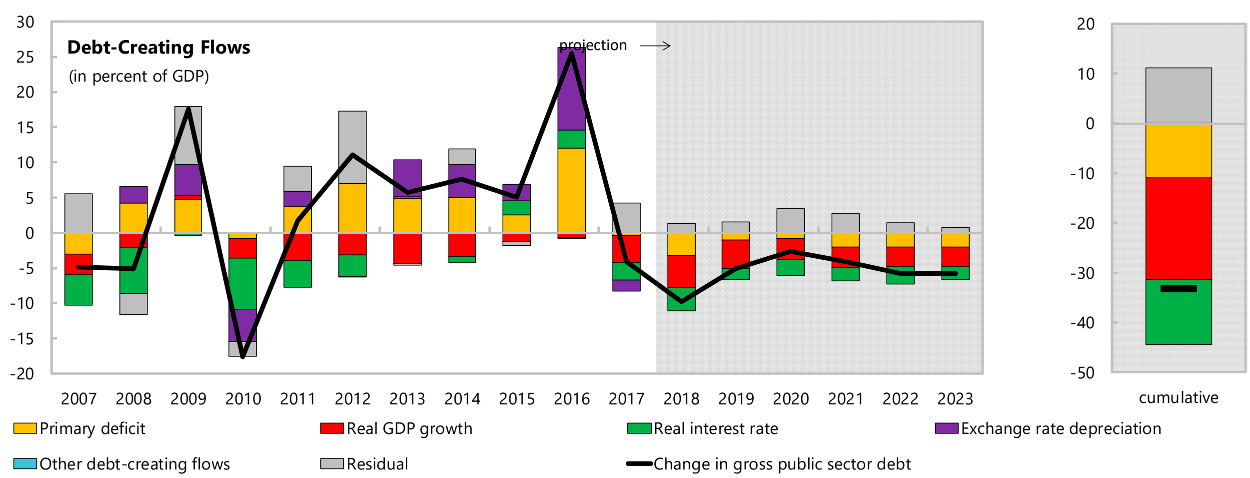
### Debt, Economic and Market Indicators [1]

| | Actual | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2007-2015 [2] | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
| Nominal gross public debt | 43.5 | 87.6 | 83.5 | 73.8 | 68.6 | 66.0 | 61.9 | 56.1 | 50.3 |
| Public gross financing needs | 4.8 | 17.0 | 5.4 | 10.7 | 8.4 | 2.8 | 3.7 | 7.0 | 6.5 |
| Real GDP growth (in percent) | 8.1 | 1.2 | 5.1 | 6.2 | 6.3 | 4.9 | 5.0 | 5.2 | 5.7 |
| Inflation (GDP deflator, in percent) | 10.9 | 2.2 | 8.0 | 8.1 | 6.5 | 6.5 | 6.4 | 6.7 | 6.3 |
| Nominal GDP growth (in percent) | 22.3 | 3.4 | 13.5 | 14.8 | 13.2 | 11.7 | 11.7 | 12.2 | 12.4 |
| Effective interest rate (in percent) [4] | 2.7 | 6.6 | 5.2 | 4.1 | 4.6 | 3.1 | 3.6 | 2.7 | 3.2 |

| As of April 01, 2018 | | |
|---|---|---|
| Sovereign Spreads | | |
| EMBIG (bp) 3/ | | 290 |
| 5Y CDS (bp) | | 258 |
| Ratings | Foreign | Local |
| Moody's | B3 | B3 |
| S&Ps | B- | B- |
| Fitch | B | B |

### Contribution to Changes in Public Debt

| | Actual | | | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2007-2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | cumulative | debt-stabilizing primary balance [9] |
| Change in gross public sector debt | 2.4 | 25.5 | -4.1 | -9.7 | -5.1 | -2.6 | -4.1 | -5.8 | -5.8 | -33.2 | |
| Identified debt-creating flows | -0.3 | 25.6 | -8.3 | -11.0 | -6.6 | -6.1 | -6.8 | -7.2 | -6.6 | -44.4 | |
| Primary deficit | 3.1 | 12.0 | -0.4 | -3.2 | -1.0 | -0.8 | -2.0 | -2.0 | -2.0 | -11.0 | -4.6 |
| Primary (noninterest) revenue and grants | 31.2 | 23.5 | 29.2 | 30.5 | 31.3 | 30.4 | 30.0 | 29.4 | 29.3 | 180.8 | |
| Primary (noninterest) expenditure | 34.4 | 35.5 | 28.8 | 27.3 | 30.4 | 29.6 | 28.0 | 27.4 | 27.3 | 169.8 | |
| Automatic debt dynamics [5] | -3.4 | 13.6 | -7.9 | -7.8 | -5.6 | -5.3 | -4.8 | -5.3 | -4.6 | -33.4 | |
| Interest rate/growth differential [6] | -5.3 | 1.9 | -6.4 | -7.8 | -5.6 | -5.3 | -4.8 | -5.3 | -4.6 | -33.4 | |
| Of which: real interest rate | -2.7 | 2.6 | -2.4 | -3.3 | -1.5 | -2.3 | -1.8 | -2.4 | -1.7 | -13.1 | |
| Of which: real GDP growth | -2.6 | -0.7 | -3.9 | -4.5 | -4.1 | -3.0 | -3.0 | -2.9 | -2.8 | -20.3 | |
| Exchange rate depreciation [7] | 1.8 | 11.7 | -1.5 | … | … | … | … | … | … | … | |
| Other identified debt-creating flows | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| 0 (negative) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Please specify | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Residual, including asset changes [8] | 2.6 | -0.1 | 4.2 | 1.3 | 1.5 | 3.5 | 2.7 | 1.4 | 0.8 | 11.1 | |




Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = 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 numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

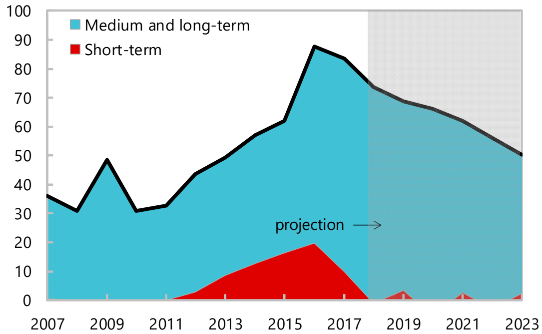
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

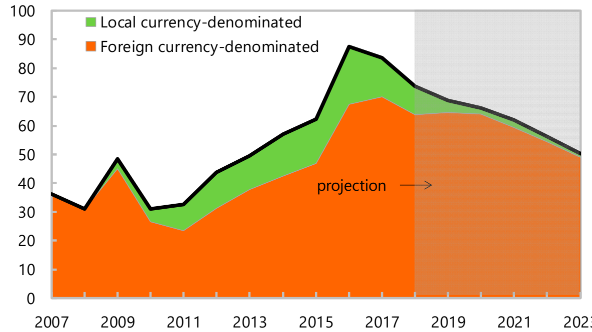
## Figure 2. Mongolia Public DSA - Composition of Public Debt and Alternative Scenarios

### Composition of Public Debt

**By Maturity**
(in percent of GDP)



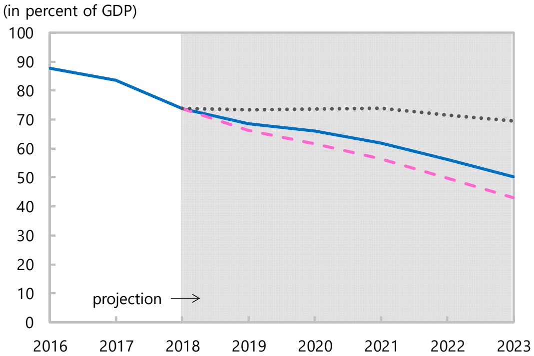

**By Currency**
(in percent of GDP)



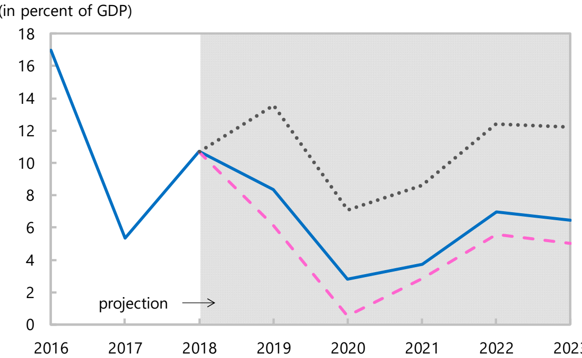

### Alternative Scenarios

Baseline Historical Constant Primary Balance

**Gross Nominal Public Debt**
(in percent of GDP)




**Public Gross Financing Needs**
(in percent of GDP)



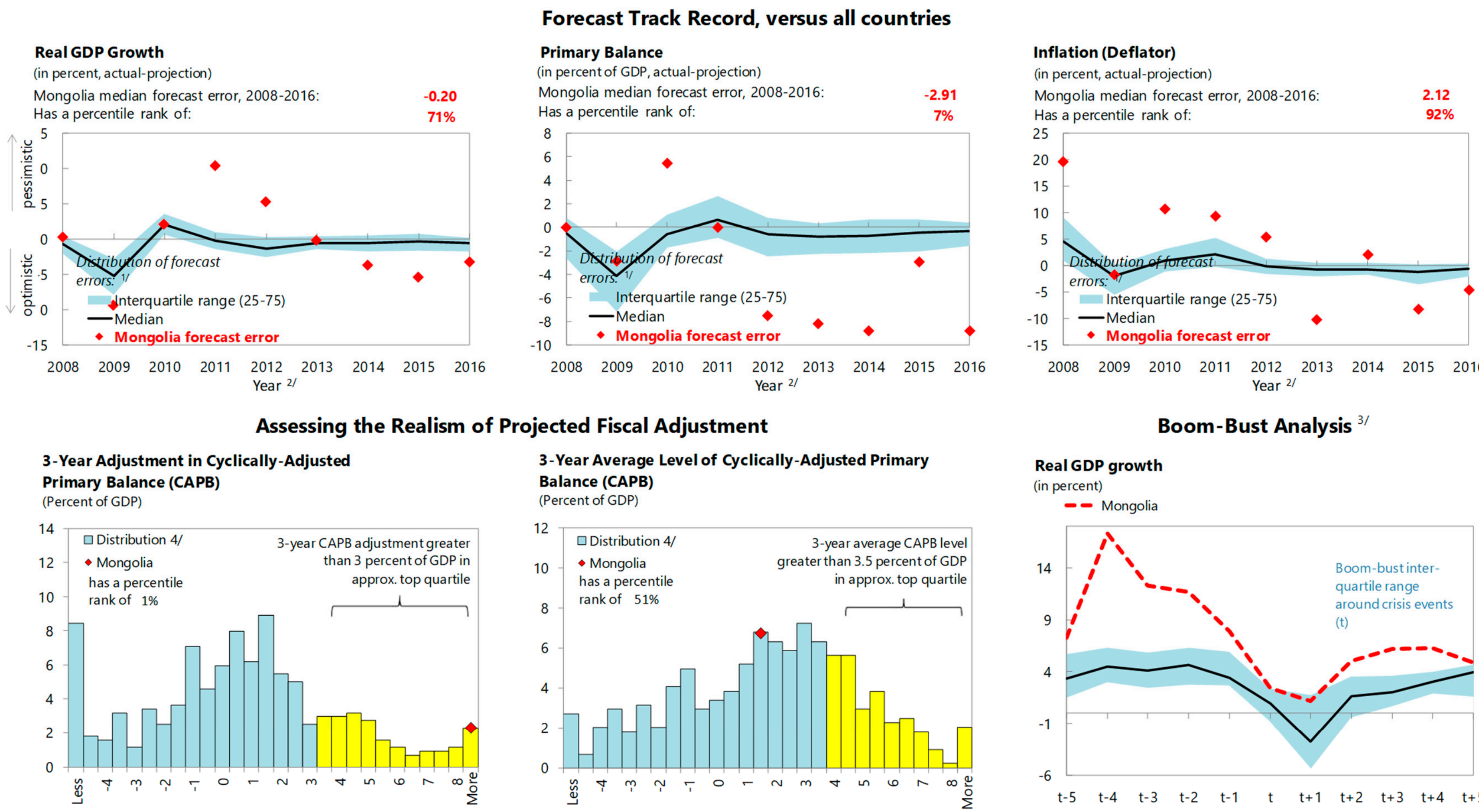

### Underlying Assumptions
(in percent)

| **Baseline Scenario** | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Real GDP growth | 6.2 | 6.3 | 4.9 | 5.0 | 5.2 | 5.7 |
| Inflation | 8.1 | 6.5 | 6.5 | 6.4 | 6.7 | 6.3 |
| Primary Balance | 3.2 | 1.0 | 0.8 | 2.0 | 2.0 | 2.0 |
| Effective interest rate | 4.1 | 4.6 | 3.1 | 3.6 | 2.7 | 3.2 |
| **Constant Primary Balance Scenario** | | | | | | |
| Real GDP growth | 6.2 | 6.3 | 4.9 | 5.0 | 5.2 | 5.7 |
| Inflation | 8.1 | 6.5 | 6.5 | 6.4 | 6.7 | 6.3 |
| Primary Balance | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 |
| Effective interest rate | 4.1 | 4.6 | 3.3 | 3.5 | 2.8 | 3.2 |

| **Historical Scenario** | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Real GDP growth | 6.2 | 7.1 | 7.1 | 7.1 | 7.1 | 7.1 |
| Inflation | 8.1 | 6.5 | 6.5 | 6.4 | 6.7 | 6.3 |
| Primary Balance | 3.2 | -4.3 | -4.3 | -4.3 | -4.3 | -4.3 |
| Effective interest rate | 4.1 | 4.6 | 2.3 | 3.0 | 1.6 | 2.3 |

Source: IMF staff.

## Figure 3. Mongolia Public DSA - Realism of Baseline Assumptions




Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

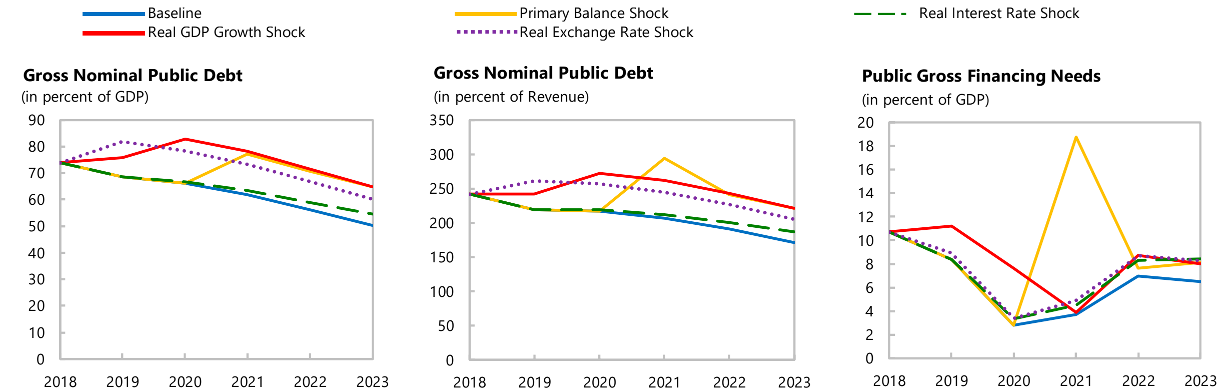
2/ Projections made in the spring WEO vintage of the preceding year.

3/ For Mongolia, t corresponds to 2015; for the distribution, t corresponds to the first year of the crisis.

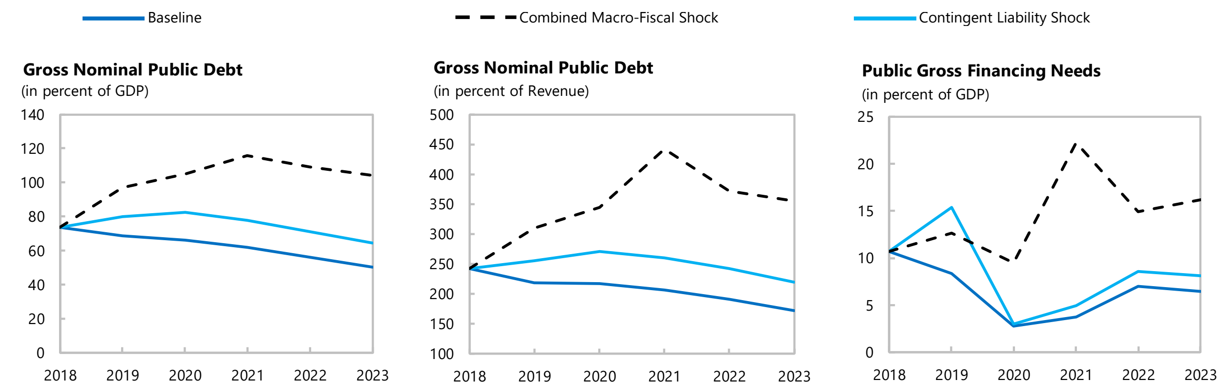
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

## Figure 4. Mongolia Public DSA - Stress Tests

### Macro-Fiscal Stress Tests




### Additional Stress Tests




### Underlying Assumptions
(in percent)

| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| **Primary Balance Shock** | | | | | | |
| Real GDP growth | 6.2 | 6.3 | 4.9 | 5.0 | 5.2 | 5.7 |
| Inflation | 8.1 | 6.5 | 6.5 | 6.4 | 6.7 | 6.3 |
| Primary balance | 3.2 | 1.0 | 0.8 | -13.0 | 2.0 | 2.0 |
| Effective interest rate | 4.1 | 4.6 | 3.1 | 3.6 | 3.4 | 4.6 |
| **Real Interest Rate Shock** | | | | | | |
| Real GDP growth | 6.2 | 6.3 | 4.9 | 5.0 | 5.2 | 5.7 |
| Inflation | 8.1 | 6.5 | 6.5 | 6.4 | 6.7 | 6.3 |
| Primary balance | 3.2 | 1.0 | 0.8 | 2.0 | 2.0 | 2.0 |
| Effective interest rate | 4.1 | 4.6 | 4.0 | 5.1 | 5.0 | 6.7 |
| **Combined Shock** | | | | | | |
| Real GDP growth | 6.2 | 0.5 | -0.8 | 5.0 | 5.2 | 5.7 |
| Inflation | 8.1 | 5.1 | 5.1 | 6.4 | 6.7 | 6.3 |
| Primary balance | 3.2 | -1.2 | -3.6 | -13.0 | 2.0 | 2.0 |
| Effective interest rate | 4.1 | 5.5 | 3.9 | 5.4 | 5.6 | 7.6 |

| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| **Real GDP Growth Shock** | | | | | | |
| Real GDP growth | 6.2 | 0.5 | -0.8 | 5.0 | 5.2 | 5.7 |
| Inflation | 8.1 | 5.1 | 5.1 | 6.4 | 6.7 | 6.3 |
| Primary balance | 3.2 | -1.2 | -3.6 | 2.0 | 2.0 | 2.0 |
| Effective interest rate | 4.1 | 4.6 | 3.0 | 3.9 | 2.9 | 3.4 |
| **Real Exchange Rate Shock** | | | | | | |
| Real GDP growth | 6.2 | 6.3 | 4.9 | 5.0 | 5.2 | 5.7 |
| Inflation | 8.1 | 14.8 | 6.5 | 6.4 | 6.7 | 6.3 |
| Primary balance | 3.2 | 1.0 | 0.8 | 2.0 | 2.0 | 2.0 |
| Effective interest rate | 4.1 | 5.5 | 3.1 | 3.5 | 2.7 | 3.2 |
| **Contingent Liability Shock** | | | | | | |
| Real GDP growth | 6.2 | 0.5 | -0.8 | 5.0 | 5.2 | 5.7 |
| Inflation | 8.1 | 5.1 | 5.1 | 6.4 | 6.7 | 6.3 |
| Primary balance | 3.2 | -5.1 | 0.8 | 2.0 | 2.0 | 2.0 |
| Effective interest rate | 4.1 | 4.9 | 2.9 | 3.7 | 2.9 | 3.4 |

Source: IMF staff.

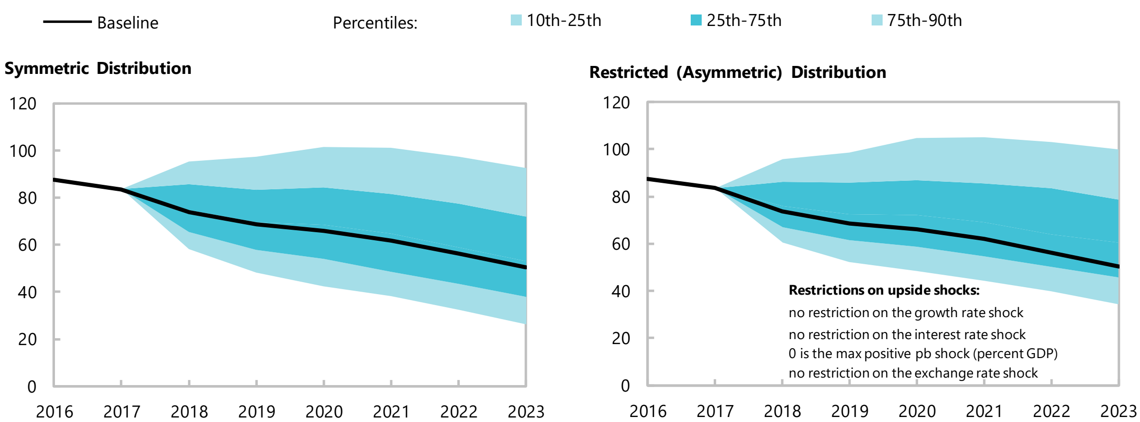
## Figure 5. Mongolia Public DSA Risk Assessment

### 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 |

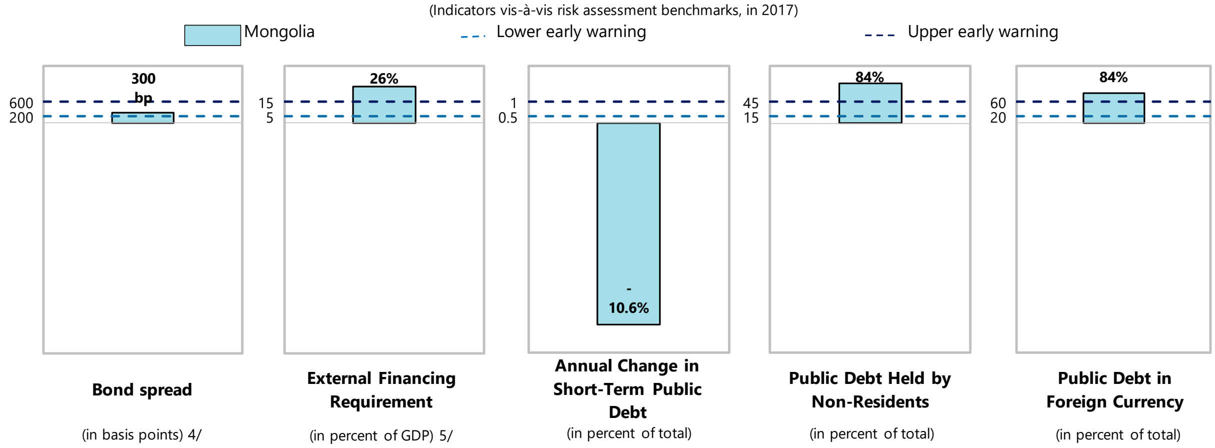
### Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)




### Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)




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.

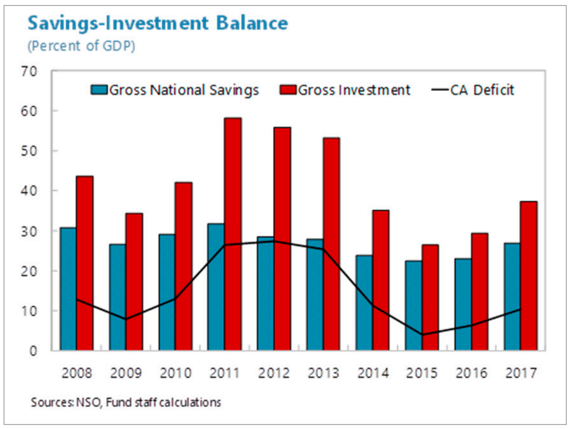
4/ Long-term bond spread over German bonds, an average over the last 3 months, 01-Jan-18 through 01-Apr-18.

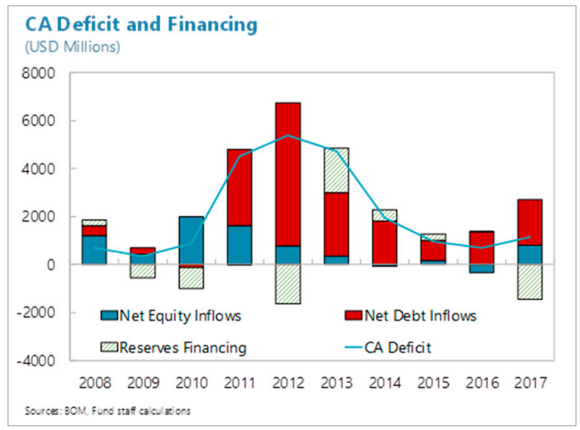
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

# Annex III. External Debt Sustainability Analysis

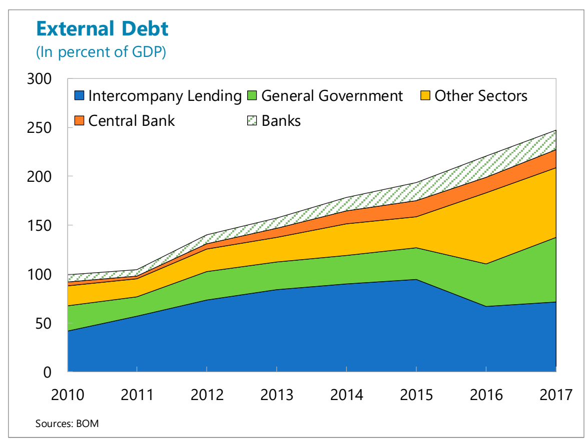
*Mongolia has extremely high external debt. This partly reflects the significant capital needs of the mining sector. However, it also reflects relatively loose fiscal and monetary policy over the last decade. While short-term external debt appears low, large foreign obligations in coming years will weigh on the external position.*

1. **In the last 10 years, Mongolia's external debt has risen from 40 to over 240 percent of GDP.** This primarily reflects high investment rates (rather than low savings rate) driving large current account deficits (average of 14 percent of GDP) that were mostly financed by debt rather than equity. The high investment ratios are a function of large mining related capital needs, public capital spending, and real estate related building booms.




2. **In the last two years, the increase in the external debt has reflected a few specific factors**. In 2016, there was a dramatic widening in the fiscal stance due to large public investment outlays and the togrog depreciated by 25 percent. In 2017, investment in the second phase of the Oyu Tolgoi mining project resumed and a significant portion of this has been financed by inter-company loans. In addition, as part of the program signed in early 2017, the authorities have borrowed about 10 percent of GDP from the multilateral and bilateral official sectors to replace high cost domestic financing and improved debt sustainability.




3. **One can break down the main borrowers in three categories**. First, intercompany loans are 70 percent of GDP and are almost entirely related to the mining sector (80% of total). Second, other corporate borrowing is also roughly 70 percent of GDP which is a mix of mining and construction/real estate. And third, there is the government at 63 percent of GDP, which is roughly evenly broken down into concessional loans from the official sector and international bonds.

**4. The public and private financial sectors also have foreign liabilities but to a significantly lesser degree**. Between 2013 and 2016, the Central Bank drew on its swap line with the PBOC to support the exchange rate during a period of weak terms of trade and loose macro policies. Meanwhile, private banks have borrowed abroad to support their lending (20 percent of GDP and 20 percent of bank liabilities). One quarter of bank liabilities are to international organizations.

**5. Short-term external debt appears low and spikes in external debt amortizations are driven by bond maturities**. Short-term external debt on an original maturity basis is 12 percent of GDP and only 40 percent of gross reserves. Spikes in short term debt by remaining maturity are mostly driven by amortization of medium and long term external debt. Since such maturities are low in both 2018 and 2019, external amortization is expected to remain manageable. Moreover, one would not expect any risks from short-term inter-company loans.

**Mongolia: External Debt**
(in percentage of GDP)

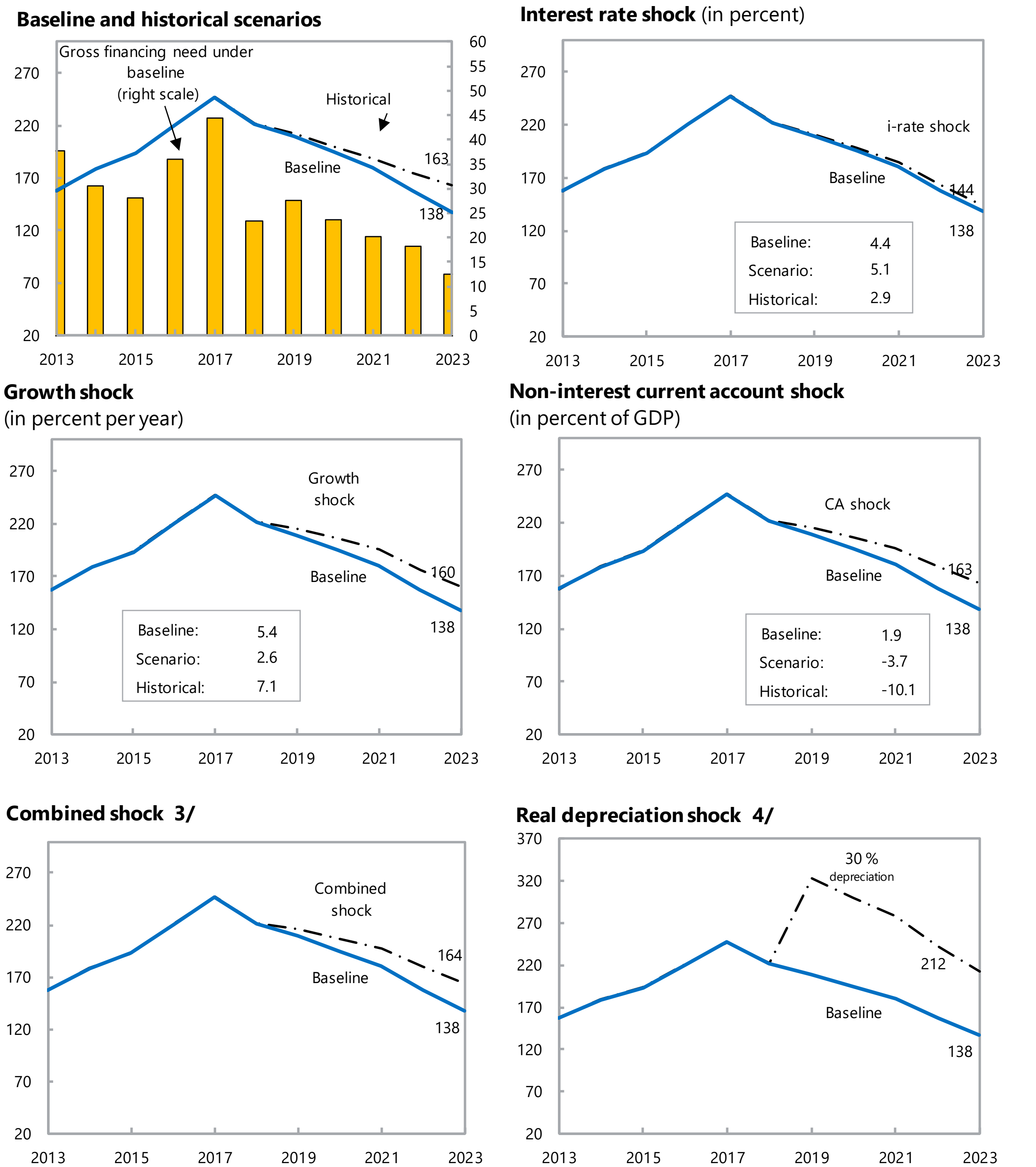
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|
| **Total** | **105** | **140** | **158** | **179** | **193** | **221** | **247** |
| General Government | 20 | 29 | 28 | 29 | 32 | 44 | 66 |
| Bank of Mongolia | 3 | 5 | 9 | 13 | 17 | 16 | 18 |
| Banks | 7 | 10 | 11 | 14 | 18 | 22 | 20 |
| Corporate /1 | 18 | 23 | 25 | 33 | 32 | 73 | 71 |
| Intercompany Lending | 57 | 74 | 84 | 90 | 95 | 67 | 72 |
| Memo: | | | | | | | |
| Short Term Loans (Original maturity) /2 | 8 | 7 | 6 | 7 | 6 | 8 | 12 |
| Short Term Loans (Remaining maturity) /2 | 17 | 13 | 15 | 20 | 21 | 55 | 22 |

Source: Bank of Mongolia.
1/ In 2016, USD4.1bn (around 37 percent of GDP) of intercompany FDI by Oyu Tolgoi was converted into a long term external loan.
2/ Excludes drawings from the PBoC swap line.

**6. In conclusion, external leverage is appropriate to some degree for Mongolia but the extent of foreign liabilities leaves Mongolia at risk going forward.** Significant external borrowing to increase the export potential of the mining sector is appropriate. The fact that much of this is done via inter-company loans further reduces the risks around such borrowing. In addition, the recent increase in government borrowing on concessional terms to replace high cost and short-maturity domestic borrowing lowers overall risks. However, at 240 percent of GDP, external borrowing has likely also been used to support excessive domestic demand and runs the risk of a correction in future years.

## 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, 2013-2023

(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2013 | 2014 | 2015 | 2016 | 2017 | 10-Year Historical Average | 10-Year Standard Deviation | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | Debt-stabilizing non-interest current account 6/ |
| 1 **Baseline: External debt** | 157.6 | 178.7 | 193.3 | 220.7 | 246.9 | | | **221.7** | **209.4** | **194.9** | **180.3** | **157.7** | **137.8** | **-13.1** |
| 2 Change in external debt | 17.4 | 21.1 | 14.6 | 27.3 | 26.2 | | | -25.2 | -12.4 | -14.5 | -14.7 | -22.5 | -19.9 | |
| 3 Identified external debt-creating flows (4+8+9) | 5.3 | 13.6 | 10.3 | 53.9 | 4.8 | | | -9.2 | -10.2 | -7.6 | -9.5 | -13.5 | -13.9 | |
| 4 Current account deficit, excluding interest payments | 21.6 | 5.0 | -3.7 | -3.0 | -1.1 | | | 0.8 | 1 | 1 | -1 | -4 | -7 | |
| 5 Deficit in balance of goods and services | -100.1 | -108.4 | -87.6 | -100.5 | -119.7 | | | -0.8 | 2.4 | 2.2 | 0.4 | -2.3 | -5.3 | |
| 6 Exports | 39.6 | 51.9 | 45.2 | 50.2 | 61.1 | | | 62.7 | 57.1 | 52.3 | 50.9 | 49.4 | 50.0 | |
| 7 Imports | -60.5 | -56.5 | -42.4 | -50.2 | -58.6 | | | 61.9 | 59.5 | 54.5 | 51.3 | 47.2 | 44.7 | |
| 8 Net non-debt creating capital inflows (negative) | -16.7 | -2.3 | -0.9 | 37.4 | -6.1 | | | -4.0 | -8.2 | -7.7 | -7.1 | -8.3 | -5.2 | |
| 9 Automatic debt dynamics 1/ | 0.4 | 10.9 | 15.0 | 19.5 | 12.0 | | | -5.9 | -3.3 | -0.9 | -1.2 | -1.4 | -2.0 | |
| 10 Contribution from nominal interest rate | 3.8 | 6.3 | 7.7 | 9.3 | 11.5 | | | 7.5 | 9.3 | 8.5 | 7.7 | 7.1 | 6.1 | |
| 11 Contribution from real GDP growth | -15.9 | -12.8 | -4.4 | -2.4 | -11.2 | | | -13.4 | -12.6 | -9.4 | -9.0 | -8.5 | -8.1 | |
| 12 Contribution from price and exchange rate changes 2/ | 12.5 | 17.4 | 11.7 | 12.6 | 11.7 | | | ... | ... | ... | ... | ... | ... | |
| 13 Residual, incl. change in gross foreign assets (2-3) 3/ | 12.1 | 7.5 | 4.3 | -26.6 | 21.4 | | | -16.0 | -2.2 | -6.8 | -5.2 | -9.0 | -6.0 | |
| External debt-to-exports ratio (in percent) | 398.3 | 344.1 | 428.1 | 439.3 | 404.3 | | | 353.7 | 366.8 | 372.7 | 354.0 | 319.0 | 275.4 | |
| **Gross external financing need (in billions of US dollars) 4/** | 4.7 | 3.7 | 3.3 | 4.0 | 5.0 | | | 3.0 | 3.9 | 3.6 | 3.4 | 3.4 | 2.6 | |
| in percent of GDP | 37.7 | 30.4 | 28.1 | 36.0 | 44.5 | | | 23.3 | 27.7 | 23.6 | 20.3 | 18.2 | 12.6 | |
| **Scenario with key variables at their historical averages 5/** | | | | | | | | **221.7** | **212.9** | **199.7** | **188.6** | **174.6** | **163.1** | **-21.9** |
| **Key Macroeconomic Assumptions Underlying Baseline** | | | | | | | | | | | | | | |
| Real GDP growth (in percent) | 11.6 | 7.9 | 2.4 | 1.2 | 5.1 | 7.1 | 5.8 | 6.2 | 6.3 | 4.9 | 5.0 | 5.2 | 5.7 | |
| GDP deflator in US dollars (change in percent) | -8.2 | -9.9 | -6.1 | -6.1 | -5.0 | 2.6 | 15.9 | 7.6 | 4.1 | 4.3 | 4.4 | 4.9 | 4.7 | |
| Nominal external interest rate (in percent) | 2.8 | 3.9 | 4.1 | 4.5 | 5.2 | 2.9 | 1.5 | 3.5 | 4.6 | 4.4 | 4.4 | 4.4 | 4.3 | |
| Growth of exports (US dollar terms, in percent) | -6.9 | 27.5 | -16.4 | 5.6 | 21.3 | 13.3 | 27.3 | 17.3 | 0.8 | 0.3 | 6.8 | 7.1 | 12.0 | |
| Growth of imports (US dollar terms, in percent) | -4.8 | -9.3 | -27.8 | 12.4 | 16.4 | 16.1 | 39.4 | 20.7 | 6.5 | 0.3 | 3.1 | 1.4 | 5.0 | |
| Current account balance, excluding interest payments | -21.6 | -5.0 | 3.7 | 3.0 | 1.1 | -10.1 | 11.2 | -0.8 | -1.3 | -1.0 | 1.2 | 3.9 | 6.7 | |
| Net non-debt creating capital inflows | 16.7 | 2.3 | 0.9 | -37.4 | 6.1 | 11.6 | 22.2 | 4.0 | 8.2 | 7.7 | 7.1 | 8.3 | 5.2 | |

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.

# Appendix I. Letter of Intent

October 10, 2018
Ulaanbaatar

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

Dear Ms. Lagarde,

This letter serves as an update to our Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) of April 13, 2017, our supplementary LOI of May 17, 2017, the LOI from the First and Second review of November 30, 2017, the LOI from the third review of March 12, 2018, and the LOI from the fourth review of June 8, 2018. The policy commitments laid out in those documents remain valid, except as amended here.

**Program Performance**

1. We have met all end-September 2018 quantitative performance criteria (QPCs) under the program. Revenues remained strong in the third quarter, helping us reach a primary surplus of 5.3 percent of GDP year-to-date, exceeding the target. Amid an increase in balance of payments pressure, we sold some reserves to avoid a disorderly correction in the exchange rate. However, we were still able to safely meet the NIR target due to previous over-performance. The net domestic assets of the BOM were also comfortably within the reserve money ceiling at end-Q2 2018. The indicative target on social spending in Q3 has been missed as the spending is concentrated in the final quarter but we are confident we will meet the social spending target for the full year.

2. With respect to structural benchmarks under the program, we continue to make progress:

- In the fiscal sector, we are in the process of finalizing an audit of completed concessions contracts and developed a repayment plan based on this audit. In the 2019 budget submission we plan to allot roughly 0.4 percent of GDP for repayment of concessions. We will also update the payments for future years when we submit the next medium-term budget framework in first quarter of 2019. We expect to have designed the 2019 operational plan that sets out the tax compliance improvement strategies for SMEs by end-October.

- In the financial sector, banks have now booked provisioning gaps identified by the AQR. In addition, the Financial Stability Council has approved and published an NPL resolution strategy which sets out the legal and regulatory steps we envision taking over the next year.

However, banks have not yet classified non-performing loans in line with AQR findings and local regulations. In addition, we have not yet updated our asset classification regulation but intend to do so by March of 2019.

3. In the area of tax administration, a joint MoF/GDT taskforce has been established by ministerial order to develop an action plan and timetable for implementing the new tax legislation that is expected to enter into effect on January 1, 2019. In addition, the GDT has completed a comprehensive review of the first half-year implementation of the 2018 compliance improvement strategies.

**Fiscal Policy**

4. For 2018, our fiscal program continues to over-perform. Revenues are exceeding forecasts due to strong mining sector exports and investment. Cash expenditures are broadly in line with the budget with some under-execution of capital spending due to heavy rains. As noted in the previous review, commitments on concessional donor-financed capital expenditures have exceeded the budget envelope. However, on further analysis of the actual execution of the projects, the magnitude of over-commitment is less than previously thought (1.3 percent of GDP, instead of 2.2 percent). We can meet the additional obligations without a supplementary budget or incurring arrears by expenditure restraint on other capital spending. Recognizing the loss of purchasing power in recent years, we have increased the average salary of civil servants by about 9 percent starting from September 1. The fiscal cost of 56 billion *togrog* will be covered by a bonus in the budget.

5. In the 2019 budget submission, we intend to meet our key social obligations while maintaining a fiscal balance that supports further debt reduction. The budget submission is consistent with a primary surplus of 1 percent of GDP. On revenues, we will pass the General tax law and the Corporate income tax law in the fall session of the Parliament, which will contribute 0.3 percent of GDP in tax administration gains. In addition, we will continue efforts to improve the sustainability of the pension system by increasing social security contribution rates by 1 percentage point (split evenly between the employer and employee portion). On the expenditure side, there are two key changes.

- First, recognizing the loss of purchasing power in recent years, we intend to increase the annual wage bill (including bonuses) by 16 percent in 2019. This will include a 14 percent increase in average wages (higher for education and health and correspondingly lower for other sectors) and a 2 percent increase in the number of public sector workers (focused on priority public workers such as doctors, nurses, and teachers). This increase is equivalent to an 8 percent increase in average wages over the wage level at end-2018. We envision inflation-indexed increases in subsequent years, financed by streamlining other public expenditures, but recognize the need to maintain caution in increasing any permanent public expenditure while public debt remains high.

- Second, we have adjusted the capital spending budget and improved our public financial management practices to ensure that the budget ceiling for foreign-financed capital spending reflects our best projection of required project disbursements in 2019. While keeping within an overall capital expenditure budget of 9.1 percent of GDP, we have confirmed that the share allocated to donor-financed projects is sufficient to take advantage of the concessional funds available to us. To help avoid a repeat of the over-commitment experienced this year, starting with the 2019 budget, a new procedure will be established, in which immediately following the approval of the Budget, the MoF will issue a circular which informs donors and all line ministries of the respective allocations approved for capital spending.

6. We propose to adjust the TMU regarding two concepts. First, we propose to exclude DBM from the primary balance QPC as it introduced noise to measurement of the fiscal stance. We will continue monitoring DBM by setting a separate QPC explicitly on DBM net lending. Second, we propose to revise the definition of social spending to include only social protection spending.

7. We will also continue our progress with fiscal structural reforms.

- We have discussed a three-stage approach to improving retail fuel pricing in Mongolia. The first step would be ensuring there are no fuel shortages by promptly allowing retail prices to adjust to cover existing operating costs and margins for suppliers and adjusting these prices each month according to an automatic fuel pricing mechanism. Second, after allowing an initial period for consumers to adjust to more flexible retail prices, we would begin to re-introduce excise taxes gradually using the automatic fuel pricing mechanism, again based on a fixed schedule, to support fiscal revenue, discourage over-consumption of fuel and put us in a better position to smooth retail prices in the future. The final stage would be setting an automatic fuel pricing mechanism that could be used in the steady state. This could include reverting to some smoothing of retail prices with adjustments in excise tax rates, based on an explicit automatic fuel price smoothing mechanism that would ensure it is done in a sustainable and transparent way. We will work on these options and submit to Fund staff by end-December a draft strategy for improved automatic fuel pricing. By end-June 2019, the government will enact legislation enforcing the automatic adjustment of fuel prices every month to fully cover operational costs and margins according to an automatic fuel pricing formula with no government subsidies effective July 1, 2019 **(end-June structural benchmark**). There will be no increase in implicit government subsidies of fuel whether through reductions in taxes or increases in expenditures.
- We will ensure that social protection assistance spending reaches the indicative program target for 2018 (2.1 percent of GDP) and will continue to look for ways to improve its effectiveness. For the 2019 budget submission, total social protection assistance is unchanged in percent of GDP. Within this envelope, we have increased the coverage of the targeted social protection programs to 0.2 percent of GDP. To improve the efficiency of social protection spending, we plan to do an audit of select programs to verify the assistance is reaching the intended recipients.

- Considering potential fiscal risks, MOF is preparing a regulation containing guidance on appraisal and selection of public investment projects, including specific methodology and evaluation criteria. We plan to have the final draft of the regulation ready by end-October 2018 and approve and publish this regulation by end-December 2018 (**structural benchmark**).

- The Board of the Development Bank of Mongolia has formally agreed to have a comprehensive review of its 2012-2017 operations conducted by an international auditing firm and published on its website by mid-December. As agreed at the time of program approval, there will continue to be fiscal targets monitoring DBM net lending until the audit confirms that there is not quasi-fiscal spending. However, to facilitate monitoring, going forward, there will be an explicit quantitative performance criterion on net lending by DBM rather than adding DBM to the general government primary balance target.

- To continue to strengthen tax collection, the GDT will complete the design of its 2019 Operational Plan (which will include a new set of tax compliance improvement strategies) by end-October (**structural benchmark)**. We will also ensure that sufficient budgetary resources are allocated during the balance of 2018 and 2019 to support the implementation of the above activities.

- As agreed in the MoU between MOF and BOM and building on the advice from ongoing World Bank technical assistance, we intend to reduce quasi-fiscal risks and improve the efficiency in the subsidized mortgage program including by targeting the program to current *Ger* district inhabitants. Further changes will be done in consultation with Fund staff and the World Bank.

- To help the Financial Regulatory Commission (FRC) and relevant law enforcement agencies to address concerns raised by the APG on the AML/CFT framework, we have increased their budget for such activities by 941.6 million MNT in the 2019 draft budget.

**Monetary and Exchange Rate Policy**

8. While inflation is broadly in line with our current target, rapid credit growth poses risks to the balance of payments (which is still fragile), and financial stability (especially from rapidly escalating household debts). As we remain fully committed to meeting our credit and NIR targets under the program and safeguarding financial stability, we are taking the following ***prior actions*** for completion of the current review.

- Regarding macro-prudential measures, we will impose a limit of 30 months on all non-mortgage consumer loans effective January 1, 2019; and introduce sanctions for violations of the limits which at the very minimum requires banks to provision any loan that violates the DSTI limit.

- On monetary policy, we will adopt a tightening bias in our official communication in the September monetary policy committee meeting given the risks from rapid credit growth, with a view to tightening our monetary policy stance in the coming months if credit growth remains strong or if imports continue to rise.

9. We will also ensure that our intervention policy is consistent with the need to significantly increase our reserves while maintaining a flexible exchange rate. At present, we intervene on an ad hoc basis to manage liquidity needs, purchasing dollars when banks have an excess and selling dollars when there is a shortage. To support our reserve accumulation goal going forward, we will discuss with IMF technical experts a possible move toward a policy of regular and announced foreign exchange purchases without regard to the level of the exchange rate or domestic liquidity conditions. Provided the fiscal and monetary policy mix is sufficiently tight, this policy should not result in sustained pressure on the exchange rate. Nonetheless, starting immediately we will ensure that sales of foreign exchange are limited to disorderly market conditions, which have not been witnessed since the start of the program.

**Financial Sector Policy**

*Follow-Up to the AQR*

10. We are taking several steps as part of the rehabilitation of the banking system.

- Banks have begun to incorporate the results of the AQR. As a **prior action** for this review, we took two steps to ensure the AQR is on track. First, upon our request, banks booked all provisioning needs identified by the AQR, adjusted only by loans that have been repaid in line with the template agreed with BoM. And second, also ahead of the board date, BOM will require banks to submit, by end-September 2018, a detailed plan regarding how they will issue new capital in the amounts detailed in the May 8 letter from BOM. A plan will be considered “detailed” if it includes a timeline, method of issuance, type and terms of capital instruments, targeted investors, information package to investors, and hired advisors. BoM will check the implementation of the plans monthly in consultation with IMF staff. BoM will also ensure that NPLs are reported in accordance with AQR results and BoM regulation from end-September. BOM will promptly take action with those banks that by end-December 2018 do not raise capital by the amounts stated in the early May communication to Banks (**structural benchmark**).

- In order to ensure that banks remain well capitalized, BoM will order banks from 1 January 2019 not to pay dividends, coupon or principal of Tier 2 instruments, and bonuses to management until banks have reached a Tier 1 capital ratio of 11%. BoM will ensure that from now on all newly issued Tier 2 instruments have early intervention triggers, so that they are loss-absorbing by full or partial write-down and/or conversion to equity upon request of the competent authority.

- As a general matter, it is important that the Financial Stability Council (BOM, MOF, FRC) is constantly ready to protect financial stability under all possible scenarios. To this end, we will continue to strengthen contingency planning, crisis preparedness, and readiness for bank resolutions. Moreover, BOM will continue to provide liquidity only to banks that are solvent and viable on a forward-looking basis.

- By end-June 2019, we will adopt new prudential regulations with select elements from Basel II/III (such as the definition of capital, more sensitive credit risk weights, capital buffers, and the Pillar 2) (**structural benchmark**). In addition, by end-March 2019, we will amend the BoM Regulation on asset classification and provisioning (structural benchmark originally due end-September 2018). The BoM will also issue a new regulation on credit origination and risk management by end-June 2019.

*Addressing Non-Performing Loans*

11. Going forward, it is important that we strengthen banks' ability to resolve non-performing loans (NPLs), both to improve financial stability and to support a reduction in large interest spreads which weigh on economic growth. To this end, we will move forward on implementing the comprehensive NPL strategy which was adopted and published by the Financial Stability Council (FSC) in May.

- By end-September 2018, the MoJ, in cooperation with BoM, will share with IMF staff draft amendments to a reformed corporate bankruptcy law (including improved access to procedures, protection of secured creditors, and an efficient reorganization process). The reformed law shall be adopted by end-March 2019 (**structural benchmark**).

- By end-October 2018, the MoJ, in cooperation with BoM and in consultation with IMF staff, will present draft amendments to legislations - including the civil code - to strengthen the enforcement of creditor rights (e.g. simplifying appeals and notifications, improving auctions, preventing borrowers from unilaterally selling collateral, and allowing effective out-of-court enforcement of collateral). These legislative amendments shall be adopted by end-February 2019 (**structural benchmark**).

- By end-December 2018, in consultation with IMF staff, we will i) prepare a draft of amendments to laws related to the real estate registry that, among other things, ensures full disclosure of ownership of real estates to the public, ii) create a price and transaction registry for real estate, iii) adopt a law on private bailiffs and iv) adopt a law to establish commercial courts. All four measures will be implemented by end-April (**structural benchmark**).

12. By end-December 2018, BOM will adopt a new regulation on collateral valuation and a new regulation on resolution of non-performing loans. Also, we will explore the possibility of setting up a registry for movable collateral. In addition, a new law on appraisers will be adopted by end-March 2019. We have decided not to proceed with a public Asset Management Company (AMC). In the event we do proceed with an AMC structure, we will take several steps to protect the public-sector balance sheet. In particular, the implementing legislation will not allow a Mongolian public stake

greater than 5 percent nor will the government, BOM, or any other public-sector entity lend to or issue any guarantees to the AMC.

*AML/CFT Framework*

13. We are committed to continuing to rectify concerns raised by the Asia Pacific Group (APG) on Money Laundering. In recent months, we have passed amendments to the Anti-Money Laundering Law and the Law on infringements to which address some of the concerns. Nonetheless, more work remains. At the recent meeting of the Financial Action Task Force, we were given until June 2019 to make substantial progress in addressing the most significant concerns. By end-April 2019, we intend to take several steps including issuing and implementing the needed regulations related to the recent amendments, adopting a new legal framework to address proliferation financing (**structural benchmark**), and will continue to deepen our risk-based approach to AML/CFT supervision. In addition, in the 2019 draft budget, we have increased resources available to the Financial Regulatory Commission (FRC) and law enforcement agencies in order to improve the enforcement of preventative measures.

**Conclusions**

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

15. Against the background of the strong performance under the program to date and our strong commitment going forward, we request completion of the fifth review of the arrangement under the Extended Fund Facility and modification of performance criteria, following which we intend to draw one tranche amounting to SDR 26.2088 million. In keeping with its policy of transparency, the Government has authorized the publication of this letter and its attachments as well as the associated staff report.

| | |
|---|---|
| /s/ | /s/ |
| Ch. Khurelbaatar<br>Minister of Finance | N. Bayartsaikhan<br>Governor, Bank of Mongolia |

## Table 1. Mongolia: Quantitative Performance Criteria and Indicative Targets

| | Mar-18 | | Jun-18 | | Sep-18 | | Dec-18 | | Mar-19 | | Jun-19 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Target | Actual | Target | Actual | Target | Actual | Target | Revised Target | Target | Revised Target | Indicative Target |
| **Performance Criteria 1/ 2/ 3/ 4/** | | | | | | | | | | | |
| Change in net international reserves (NIR) of the Bank of Mongolia (BOM) (floor, cumulative, change in eop stock, in million US$ at program exchange rate) | 1,700 | 2,087 | 1,900 | 2,147 | 2,000 | 2,137 | 2,200 | 2,200 | 2,500 | 2,700 | 2,900 |
| Net domestic assets (NDA) of the BOM (ceiling, eop stock, in billion togrog at program exchange rate) | 2,400 | 1,351 | 2,700 | 1,443 | 2,300 | 1,663 | 1,950 | 1,950 | 1,800 | 1,800 | 1,700 |
| Primary balance of the general government (floor, cumulative since the beginning of the fiscal year, in billion togrog) | -377 | 637 | 240 | 948 | -20 | | | | | | |
| Primary balance of the general government (floor, excluding DBM, cumulative since the beginning of the fiscal year, in billion togrog) | | | | | | | | 1,011 | | 62 | 200 |
| Net nonconcessional external debt maturing in one year or more, contracted and/or guaranteed by the government or the BOM (ceiling, cumulative flow from November 15, 2017, in million US$). /5 | NA | NA | 20 | 20 | NA | NA | 20 | 20 | NA | NA | 20 |
| Stock of guarantees on external debt extended by the government or BOM (ceiling, eop stock, in million US$) | 750 | 648 | 750 | 634 | 750 | 573 | 750 | 750 | 750 | 750 | 750 |
| DBM net lending (ceiling, in billion togrog) | | | | | | | | 254 | | 20 | 80 |
| **Indicative Targets (IT)** | | | | | | | | | | | |
| Reserve money (ceiling, in billion togrog) | 4,000 | 2,941 | 4,400 | 3,420 | 4,600 | 3,706 | 4,750 | 4,750 | 4,900 | 4,900 | 5,000 |
| Social spending (floor, cumulative since the beginning of the fiscal year, in billion togrog) | 1,387 | 1,201 | 2,841 | 2,594 | 4,287 | 3,843 | | | | | |
| Social protection spending (floor, cumulative since the beginning of the fiscal year, in billion togrog) | | | | | | | | 622 | | 174 | 336 |
| **Continuous Performance Criteria** | | | | | | | | | | | |
| New nonconcessional external debt maturing in less than one year, contracted and/or guaranteed by the government or the BOM (ceiling, eop stock, in million US$). | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Accumulation of new external payment arrears (ceiling, eop, in million US$). | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Memorandum items** | | | | | | | | | | | |
| Budget support from bilateral and multilateral donors excluding Fund under the program baseline (eop stock, cumulative, in million US$) | 603 | 603 | 703 | 703 | 753 | 706 | 753 | 753 | 1,096 | 1,096 | 1,155 |
| Net nonconcessional borrowing received and repatriated by the general government (including the DBM) under the program baseline (eop stock, cumulative, in million US$) | 306 | 306 | 160 | 160 | 160 | 160 | 160 | 160 | 160 | 160 | 160 |
| Program exchange rate (togrog/U.S. dollar) | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 |
| U.S. dollar per SDR | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 |
| Monetary gold price (U.S. dollar/ounce) | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 |

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

| Table 2. Mongolia: Structural Conditionality | | |
|---|---|---|
| **Prior Actions Due before Board Meeting** | | **Status** |
| Impose a limit of 30 months on all non-mortgage consumer loans effective January 1, 2019; and introduce sanctions for violations of the limits which at the very minimum requires banks to provision any loan that violates the DSTI limit. | | Met |
| Adopt a tightening bias in the official communication in the September monetary policy committee meeting given the risks from rapid credit growth, with a view to tightening monetary policy stance in the coming months if credit growth remains strong or if imports continue to rise. | | Met |
| Banks book all provisioning needs identified by the AQR adjusted only by loans that have been repaid in line with the template agreed with BoM. | | Met |
| BoM requires banks to submit, by end-September 2018, a detailed plan regarding how they will issue new capital in the amounts detailed in the May 8 letter from BoM. | | Expected to be met |
| **Structural Benchmark** | **Target Date** | **Status** |
| **Fiscal** | | |
| Complete an audit of all existing concessions contracts, develop a repayment plan based on audit recommendations, contractual obligations and fiscal path, and incorporate in the medium-term fiscal framework (MTFF) repayment plan to be paid by the budget i) for each year of the MTFF and ii) the nominal sum for future years not covered by the MTFF. | End-August 2018 | Expected to be Met |
| Implementation of 2019 Operational Plan that sets out the tax compliance improvement strategies for SMEs. | End-October 2018 | Expected to be Met |
| The MoF to approve a Guideline on appraisal and selection of public investment projects, including specific methodology and evaluation criteria. | End-December 2018 | |
| Enact a legislation to reform structure of retail fuel prices and increased excise tax rates. | End-December 2018 | Proposed to be reset to end-June 2019 |

**Table 2. Mongolia: Structural Conditionality (Concluded)**

| Structural Benchmark | Target Date | Status |
|---|---|---|
| **Banking** | | |
| Financial Stability Council (FSC) finalization and publication of an NPL resolution strategy. | end-April 2018 | Not met, implemented with delay |
| Banks will book the provisioning gap identified by the AQR and reclassify their assets to non-performing category in line with the AQR. | End-June 2018 | Not Met |
| Based on the AQR findings and advice provided by external experts, regulation on asset classification and provisioning to be further improved in consultation with IMF staff. | End-September 2018 | Not Met |
| BoM to carry out a review of related party exposures based on improved legislation. | End-December 2018 | |
| BoM will intervene promptly on those banks that by-end December 2018 do not raise capital by the amounts stated in the May 8th letter sent to banks. | End-January 2019 | |
| Adoption of legislative amendments to strengthen the enforcement of creditor rights (simplifying appeals and notifications, improving auctions, and allowing effective out-of-court enforcement of collateral). | End-November 2018 | Proposed to be reset to end-February 2019 |
| Adoption of new prudential regulation with select elements from Basel II/III. | End-December 2018 | Proposed to be reset to end-June 2019 |
| Adoption of a reformed bankruptcy law (including improved access to procedures, protection of secured creditors, and an efficient reorganization process). | End-March 2019 | |
| Adoption of the law on private bailiffs and introduction of commercial courts. | End-April 2019 | |
| Adoption of a law for full public access to the real estate registry and establishing a price and transaction registry for real estate. | End-April 2019 | |
| Adoption of a new legal framework to address proliferation financing (newly proposed). | End-April 2019 | |

# Attachment I. Technical Memorandum of Understanding

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

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

***Test Dates***

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

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

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

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

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

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

***Definitions***

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

- The general government (GG) includes all units of budgetary central government, social security funds, extra-budgetary funds (including but not limited to the Stabilization Fund and the Future Development Heritage Fund), and local governments, and the Development Bank of Mongolia (DBM). Debts of other legally autonomous state-owned enterprises (SOEs) and BOM liabilities including the swap line with the People's Bank of China (PBOC) are excluded.
- The domestic banking system is defined as the BOM and licensed commercial banks incorporated in Mongolia.
- The fiscal year is the calendar year, starting on January 1 and ending on December 31.
- For program purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "program accounting exchange rates" as defined below, with the exception of items affecting government fiscal balances, which will be measured at current exchange rates. Unless otherwise indicated, U.S. dollar denominated components of the balance sheet of the Bank of Mongolia (BOM) will be valued at the reference exchange rate of the Mongolian togrog to the U.S. dollar of 2489.4 announced by the BOM as of December 31, 2016. Amounts denominated Chinese Renminbi (RMB), SDR and gold will be converted for program purposes into U.S. dollar amounts using the following cross-rates as of December 31, 2016: Chinese Renminbi (RMB) valued at 0.14389 U.S. dollars, Special Drawing Right (SDR) valued at 1.344330 U.S. dollars, and official gold holdings at 1142.54 U.S. dollars per troy ounce.
- For program purposes nonconcessional external borrowing excludes (i) the use of IMF resources; (ii) lending from the Asian Development Bank, European Bank for Reconstruction and Development, Asian Infrastructure Investment Bank, and the World Bank Group, and; (iii) lending from governments and government agencies such as the Japan International Cooperation Agency, the Export-Import Banks of India, Korea, and Turkey, and the Development Bank of Germany; (iv) concessional debts; (v) any togrog-denominated treasury bill and government bond holdings by nonresidents.
- For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. [2]
- 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.

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

5. The spread of six-month GBP LIBOR over six-month USD LIBOR is -231 basis points. For interest rates on currencies other than Euro, JPY, and GDP, the spread over six-month USD LIBOR is 0 basis points.[3]

## A. Net International Reserves of the BOM

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

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

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

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

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

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

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

## B. Reserve Money

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

## C. Social Protection Spending

10. An indicative floor applies to the level of social protection spending, defined in the table below. This indicative target on social spending covers only current spending of both the central government and the local governments.

**General Government Social Protection Spending**

| State budget: Social Welfare Fund: | Local governments |
|---|---|
| - Expenses of core activities | - Expenses of core activities |
| - Scientific and research work | - Support and compensations to citizens |
| - Allowance to veterans, the elderly awarded with state medal | - Council, commission members pay |
| - Benefit to Honorary mothers (with more than 4 children) | - Pregnant and maternity benefit |
| - Child money | - Welfare pension |
| - Caregivers service | - Pregnant and mothers benefit |
| - Other SW fund compensations | - Conditional cash allowance |
| - Allowance to the elderly | - Community based welfare services |
| - Other welfare services and allowance | - Livelihood support conditional cash allowance |
| - Old-age benefit | - Caregivers service |
| | - Food stamp |
| | - Other SW fund compensations |
| | - Social welfare services to the disabled |
| | - Allowance to the elderly |
| | - To increase source of Pension |
| | - To increase source of Social benefit |
| | - Employers benefit, allowance |
| | - Incentives for discipline, responsibility and work results |
| | - Other unclassified activities |

## D. Net Domestic Assets of the BOM

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

- NDA will be calculated as the difference between reserve money and the sum of NIR and other net foreign assets (ONFA) of the BOM. For calculating the NDA, NIR will be adjusted for the swap program with commercial banks, foreign exchange demand deposits of commercial banks that are already part of the reserve money, and government foreign currency current accounts.
- ONFA is defined as other net foreign assets of the BOM, including the difference between accrued interest receivables on gross international reserves of the BOM and accrued interest payables on international reserve liabilities of the BOM and deposits of international financial institutions.

## E. Primary Balance of the General Government

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

- Overall balance of general government, excluding DBM's net lending, defined below the line as:
    - net bank credit to the general government—this includes net borrowing from BOM (ways and means advances, loans, holdings of treasury bills and government bonds, minus deposits) and commercial banks (loans, advances, and holdings of treasury bills and government bonds, minus deposits).
    - net nonbank financing—this would include tax prepayments and holdings of government by pension and insurance funds, as well as any changes to the net assets (negative financing flows) of Fiscal Stability Fund, Social Security Funds, and Future Heritage Fund.
    - net external financing—this would include program loans, project loans, nonconcessional borrowing or long term external debts such as sovereign bonds or commercial loans.
    - Privatization receipts

- Gross Interest payments of the general government on domestic and external debt measured above the line.

## F. DBM's Net Lending

13. A ceiling applies to the net lending of DBM. DBM's net lending is defined as loan disbursements in the calendar year less repayments in that year.

## G. Non-Concessional Medium- and Long-Term External Debt

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

15. Starting from the completion of the second review, there will be a ceiling on net debt issuance rather than gross debt issuance. The ceiling applies to contracting and/or guaranteeing by the general government or the BOM or other agencies acting on behalf of the general government of debt with nonresidents with original maturities one year or more. The ceiling will apply end-June and end-December of every year, starting from end-December 2017. Such a ceiling allows the authorities to conduct debt liability management. When conducting such operations, and for the purpose of netting, there should be no more than 6 months between the contracting of new debt and the retirement of existing debt. During the 6 month window, gross issuance will be adjusted by subtracting the refinancing of existing debt of general government or the BOM or other agencies acting on behalf of the general government with nonresidents with original maturities of one year or more as well as any debt of general government or the BOM or other agencies acting on behalf of the general government with nonresidents with original maturity of less than one year that is being refinanced by longer maturity debt. If a new issuance falls before the date of ceiling application, but the repayment is scheduled after that date, netting still applies as long as the 6 months limit is adhered to. The two GOM bonds maturing in January 2018 and June 2018 will be excluded from the netting since they are already in the process of being refinanced through the issuance of the US$800 million Eurobond in November 2017. The definition of debt, for the purposes of the program, is set out in Executive Board Decision No. 15688, Point 8, adopted December 5, 2014 (see Annex 1).

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

### H. Stock of Guarantees on External Debt

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

### I. Short-Term External Debt

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

19. 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

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

### A. Monetary Data (BOM)

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

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

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

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

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

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

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

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

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

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

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

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

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

- Classified transactions of all social insurance funds.

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

- Monthly accounts of the DBM detailing new lending and repayment as well as the stock of outstanding loans on a cash basis.

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

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

- Monthly report on the stock of outstanding debt of the general government including DBM, including domestic and external debt, promissory notes, tax pre-payments and guaranteed debt netting out any cross holdings between DBM and the GoM.

## C. External Sector Data (BOM and MOF)

- Complete list of new contracts above $10 million for the execution of public investment projects, which have been signed or are under negotiation with foreign or domestic entities, including details on the amounts, terms, and conditions of current or future debt or nondebt obligations arising from these contracts on a quarterly basis by MoF.

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

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

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

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

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

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

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

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

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

8.

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

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

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

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

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

# MONGOLIA

October 26, 2018

## FIFTH REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA—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 contains information that has become available since the issuance of the staff report (EBS/18/91). The supplement does not alter the thrust of the staff appraisal.*

1. **Recent data have confirmed that the authorities met the end-September primary balance target.** In the staff report issued to the Board, staff proposed a waiver of applicability for the end-September quantitative performance criteria (QPC) target on the primary balance as the needed data was unavailable. Since then, the authorities confirmed that the target (-20 billion togrog, cumulative January-September) was met by a comfortable margin (actual number was 1644 billion togrog) (See Table 1 attached).

2. **This strong performance suggests there will likely be further over-performance on fiscal targets in 2018.** Revenues remained strong in the third quarter and have risen 31 percent year-to-date. The key drivers remain mineral exports and strong imports. In light of this, staff project that the primary surplus will now reach 4.5 percent of GDP in 2018.

3. **In mid-October, the Development Bank of Mongolia (DBM) issued an external bond raising US$500 million.** The 5-year bond carries a coupon of 7.25 percent and was 8 times over-subscribed. Even though it did not come with a government guarantee, it received the same credit rating as that of government bonds: B- (Standard & Poor) and B (Fitch). The proceeds are expected to be solely for liability management (paying off short-term external debt with floating interest rates) and thus should not affect the stock of external public debt.

4. **Since end-September, net international reserves have declined by about $100 million amid ongoing balance of payment pressures.** The fall in reserves would be larger

but the authorities have been able to monetize $38 million in gold in the month through October 18. Against the dollar, the togrog has depreciated 5.4 percent year-to-date and 0.7 percent since end-September.

**5. Recently, BOM has taken several steps to ensure that the follow-up to the Asset Quality Review remains on track.** BOM met the final prior action pending in the Staff Report by requesting that banks provide an update on progress in meeting the capital shortfall from the Asset Quality Review (AQR)**.** However, these updates suggested further actions were necessary to ensure sufficient progress going forward. As this is a key program goal, staff returned to Ulaanbaatar for further discussions in mid-October and reached understandings on an addendum to the LOI (see attached) outlining an additional prior action (See Table 2 attached). Specifically, BOM would send a formal communication to the banks which a) requires them to incorporate the results of the AQR and recent on-site inspections in their October balance sheets and b) underscores that banks must raise the previously requested amount and type of capital by end-December 2018 or face intervention by BOM. On October 23, the authorities sent this communication to the banks and have now met the final prior action for this review.

# Supplementary Letter of Intent

October 23, 2018
Ulaanbaatar

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

Dear Ms. Lagarde,

This letter is a supplement to the Letter of Intent signed on October 10. I am writing to inform you that I have taken the steps necessary to meet the final prior action under the 5th Review and ensure that the follow-up to the Asset Quality Review remains on track.

Specifically, in early September, I asked the 7 banks with capital shortfalls to submit plans by end-September which detailed how they would raise the capital requested by the Bank of Mongolia in May. All seven banks have now submitted capital plans to the Bank of Mongolia.

In addition, on October 23, the Bank of Mongolia (BOM) conveyed the results of the recent on-site inspections to all 7 banks. BOM indicated in this letter that Banks must update their balance sheets as of end-September accordingly. This means adequately classifying assets, making provisioning and adjusting capital adequacy ratios in line with the results of the on-site inspections. We asked the banks to share the updated balance sheets no later than end-October.

In this message to the banks, we also clarified that the amount and type of capital to be raised remains that communicated in May, that any Tier 1 shortfall must be met by issuing new common shares, and a failure to raise the amount and type of capital required by end-December would result either in public injections of capital or resolution consistent with the Banking Law.

We look forward to continuing to work together on ensuring a well-capitalized financial system in the months ahead.

/s/

N. Bayartsaikhan
Governor, Bank of Mongolia

## Table 1. Mongolia: Quantitative Performance Criteria and Indicative Targets

(Replaces Staff Report Table)

| | Mar-18 | | Jun-18 | | Sep-18 | | Dec-18 | | Mar-19 | | Jun-19 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Target | Actual | Target | Actual | Target | Actual | Target | Revised Target | Target | Revised Target | Indicative Target |
| **Performance Criteria 1/ 2/ 3/ 4/** | | | | | | | | | | | |
| Change in net international reserves (NIR) of the Bank of Mongolia (BOM) (floor, cumulative, change in eop stock, in million US$ at program exchange rate) | 1,700 | 2,087 | 1,900 | 2,147 | 2,000 | 2,137 | 2,200 | 2,200 | 2,500 | 2,700 | 2,900 |
| Net domestic assets (NDA) of the BOM (ceiling, eop stock, in billion togrog at program exchange rate) | 2,400 | 1,351 | 2,700 | 1,443 | 2,300 | 1,663 | 1,950 | 1,950 | 1,800 | 1,800 | 1,700 |
| Primary balance of the general government (floor, cumulative since the beginning of the fiscal year, in billion togrog) | -377 | 637 | 240 | 948 | -20 | 1,644 | | | | | |
| Primary balance of the general government (floor, excluding DBM, cumulative since the beginning of the fiscal year, in billion togrog) | | | | | | | | 1,011 | | 62 | 200 |
| Net nonconcessional external debt maturing in one year or more, contracted and/or guaranteed by the government or the BOM (ceiling, cumulative flow from November 15, 2017, in million US$). /5 | NA | NA | 20 | 20 | NA | NA | 20 | 20 | NA | NA | 20 |
| Stock of guarantees on external debt extended by the government or BOM (ceiling, eop stock, in million US$) | 750 | 648 | 750 | 634 | 750 | 573 | 750 | 750 | 750 | 750 | 750 |
| DBM net lending (ceiling, in billion togrog) | | | | | | | | 254 | | 20 | 80 |
| **Indicative Targets (IT)** | | | | | | | | | | | |
| Reserve money (ceiling, in billion togrog) | 4,000 | 2,941 | 4,400 | 3,420 | 4,600 | 3,706 | 4,750 | 4,750 | 4,900 | 4,900 | 5,000 |
| Social spending (floor, cumulative since the beginning of the fiscal year, in billion togrog) | 1,387 | 1,201 | 2,841 | 2,594 | 4,287 | 3,843 | | | | | |
| Social protection spending (floor, cumulative since the beginning of the fiscal year, in billion togrog) | | | | | | | | 622 | | 174 | 336 |
| **Continuous Performance Criteria** | | | | | | | | | | | |
| New nonconcessional external debt maturing in less than one year, contracted and/or guaranteed by the government or the BOM (ceiling, eop stock, in million US$). | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Accumulation of new external payment arrears (ceiling, eop, in million US$). | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Memorandum items** | | | | | | | | | | | |
| Budget support from bilateral and multilateral donors excluding Fund under the program baseline (eop stock, cumulative, in million US$) | 603 | 603 | 703 | 703 | 753 | 706 | 753 | 753 | 1,096 | 1,096 | 1,155 |
| Net nonconcessional borrowing received and repatriated by the general government (including the DBM) under the program baseline (eop stock, cumulative, in million US$) | 306 | 306 | 160 | 160 | 160 | 160 | 160 | 160 | 160 | 160 | 160 |
| Program exchange rate (togrog/U.S. dollar) | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 | 2,489 |
| U.S. dollar per SDR | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 | 1.35 |
| Monetary gold price (U.S. dollar/ounce) | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 | 1,142 |

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

| Table 2. Mongolia: Structural Conditionality<br>(Replaces Staff Report Table) | | |
|---|---|---|
| **Prior Actions Due before Board Meeting** | | **Status** |
| Impose a limit of 30 months on all non-mortgage consumer loans effective January 1, 2019; and introduce sanctions for violations of the limits which at the very minimum requires banks to provision any loan that violates the DSTI limit. | | Met |
| Adopt a tightening bias in the official communication in the September monetary policy committee meeting given the risks from rapid credit growth, with a view to tightening monetary policy stance in the coming months if credit growth remains strong or if imports continue to rise. | | Met |
| Banks book all provisioning needs identified by the AQR adjusted only by loans that have been repaid in line with the template agreed with BoM. | | Met |
| BoM requires banks to submit, by end-September 2018, a detailed plan regarding how they will issue new capital in the amounts detailed in the May 8 letter from BoM. | | Met |
| BOM sends letters to banks with capital shortfalls which a) request that they update their balance sheets to reflect recent on-site inspections and b) underscore that capital to be raised remains at the amount communicated in May and that any Tier 1 shortfall must be met with common shares. | | Met |
| **Structural Benchmark** | **Target Date** | **Status** |
| **Fiscal** | | |
| Complete an audit of all existing concessions contracts, develop a repayment plan based on audit recommendations, contractual obligations and fiscal path, and incorporate in the medium-term fiscal framework (MTFF) repayment plan to be paid by the budget i) for each year of the MTFF and ii) the nominal sum for future years not covered by the MTFF. | End-August 2018 | Not met, implemented with delay in October 2018 |
| Implementation of 2019 Operational Plan that sets out the tax compliance improvement strategies for SMEs. | End-October 2018 | Expected to be Met |
| The MoF to approve a Guideline on appraisal and selection of public investment projects, including specific methodology and evaluation criteria. | End-December 2018 | |
| Enact a legislation to reform structure of retail fuel prices and increased excise tax rates. | End-December 2018 | Proposed to be reset to end-June 2019 |

**Table 2. Mongolia: Structural Conditionality (Concluded)**
(Replaces Staff Report Table)

| Structural Benchmark | Target Date | Status |
|---|---|---|
| **Banking** | | |
| Financial Stability Council (FSC) finalization and publication of an NPL resolution strategy. | end-April 2018 | Not met, implemented with delay |
| Banks will book the provisioning gap identified by the AQR and reclassify their assets to non-performing category in line with the AQR. | End-June 2018 | Not Met |
| Based on the AQR findings and advice provided by external experts, regulation on asset classification and provisioning to be further improved in consultation with IMF staff. | End-September 2018 | Not Met |
| BoM to carry out a review of related party exposures based on improved legislation. | End-December 2018 | |
| BoM will intervene promptly on those banks that by-end December 2018 do not raise capital by the amounts stated in the May 8th letter sent to banks. | End-January 2019 | |
| Adoption of legislative amendments to strengthen the enforcement of creditor rights (simplifying appeals and notifications, improving auctions, and allowing effective out-of-court enforcement of collateral). | End-November 2018 | Proposed to be reset to end-February 2019 |
| Adoption of new prudential regulation with select elements from Basel II/III. | End-December 2018 | Proposed to be reset to end-June 2019 |
| Adoption of a reformed bankruptcy law (including improved access to procedures, protection of secured creditors, and an efficient reorganization process). | End-March 2019 | |
| Adoption of the law on private bailiffs and introduction of commercial courts. | End-April 2019 | |
| Adoption of a law for full public access to the real estate registry and establishing a price and transaction registry for real estate. | End-April 2019 | |
| Adoption of a new legal framework to address proliferation financing (newly proposed). | End-April 2019 | |

**Statement by Grant Johnston, Alternate Executive Director for Mongolia and Gantsogt Khurelbaatar, Advisor to Executive Director October 31, 2018**

Our Mongolian authorities are very thankful for the support they are receiving from the Fund and from their development partners. Performance under the EFF has been good, helped by solid demand for exports and buoyant mineral prices. However, challenges lie ahead for Mongolia and there is no room for complacency.

**Program performance**

All quantitative targets for end-September 2018 have been met, despite an increase in imports that has put pressure on international reserves. Also, all prior actions for the fifth review—regarding monetary policy actions, macroprudential measures and the recapitalization of banks—have been completed. In particular, the submission of business plans by banks, regarding how they will raise new capital, was completed recently. While some structural benchmarks have taken a little more time than originally expected, the authorities remain committed to implementing all of these tasks, and are working hard to do so.

**Fiscal policy**

Revenue continues to overperform, based on the strong performance of the mining sector and increased imports. In fact, revenue at end-September was over 30 percent higher than a year earlier. This has allowed the Government to propose an increase in spending for 2019 and still deliver a primary surplus of 1 percent of GDP.

At the outset of the EFF program, Mongolia undertook a strong fiscal adjustment including freezing capital expenditure. Next year's budget—which is currently being discussed in Parliament—includes an increase in expenditure, mostly on capital projects, with priority given to resolving issues in the health and education sectors. With little or no recent investment, existing health and education facilities have been unable to cope with demand from the public, or provide adequate services. Some secondary schools, for example, have had to operate two or three shifts each day to accommodate their pupils. There are hospital patients in corridors due to a shortage of proper rooms, and resources are stretched. With an increase in investment, the authorities are aiming to provide adequate social services to the population while continuing the successful implementation of the program.

Upside surprises in revenue will be saved and used for reducing debt. Public debt is on a more aggressively declining path than envisaged at the outset of the program, thanks to positive global mineral prices and prudent fiscal management. Originally, debt was projected to peak at close to 100 percent of GDP in 2018 but is now expected to be down to 70 percent by the end of the year.

**Financial markets and monetary policy**

Inflation at the end of September was 5.7 percent but in the medium term is expected to stabilize around the central bank's target rate of 8 percent. The tugrik has been depreciating as a result of a weakening balance of payments. The Bank of Mongolia has intervened in the foreign exchange market a number of times to address liquidity shortages and avoid excessive volatility. The accumulation of international reserves has therefore slowed, but the central bank is committed to continuing its reserve accumulation and to maintaining a floating exchange rate.

A key part of the EFF program is creating a strong, resilient banking sector. An asset quality review was conducted earlier this year and as a consequence a number of banks are required to raise additional capital by the end of the year. Banks have incorporated the findings of the AQR in their balance sheets and set out how they will raise this capital. The last two months of this year are a critical period in the bank recapitalization process as the deadline for raising this required capital is approaching. The Bank of Mongolia is committed to undertaking all necessary measures in coordination with the mission team.

Mongolia scored poorly on most AML/CFT requirements in last year's APG mutual evaluation and was given until June 2019 to make a substantial progress. The authorities are committed to undertake the required measures, including adopting the appropriate legal framework and strengthening supervision of financial entities. The authorities are also increasing funding for the organizations responsible for implementing the AML/CFT requirements.