INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/297

# MONGOLIA

September 2019

## 2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MONGOLIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Mongolia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 11, 2019, consideration of the staff report that concluded the Article IV consultation with Mongolia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 11, 2019, following discussions that ended on June 28, 2019, with the officials of Mongolia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 2, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Mongolia.

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

Selected Issues

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

Copies of this report are available to the public from

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

**International Monetary Fund**
**Washington, D.C.**

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 19/333
FOR IMMEDIATE RELEASE
September 17, 2019

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

**IMF Executive Board Concludes 2019 Article IV Consultation with Mongolia**

On September 11, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Mongolia.

Mongolia's economy has recovered vigorously from the recent downturn. Economy growth accelerated to 8.6 percent in the first quarter of 2019, over fiscal balance turned into surplus in 2018, and gross international reserves have increased by $2½ billion since 2016. The recovery stems from a stronger policy framework, significant official financing and a rebound in external demand. Notwithstanding the progress, Mongolia remains vulnerable to external shocks given its high debt levels and the economy's dependence on mineral exports.

Structural reforms progressed in several key areas: the budget process is more resilient to political pressure and quasi-fiscal activities were curtailed. To achieve sustainable and inclusive growth, it is necessary to advance the current reform efforts by strengthening the rule-based fiscal policy framework, ensuring financial sector soundness and improving governance.

Economic outlook remains strong despite some headwinds. Growth is expected to remain above 6½ percent in 2019 and moderate to around 5-6 percent over the medium term. The primary headwinds are weaker export growth and slower credit growth. Partially offsetting these headwinds, fiscal policy is expected to loosen in 2019 and 2020 relative to the 6 percent primary surplus seen in 2018. The moderation in growth will contribute to a reduction in the double-digit current account deficit and allow inflation to converge toward the target of 8 percent. Projected strong FDI and improving current accounts will support further reserve accumulation, but the trend will likely be reversed from 2021 onward due to looser domestic policies, the end of large-scale concessional financing from donors, and continued reluctance to allow exchange rate flexibility.

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

Risks are tilted towards the downside in the near-term. Shocks to mineral demand can lead to sharp fall in exports, weakening growth outlook and fiscal accounts. A slowdown in growth could trigger financial instability given still inadequate capital buffers at some banks and over-indebted households. Current fiscal and external buffers are still inadequate in the event downside risks materialize. On the upside, successful completion of the OT investment and key infrastructure projects could boost investor confidence, improve productivity, and attract FDI on new mining projects.

**Executive Board Assessment**[2]

Executive Directors welcomed Mongolia's economic recovery underpinned by the Fund-supported program. Growth has been robust, the fiscal balance has improved, and gross reserves have increased. However, Directors noted that the economy remains vulnerable to external shocks with still high debt and exposures to shifts in commodity demand. They emphasized the need for continued strong commitment to sound macroeconomic policies to increase buffers, reduce vulnerabilities, and achieve high, inclusive, and green growth. Directors encouraged the authorities to take measures to complete financial sector reforms to enable the completion of the sixth review of the EFF-supported program.

Directors underscored that fiscal policy should remain tight to bring public debt down to a safe level. For the near term, they welcomed authorities' plan to save any revenue over-performance in 2019 and underscored the need to pass a prudent budget for 2020. Directors encouraged the authorities to streamline the fiscal framework with a more independent Fiscal Council. They emphasized that priority also needs to be given to better address core social challenges, including by ensuring sufficient health spending for the most vulnerable. To further reduce risks around public debt, Directors encouraged the authorities to proactively address large near-term rollover needs on external debt.

Directors underscored that monetary policy should focus on anchoring inflation and addressing external imbalances. They advised the authorities to remain vigilant and further tighten the policy stance if necessary. Directors mostly considered that a more flexible exchange rate would be helpful in addressing external imbalances and building reserves.
Directors encouraged the Bank of Mongolia to continue to build reserves and do so through direct purchases and limit sales of foreign exchange to address disorderly market conditions.

Directors highlighted that financial sector reforms, including enhancing risk-based supervision, and increasing bank capital are key to ensuring macroeconomic stability.
Recognizing the challenges identified by the recent forensic audit of capital raising transactions, Directors called for measures to address the shortfall identified by the Asset Quality Review. They called for a prompt response by the Bank of Mongolia in line with commitments made

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

under the program. Directors also called for further efforts to facilitate the resolution of non-performing loans and improve the AML/CFT framework.

Directors emphasized that structural reforms should focus on strengthening governance and diversifying the economy. They encouraged the authorities to improve infrastructure, enhance the legal framework and the investment climate, reduce environmental degradation, and make the agriculture sector more resilient to climate change.

## Table 1. Mongolia: Selected Economic and Financial Indicators, 2016-24

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| | Act. | Act. | Act. | ← | | Proj. | | | → |
| | (In percent of GDP, unless otherwise indicated) | | | | | | | | |
| ***National Accounts*** | | | | | | | | | |
| Nominal GDP (in billions of togrogs) | 23943 | 27876 | 32094 | 37129 | 42092 | 47531 | 53652 | 60002 | 66798 |
| Real GDP growth (percent change) | 1.2 | 5.3 | 6.9 | 6.5 | 5.4 | 5.1 | 5.6 | 6.0 | 5.0 |
| Domestic Demand | 0.2 | 12.1 | 12.8 | 9.7 | 3.9 | 5.9 | 1.6 | 5.1 | 4.3 |
| Consumption | -0.2 | 3.9 | -1.2 | 1.0 | -1.3 | 6.3 | 8.7 | 5.5 | 9.5 |
| *Private* | -2.6 | 5.4 | -1.7 | 0.1 | -3.1 | 6.6 | 9.6 | 5.4 | 10.7 |
| *Public* | 10.6 | -1.8 | 0.5 | 5.0 | 5.4 | 5.1 | 5.6 | 6.0 | 5.0 |
| Investment | 1.3 | 35.2 | 43.5 | 22.6 | 10.3 | 5.5 | -6.3 | 4.5 | -2.5 |
| *o/w GFCF* | 0.5 | 35.6 | 22.6 | 26.8 | 15.1 | 5.3 | -4.3 | 6.3 | -2.7 |
| Exports of G&S | 13.8 | 14.8 | 14.1 | 13.6 | 8.5 | 13.7 | 12.6 | 14.9 | 12.1 |
| Imports of G&S | 12.7 | 24.8 | 21.4 | 16.7 | 6.4 | 13.7 | 7.9 | 13.4 | 11.2 |
| Contributions to Real GDP (ppts) | | | | | | | | | |
| *Domestic Demand* | 0.2 | 11.7 | 13.2 | 10.5 | 4.3 | 6.5 | 1.8 | 5.4 | 4.6 |
| *Net Exports of G&S* | 1.0 | -6.3 | -6.3 | -4.0 | 1.1 | -1.4 | 3.8 | 0.6 | 0.4 |
| Gross national saving | 26.0 | 21.3 | 25.4 | 28.8 | 33.3 | 33.8 | 31.4 | 31.6 | 28.5 |
| *Public* | -3.6 | 3.1 | 8.3 | 8.4 | 8.2 | 8.7 | 8.8 | 9.0 | 9.0 |
| *Private* | 29.6 | 18.2 | 17.0 | 20.4 | 25.1 | 25.1 | 22.6 | 22.6 | 19.5 |
| Gross capital formation | 25.7 | 31.4 | 42.3 | 43.2 | 45.7 | 45.1 | 40.8 | 40.4 | 37.3 |
| *Public* | 9.9 | 5.9 | 5.0 | 7.8 | 8.3 | 10.3 | 10.2 | 10.6 | 10.7 |
| *Private* | 15.9 | 25.4 | 37.3 | 35.4 | 37.4 | 34.8 | 30.7 | 29.8 | 26.6 |
| ***Prices*** | | | | | | | | | |
| Consumer Prices (EoP; percent change) | 0.8 | 7.2 | 9.7 | 8.4 | 8.1 | 7.0 | 6.9 | 7.1 | 7.2 |
| Copper prices (US$ per ton) | 4868 | 6170 | 6530 | 6058 | 5991 | 6045 | 6090 | 6123 | 6123 |
| Gold prices (US$ per ounce) | 1248 | 1257 | 1269 | 1288 | 1309 | 1336 | 1367 | 1393 | 1393 |
| Oil price (in U.S. dollars per barrel) | 42.8 | 52.8 | 68.3 | 65.5 | 63.9 | 60.7 | 58.5 | 57.6 | 57.6 |
| GDP deflator (percent change) | 2.2 | 10.5 | 7.7 | 8.6 | 7.6 | 7.4 | 6.9 | 5.5 | 6.0 |
| ***General government accounts*** | | | | | | | | | |
| Primary balance (IMF definition) 1/ | -11.2 | 0.4 | 5.9 | 3.0 | 1.1 | -0.5 | -0.5 | -0.5 | -0.5 |
| Total revenue and grants | 24.4 | 28.5 | 31.4 | 30.9 | 30.2 | 30.2 | 29.9 | 30.3 | 30.4 |
| Primary expenditure and net lending | 35.5 | 28.2 | 25.5 | 28.0 | 29.1 | 30.7 | 30.4 | 30.8 | 30.9 |
| Interest | 4.1 | 4.1 | 3.3 | 2.4 | 2.0 | 1.7 | 1.4 | 1.6 | 1.6 |
| Overall balance (IMF definition) 2/ | -15.3 | -3.8 | 2.6 | 0.6 | -0.9 | -2.2 | -1.9 | -2.1 | -2.1 |
| Gross Financing Needs | 18.0 | 3.6 | 5.3 | 2.4 | 2.6 | 7.0 | 9.5 | 8.2 | 6.6 |
| General government debt 3/ | 87.6 | 84.6 | 73.3 | 73.0 | 71.0 | 66.2 | 61.7 | 58.9 | 57.2 |
| *Domestic* | 20.2 | 13.6 | 5.3 | 4.2 | 3.0 | 2.2 | 1.5 | 2.8 | 4.9 |
| *External* | 67.5 | 71.0 | 68.0 | 68.9 | 68.0 | 64.0 | 60.1 | 56.1 | 52.3 |
| ***Monetary sector*** | | | | | | | | | |
| Broad money growth (percent change) | 21.0 | 30.4 | 22.8 | 25.4 | 13.4 | 12.9 | 12.9 | 11.8 | 11.3 |
| Reserve money growth (percent change) | 24.6 | 30.5 | 19.1 | 17.1 | 13.8 | 17.6 | 12.3 | 17.5 | 17.7 |
| Credit growth (percent change) | 6.7 | 11.1 | 23.4 | 18.0 | 17.0 | 15.0 | 15.0 | 16.0 | 17.0 |
| ***Balance of payments*** | | | | | | | | | |
| Current account balance | -6.3 | -10.1 | -17.0 | -14.4 | -12.4 | -11.3 | -9.5 | -8.8 | -8.8 |
| Exports of goods (y/y percent change) | 4.1 | 21.4 | 12.4 | 10.1 | 2.6 | 8.9 | 7.5 | 9.9 | 7.0 |
| Imports of goods (y/y percent change) | 0.8 | 25.3 | 35.4 | 1.4 | 0.3 | 9.4 | 2.8 | 8.7 | 6.0 |
| Gross official reserves (in USD millions) 4/ | 1297 | 3012 | 3461 | 3655 | 4033 | 4018 | 3638 | 3325 | 2802 |
| *(In months of imports)* | 2.4 | 4.0 | 4.7 | 5.0 | 5.0 | 4.9 | 4.1 | 3.5 | 2.9 |
| ***Exchange rate*** | | | | | | | | | |
| Togrog per U.S. dollar (eop) | 2490 | 2427 | 2644 | … | … | … | … | … | … |
| ***Memorandum item*** | | | | | | | | | |
| Population in million (eop) | 3.1 | 3.2 | 3.2 | … | … | … | … | … | … |

Sources: Mongolian authorities; and Fund staff projections.
1/ DBM spending is excluded from fiscal balance and monitored separately.
2/ Excludes privatization receipts; includes interest financed mortgage spending from 2017 onwards.
3/ General government debt data excludes SOEs debt and central bank's liabilities from PBOC swap line.
4/ Gross official reserves includes drawings from swap line.

INTERNATIONAL MONETARY FUND

# MONGOLIA

## STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

August 2, 2019

## KEY ISSUES

**Context**. Since the start of the IMF-supported program in early 2017, the economy has recovered significantly and is now more resilient due to a stronger policy framework, significant official financing, and a rebound in external demand. Nonetheless, fiscal, financial, and external buffers remain insufficient, particularly given Mongolia's vulnerability to shocks. Moreover, the IMF-supported program is currently delayed. The near-term priority is addressing outstanding prior actions under the program and passing a 2020 budget consistent with continued debt reduction.

**Recent Developments and Outlook.** Since 2016, economic growth rose from around 1 to 7 percent, the fiscal balance improved by 18 percentage points of GDP, and gross reserves roughly tripled. Looking ahead, the baseline projects that growth remains robust and debt continues to fall. Nonetheless, there are significant risks around the baseline with respect to global commodity demand, external amortizations, financial sector stability, and political uncertainty around the 2020 elections.

**Article IV Discussions**. There were four key policy messages: 1) Tight macro policies and a more flexible exchange rate to reduce current account deficits and increase foreign exchange reserves. 2) Increase bank capital, enhance risk-based supervision, and eliminate regulatory forbearance to ensure the banking sector can support sustainable growth. 3) Strengthen the investment climate for the tradable sector with upgrades to infrastructure and governance, including by reducing vulnerabilities to corruption, to help address large external imbalances; 4) Improve the tax/regulatory framework to address overgrazing and desertification to make the agriculture sector more resilient to climate change.

**Extended Fund Facility.** The Executive Board of the IMF has completed 5 out of 12 scheduled reviews under the 3-year Fund-supported program originally approved in May 2017. In November 2018, the IMF reached staff-level agreement with the authorities on the 6th review. Performance on key quantitative performance criterion had been strong with all end-September targets met. However, implementation of structural benchmarks was mixed with several financial sector reforms delayed, including those related to the follow-up to the AQR. As a result, completion of the 6$^{th}$ review is delayed due to lack of progress on completion of two financial sector prior actions.

Approved By
**Kenneth Kang, (APD) and Daria Zakharova, (SPR)**

Discussions took place during June 19-28, 2019. The team included Geoff Gottlieb (head), Neil Saker (Resident Representative), Ruchir Agarwal, Rui Xu, (all APD), Laszlo Butt, Paul Leonovich (both MCM), Shakill Hassan (SPR), and Robert Blotevogel (FAD). The team was supported by Mmes. Selenge, Ardak, and Khulan (all economists in the res rep office), Ms. Madhu Nair, and Ms. Tolentino (all APD). Messrs. N. Ray and G. Khurelbaatar participated in some of the discussions. The Fund team met with Speaker of the Parliament G. Zandanshatar, Cabinet Secretary L. Oyun-Erdene, Finance Minister Ch. Khurelbaatar, Bank of Mongolia Governor N. Bayartsaikhan, Mining and Heavy Industry Minister D. Sumiyabazar, Food, Agriculture, and Light Industry Minister Ch. Ulaan, and other senior officials.

# CONTENTS

## TABLES



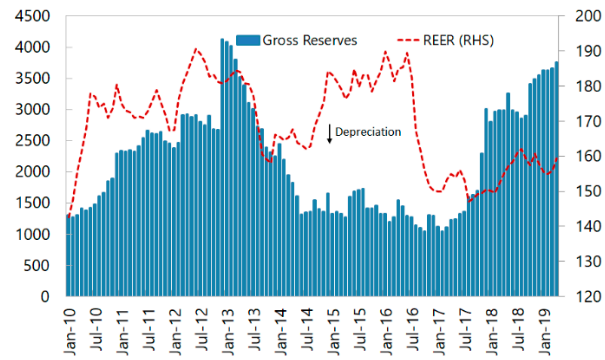
## ANNEXES

# CONTEXT

1. **Mongolia's economy has recovered quickly from the most recent downturn.** In 2016, the economy was nearly in a recession, the real exchange rate had depreciated 25 percent, the fiscal deficit had ballooned to 15 percent of GDP and sovereign spreads had spiked to double digits. In response, the authorities adopted a new package of policies (the "Economic Recovery Program") supported by $5.5 billion in official sector assistance including a three-year $425 million Extended Fund Facility from the IMF. At the same time, a sharp improvement in external conditions generated a swift recovery in mining investment and exports. By early 2019, the stronger policy framework, significant official financing, and rebound in economic activity had contributed to a 17 percent of GDP improvement in the fiscal balance, a 14 percentage points of GDP decline in public debt, and a $2½ billion increase in gross international reserves ($3.8 billion at end-March).

**Foreign Exchange Reserves and REER**

(In USD Billions; Dec. 2000=100)

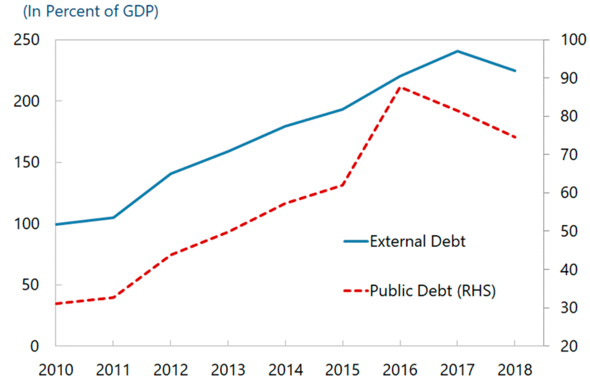



Sources: BOM

2. **Nonetheless, buffers are still insufficient, and the economy remains vulnerable to external shocks.** In the decade prior to the current IMF-supported program, Mongolia experienced a series of external shocks (the Global Financial Crisis in 2008-9, commodity price shock in 2012-15) and sharp falls in FDI (suspension of the second phase of the Oyu Tolgoi (OT) mine over a shareholder dispute). To support growth, the authorities pursued highly expansionary policies leading to double digit credit growth and fiscal deficits and large-scale money creation, and used borrowed funds, including a PBOC swap and sovereign bonds, to prevent exchange rate depreciation. The legacy of these shocks and policies is that buffers remain insufficient even after two years of progress. The level of international reserves, once short-term on- and off-balance sheet liabilities are netted out, is just above zero. Public and external debt are still high at 73 and 220 percent of GDP, respectively. And capital ratios in the banking sector remain below adequate levels. Building buffers is particularly important because Mongolia has a narrow economic base (80 percent of exports on average are minerals) and is facing a rising frequency and severity of climate disasters.

**Public and External Debt**

(In Percent of GDP)




Sources: Haver Analytics and IMF Staff Calculations.

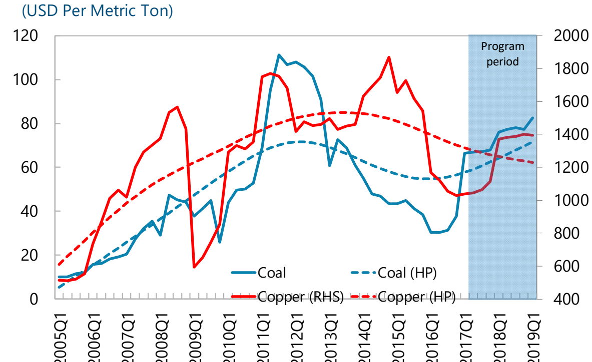
3. **Looking ahead, there are four policy priorities that can help Mongolia achieve high, inclusive and green growth**.

- Tight macro policies and a more flexible exchange rate to reduce current account deficits and increase foreign exchange reserves.
- Increase bank capital, enhance risk-based supervision, and eliminate regulatory forbearance to ensure the banking sector can support sustainable growth.
- Strengthen the investment climate for the tradable sector with upgrades to infrastructure and governance, including by reducing vulnerabilities to corruption, to help address large external imbalances.
- Improve the tax/regulatory framework to address overgrazing and desertification to make the agriculture sector more resilient to climate change.

# THE ECONOMIC BACKDROP

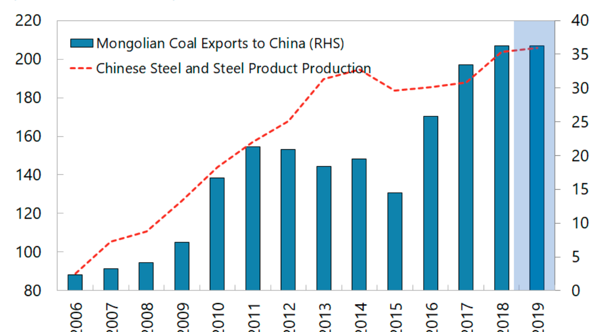
4. **Since 2016, Mongolia has experienced a sharp recovery in real GDP growth, driven primarily by the mining sector.** Rising from about 1 percent (y/y) in 2016, growth reached 6.9 percent in 2018 and 8.6 percent in 2019Q1. Three key factors explain the turnaround. First, annual mineral exports, especially coal, have increased by about 50 percent over two years to reach $6 billion, due to a combination of stronger volumes, reflecting China's rising preference for imported coking coal even as steel production flatlined in recent years, and a significant rise in commodity prices, around 15-20 percent above long-term trends. Second, during the same period, annual foreign direct investment increased from about $300 million to $2.1 billion, due in large part to the resumption of the second investment phase of the OT copper mine. And third, a recovery in domestic confidence and loosening in financial conditions have supported a sharp recovery in bank lending and domestic demand more broadly. Because of the recovery in economic activity and supply side pressures, inflation rose sharply in 2017 and has hovered around the BOM's target of 8 percent since. In recent months, inflation has remained broadly around the 8 percent target, but ticked up slightly in June, reflecting higher food and utilities prices.

**Mineral Export Prices**
(USD Per Metric Ton)




Sources: Haver and Staff Estimates
Prices equal the ratio of value of exports over volume

**Steel and Coal Dynamics**
(In Million Metric Tons)

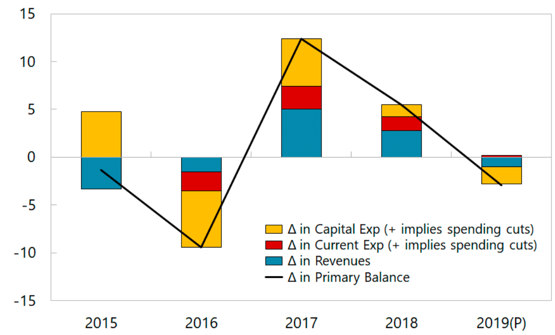



Sources: Haver Analytics.
Note: Shaded region represents projection period.

5. **The fiscal stance tightened substantially in 2017 and 2018, helping reduce public debt**. The primary balance improved from a deficit of 11.2 percent of GDP in 2016 to a surplus of 5.9 percent of GDP in 2018. This significant fiscal consolidation reflected equally strong mining and non-mining revenue mobilization and expenditure restraint. Meanwhile, significant concessional

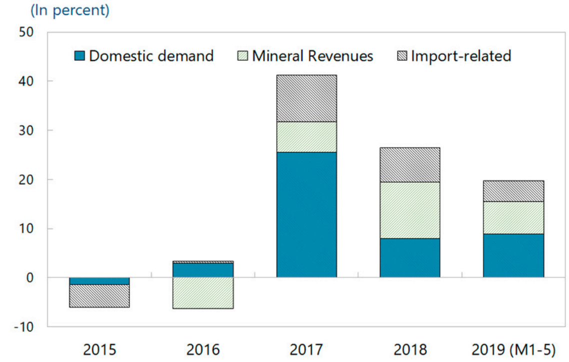
financing contributed to a reduction in the interest bill by 1 percentage point of GDP in 2018. Given the combination of fiscal consolidation, concessional financing, and strong economic activity, public debt fell by 14 ppts over 2 years to reach 73 percent of GDP at end-2018.

**Changes in Primary Fiscal Balance**
(in percent of GDP)




Sources: MoF and Staff Estimates.

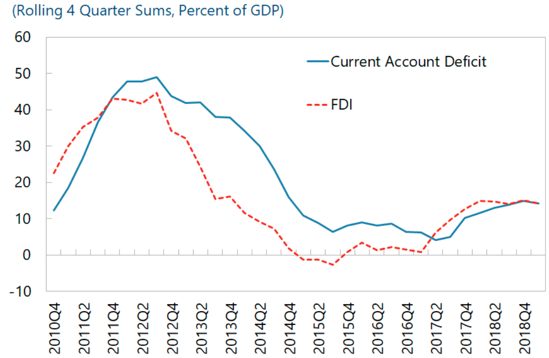
**Year-over-Year Changes in Revenues**
(In percent)




Sources: Mongolian authorities; and Staff estimates

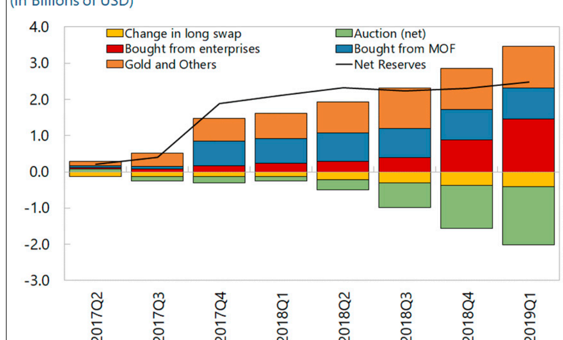
6. **The widening of the current account deficit in recent years mainly reflects the surge in FDI but also some over-heating.** Despite consistent goods surpluses, Mongolia has a structurally large current account deficit due to interest income and dividend payments and services (freight purchases) balances which average a combined 15 percent of GDP. The rise in the current account deficit in recent years to double digit levels largely reflected an increase in FDI-financed imports, which limited the pressure on the overall balance of payments. In this environment, gross international reserves (GIR) rose rapidly—from 37 to 74 percent of the IMF's ARA metric, in 2017—with large scale donor flows and gold purchases from local miners (see Annex VI). However, reserve accumulation over the past 18 months has slowed, due to delays in donor financing, rapid growth in goods imports which peaked at 50 percent in mid-2018, and rising sales by BOM of foreign exchange to limit pressure on the exchange rate.

**Current Account Deficit and FDI**
(Rolling 4 Quarter Sums, Percent of GDP)




Sources: Haver, NSO

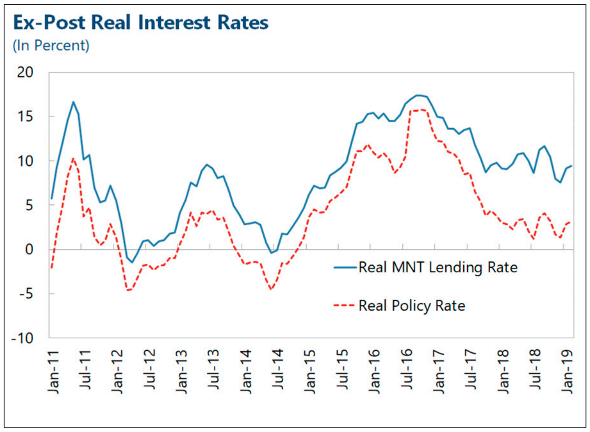
**Cumulative Change in Net FX Reserves, by Source**
(In Billions of USD)

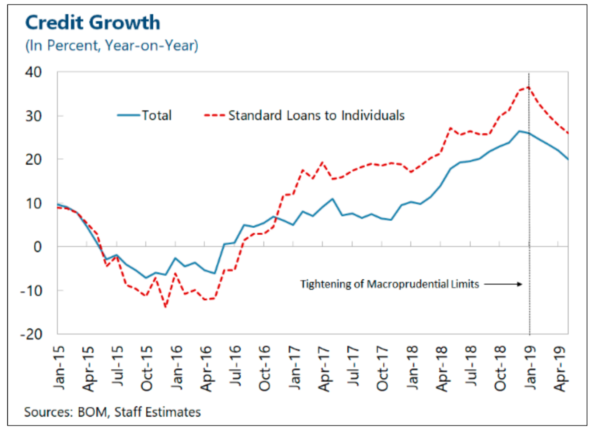



Sources: IMF Staff Estimates.

7. **The Bank of Mongolia has started to address overly rapid credit growth.** As risk perceptions improved in 2017 and 2018, the central bank lowered policy rates by 500 bps (1300bps in real terms given rising inflation) to 10 percent. Easier financial conditions along with a preannouncement of the planned debt-service-to-income (DSTI) prudential limit to be introduced on January 1, 2019, helped credit growth surge to 24 percent y.o.y. as of 2018Q4. The credit growth was driven by sharply rising household leverage with the average debt-service-to-income ratio now

over 50 percent for half of households. Recognizing these concerns, BOM (i) raised policy rates by 100 bps in December 2018 with a tightening bias, (ii) introduced a 30-month loan maturity limit and a ceiling of 60 percent on debt-service-to-income ratios for all new non-mortgage consumer loans effective April 2019, and (iii) increased the risk weight on unhedged FX lending from 120 percent to 150 percent. The macro-prudential limit has been particularly effective and credit growth has started to correct. These actions resulted in a significantly lower level of credit expansion in Q1 2019 but the flow of new credit increased again in Q2 and should continue to be monitored.




**8. Efforts to ensure a sufficiently capitalized and well-regulated banking sector remain incomplete.** Out of the seven banks which the Asset Quality Review (AQR) identified as having shortfalls, one has been closed (Capital Bank) with an estimated fiscal cost of 1 percent of GDP, due to public sector deposits in the bank. The other six banks are reported to have raised most of the capital required by the AQR (about 2 percent of GDP) but there are significant concerns as to whether the transactions comply with local regulations and international best practice. As a result, the authorities agreed under the IMF-supported program to a 'forensic audit' of these transactions as a prior action under the EFF. To date, the BOM has made limited progress on strengthening its regulatory and supervisory framework and the official capital numbers still reflect significant forbearance.

### Box 1. Status of Extended Fund Facility (EFF) Program

The Executive Board of the IMF has completed 5 out of 11 scheduled reviews under the 3-year Fund-supported program originally approved in May 2017. In November 2018, the IMF reached "staff-level agreement" with the authorities on the 6th review. Performance on key quantitative performance criterion had been strong with all end-September targets met. However, implementation of structural benchmarks was mixed with several financial sector reforms delayed, including those related to the follow-up to the AQR.

To address this concern, the authorities committed, as a prior action for the completion of the 6th review, to take supervisory action against any bank which did not raise the capital requested by the BOM by the end 2018 deadline. This prior action has not yet been completed leading to a delay in completing the review.

In addition, information shared by the BOM in early 2019 about the capital that banks had raised triggered several concerns about its consistency with Mongolian regulations and international best practice. As a result, IMF staff also requested that the BOM hire a third party to conduct a forensic audit of the capital raising transactions thus far. If the audit, which was initiated in June 2019, finds information to suggest the source or nature of equity injections thus far is insufficient, banks' capital will be deducted accordingly, and banks will be asked to find new capital in its place.

# OUTLOOK, NEAR-TERM RISKS, AND LONGER-TERM MACRO CHALLENGES

## A. Outlook

9. **Growth is expected to remain robust but decelerate to around 5½ percent by end-2020.** The primary headwinds in projections are slower export growth (real coal volumes, coal and copper prices) and slower credit growth (due to recent macro-prudential measures). Partially offsetting these headwinds, fiscal policy will provide material stimulus in 2019, driven by a normalization in infrastructure spending. Staff projects the primary surplus to fall to about 3 percent of GDP in 2019, still higher than the budget target of 1 percent of GDP due to revenue overperformance and spending under-execution, and to around 1 percent in 2020 assuming the expenditure levels in the authorities recently approved Medium Term Budget Framework. The slower growth will contribute to a reduction in the current account deficit and allow consumer price inflation to converge toward the BOM's target of 8 percent.

**Key Macro Assumptions**

| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|
| Real GDP Growth (%) | 6.9 | 6.5 | 5.4 | 5.1 | 5.6 | 6.0 | 5.0 |
| FDI (USD Billion) | 2.1 | 1.9 | 1.8 | 1.8 | 1.4 | 1.4 | 0.7 |
| Nominal Exports Growth (%) | 12.4 | 10.1 | 2.6 | 8.9 | 7.5 | 9.9 | 7.0 |
| Credit Growth (%) | 23.4 | 18.0 | 17.0 | 15.0 | 15.0 | 16.0 | 17.0 |
| Primary Balance (%of GDP) | 5.9 | 2.8 | 1.1 | -0.5 | -0.5 | -0.5 | -0.5 |
| Gross Reserves (USD Billions) | 3.4 | 3.6 | 4.0 | 4.0 | 3.6 | 3.3 | 2.8 |

10. **Looking further ahead, the outlook for the Mongolian economy remains relatively strong but with declining foreign reserves.** IMF staff assume that the projected near-term fall in prices for key commodities does not continue over the medium term, the OT underground mine comes on line in the 2022-23 timeframe and developments in China do not excessively limit coal exports. In addition, some loosening in fiscal and monetary policies in the period after the IMF-supported program expires is assumed. Under these parameters, growth is projected to remain strong over the medium term (around 5–6 percent) with continued declines in public and external debt *(See Annex IV and V for Public and External Debt Sustainability Assessments)*. However, we also assume that a combination of looser domestic policies, the end of large-scale concessional financing from donors, and continued reluctance to allow the exchange rate to adjust will weigh on foreign exchange reserves, which are projected to fall to 83-84 percent of ARA metric by 2023, reversing projected near-term gains (see Annex VI).

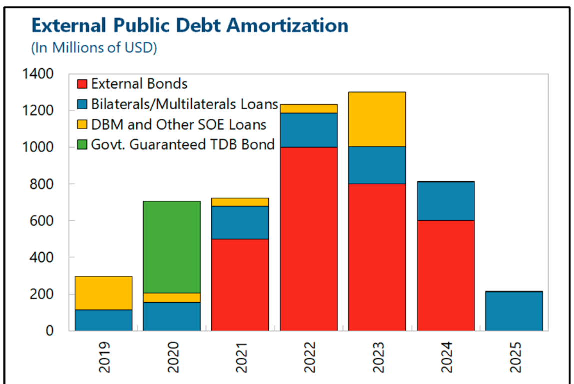
## B. Near-term Risks

11. **Downside risks in the near-term continue to loom large.** Mongolia's narrow economic base - 80 percent of exports are minerals, 90 percent of exports go to China; and half of FDI is in one project – leave it highly exposed to changes in external conditions (*See Annex I for Risk*

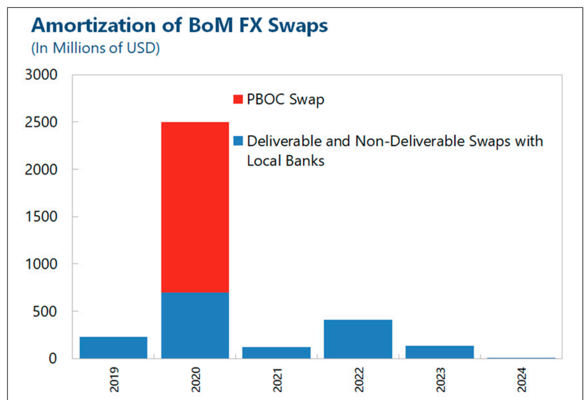
*Assessment Matrix*). In addition, there is significant uncertainty about the economic priorities of future administrations. There are four key risks:

- *Shocks to mineral demand.* Mongolia could be affected by a fall in commodity revenues due to a slowdown in global demand, renewed bottlenecks at the Chinese border, or a reversal of China's growing reliance on imported coking coal to supply its steel sector.

- *External financing risk.* Mongolia faces large external financing requirements in the near-term that could put pressure on the balance of payments, especially in the event the IMF-supported program remains delayed. A $500 million BOM FX swap with a large domestic commercial bank matures in 1H-2020 and the PBoC swap with the BOM ($1.8 billion drawn) expires in August 2020. Starting in 2021, the government faces a series of large bullet amortizations on eurobonds. In the event that the IMF-supported program remains delayed, Mongolia may also lose some access to roughly $500 million in scheduled concessional multilateral and bilateral financing currently assumed in the baseline, which would lead to an increase in the funding costs and could hurt confidence.



Sources: IMF Staff Calculations.



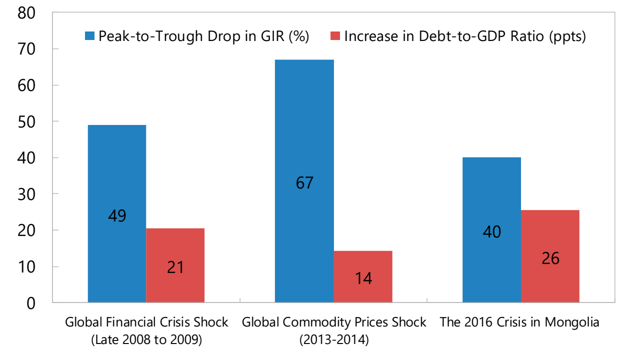
Sources: Mongolian Authorities.

- *Financial stability risks.* With bank recapitalization under the AQR exercise incomplete, several banks remain under-capitalized, including two systemic institutions, and could be a source of financial distress or an amplifier of a shock from elsewhere. Meanwhile, risks also stem from household loans, which make up 50 percent of total credit outstanding and are concentrated in over-leveraged borrowers. Credit losses from these loans could hurt bank profitability and combined with the high household leverage, could exacerbate a recession. Household loans now account for 16 percent of total NPLs, up from 12.5 percent in November 2018. Given the lag in which NPLs materialize and the surge in lending at end-2018, it will be important to monitor this indicator closely going forward.

- *Political Uncertainties and Broader Governance Concerns.* Political pressures during the parliamentary election cycle in 2020 could lead to procyclical policies. The main concerns are a destabilizing easing in monetary and fiscal policies, a return to quasi-fiscal activities, and a disorderly rupture in discussions with OT, leading to a suspension of investment and construction on the underground mine.

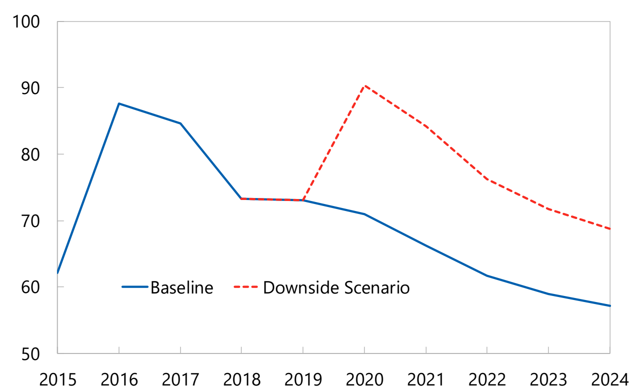
**12. If shocks do materialize, current buffers are insufficient**. Over the last decade, Mongolia has been hit by three large shocks: (i) the global financial crisis (2008-09), (ii) the global commodity price shock (2013-14), and (iii) the domestic crisis of 2016. In these episodes, public debt as a share of GDP increased by 14–26 percentage points, while the GIR fell by 49–67 percent (see chart). To assess Mongolia's buffers under the current baseline, staff calibrated an adverse scenario informed by these past shocks. In the *hypothetical* adverse scenario, commodity prices in 2020–21 fall by a similar magnitude as in the past shock, affecting growth and balance of payments and triggering a policy response akin to that used in past episodes. In such an adverse scenario, the buffers are assessed to be insufficient—as public debt reaches 95 percent of GDP and reserves decline below $1 billion (or just above 0.5 month of imports).

**Size of Vulnerabilities in Mongolia: Impact of Past Shocks**



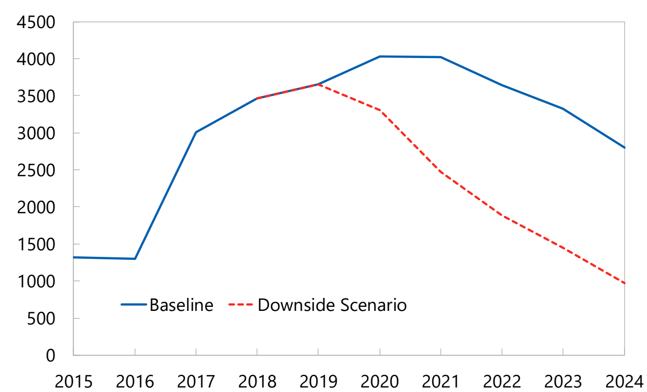

Source: Fund staff calculations
Notes: For the 2009 shock, the GIR calculation is based on difference between End-July 2008 and End-Mar 2009; for the 2013-14 shock, the GIR calculation is based on difference between Jan 1, 2013 and End-Nov 2014; for the 2016 shock, the GIR calculation is based on difference between End-Aug 2015 and End-Feb 2017.

**Debt-to-GDP Ratio**
(In Percent of GDP)




Sources: IMF Staff Estimates

**Gross International Reserves**
(In Millions of Dollars)




Sources: IMF Staff Calculations

### *Authorities' Views*

**13. The authorities were more optimistic than staff about headline growth in the near term.** They see moderate acceleration in the economy this year, citing strong mineral exports in the first five months of the year and the moderate loosening in the budgeted fiscal stance. Looking beyond this year, the authorities shared staff's view that growth will likely moderate in line with a projected deterioration in terms of trade and falling FDI. The authorities also recognized the downside risks cited by staff. They underscored the need for diversification, continued public debt reduction and additional foreign exchange reserves. Nonetheless, the authorities argued that progress under the program had enhanced buffers against external shocks. Moreover, they saw significant upside in the event they can increase the productivity of strategic mining assets via their public investment plans.

## C. Longer-term Macro Challenges

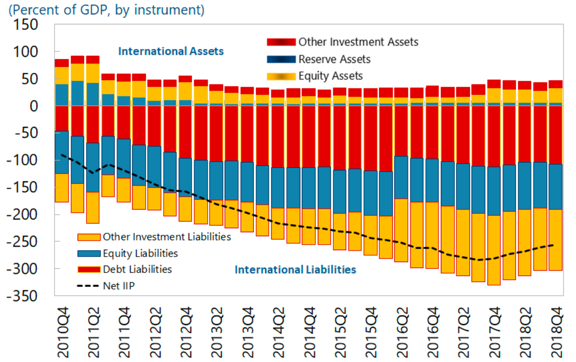
**14. Over the last ten years, external and environmental vulnerabilities have risen in Mongolia.** As a result, Mongolia is less prepared to deal with shocks going forward, whether it is a sharp fall in global growth or a repeat of the extreme climate events that are occurring with increasing frequency. Addressing these concerns will take time and sustained policy effort. Nonetheless, identifying and understanding these challenges is central to securing sustainable growth and macroeconomic stability going forward.

### External Sustainability

**15. While partly necessary to build mining capacity, investment in Mongolia has vastly outpaced national savings, resulting in very high levels of external liabilities.** For the last decade, Mongolia has averaged current account deficits of 20 percent of GDP, leading to a rapid buildup of external liabilities (309 percent of GDP, of which 70 percent is debt)—and deterioration in the Net International Investment Position (NIIP) (-260 percent of GDP). The primary driver is investment to GDP ratios of 40 percent or more. This raises two concerns: (i) while slightly more than half of the liabilities has financed tradable sectors like mining, significant financing has also been absorbed by 'other' private companies for which large data gaps exist about the ability to service the debt, and (ii) some large mining projects have not been completed and still face implementation risk, raising questions about their ability to generate foreign exchange over the medium-term.

**IIP Assets and Liabilities**

(Percent of GDP, by instrument)

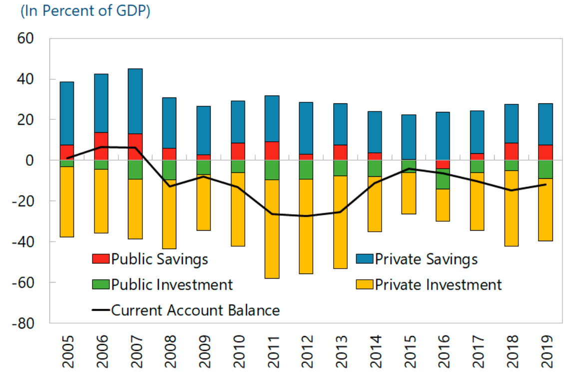



Source: Haver Analytics.

Note: Equity assets include DI and portfolio equities. Debt liabilities include DI and portfolio debt.

**Savings Investment Balance**

(In Percent of GDP)




Sources: IMF Staff Calculations.

**16. Considering Mongolia's sizable external imbalances, staff assesses the external position as substantially weaker than implied by fundamentals and desirable policy settings**. Due to Mongolia's large external stock imbalances, the assessment draws on the EBA-Lite External Sustainability (ES) approach which calculates the external adjustment needed to stabilize the NIIP. The model implies a current account gap of -4 percent of GDP and a real effective exchange rate (REER) overvaluation of 9 percent. However, given how negative this NIIP position is, the goal should be *improving*, not *stabilizing* the NIIP at current levels—suggesting a larger adjustment would be necessary. A more flexible exchange rate—via less sales of foreign exchange – should play a role in making this adjustment. This is particularly important given Mongolia's high inflation relative to trading partners which will erode competitiveness absent nominal depreciation. But given the high proportion of foreign currency denominated public debt, the adjustment should not rely entirely on a weaker currency but rather also tighter macro policies and a more competitive tradable sector (*See Annex VI for External Sector Assessment*).

***Authorities' Views***

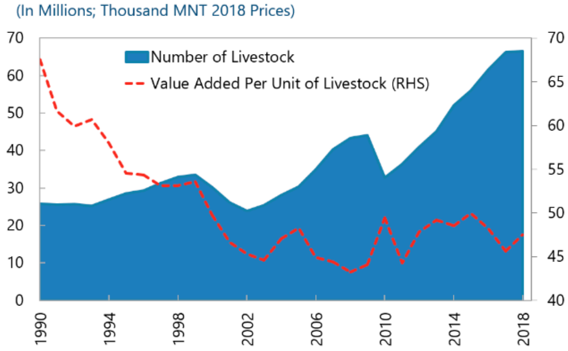
**17. The authorities shared the view that net external liabilities were too large and that building further foreign exchange reserves was a priority**. They disagreed that the exchange rate was excessively overvalued and did not feel that depreciation would help address external imbalances as it could quickly become disorderly and would not demonstrably improve the trade balance given that exports are dominated by commodities and imports are dominated by mining related capital goods, industrial materials and fuel. The BOM emphasized the need for prudent fiscal policy and structural reforms (e.g. better infrastructure, stable investment climate) to improve competitiveness of the export sector.

**Environmental Sustainability**

**18. Massive land degradation is hurting the livestock industry and undermining a key opportunity for diversification.** Mongolia has a comparative advantage in livestock production for either cashmere or meat due to vast grasslands—spanning 80 percent of the country—and proximity to large Asian markets. The sector also employs one in four Mongolians. However, 65 percent of all grasslands are now considered "degraded" (i.e. reduction in land's productive capacity) and over 90 percent of them have experienced some desertification (see SIP). This stems from two worrisome trends:

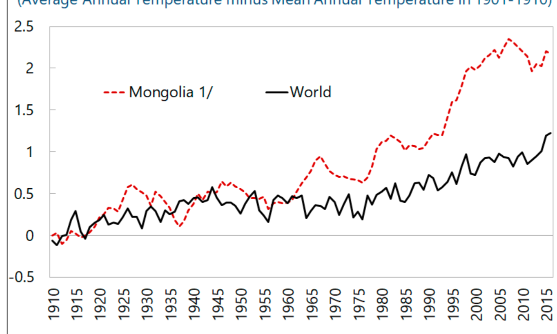
- *Overgrazing* - With virtually no land use regulations since the socialist period, herders responded to rising global demand for cashmere by vastly expanding their goatherds. At the same time, without a developed meat industry and strategic animal breeding there have been no serious limits on livestock growth. Thus, the livestock population almost tripled since 1990 to about 70 million animals now—leading to serious overgrazing pressures.

**Number of Livestock and Estimated Productivity**
(In Millions; Thousand MNT 2018 Prices)




Sources: Mongolian Authorities and Authors' Calculations.

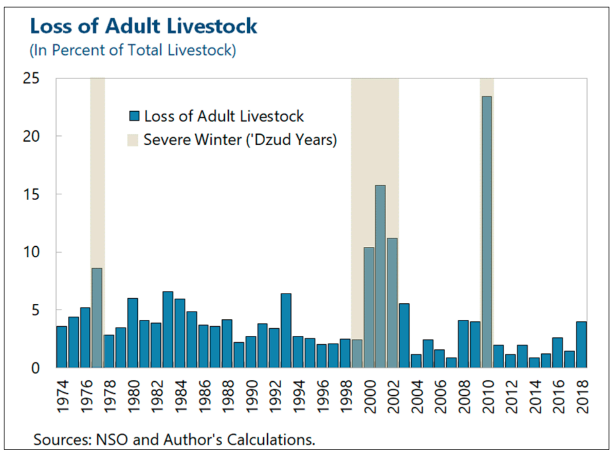
**Temperature Anomalies**
(Average Annual Temperature minus Mean Annual Temperature in 1901-1910)

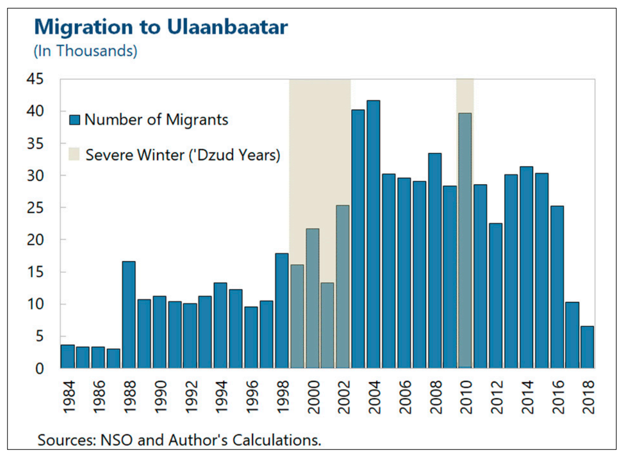



Sources: World Bank, UK Met Office, and Fund Staff Calculations
1/ reported series is a 10 year moving average.

- *Climate Change* - Due to its unique geography, Mongolia has warmed three times faster than the rest of the world and 80 percent of the country is defined as highly vulnerable to climate change. Both the higher average temperatures and the increase in weather extremes have accelerated land degradation.

**19. There are several important macro-critical implications of the land degradation.** First, there is an increase in the severity of livestock loss: during harsh winters ('dzuds'), which have increased in frequency, there can be extreme losses of wealth of up to 15 percent of GDP. Second, there is a decline in the value-added of the sector as the older average age of livestock combined with absence of strategic breeding has led to a decline in cashmere and meat quality. Third, more difficult conditions for herders have resulted in massive emigration to the capital, outpacing the government's ability to provide basic services. This rapid urbanization has contributed to an expansion of the *ger* district (shantytown) which in turn drives up pollution due to the reliance on coal burning for heat. Finally, the size and goat-heavy composition of the Mongolia's livestock accelerates desertification as they destroy the protective crust of the soil that naturally checks wind erosion. Desertification in Mongolia is linked to the intense dust storms ('Yellow Dust') across East Asia leading to rising health and economic costs across the region (*See SIP*).




***Authorities' Views***

**20. The authorities acknowledged the importance of securing environmental sustainability.** With respect to the livestock sector, they shared staff's assessment regarding the drivers of land degradation and overgrazing. The authorities also recognized that the consequences were macro-critical in nature and required a policy response.

# POLICIES FOR STABLE, INCLUSIVE, AND GREEN GROWTH

*To firmly place Mongolia on a stable, inclusive, and green growth path, policy priorities should focus on five broad areas: (A) making fiscal policy sustainable and more equitable, (B) building buffers against external shocks, (C) restoring health to the banking system, (D) making the agriculture sector more productive and resilient to climate shocks, and (E) combatting corruption.*

## A. Macro-Policy Settings

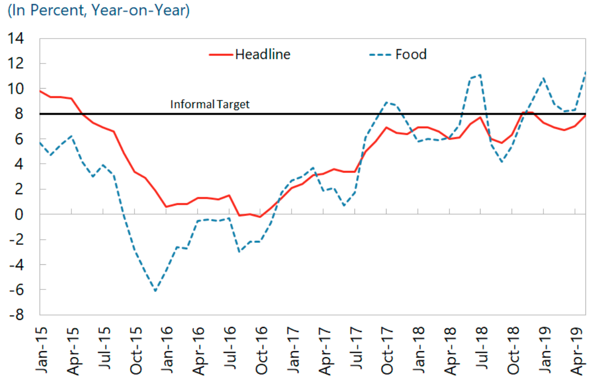
### Fiscal Policy

**21. Fiscal policy should prioritize further debt reduction and proactively address large rollover needs on external debt.** For 2019, the main priority is to refrain from a supplementary budget and save any revenue over-performance to pay down debt faster. Given the large increase in budgeted investment spending this year and constraints on absorptive capacity, some under-execution is expected, which would be appropriate. For 2020–24, the authorities should target a primary surplus of at least 1 percent of GDP, the level necessary to bring the public debt-GDP ratio down to a safe level in the medium term, based on current assumptions (see discussion below). Staff advised that any overperformance should be saved to help further rebuild buffers and guard against downside risks to the debt profile. Staff considers the 2020 expenditure ceilings outlined in the recently approved Medium Term Budget Framework to be broadly consistent with above target: given staff's current macroeconomic projections, the 2020 expenditure ceilings would result in a primary surplus of 1.1 percent of GDP. To further reduce risks around public debt, the authorities should also promptly seek opportunities to refinance the substantial Eurobond amortizations in the 2021–24 period.

### Monetary Policy

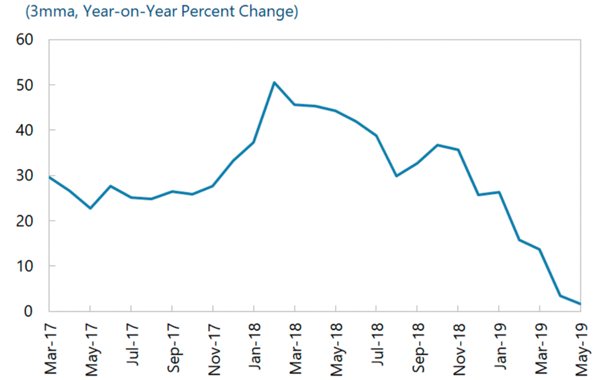
**22. To help correct imbalances, BOM should stand ready to tighten monetary policy further.** The goal of monetary policy in Mongolia should be to anchor inflation below the current target of 8 percent at around 5–6 percent (the current 8 percent target is among the highest in the world and was increased recently from 6 percent to 8 percent in 2014) and help address Mongolia's large external stock imbalances (high external debt, low international reserves). At present, the estimated output gap remains positive, inflation is high at around 8 percent, and the balance of payments are not sufficiently strong to allow fast enough reserve accumulation. However, on a forward-looking basis, there is evidence that the current policy stance has initiated some of the needed correction. The December hike in the policy rate and January tightening in macro-prudential ratios are reducing credit growth sharply, albeit from high levels. Import growth is also decelerating sharply, from 30 percent (y/y) in 2018 to about zero at end-June. These developments, combined

**National Consumer Price Inflation**
(In Percent, Year-on-Year)




Sources: National Statistics Office

**Imports**
(3mma, Year-on-Year Percent Change)




Sources: BOM, Staff Estimates

with broader headwinds to growth in staff's baseline projections, should help inflation moderate going forward. Nonetheless, the BOM should remain vigilant with further tightening as necessary, particularly if credit growth does not continue to decelerate below nominal GDP. In addition, tighter debt-service to income ratios (see ¶30), clear communication to better anchor expectations, and significantly stronger supervision of non-bank institutions would all help achieve key goals of the central bank.

## FX Intervention and Exchange Rate Policy

**23. The BOM should continue to bolster foreign exchange reserves and do so through direct purchases instead of borrowing**. The BOM has made progress in increasing GIR which reached $3.7 billion at end-May 2019, up from $1.3 billion at end-2016. This is however a materially lower pace of accumulation than what would have been possible with less foreign exchange sales by BOM. Moreover, Mongolia has short-term, on and off-balance sheet liabilities of $3.1 billion. If one nets these out, gross reserves would fall to $600 million. In addition, the BOM has $1.2 billion in non-deliverable off-balance sheet swaps which are denominated in FX but settled in local currency and can create indirect pressure on the exchange rate at settlement. The goal over time should be to move away from reliance on such borrowed funds. Specifically, the BOM should undertake direct FX purchases to increase gross reserves, net of any short-term foreign exchange liabilities, to at least 100 percent of the IMF's ARA Metric (a composite of current and capital account obligations) which would imply a $3–4 billion increase from current levels. Such an increase will take time. It will require tight fiscal and monetary policy; limiting sales of foreign exchange to disorderly market conditions, which requires greater acceptance of depreciation, and a stronger investment climate to attract the needed long-term capital flows—see Annex VI: External Sector Assessment.

**Data Template on International Reserves and Foreign Currency Liquidity**
(USD Billions, End-May 2019)

| | |
|---|---|
| **Gross Foreign Assets** | 3706 |
| **Pre-Determined Short-Term Drains on Foreign Currency** | -3076 |
| *of which* | |
| Loans, Securities and Deposits | -2441 |
| Forwards and Futures | -635 |
| ***Memo*** | |
| Financial Instruments Denominated in FX but Settled in Local Currency | -1206 |
| Long Term FX Liabilities | -163 |

Source: Bank of Mongolia

### *Authorities' Views*

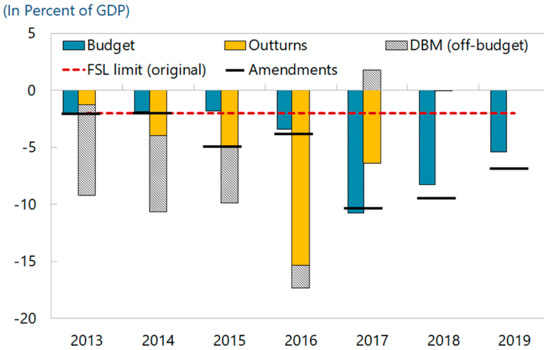
**24. The authorities felt that current policies were broadly appropriate to tackle outstanding macro-risks.** On fiscal policy, the authorities agreed with staff on the need to save any revenue over-performance in 2019 given the importance of debt reduction**.** For next year, the authorities felt their Medium-Term Budget Framework (MTBF) approved in June appropriately balanced spending needs with debt reduction objectives. For monetary policy, the authorities felt that the current stance was appropriate for now. They pointed to national inflation which remains in line with the 8 percent target and felt inflation pressures are contained given the anticipated slowdown of growth. In fact, they foresaw a potential need to loosen given the pace at which credit growth was currently decelerating. The authorities agreed that further accumulation in foreign exchange reserves was necessary but emphasized that the shallow foreign exchange market made it difficult to build reserves and increased the risk of disorderly moves. The BOM felt that material increases in international reserves required a much stronger investment climate and more diversified sources of foreign exchange.

## B. Structural Reforms

### Fiscal Structural

**25. While fiscal performance has been strong under the IMF-supported program, some adjustments to the fiscal framework could help medium term fiscal sustainability.** For most of the years since the Fiscal Stability Law (FSL) took effect in 2013, governments have not fully complied with the original targets in the law (especially if one includes off-budget quasi-fiscal spending) . Going forward, a more independent Fiscal Council could help monitor the budget process and a formal procedure by which the authorities adjust fiscal targets if outturns deviate from expectation would help manage cases of non-compliance. Moreover, to sustain the fiscal discipline demonstrated during the program period, the authorities could consider strengthening the framework *(See SIP)*:

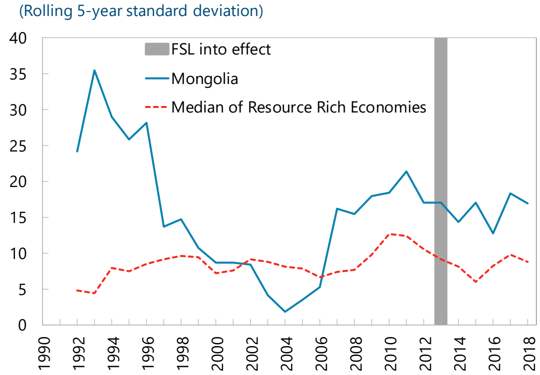
**Structural Fiscal Balance: Rule vs. Actual**
(In Percent of GDP)




Sources: Mongolian authorities; and Staff estimates
Note: The Structural balance is defined by authorities as overall balance minus cyclical revenues on major minerals.

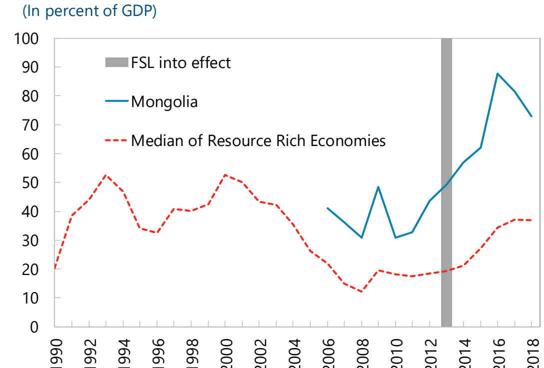
- The structural balance rule could be reconsidered. It is difficult to communicate to the public and challenging to monitor. Moreover, during downturns, it calls for accommodating the cyclical decline in revenue, which could complicate the objective of bringing debt down to prudent levels.
- The debt anchor, currently set at 60 percent of GDP in present valued terms could be tightened and communicated in nominal terms to make it more robust and transparent. Based on an FAD template which calibrates fiscal space based on past shocks, a debt anchor of 50 percent of GDP in nominal terms in the medium term would mitigate the risk of debt exceeding safe levels in the face of adverse shocks.

**Real Expenditure Growth**
(Rolling 5-year standard deviation)




Sources: IMF Staff Estimates.

**Public Debt**
(In percent of GDP)

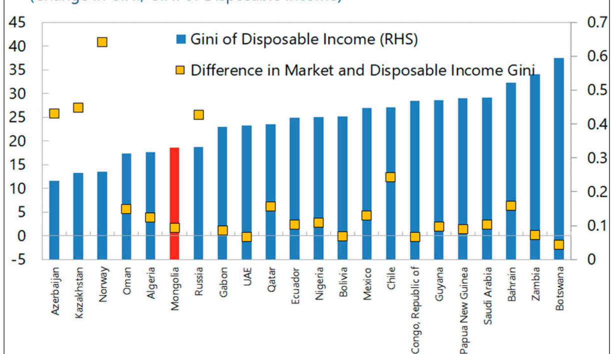



Sources: IMF Staff Estimates.

- Expenditure growth should be constrained sufficiently below the long run historical average growth rate of non-mining nominal GDP to ensure public debt reaches the debt anchor by 2024. Afterwards, public expenditures should grow in line with the long-run average of historical (not projected) non-mining nominal GDP.

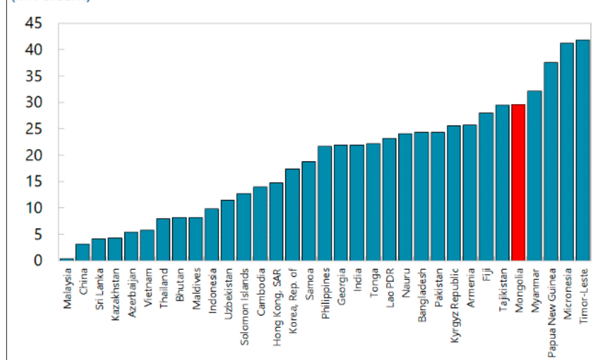
**26. The composition of government spending could be adjusted to better address core social problems.** Mongolia suffers from a high poverty rate (28 percent in 2018) and the second highest mortality rate from non-communicable diseases in Asia. The main social program is an unconditional cash transfer program (Child Money Program) which is effective at reaching a broad segment of the population but has been insufficient to improve living standards of the most vulnerable. The core priorities should be bringing public health expenditures in line with peers, complementing the Child Money program with social programs that better target the poor (e.g. food stamps), and expanding social insurance to protect vulnerable groups from shocks. Such programs could be done in a budget-neutral way by streamlining inefficient public expenditure, gradually re-introducing fuel excise taxes or introducing taxes on luxury cars and moving towards a more progressive personal income tax.

**Inequality and Fiscal Redistribution Dynamics**
(Change in GINI; GINI of Disposable Income)




Sources: IMF Staff Calculations.

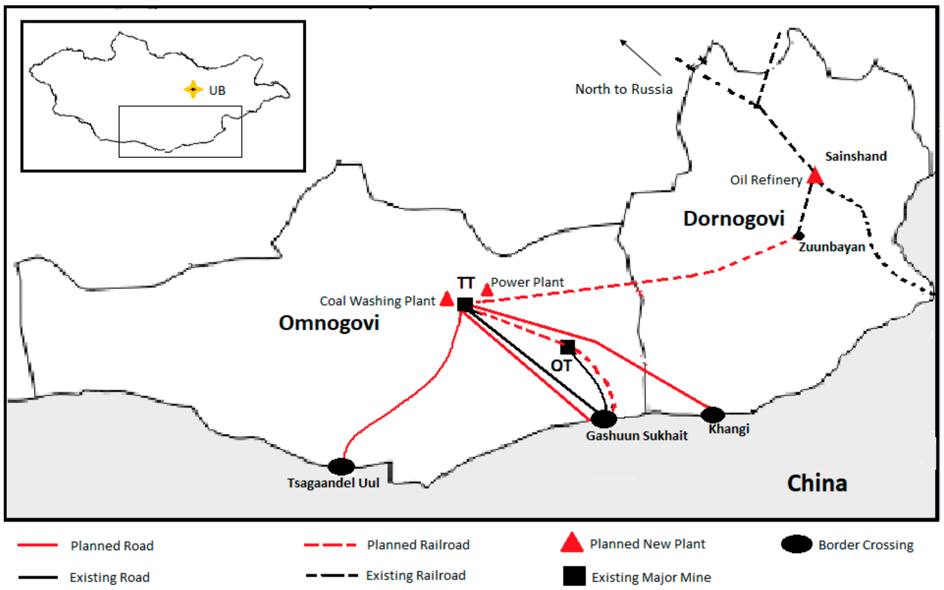
**Proportion of Population Living Below National Poverty Line**
(In Percent)




Sources: ADB

**27. Strengthening fiscal governance around public investment spending is critical, particularly given the ambition of the authorities' spending plans in the coming years.** Historically, public investment spending in Mongolia has raised several concerns: pro-cyclical, uneven quality, and often off-budget (e.g. by the Development Bank of Mongolia) and thus not transparent. In addition, the BoM has in some cases financed this spending, putting severe strains on macroeconomic stability. Encouragingly, the authorities have made progress under the Fund-supported program, both in containing the level of public investment and moving such spending on budget. However, further progress is necessary, particularly given that the authorities have announced intentions to embark on a series of mega projects that aim to overhaul Mongolia's infrastructure (e.g. roads, railroads, power plants and coal-washing plants). Priorities for improving governance around investment spending include: (i) applying the recently adopted investment guidelines to all new capital projects, including PPPs and investments by state-owned enterprises, leading to a unified framework for assessing, selecting and implementing infrastructure projects; (ii) enhancing fiscal risks assessments by including in the yearly budget a discussion of fiscal risks stemming from large infrastructure projects, especially large mega projects; (iii) ensuring that all non-commercial programs with a social objective (e.g. the subsidized mortgage program) are on the general government's budget rather than pushed to SOEs; and (iv) refraining from using BoM's balance sheet for the financing of any quasi-fiscal activity (which is consistent with the new central bank law).

**Map of Planned Mega Projects**




***Authorities' Views***

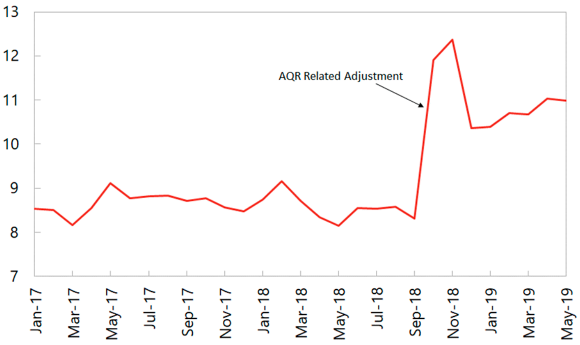
28. **With respect to fiscal structural policies, the authorities felt strongly that this was not the time to revise the fiscal rules framework.** They stressed that political support for the rules had been rising and any attempt to change the framework now would risk weakening key parameters. In addition, the authorities argued that the structural balance rule provided a vehicle to accumulate assets in the two special fiscal funds (Fiscal Stabilization Fund (FSF) and Future Heritage Fund (FHF)). They thought that this is useful even though debt remains high as it promotes discipline and reduces the economy's dependency on the mining sector. On social policy, the authorities preferred to assess the impact of recent increases before committing to increasing social spending. They also saw scope for improving the efficiency of existing programs, particularly in the health sector to enhance service delivery. The authorities fully acknowledged the ambition of planned mega-projects as well as the contingent fiscal risks from taking on such large exposures. They emphasized their commitment to transparency in financing and execution.

## Financial Sector

29. **Commercial bank business practices and Central Bank supervision remain inadequate for ensuring macroeconomic stability.** There are several concerns. First, loan origination lacks adequate due diligence as demonstrated by the recent surge in household lending, often to borrowers with debt service to income above 90 percent. Second, banks' asset classification

standards are short of best practice, leading the AQR in 2018 to require significant changes to NPLs and provisions. Third, the supervisor allows forbearance to flatter banks' end-year accounts which delays the need to strengthen balance sheets. And when banks do raise capital, there are serious concerns about the sources of the equity injection. Fourth, there has been limited progress on initiatives to reform the insolvency law, improve debt enforcement, and incorporate debt restructuring mechanisms. In the near-term, there are four priorities to address these issues and help resume the IMF-supported program:

**Non-Performing Loans**
(Percent of Total Loans)

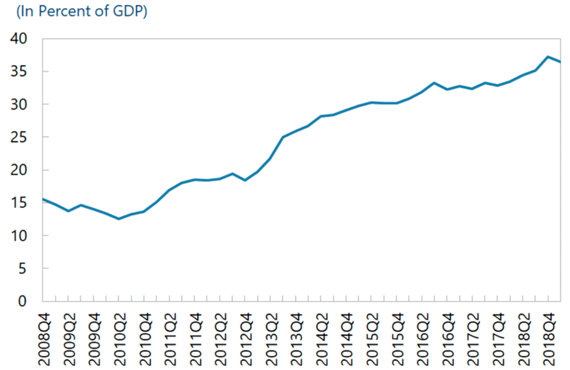



Sources: BOM, Staff Estimates

- The BOM must ensure the completion of an independent forensic audit which provides sufficient information to verify the appropriateness of recent capital injections.
- If the forensic audit finds that any capital raised is not consistent with local regulations and best practice, supervisors should deduct capital accordingly
- The BOM should intervene any bank which does not raise the capital requested in May 2018.
- It is critical to proceed with planned regulations to strengthen standards on loan origination, collateral valuation and asset classification.

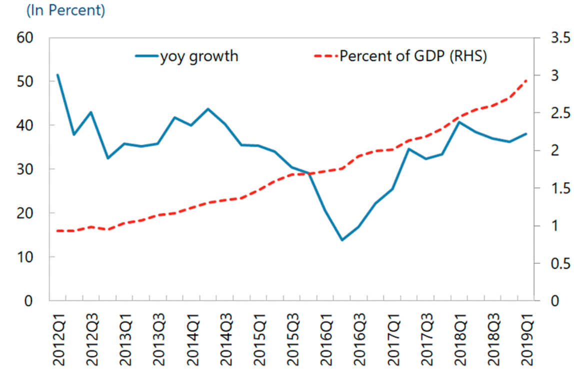
**30. Further tightening in macroprudential ratios and a broadening of their coverage is necessary for financial stability and consumer protection.** The recent move by the BOM to introduce a debt service to income limit of 60 percent was welcome and will help to protect households from unsustainable burdens. However, households are responding to the recent regulations by increasingly relying on non-bank financial institutions which charge considerably higher interest rates (average interest rates of 41 percent vs 17 percent at banks). The immediate imperative is ensuring that the debt-service to income limit has no gaps in coverage by extending to all household loans, regardless of the source (bank or non-bank), use (mortgage or consumer), or collateral (salary or pension). Going forward, the debt service limit should be lowered further as 60 percent remains high by international comparison.

**Household Debt**
(In Percent of GDP)




Sources: Mongolian Authorities.

**Non-Bank Lending**
(In Percent)




Sources: Haver Analytics

In addition, consumer protection needs to be a greater focus of financial sector reforms, including better information provisions (e.g. annual percentage rate (APR) and the impact of depreciation of foreign exchange denominated loans), prohibition of usury practices and designating an adequate institution responsible for the resolution of consumer complaints.

**31. Implementation of recommendations from the 2017 safeguards assessment is ongoing.** Recommendations on the external audit policy and internal audit charter have been completed following review by the Supervisory Board and approval by management. Remaining outstanding recommendations include, transfer of the mortgage program from the BOM to the MOF and peer reviews of internal audit and currency operations. While discussions between the BOM and the MOF are ongoing, agreement on the modalities and the date of transfer of the mortgage program have not yet been reached. To strengthen internal audit, the BOM is in the process of formalizing a technical assistance agreement with a consultant under a World Bank project and work is expected to commence in September 2019. The peer review of currency operations by another central bank is expected to be completed by end-2019.

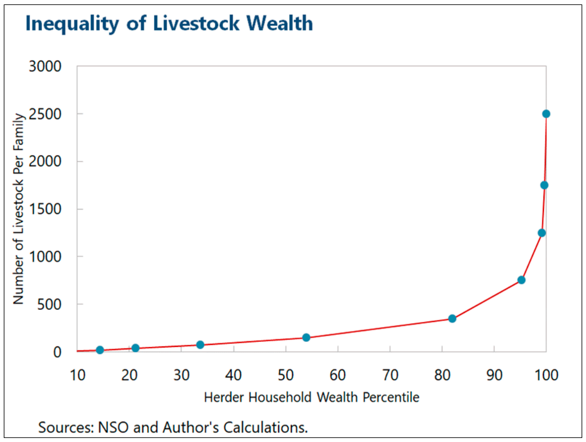
***Authorities Views***

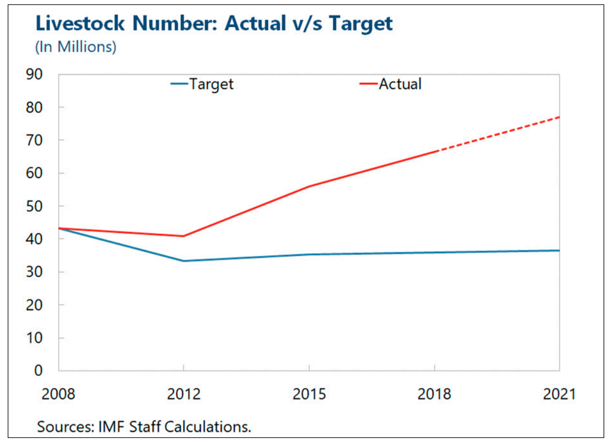
**32. The authorities believe that banks' capital ratios are now in compliance with prudential requirements.** However, they also underscored their commitment to ensuring that banks raise the capital requested by BOM in May 2018 and recognized that the forensic audit will be useful in verifying the integrity of recent capital injections. The Bank of Mongolia shared staff concerns about household debt and saw scope for further tightening in macro-prudential ratios going forward. However, officials were somewhat concerned at the pace of the slowdown in household lending resulting from previous tightening and felt more time was necessary before further changes. The Financial Regulatory Commission did not see financial stability concerns from the recent rise in non-bank lending and thus saw no need at this time to extend debt service to income limits to these institutions.

## Environmental Sustainability and Upgrading the Agriculture Sector

**33. Mongolia cannot do much to slow climate change, but policies can help mitigate its impact while promoting stable and inclusive growth.** Balancing the livestock population with nature's capacity to regrow is crucial to secure the sector's sustainability. While better pasture management and programs to improve livestock productivity are much needed, from a macro perspective two key policies can help (i) using a pasture tax to feasibly cut livestock population in half in line with national targets (as also recommended by other IFIs), and (ii) boost value-added of the entire sector by upgrading the meat and cashmere industry:

- ***A progressive pasture tax***. Ahead of the 2009 presidential election, Parliament repealed all taxes on herders, allowing huge inequality in livestock holdings to persist. Re-introducing a pasture tax with an exception for small/medium herders can reduce herd size and in turn help reduce land degradation and wealth inequality.




- ***Upgrading the meat and cashmere industry***. Stronger meat exports would provide a natural limitation on herd size. The three key priorities for upgrading the meat industry are (1) reduced trade barriers, (2) joint investment in logistics, and (3) cooperation and assistance in addressing food safety concerns (e.g. achieving 'Foot and Mouth Disease Free' status). In addition, improving cashmere quality will enable a larger share of Mongolian cashmere to be used by the luxury garment industry—boosting incomes of herders. This will require better animal management practices, improving grading and standardization, and expanding market access to Mongolian traders. For all of these, Mongolia would benefit from technical assistance, foreign investment, and trade agreements. Securing trade deals that include Mongolia's commitments to curb desertification offers a unique opportunity for a win-win for the region.

***Authorities' Views***

**34. The authorities broadly shared staff's assessment and policy recommendations regarding land degradation and overgrazing in Mongolia.** With respect to a pasture tax, the authorities suggested that enabling local governments to retain and spend the tax revenues to improve pasture quality and address water shortages will increase its political acceptability. The authorities also recognized the imperative of developing the meat sector and emphasized that their current focus is improving phytosanitary standards and further developing logistics.

## Governance

**35. Improving governance is a crucial step for Mongolia to achieve sustainable and inclusive growth.** As a relatively young democracy and a natural resource-based economy, Mongolia has many features that weigh on governance including relatively weak institutions, large lumpy capital projects, and windfall revenues from mining booms. Encouragingly, there are important signs of progress in strengthening governance. The authorities have upgraded the anti-corruption framework and civil society is active in advocating for the required reforms. Nonetheless, more work remains. The authorities should follow through on recommendations identified in the 2019 OECD-Anti-Corruption Network Monitoring Report, including steps to improve the legal framework, strengthen the integrity and independence of judicial and anti-corruption institutions, as well as strengthen the capabilities of the judiciary, especially relating to commercial issues and debt resolution. Given the opportunities for rent seeking, special attention should be focused on politically exposed persons including through enhancing the income and asset declaration framework which will also improve AML/CFT compliance. Other important areas for reform include i) more disclosure/transparency around PPP/concession obligations and the allocation of mining licenses and ii) a more diversified and open shareholding structure of the banks, including through IPOs and foreign bank entry, and iii) strengthening implementation of procurement controls, including at SOEs (*See Annex III and SIP*).

***Authorities' Views***

36. **The authorities agreed with staff that improvements in governance were necessary for sustainable growth.** They highlighted concrete actions in recent years including improvements in the management of Special Funds in the budget, constraints on the DBM and BOM to limit quasi-fiscal spending, better controls over public-private partnerships and a stronger AML/CFT framework. They also highlighted enactment of recent powers to replace prosecutors and judges would strengthen the state's enforcement powers against corruption.

# STAFF APPRAISAL

37. **Mongolia has made major progress since 2017 in boosting growth and increasing resilience, yet vulnerability to external shocks remains.** Growth accelerated to 6.9 percent in 2018 and 8.6 percent in Q1 2019. The fiscal balance has improved by 18 percentage points, enabling public debt to fall by 14 percentage points. Net foreign exchange reserves have increased by about $3 billion since 2016. Structural reforms progressed in several key areas: the budget process is more resilient to political pressure and quasi-fiscal activities were curtailed. Notwithstanding the progress, Mongolia's current buffers are inadequate in the event downside risks materialize. A sharp fall in external demand could halt the growth momentum, reverse public debt dynamics and trigger financial instability.

38. **Tight macro policies are needed for further debt reduction and reserve accumulation.** Public and external debt are still elevated at about 73 and 220 percent of GDP, respectively, at end-2018. The authorities should target a primary surplus of at least 1 percent of GDP beyond 2019 to bring public debt to around 50 percent of GDP in the medium term, and use any revenue overperformance to further rebuild buffers and guard against downside risks to the debt profile. With inflation high and international reserves still too low, further tightening in policy rates may be necessary to ensure price stability and rein in credit growth. The BOM should continue to build FX reserves through spot purchases. Since the external position is assessed to be substantially weaker than implied by fundamentals and desirable policy settings, the BOM should allow a more flexible exchange rate and refrain from FX sales other than preventing disorderly market conditions.

39. **Fiscal governance and the composition of fiscal policy can be improved further to prevent boom-bust cycles.** Current fiscal rules have not been consistently effective in preventing excess fiscal deficits. A streamlining of the framework with a more independent Fiscal Council and a formal correction mechanism would be useful. Regarding the execution of the planned mega

projects, it is important to ensure good governance and refrain from quasi-fiscal spending. There is also scope to strengthen social spending, especially in the public health sector.

**40. The financial sector would benefit from building capital buffers and targeted regulatory tightening.** The BOM needs to ensure banks have raised sufficient capital in a manner consistent with Mongolian law and international best practice. For banks that fail to do so, the BOM should be prepared to take necessary regulatory actions. Going forward, proceeding with tighter regulations on loan origination, collateral valuation, and asset classification will help. In addition, debt service to income limits should be tighter and have broader coverage to address the rapid rise in household debt.

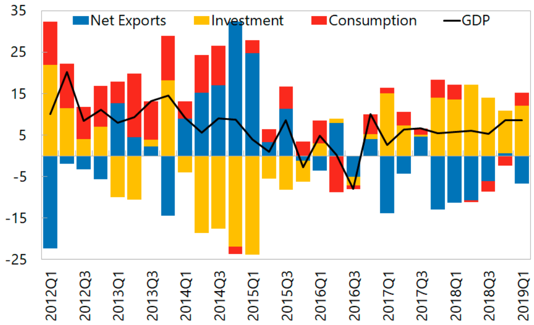
**41. To achieve lasting growth that benefits all Mongolians, the authorities should strengthen governance and diversify the economy in a sustainable manner.** Weak governance and rule of law and the resulting vulnerabilities to corruption remain limiting factors for development. The authorities should improve the legal framework and strengthen the capabilities of the judiciary in line with OECD-ACN recommendations. For economic diversification, upgrading the livestock industries and developing tourism offer vital opportunities to leverage Mongolia's vast grasslands. Policies, such as a progressive pasture tax and better quality control on meat product, can help provide a natural limit on livestock quantity and address the pressing issue of overgrazing.

**It is expected that the next Article IV consultation with Mongolia will be held in accordance with the Executive Board decision on the consultation cycle for members with Fund arrangements.**

## Figure 1. Real Sector Developments

*Growth continued to accelerate in 2018, driven on expenditure side by robust investment…*

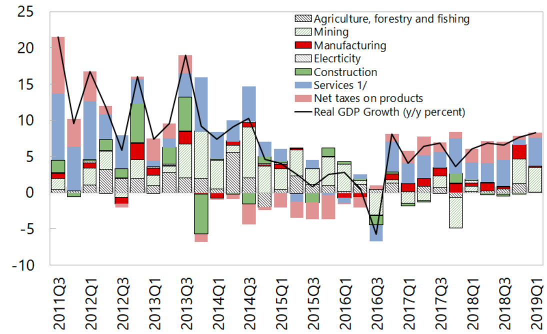
**Real GDP Growth: Expenditure Side**
(Contribution; Year-on-Year Percentage Change)




Sources: IMF Staff Estimates

*…and on supply side by services…*

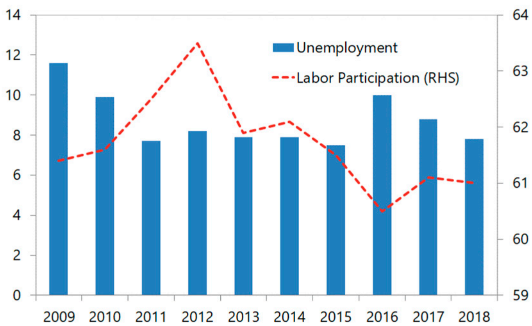
**Real GDP Growth: Supply Side**
(Contribution; Year-on-Year Percentage Change)




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

*The unemployment rate has returned to the pre-crisis lows but labor force participation remains low…*

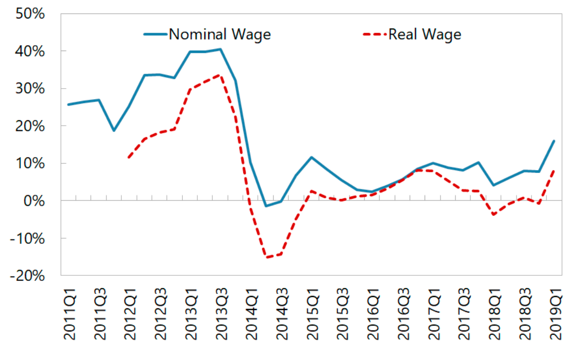
**Labor Market**
(In Percent)




Sources: Haver Analytics

*…and real wage growth has remained flat.*

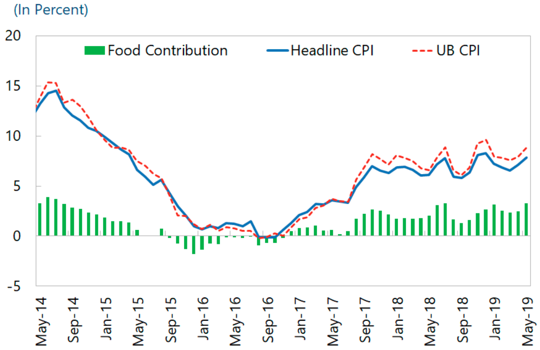
**Nominal and Real Wage Growth**
(In Percent, Year-on-Year)




Sources: CEIC, Haver Analytics and IMF Staff Calculations

*Inflation remains somewhat high, broadly in line with the authorities target of 8 percent…*

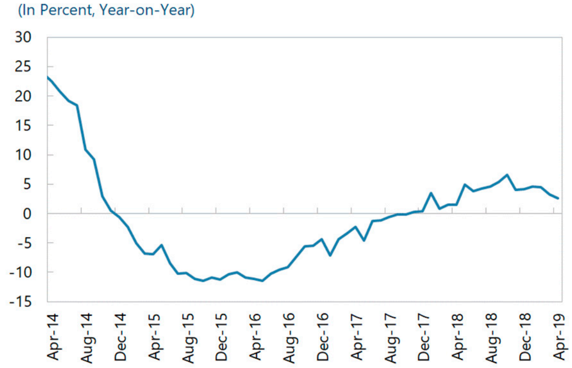
**National Consumer Price Inflation**
(In Percent)




Sources: Haver Analytics.

*…while housing price inflation has started to moderate.*

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

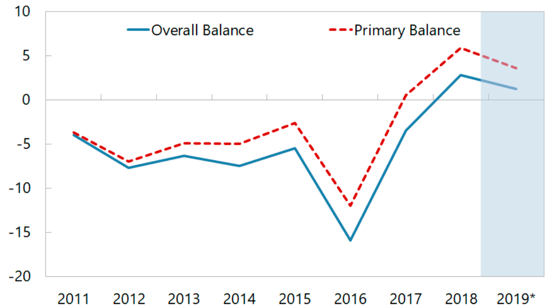


Sources: Haver Analytics; and IMF Staff Calculations

## Figure 2. Fiscal Sector Developments

*Fiscal performance improved substantially in 2018…*

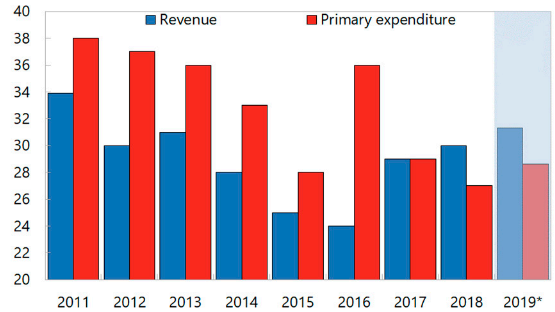
**Fiscal Balance**
(In Percent of GDP)




Sources: Mongolian Authorities and IMF staff calculations
Note: The balance excludes DBM. 2019 is an estimate

*…supported by both a reduction in expenditures and continued strong revenue performance.*

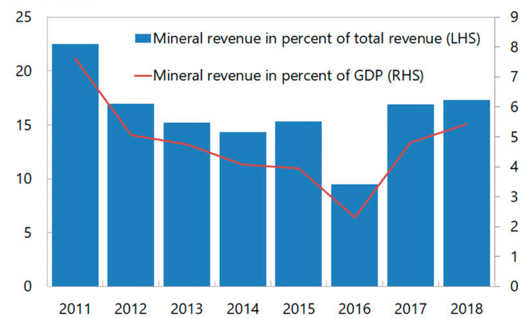
**Revenue and Primary Expenditure**
(In Percent of GDP)




Sources: Haver Analytics; Staff Estimates
Note: The expenditure excludes DBM. 2019 is an estimate

*The strong revenues reflect robust mining activities and solid domestic demand.*

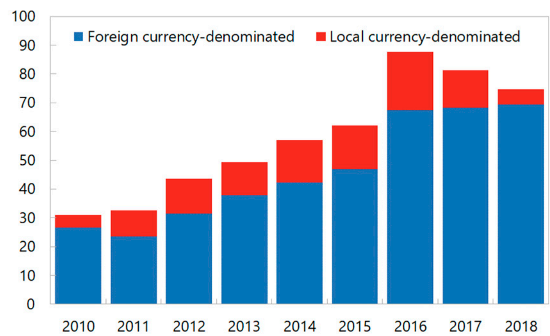
**Direct Mining Related Revenues**
(In Percent)




Sources: Mongolian Authorities; IMF staff estimates

*Because of the strong fiscal outturn and growth, the public debt ratio continued to decline rapidly…*

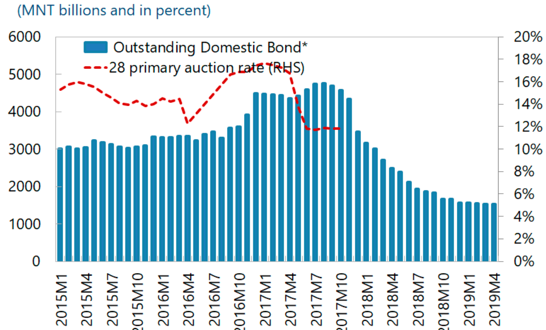
**Public Debt**
(In Percent of GDP)




Sources: Mongolian Authorities, IMF Staff Estimates

*…particularly with respect to domestic debt.*

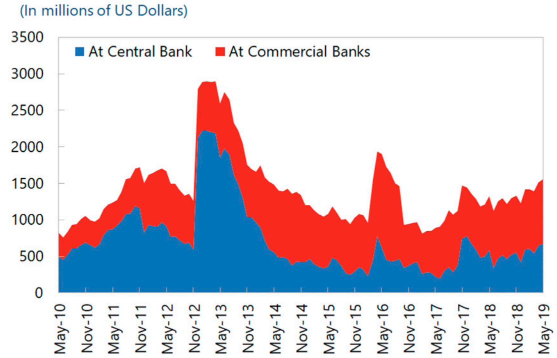
**Government Securities**
(MNT billions and in percent)




Sources: Ministry of Finance
*These are primary market issuance

*Meanwhile, public deposits have continued to rise.*

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

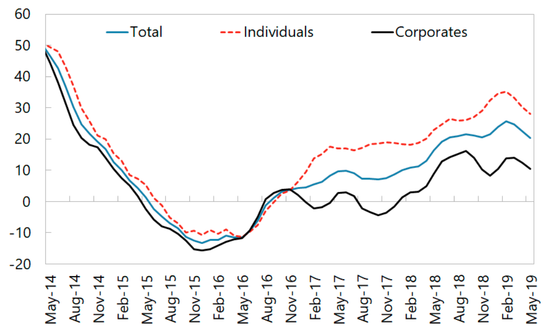



Sources: Haver Analytics

## Figure 3. Financial Sector Developments

*Private sector credit growth accelerated sharply to above 20 percent in 2018, driven mostly by strong lending to households.*

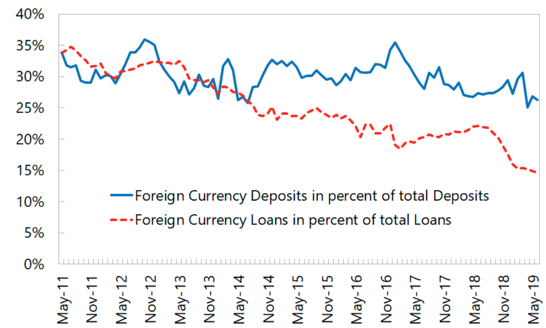
**Credit Growth**
(Year-on-Year Percent Change of 3 Month Moving Average)




Sources: Haver Analytics and IMF staff calculations

*The share of foreign currency loans has declined sharply in recent years, while the share of FX deposits has been broadly stable.*

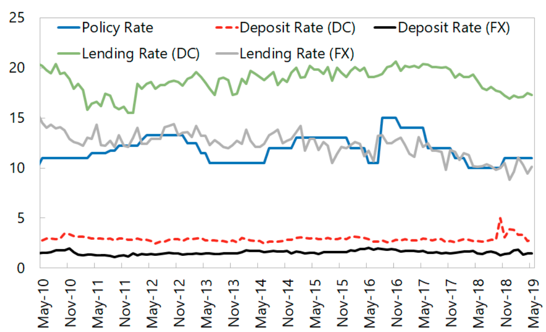
**Loans and Deposits in FX**
(In Percent)




Sources: CEIC and IMF Staff Calculations

*Nominal lending rates have fallen as a lagged response to the rate cuts in 2017.*

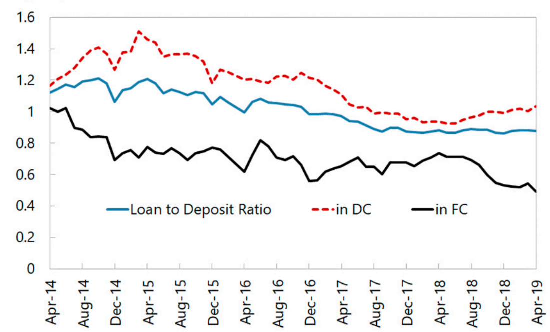
**Interest Rates**
(In Percent)




Sources: CEIC and Haver Analytics

*Meanwhile, the aggregate loan-to-deposit ratio has been stable below 1 since early 2018.*

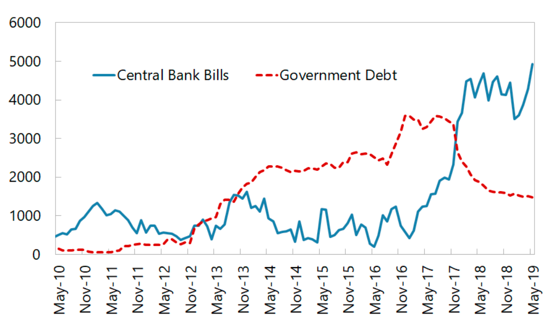
**Loan to Deposit**
(Ratio)




Sources: IMF Staff Calculation

*As the government has retired Tbills, banks have shifted towards holding central bank bills as liquid assets.*

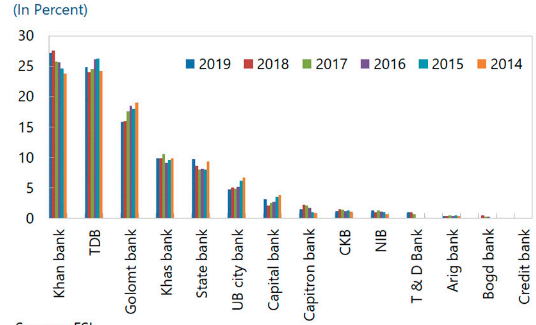
**Banks' Exposure to the Public Sector**
(MNT Billions)




Sources: Haver, BOM.

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

**Market Share by Bank**
(In Percent)

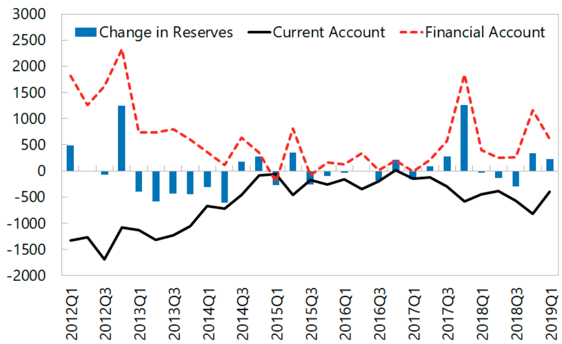



Sources: FSI
Note: TDB stands for Trade and Development Bank; CKB stands for Chinggis Khan Bank; T&D Bank stands for Transport and Development Bank; NIB stands for National Investment Bank

## Figure 4. External Sector Developments

*The external accounts have been broadly balanced…*

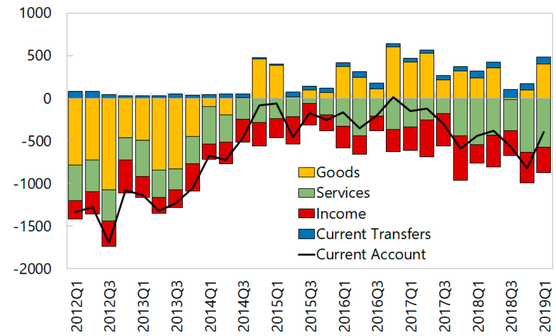
**Balance of Payments**
(In millions of US dollars)




Sources: Haver Analytics

*With a large current account deficit…*

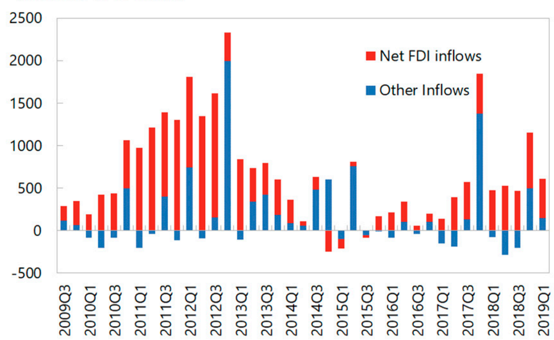
**Current Account Balance**
(In millions of USD)




Sources: Haver Analytics.

*…driven primarily by strong mining related FDI flows…*

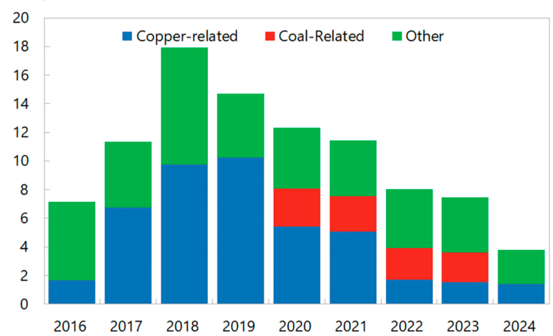
**Net Capital Inflows**
(In millions of US dollars)




Sources: Haver Analytics

*…which are expected to decline over the medium term.*

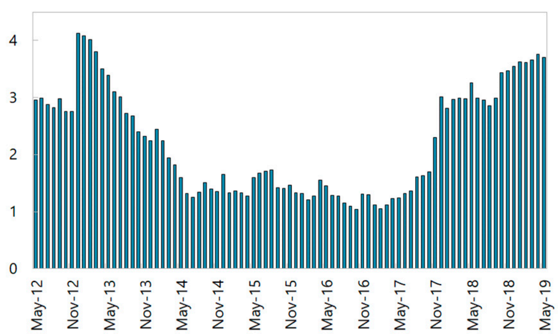
**FDI Inflows**
(In percent of GDP)




Sources: Haver Analytics, Staff Estimates

*Gross reserves continue to increase, helped at margin by gold purchases, FX swaps, and purchases from firms…*

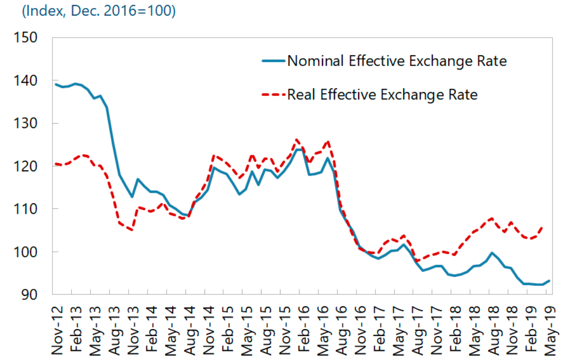
**Gross International Reserves**
(In billions of USD)




Sources: Mongolian authorities

*…while the real effective exchange rate has appreciated despite sizeable nominal depreciation.*

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

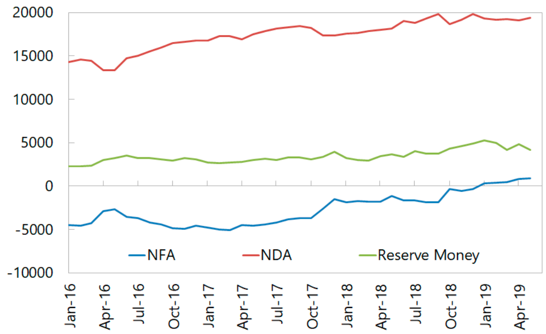



Sources: Haver Analytics

## Figure 5. Monetary Sector

*In 2018, net foreign assets of the BOM continued to strengthen due to foreign exchange accumulation…*

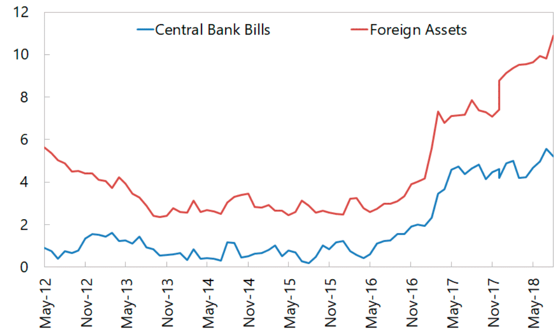
### BOM NFA, NDA and Reserve Money
(In Billions of Togrog)




Sources: BOM

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

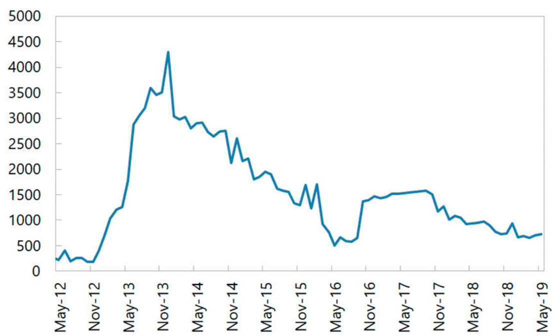
### BOM Foreign Assets and Central Bank Bills
(In Millions of Togrog)




Sources: BOM

*BOM has continued to unwind the large scale direct lending to banks of the past…*

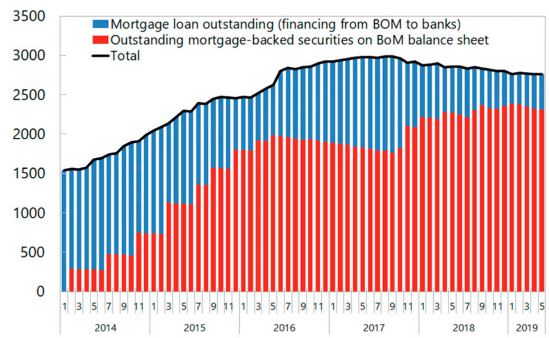
### BOM Claims on Banks
(In billions of togrog)




Sources: BOM

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

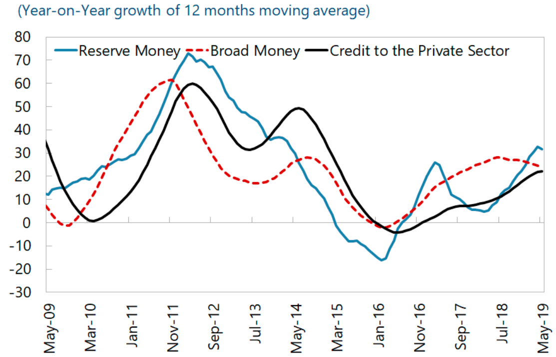
### Mortgage Exposure
(Billions of MNT)




Source: BOM

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

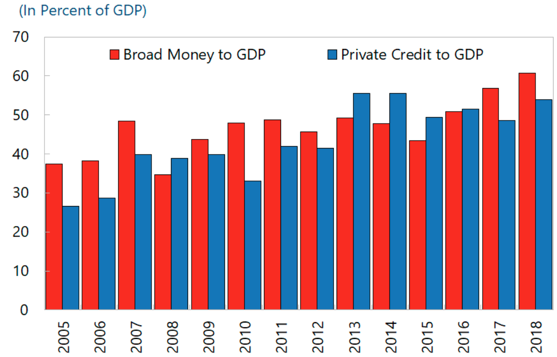
### Reserve Money, Broad Money and Private Credit
(Year-on-Year growth of 12 months moving average)




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)

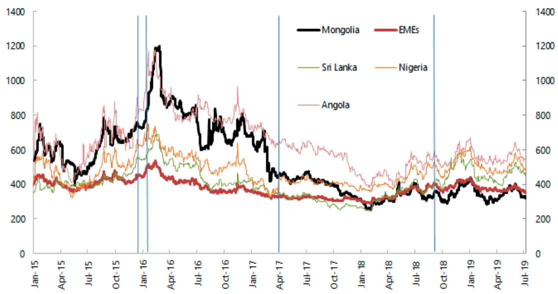



Sources: BOM Staff Calculations

## Figure 6. Markets

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

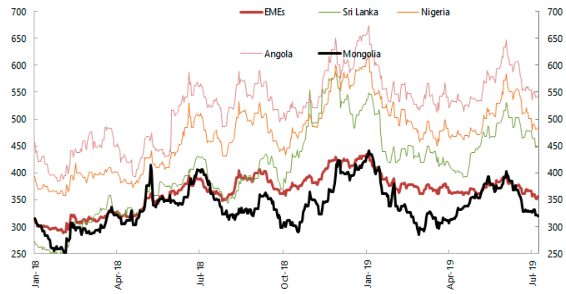
**EMBI Global Sovereign Spreads**
(In basis points)




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

*…but, more recently, Mongolia's spreads have mostly traded sideways…*

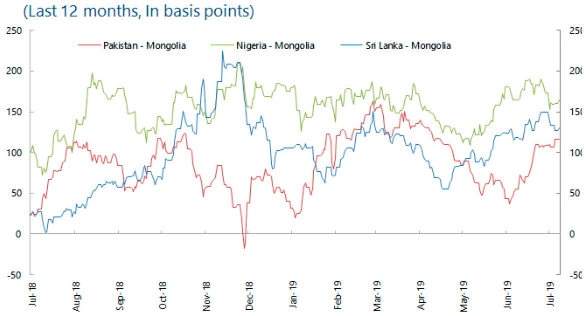
**EMBI Global Sovereign Spreads**
(Last 6 months, In basis points)




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

*…Including relative to other frontier economies.*

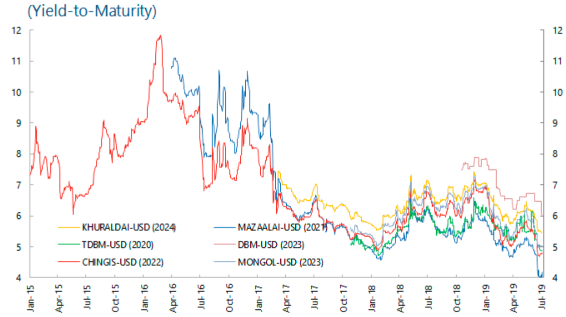
**EMBI Spread Differences**
(Last 12 months, In basis points)




Sources: Bloomberg LP

*External borrowing costs remain about half of the level seen at the start of the program.*

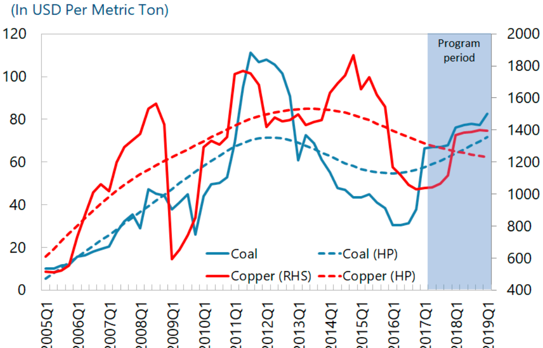
**Outstanding Govt. Bonds**
(Yield-to-Maturity)




Sources: Bloomberg LP

*Prices of Mongolia's major export commodities have risen over the last 3 years.*

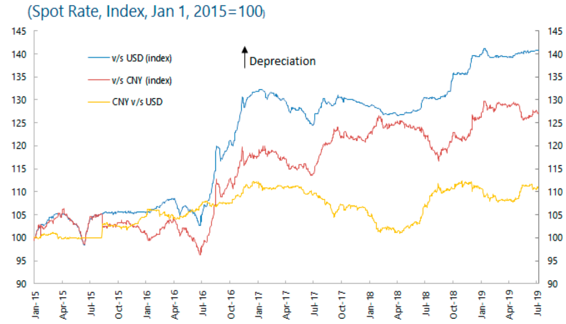
**Mineral Export Prices**
(In USD Per Metric Ton)




Sources: Haver and Staff Estimates
Prices equal the ratio of value of exports over volume

*After a period of depreciation against the dollar and renminbi in 2018, the currency has again stabilized.*

**Exchange Rate: Togrog**
(Spot Rate, Index, Jan 1, 2015=100)

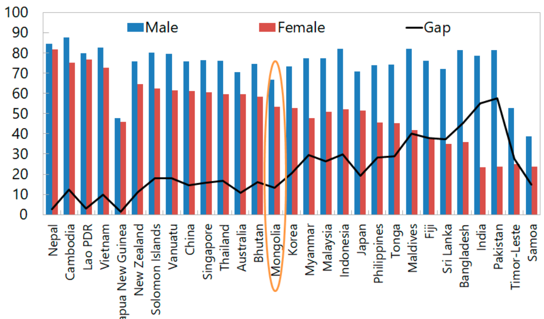



Sources: Bloomberg LP

## Figure 7. Gender

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

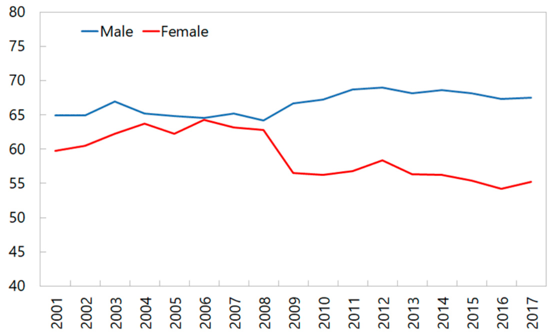
### Labour Force Participation in Asia
(2018; In Percent of Male and Female Population Respectively)




Sources: World Development Indicators

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

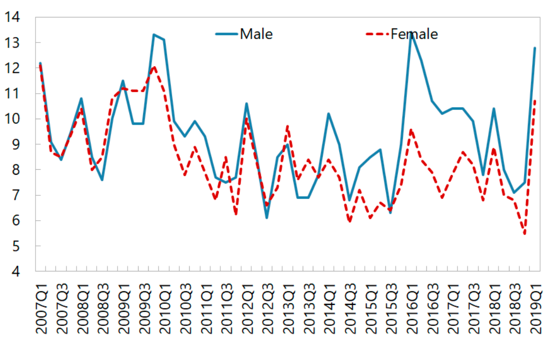
### Labour Force Participation Rates
(In Percent of Working Age Population)




Sources: National Statistics Offfice and World Development Indicators

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

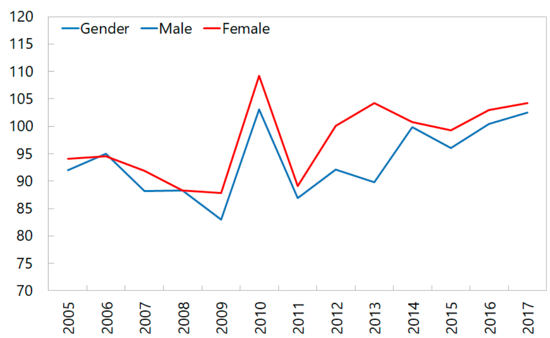
### Unemployment
(In Percent)




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

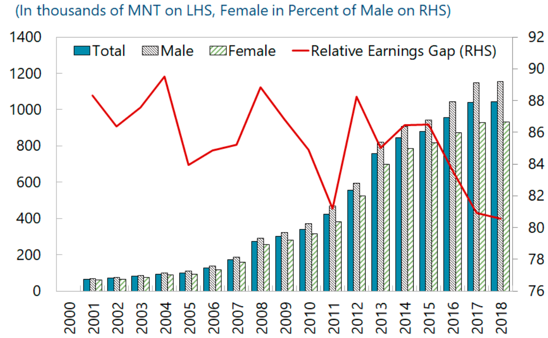
*Mongolia has relatively low gender inequality relative to regional peers…*

### 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, 2016-24

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| | Act. | Act. | Act. | ← | | Proj. | | | → |
| | (In percent of GDP, unless otherwise indicated) | | | | | | | | |
| ***National Accounts*** | | | | | | | | | |
| Nominal GDP (in billions of togrogs) | 23943 | 27876 | 32094 | 37129 | 42092 | 47531 | 53652 | 60002 | 66798 |
| Real GDP growth (percent change) | 1.2 | 5.3 | 6.9 | 6.5 | 5.4 | 5.1 | 5.6 | 6.0 | 5.0 |
| Domestic Demand | 0.2 | 12.1 | 12.8 | 9.7 | 3.9 | 5.9 | 1.6 | 5.1 | 4.3 |
| Consumption | -0.2 | 3.9 | -1.2 | 1.0 | -1.3 | 6.3 | 8.7 | 5.5 | 9.5 |
| *Private* | -2.6 | 5.4 | -1.7 | 0.1 | -3.1 | 6.6 | 9.6 | 5.4 | 10.7 |
| *Public* | 10.6 | -1.8 | 0.5 | 5.0 | 5.4 | 5.1 | 5.6 | 6.0 | 5.0 |
| Investment | 1.3 | 35.2 | 43.5 | 22.6 | 10.3 | 5.5 | -6.3 | 4.5 | -2.5 |
| *o/w GFCF* | 0.5 | 35.6 | 22.6 | 26.8 | 15.1 | 5.3 | -4.3 | 6.3 | -2.7 |
| Exports of G&S | 13.8 | 14.8 | 14.1 | 13.6 | 8.5 | 13.7 | 12.6 | 14.9 | 12.1 |
| Imports of G&S | 12.7 | 24.8 | 21.4 | 16.7 | 6.4 | 13.7 | 7.9 | 13.4 | 11.2 |
| Contributions to Real GDP (ppts) | | | | | | | | | |
| *Domestic Demand* | 0.2 | 11.7 | 13.2 | 10.5 | 4.3 | 6.5 | 1.8 | 5.4 | 4.6 |
| *Net Exports of G&S* | 1.0 | -6.3 | -6.3 | -4.0 | 1.1 | -1.4 | 3.8 | 0.6 | 0.4 |
| Gross national saving | 26.0 | 21.3 | 25.4 | 28.8 | 33.3 | 33.8 | 31.4 | 31.6 | 28.5 |
| *Public* | -3.6 | 3.1 | 8.3 | 8.4 | 8.2 | 8.7 | 8.8 | 9.0 | 9.0 |
| *Private* | 29.6 | 18.2 | 17.0 | 20.4 | 25.1 | 25.1 | 22.6 | 22.6 | 19.5 |
| Gross capital formation | 25.7 | 31.4 | 42.3 | 43.2 | 45.7 | 45.1 | 40.8 | 40.4 | 37.3 |
| *Public* | 9.9 | 5.9 | 5.0 | 7.8 | 8.3 | 10.3 | 10.2 | 10.6 | 10.7 |
| *Private* | 15.9 | 25.4 | 37.3 | 35.4 | 37.4 | 34.8 | 30.7 | 29.8 | 26.6 |
| ***Prices*** | | | | | | | | | |
| Consumer Prices (EoP; percent change) | 0.8 | 7.2 | 9.7 | 8.4 | 8.1 | 7.0 | 6.9 | 7.1 | 7.2 |
| Copper prices (US$ per ton) | 4868 | 6170 | 6530 | 6058 | 5991 | 6045 | 6090 | 6123 | 6123 |
| Gold prices (US$ per ounce) | 1248 | 1257 | 1269 | 1288 | 1309 | 1336 | 1367 | 1393 | 1393 |
| Oil price (in U.S. dollars per barrel) | 42.8 | 52.8 | 68.3 | 65.5 | 63.9 | 60.7 | 58.5 | 57.6 | 57.6 |
| GDP deflator (percent change) | 2.2 | 10.5 | 7.7 | 8.6 | 7.6 | 7.4 | 6.9 | 5.5 | 6.0 |
| ***General government accounts*** | | | | | | | | | |
| Primary balance (IMF definition) 1/ | -11.2 | 0.4 | 5.9 | 3.0 | 1.1 | -0.5 | -0.5 | -0.5 | -0.5 |
| Total revenue and grants | 24.4 | 28.5 | 31.4 | 30.9 | 30.2 | 30.2 | 29.9 | 30.3 | 30.4 |
| Primary expenditure and net lending | 35.5 | 28.2 | 25.5 | 28.0 | 29.1 | 30.7 | 30.4 | 30.8 | 30.9 |
| Interest | 4.1 | 4.1 | 3.3 | 2.4 | 2.0 | 1.7 | 1.4 | 1.6 | 1.6 |
| Overall balance (IMF definition) 2/ | -15.3 | -3.8 | 2.6 | 0.6 | -0.9 | -2.2 | -1.9 | -2.1 | -2.1 |
| Gross Financing Needs | 18.0 | 3.6 | 5.3 | 2.4 | 2.6 | 7.0 | 9.5 | 8.2 | 6.6 |
| General government debt 3/ | 87.6 | 84.6 | 73.3 | 73.0 | 71.0 | 66.2 | 61.7 | 58.9 | 57.2 |
| *Domestic* | 20.2 | 13.6 | 5.3 | 4.2 | 3.0 | 2.2 | 1.5 | 2.8 | 4.9 |
| *External* | 67.5 | 71.0 | 68.0 | 68.9 | 68.0 | 64.0 | 60.1 | 56.1 | 52.3 |
| ***Monetary sector*** | | | | | | | | | |
| Broad money growth (percent change) | 21.0 | 30.4 | 22.8 | 25.4 | 13.4 | 12.9 | 12.9 | 11.8 | 11.3 |
| Reserve money growth (percent change) | 24.6 | 30.5 | 19.1 | 17.1 | 13.8 | 17.6 | 12.3 | 17.5 | 17.7 |
| Credit growth (percent change) | 6.7 | 11.1 | 23.4 | 18.0 | 17.0 | 15.0 | 15.0 | 16.0 | 17.0 |
| ***Balance of payments*** | | | | | | | | | |
| Current account balance | -6.3 | -10.1 | -17.0 | -14.4 | -12.4 | -11.3 | -9.5 | -8.8 | -8.8 |
| Exports of goods (y/y percent change) | 4.1 | 21.4 | 12.4 | 10.1 | 2.6 | 8.9 | 7.5 | 9.9 | 7.0 |
| Imports of goods (y/y percent change) | 0.8 | 25.3 | 35.4 | 1.4 | 0.3 | 9.4 | 2.8 | 8.7 | 6.0 |
| Gross official reserves (in USD millions) 4/ | 1297 | 3012 | 3461 | 3655 | 4033 | 4018 | 3638 | 3325 | 2802 |
| *(In months of imports)* | 2.4 | 4.0 | 4.7 | 5.0 | 5.0 | 4.9 | 4.1 | 3.5 | 2.9 |
| ***Exchange rate*** | | | | | | | | | |
| Togrog per U.S. dollar (eop) | 2490 | 2427 | 2644 | … | … | … | … | … | … |
| ***Memorandum item*** | | | | | | | | | |
| Population in million (eop) | 3.1 | 3.2 | 3.2 | … | … | … | … | … | … |

Sources: Mongolian authorities; and Fund staff projections.
1/ DBM spending is excluded from fiscal balance and monitored separately.
2/ Excludes privatization receipts; includes interest financed mortgage spending from 2017 onwards.
3/ General government debt data excludes SOEs debt and central bank's liabilities from PBOC swap line.
4/ Gross official reserves includes drawings from swap line.

## Table 2a. Mongolia: Summary Operations of the General Government, 2016–24

(In billions of togrogs)

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| | Act. | Act. | Act. | ← | | Proj. | | | → |
| Total revenue and grants | 5835 | 7958 | 10063 | 11478 | 12702 | 14364 | 16055 | 18159 | 20280 |
| Current revenue | 5756 | 7896 | 10024 | 11353 | 12639 | 14343 | 16031 | 18133 | 20251 |
| Tax revenue and social security contributions | 4951 | 7013 | 9035 | 10281 | 11424 | 12972 | 14483 | 16401 | 18323 |
| Income taxes | 1043 | 1610 | 2086 | 2406 | 2650 | 3020 | 3415 | 3904 | 4379 |
| CIT | 520 | 962 | 1277 | 1487 | 1611 | 1848 | 2092 | 2424 | 2732 |
| PIT | 523 | 648 | 809 | 919 | 1039 | 1173 | 1323 | 1479 | 1647 |
| Social security contributions | 1110 | 1321 | 1621 | 1881 | 2226 | 2497 | 2801 | 3132 | 3487 |
| VAT | 1141 | 1619 | 2196 | 2438 | 2646 | 3015 | 3308 | 3746 | 4170 |
| Excise taxes | 630 | 520 | 754 | 854 | 966 | 1087 | 1216 | 1360 | 1515 |
| Customs duties and export taxes | 328 | 512 | 682 | 750 | 791 | 905 | 973 | 1083 | 1206 |
| Other taxes | 698 | 1431 | 1694 | 1953 | 2144 | 2448 | 2769 | 3176 | 3567 |
| Non-tax revenue | 805 | 882 | 989 | 1072 | 1215 | 1372 | 1549 | 1732 | 1928 |
| Total expenditure and net lending | 9495 | 9013 | 9223 | 11272 | 13061 | 15409 | 17065 | 19395 | 21700 |
| Current expenditure | 6614 | 7039 | 7348 | 8245 | 9179 | 10220 | 11312 | 12735 | 14208 |
| Wages and salaries | 1747 | 1800 | 1879 | 2215 | 2511 | 2836 | 3201 | 3580 | 3985 |
| Purchase of goods and services | 1386 | 1337 | 1438 | 1732 | 1964 | 2218 | 2503 | 2799 | 3117 |
| Subsidies | 229 | 261 | 228 | 252 | 256 | 321 | 363 | 406 | 452 |
| Transfers | 2265 | 2484 | 2757 | 3152 | 3624 | 4038 | 4502 | 5014 | 5569 |
| Interest payments | 986 | 1156 | 1047 | 893 | 823 | 807 | 743 | 936 | 1086 |
| Capital expenditure and net lending | 2882 | 1974 | 1875 | 3027 | 3883 | 5189 | 5754 | 6660 | 7492 |
| Capital expenditure | 2360 | 1658 | 1608 | 2899 | 3491 | 4920 | 5450 | 6346 | 7148 |
| Domestically-financed | 1664 | 1105 | 1108 | 1955 | 2333 | 3575 | 4498 | 5549 | 6415 |
| o/w DBM noncommercial spending | 240 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Foreign-financed | 696 | 553 | 500 | 944 | 1159 | 1345 | 952 | 798 | 733 |
| Net lending | 521 | 316 | 267 | 128 | 391 | 269 | 304 | 314 | 344 |
| o/w Mortgage program net lending | 0 | 0 | 120 | 115 | 124 | 134 | 151 | 164 | 177 |
| Overall balance (IMF definition) | -3660 | -1055 | 840 | 206 | -360 | -1045 | -1011 | -1236 | -1420 |
| Primary balance (IMF definition) | -2674 | 102 | 1886 | 1099 | 464 | -238 | -268 | -300 | -334 |
| Financing | 3660 | 1055 | -2719 | -206 | 360 | 1045 | 1011 | 1236 | 1420 |
| External | 1214 | 1716 | -916 | 850 | 1778 | 408 | 348 | -216 | -418 |
| Disbursement | 1350 | 1881 | 0 | 1765 | 2249 | 2491 | 4152 | 3192 | 2510 |
| Amortization | -136 | -165 | -916 | -915 | -471 | -2083 | -3803 | -3408 | -2928 |
| Domestic (net) | 2446 | -661 | -1804 | -1056 | -1418 | 637 | 662 | 1452 | 1838 |
| Government bonds (net issuance) | 2049 | -419 | -1804 | 94 | -318 | -63 | -138 | 952 | 1638 |
| Privatization | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other 1/ | 396 | -242 | 0 | -1150 | -1100 | 700 | 800 | 500 | 200 |
| ***Memorandum items:*** | | | | | | | | | |
| DBM commercial spending 2/ | 247 | -475 | 44 | 177 | 201 | 227 | 256 | 286 | 318 |
| Mineral revenue (in percent of GDP) | 2.3 | 4.8 | 5.4 | 5.3 | 5.5 | 5.6 | 5.6 | 5.8 | 5.9 |
| Non-mineral revenue (in percent of GDP) | 22.1 | 23.7 | 25.9 | 25.6 | 24.7 | 24.7 | 24.3 | 24.5 | 24.5 |
| Total expenditure (in percent of non-mineral GDP) | 49.6 | 42.2 | 37.6 | 37.0 | 37.8 | 39.5 | 38.8 | 39.4 | 39.6 |
| Non-mineral overall balance (in percent of non-mineral GI | -16.9 | -5.8 | 0.6 | -5.8 | -7.7 | -9.5 | -9.1 | -9.6 | -9.7 |
| Primary spending (change in percent) | 32.8 | -7.7 | 4.1 | 26.9 | 17.9 | 19.3 | 11.8 | 13.1 | 11.7 |

Sources: Mongolian authorities; and Fund staff projections.

1/ Includes deposit buildup in government accounts

2/ DBM spending is excluded from fiscal balance and monitored separately.

## Table 2b. Mongolia: Summary Operations of the General Government, 2016–24

(In percent of GDP)

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| | Act. | Act. | Act. | ← | | Proj. | | | → |
| Total revenue and grants | 24.4 | 28.5 | 31.4 | 30.9 | 30.2 | 30.2 | 29.9 | 30.3 | 30.4 |
| Current revenue | 24.0 | 28.3 | 31.2 | 30.6 | 30.0 | 30.2 | 29.9 | 30.2 | 30.3 |
| Tax revenue and social security contributions | 20.7 | 25.2 | 28.2 | 27.7 | 27.1 | 27.3 | 27.0 | 27.3 | 27.4 |
| Income taxes | 4.4 | 5.8 | 6.5 | 6.5 | 6.3 | 6.4 | 6.4 | 6.5 | 6.6 |
| CIT | 2.2 | 3.5 | 4.0 | 4.0 | 3.8 | 3.9 | 3.9 | 4.0 | 4.1 |
| PIT | 2.2 | 2.3 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| Social security contributions | 4.6 | 4.7 | 5.1 | 5.1 | 5.3 | 5.3 | 5.2 | 5.2 | 5.2 |
| VAT | 4.8 | 5.8 | 6.8 | 6.6 | 6.3 | 6.3 | 6.2 | 6.2 | 6.2 |
| Other taxes | 2.9 | 5.1 | 5.3 | 5.3 | 5.1 | 5.2 | 5.2 | 5.3 | 5.3 |
| Non-tax revenue | 3.4 | 3.2 | 3.1 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 |
| Capital revenue and grants | 0.3 | 0.2 | 0.1 | 0.3 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total expenditure and net lending | 39.7 | 32.3 | 28.7 | 30.4 | 31.0 | 32.4 | 31.8 | 32.3 | 32.5 |
| Current expenditure | 27.6 | 25.3 | 22.9 | 22.2 | 21.8 | 21.5 | 21.1 | 21.2 | 21.3 |
| Wages and salaries | 7.3 | 6.5 | 5.9 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 |
| Purchase of goods and services | 5.8 | 4.8 | 4.5 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 |
| Subsidies | 1.0 | 0.9 | 0.7 | 0.7 | 0.6 | 0.7 | 0.7 | 0.7 | 0.7 |
| Transfers | 9.5 | 8.9 | 8.6 | 8.5 | 8.6 | 8.5 | 8.4 | 8.4 | 8.3 |
| Interest payments 1/ | 4.1 | 4.1 | 3.3 | 2.4 | 2.0 | 1.7 | 1.4 | 1.6 | 1.6 |
| Capital expenditure and net lending | 12.0 | 7.1 | 5.8 | 8.2 | 9.2 | 10.9 | 10.7 | 11.1 | 11.2 |
| Capital expenditure | 9.9 | 5.9 | 5.0 | 7.8 | 8.3 | 10.4 | 10.2 | 10.6 | 10.7 |
| Domestically-financed | 7.0 | 4.0 | 3.5 | 5.3 | 5.5 | 7.5 | 8.4 | 9.2 | 9.6 |
| o/w DBM noncommercial spending | 1.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Foreign-financed | 2.9 | 2.0 | 1.6 | 2.5 | 2.8 | 2.8 | 1.8 | 1.3 | 1.1 |
| Net lending | 2.2 | 1.1 | 0.8 | 0.3 | 0.9 | 0.6 | 0.6 | 0.5 | 0.5 |
| o/w Mortgage program net lending | 0.0 | 0.0 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Overall balance (IMF definition) | -15.3 | -3.8 | 2.6 | 0.6 | -0.9 | -2.2 | -1.9 | -2.1 | -2.1 |
| Primary balance (IMF definition) | -11.2 | 0.4 | 5.9 | 3.0 | 1.1 | -0.5 | -0.5 | -0.5 | -0.5 |
| Financing | 15.3 | 3.8 | -8.5 | -0.6 | 0.9 | 2.2 | 1.9 | 2.1 | 2.1 |
| External | 5.1 | 6.2 | -2.9 | 2.3 | 4.2 | 0.9 | 0.6 | -0.4 | -0.6 |
| Disbursement | 5.6 | 6.7 | 0.0 | 4.8 | 5.3 | 5.2 | 7.7 | 5.3 | 3.8 |
| Amortization | -0.6 | -0.6 | -2.9 | -2.5 | -1.1 | -4.4 | -7.1 | -5.7 | -4.4 |
| Domestic (net) | 10.2 | -2.4 | -5.6 | -2.8 | -3.4 | 1.3 | 1.2 | 2.4 | 2.8 |
| Government bonds (net issuance) | 8.6 | -1.5 | -5.6 | 0.3 | -0.8 | -0.1 | -0.3 | 1.6 | 2.5 |
| Privatization | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other 1/ | 1.7 | -0.9 | 0.0 | -3.1 | -2.6 | 1.5 | 1.5 | 0.8 | 0.3 |
| ***Memorandum items:*** | | | | | | | | | |
| DBM commercial spending 2/ | 1.0 | -1.7 | 0.1 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Mineral revenue (in percent of GDP) | 2.3 | 4.8 | 5.4 | 5.3 | 5.5 | 5.6 | 5.6 | 5.8 | 5.9 |
| Non-mineral revenue (in percent of GDP) | 22.1 | 23.7 | 25.9 | 25.6 | 24.7 | 24.7 | 24.3 | 24.5 | 24.5 |
| Total expenditure (in percent of non-mineral GDP) | 49.6 | 42.2 | 37.6 | 37.0 | 37.8 | 39.5 | 38.8 | 39.4 | 39.6 |
| Non-mineral overall balance (in percent of non-mineral GDP) | -16.9 | -5.8 | 0.6 | -5.8 | -7.7 | -9.5 | -9.1 | -9.6 | -9.7 |
| Primary spending (change in percent) | 32.8 | -7.7 | 4.1 | 26.9 | 17.9 | 19.3 | 11.8 | 13.1 | 11.7 |

Sources: Mongolian authorities; and Fund staff projections.

1/ Includes deposit buildup in government accounts

2/ DBM spending is excluded from fiscal balance and monitored separately.

## Table 3a. Mongolia: Balance of Payments, 2016-24

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| | Act. | Act. | Act. | Proj. | | | | | |
| | (In millions of U.S. dollars, unless otherwise indicated) 1/ | | | | | | | | |
| Current account balance (including official grants) | -700 | -1155 | -2206 | -1963 | -1818 | -1792 | -1610 | -1594 | -1691 |
| Trade balance | 1338 | 1490 | 676 | 1254 | 1425 | 1525 | 1948 | 2220 | 2446 |
| Exports | 4804 | 5834 | 6557 | 7216 | 7406 | 8068 | 8677 | 9537 | 10203 |
| Mineral export | 3999 | 5162 | 6034 | 6495 | 6679 | 7311 | 7894 | 8717 | 9356 |
| Non-mineral export | 805 | 672 | 523 | 721 | 727 | 757 | 783 | 820 | 848 |
| Imports | -3466 | -4345 | -5881 | -5962 | -5981 | -6543 | -6729 | -7317 | -7758 |
| Services, net | -1338 | -1212 | -1978 | -1923 | -1944 | -2089 | -2125 | -2276 | -2410 |
| Income, net | -911 | -1613 | -1228 | -1500 | -1518 | -1463 | -1666 | -1782 | -1985 |
| General government | 20 | 22 | 50 | 28 | 30 | 32 | 16 | 17 | 17 |
| Other sectors | 156 | 159 | 201 | 179 | 190 | 203 | 216 | 228 | 240 |
| *Of which:* Workers remittances | 117 | 134 | 154 | 138 | 148 | 160 | 172 | 183 | 194 |
| Capital and financial account | 916 | 1996 | 1984 | 1590 | 1616 | 1652 | 1099 | 1391 | 1226 |
| Capital account | 104 | 78 | 92 | 101 | 109 | 117 | 121 | 124 | 128 |
| Financial account | 812 | 1919 | 1892 | 1489 | 1507 | 1535 | 979 | 1267 | 1098 |
| Direct investment | -4171 | 1446 | 2128 | 1976 | 1804 | 1824 | 1385 | 1410 | 763 |
| Portfolio investment | 487 | 493 | 61 | 300 | 300 | 300 | 300 | 500 | 600 |
| Trade credits, net | -221 | -44 | -4 | -73 | -43 | -8 | -54 | -31 | -31 |
| Currency and deposits, net | -204 | 489 | -11 | -400 | -221 | -217 | -237 | -240 | -226 |
| Loans, net | 4920 | -466 | -294 | -314 | -332 | -364 | -415 | -372 | -7 |
| Other, net | 0 | 0 | 12 | 0 | 0 | 0 | 0 | 0 | 0 |
| Errors and omissions | -221 | -56 | -118 | -81 | -131 | -121 | -101 | -111 | -109 |
| Overall balance | -5 | 785 | -340 | -454 | -333 | -262 | -613 | -314 | -574 |
| Change in reserves 2/ | -27 | 1715 | 449 | 194 | 379 | -16 | -380 | -314 | -574 |
| Financing Gap | 0 | 788 | 417 | 648 | 712 | 246 | 233 | 0 | 0 |
| Fund credit | n.a. | 113 | 104 | 0 | 0 | 0 | 0 | 0 | 0 |
| Donor support | n.a. | 675 | 314 | 648 | 712 | 246 | 233 | 0 | 0 |
| ***Memorandum items:*** | | | | | | | | | |
| Current account balance (in percent of GDP) | -6.3 | -10.1 | -17.0 | -14.4 | -12.4 | -11.3 | -9.5 | -8.8 | -8.8 |
| Gross official reserves (end-period) 3/ | 1297 | 3012 | 3461 | 3655 | 4033 | 4018 | 3638 | 3325 | 2750 |
| (In months of next year's imports of goods and services | 2.4 | 4.0 | 4.7 | 5.0 | 5.0 | 4.9 | 4.1 | 3.5 | 2.9 |
| Copper price (in U.S. dollars per ton) | 4868 | 6170 | 6530 | 6058 | 5991 | 6045 | 6090 | 6123 | 6123 |
| Oil price (in U.S. dollars per barrel) | 43 | 53 | 68 | 66 | 64 | 61 | 59 | 58 | 58 |
| Gold price (in U.S. dollars per troy oz.) | 1248 | 1257 | 1269 | 1288 | 1309 | 1336 | 1367 | 1393 | 1393 |
| Nominal GDP (in millions of U.S. dollars) | 11,159 | 11,426 | 13,009 | 13,637 | 14,674 | 15,810 | 17,017 | 18,136 | 19,228 |

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

2/ Changes in reserves reflect valuation adjustments.

3/ Gross official reserves includes drawings from swap line.

## Table 3b. Mongolia: Balance of Payments, 2016-24

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| | Act. | Act. | Act. | Proj. | | | | | |
| | (In percent of GDP, unless otherwise indicated) 1/ | | | | | | | | |
| Current account balance (including official grants) | -6.3 | -10 | -17.0 | -14.4 | -12.4 | -11.3 | -9.5 | -8.8 | -8.8 |
| Trade balance | 12 | 13 | 5 | 9 | 10 | 9.6 | 11.4 | 12.2 | 12.7 |
| Exports | 43 | 51 | 50 | 53 | 50 | 51 | 51 | 53 | 53 |
| Mineral export | 36 | 45 | 46 | 48 | 46 | 46 | 46 | 48 | 49 |
| Non-mineral export | 7.2 | 5.9 | 4.0 | 5.3 | 5.0 | 4.8 | 4.6 | 4.5 | 4.4 |
| Imports | -31 | -38 | -45 | -44 | -41 | -41 | -40 | -40 | -40 |
| Services, net | -12 | -11 | -15.2 | -14.1 | -13.3 | -13.2 | -12.5 | -12.6 | -12.5 |
| Income, net | -8 | -14 | -9.4 | -11.0 | -10.3 | -9.3 | -9.8 | -9.8 | -10.3 |
| General government | 0.2 | 0.2 | 0.4 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 |
| Other sectors | 0.4 | 0.2 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.2 |
| *Of which:* Workers remittances | 1.0 | 1.2 | 1.2 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 |
| Capital and financial account | 8.2 | 17 | 15.2 | 11.7 | 11.0 | 10.4 | 6.5 | 7.7 | 6.4 |
| Capital account | 0.9 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 |
| Financial account | 7.3 | 17 | 15 | 11 | 10.3 | 9.7 | 5.8 | 7.0 | 5.7 |
| Direct investment | -37 | 13 | 16.4 | 14.5 | 12.3 | 11.5 | 8.1 | 7.8 | 4.0 |
| Portfolio investment | 4.4 | 4.3 | 0.5 | 2.2 | 2.0 | 1.9 | 1.8 | 2.8 | 3.1 |
| Trade credits, net | -2.0 | -0.4 | 0.0 | -0.5 | -0.3 | 0.0 | -0.3 | -0.2 | -0.2 |
| Currency and deposits, net | -1.8 | 4.3 | -0.1 | -2.9 | -1.5 | -1.4 | -1.4 | -1.3 | -1.2 |
| Loans, net | 44 | -4.1 | -2.3 | -2.3 | -2.3 | -2.3 | -2.4 | -2.1 | 0.0 |
| Other, net | 0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Errors and omissions | -2.0 | -0.5 | -0.9 | -0.6 | -0.9 | -0.8 | -0.6 | -0.6 | -0.6 |
| Overall balance | 0.0 | 6.9 | -2.6 | -3.3 | -2.3 | -1.7 | -3.6 | -1.7 | -3.0 |
| Change in reserves 2/ | -27 | 1715 | 449 | 194 | 379 | -16 | -380 | -314 | -574 |
| Financing Gap | 0.0 | 6.9 | 3.2 | 4.8 | 4.9 | 1.6 | 1.4 | 0.0 | 0.0 |
| Fund credit | n.a. | 1.0 | 0.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Donor support | n.a. | 5.9 | 2.4 | 4.8 | 4.9 | 1.6 | 1.4 | 0.0 | 0.0 |

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.

## Table 4. Mongolia: Monetary Aggregates, 2016-24

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| | Act. | Act. | Act. | ← | | Proj. | | | → |
| | (In billions of togrog, end of period) | | | | | | | | |
| Reserve Money | 3067 | 3943 | 4908 | 6076 | 6889 | 7779 | 8780 | 9820 | 10932 |
| Broad money | 12159 | 15860 | 19474 | 24427 | 27692 | 31270 | 35297 | 39475 | 43946 |
| Currency | 563 | 612 | 670 | 733 | 831 | 938 | 1059 | 1184 | 1318 |
| Deposits | 11596 | 15248 | 18803 | 23694 | 26862 | 30332 | 34238 | 38291 | 42628 |
| Net foreign assets | -4580 | -1530 | -327 | 876 | -38 | -774 | -1708 | -3617 | -6647 |
| BOM | -1260 | 2283 | 3892 | 4983 | 6583 | 7108 | 6491 | 6011 | 4538 |
| Other Depository Corporations | -3320 | -3813 | -4219 | -4107 | -6621 | -7881 | -8200 | -9628 | -11185 |
| Net domestic assets | 16739 | 17390 | 19801 | 23551 | 27730 | 32044 | 37006 | 43092 | 50593 |
| Net Domestic credit | 17363 | 16924 | 19617 | 23235 | 27414 | 31728 | 36690 | 42776 | 50277 |
| Other Depository Corporations | 2200 | 733 | -1171 | -1171 | -1171 | -1171 | -1171 | -1171 | -1171 |
| Net claims on private sector | 13014 | 14196 | 17650 | 20827 | 24367 | 28022 | 32226 | 37382 | 43737 |
| Net claims on other financial corporation | 2437 | 3061 | 3183 | 3756 | 4395 | 5054 | 5812 | 6742 | 7888 |
| Other items, net | -563 | 512 | 316 | 316 | 316 | 316 | 316 | 316 | 316 |
| ***Memorandum items:*** | | | | | | | | | |
| Annual broad money growth | 21.0 | 30.4 | 22.8 | 25.4 | 13.4 | 12.9 | 12.9 | 11.8 | 11.3 |
| Velocity of Broad Money | 2.0 | 1.8 | 1.6 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| Credit outstanding (Domestic credit+MBS) (In MNT bn) /1 | 14866 | 16521 | 20382 | 24051 | 28140 | 32360 | 37215 | 43169 | 50508 |
| Credit to GDP ratio | 62.1 | 59.3 | 63.5 | 64.8 | 66.9 | 68.1 | 69.4 | 71.9 | 75.6 |
| Credit growth (percent) | 6.7 | 11.1 | 23.4 | 18.0 | 17.0 | 15.0 | 15.0 | 16.0 | 17.0 |

1/Includes mortgage-backed securities.

Sources: Mongolian authorities; and Fund staff projections.

## Table 5. Mongolia: External Financing Requirements and Sources, 2016-24
(In millions of U.S. dollars)

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| | Act. | Act. | Act. | ← | | Proj. | | | → |
| Gross financing requirements | 2,067 | 3,628 | 3,535 | 4,239 | 4,023 | 3,599 | 4,257 | 3,847 | 2,960 |
| External current account deficit (excl. official transfers) | 756 | 1,176 | 2,329 | 1,990 | 1,848 | 1,824 | 1,627 | 1,611 | 1,709 |
| Amortization | 689 | 1,212 | 2,028 | 1,517 | 1,476 | 1,527 | 2,703 | 2,257 | 1,493 |
| Public sector | 62 | 259 | 628 | 383 | 164 | 741 | 1,257 | 2,153 | 855 |
| o/w bonds | 0 | 0 | 273 | 0 | 0 | 500 | 1,000 | 1,073 | 600 |
| o/w loans | 62 | 259 | 355 | 383 | 164 | 241 | 257 | 1,080 | 255 |
| Private sector | 627 | 952 | 1,399 | 1,135 | 1,312 | 786 | 1,446 | 104 | 638 |
| Repayment of arrears | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other net capital outflows 1/ | 648 | -474 | -1,270 | 537 | 321 | 263 | 307 | 293 | 333 |
| | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Available financing | 2,067 | 2,840 | 3,118 | 3,591 | 3,311 | 3,353 | 4,024 | 3,847 | 2,960 |
| Grants | 56 | 20 | 122 | 28 | 30 | 32 | 16 | 17 | 17 |
| Disbursements to public sector | 1,133 | 683 | -117 | 147 | 220 | 630 | 1,134 | 2,088 | 722 |
| o/w bonds | 500 | 433 | 300 | 100 | 100 | 500 | 1,000 | 1,073 | 600 |
| o/w loans | 633 | 251 | -417 | 47 | 120 | 130 | 134 | 1,015 | 122 |
| Disbursements to private sector | 5,049 | 691 | 985 | 1,441 | 1,256 | 866 | 1,488 | 332 | 1,458 |
| Foreign direct investment | -4,171 | 1,446 | 2,128 | 1,976 | 1,804 | 1,824 | 1,385 | 1,410 | 763 |
| Financing need | 0 | 788 | 417 | 648 | 712 | 246 | 233 | 0 | 0 |
| Financing | 0 | 788 | 417 | 648 | 712 | 246 | 233 | 0 | 0 |
| IMF 2/ | 0 | 113 | 104 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other IFI | 0 | 392 | 274 | 332 | 259 | 0 | 0 | 0 | 0 |
| Identified bilateral support | 0 | 283 | 40 | 316 | 453 | 246 | 233 | 0 | 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: Selected Economic and Financial Stability Indicators, 2010-19**

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 Mar |
|---|---|---|---|---|---|---|---|---|---|---|
| **Capital** (in percent) | | | | | | | | | | |
| Risk Weighted CAR | 16.2 | 15.0 | 16.1 | 16.0 | 17.7 | 17.9 | 18.6 | 17.4 | 16.6 | 16.3 |
| **Asset quality** | | | | | | | | | | |
| Asset Growth (percent change from start of year) | 43.0 | 48.4 | 24.2 | 68.2 | 11.7 | -3.6 | 21.3 | 13.4 | 15.2 | 1.3 |
| Loan Growth (Net) (percent change from start of year) | 26.4 | 79.2 | 25.9 | 52.4 | 17.5 | -8.6 | 4.7 | 8.3 | 28.4 | 1.5 |
| Loan share in total assets (in percent) | 47.9 | 57.9 | 58.6 | 53.1 | 55.9 | 53.0 | 46.0 | 43.9 | 52.3 | 52.4 |
| **Non Performing Loan** (in percent) | | | | | | | | | | |
| Past-due to gross loans | 3.0 | 1.3 | 1.6 | 0.0 | 2.2 | 5.6 | 7.1 | 6.2 | 4.8 | 6.6 |
| NPL (old) to gross loans | 9.7 | 4.4 | 3.8 | 3.6 | 5.3 | 12.9 | 14.2 | 13.5 | 14.6 | 16.6 |
| Provision (in percent) | 9.6 | 4.7 | 4.5 | 4.0 | 6.6 | 13.5 | 15.1 | 13.8 | 17.6 | 16.7 |
| Provision/NPLs | 62.4 | 69.1 | 75.2 | 71.6 | 70.2 | 61.6 | 72.2 | 86.3 | 79.7 | 78.8 |
| Provision/NPLs (old) | 43.2 | 48.2 | 43.2 | 49.7 | 41.5 | 34.8 | 36.4 | 46.8 | 53.2 | 47.6 |
| NPLs net of provision /Capital | 12.5 | 5.5 | 2.9 | 4.3 | 5.0 | 12.7 | 7.9 | 4.1 | 10.3 | 11.0 |
| NPLs (old) net of provision/Capital | 27.2 | 13.1 | 11.5 | 11.1 | 16.5 | 38.2 | 35.7 | 29.4 | 35.3 | 45.1 |
| FX lending to total lending | 33.7 | 32.3 | 32.6 | 27.5 | 23.5 | 24.5 | 20.2 | 22.3 | 17.1 | 16.3 |
| **Interest Rate** (in percent) | | | | | | | | | | |
| Average lending rate | 20.7 | 16.8 | 16.6 | 16.9 | 16.4 | 17.1 | 16.4 | 16.7 | 16.6 | 16.6 |

Source: Mongolian authorities.

# Annex I. Risk Assessment Matrix[1]

| Nature/Sources of Risk | *Relative Likelihood* | Expected Impact If Realized | Policies to Mitigate Risks |
|---|---|---|---|
| | | ***Global and Regional Risks*** | |
| **Large swings in energy prices** | ***Medium*** | ***High*** Given minerals accounts for over 90 percent of Mongolian exports, with almost all directed towards China, this would have a significant impact on growth, hurt fiscal revenues, asset quality of banks, intensify BOP pressures, and lead to an exchange rate depreciation. | Build reserves to quickly reach 100 percent of ARA; pursue rapid reduction in public debt to create room for a countercyclical policy response; and strengthen capital buffers of banks immediately in line with AQR needs. |
| **Sharp tightening of global financial conditions** due to sustained rise in risk premium (in short term). | ***Medium*** | ***High*** Since BOM's GIR position is still low relative to ARA metrics, and NIR position is near zero, higher funding cots or challenges in rolling over external debt could lead to a significant adverse impact on BOP and growth. Moreover, with the recent rise in household indebtedness, higher interest rates are likely to directly impact households, increasing default on consumer loans and hurting bank capital. | Boost reserves through FX intervention (instead of relying on deliverable or non-deliverable swaps with local banks); while smoothing external debt amortization profile based on a consolidated perspective of both BOM and the Goma. |
| **Weaker than expected global growth,** particularly in China, either due to intensification of trade tensions and/or a housing market downturn prompt a slowdown which is not fully offset by policy easing. | ***Medium*** | ***Medium*** Since China is Mongolia's main trading partner, a slowdown in China is likely to impact Mongolian growth, fiscal revenues, and the exchange rate. Although, so far Mongolian coal exports do not appear to have been affected by the U.S. tariffs on Chinese steel. | Continue to build external and fiscal buffers, in line with advice above. |
| | | ***Domestic Risks*** | |
| **Heightening of political uncertainty,** especially in the run up to the 2020 parliamentary elections, which can be triggered by desire to engage in populist spending measures or increased calls to revise the investor agreement of the OT mine. | ***Medium*** | ***High*** This could result in premature easing in monetary and fiscal policies, eroding buffers that Mongolia critically needs; while stoppages o the OT mine could undermine key growth drivers. | Boost citizen confidence in the policymaking framework by stepping up efforts to combat corruption; and upgrade the social spending strategy to address core social issues including poverty and poor health outcomes. |
| **Concerns about health of one or more systemic banks**, especially in light of the incomplete bank recapitalization post-AQR. | ***Medium*** | ***High*** This could lead to loss of confidence in the banking system, and potentially lead to fiscal costs associated with bank resolution. | Ensure that bank recapitalization is complete immediately, undercapitalized banks are resolved, and supervision is improved to restore health of the banking system. |

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a prob. between 10 and 30 percent, and "high" a prob. between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

# Annex II. Response to Past Fund Policy Advice

*Since the crisis of 2016 the authorities have made significant progress in strengthening fiscal accounts and reducing public debt. Reserves have recovered substantially on the back of strong mineral exports and resumed capital inflows. Nevertheless, progress on financial sector reforms has been lacking. Banks have not met the capital shortfalls identified by the Asset Quality Review, and the BOM needs to strengthen the banking regulations and its supervisory practices.*

**Mongolia: Response to Past Fund Policy Advice**

| Key Recommendations | Implementation |
|---|---|
| **Fiscal Policy** | |
| Tighten fiscal policy significantly to reduce the deficit and put debt on a sustainable path | Good progress.<br>Fiscal balance improved by 12 percent of GDP in 2017 and reached an overall surplus of 2.6 percent in 2018. The adjustments came from both strong revenues and substantial spending cuts. |
| Bolster fiscal discipline through structural reforms | Mixed progress.<br>- PAYGO provision was adopted, which has limited parliament's ability to increase the overall spending envelop.<br>- Concessions are audited before making further payments and no new BT-type concessions have been contracted.<br>- Fiscal council was established in 2018 but did not meet the criteria of best practice. |
| Stop quasi-fiscal activities of BOM and Development Bank of Mongolia | Mixed progress.<br>- DBM is now supervised by the BOM in line with the new DBM law. Net lending by DBM in 2017 and 2018 has been curtailed and an independent audit of DBM was completed to verify that it is operating on a commercial basis.<br>- BOM has stopped most price stability programs but is still has sizable to the mortgage program. Since 2017, net loan increase has been on budget, but BOM has yet to transfer all mortgage securities from its balance sheet to MOF. |
| **Social Protection** | |
| Enhance existing social safety nets by better targeting the most vulnerable | Limited progress.<br>Fiscal policy does little to reduce income inequality. The authorities reversed the progressive income tax in January 2018 and expanded the coverage of the Child Money Program from the bottom 60 percent to 80 percent. Food stamps and poverty reduction programs were introduced in 2018 but at a small scale. |

| Mongolia: Response to Past Fund Advice (Concluded) | |
|---|---|
| **Key Recommendations** | **Implementation** |
| **Monetary Policy** | |
| Maintain tight policy stance until economy normalizes | Limited progress.<br>BOM cut policy rate twice in 2018 to 10 percent. Loose policy fueled rapid credit growth and worsened BOP position. In December 2018, BOM hiked policy rate by 100 bps to counter overheating, the effect of which is yet to be seen. |
| Improve central bank governance | Some progress.<br>The amended central bank law was passed in 2017 and improved governance to some extent. |
| Maintain exchange rate flexibility and build reserves | Some progress.<br>Gross reserves have improved by more than 2 billion USD since last AIV. However, net reserves still are very low and the exchange rate was not flexible enough as the central bank frequently intervened with reserve sales to support the currency in 2H2018. |
| **Financial Sector Policy** | |
| Safeguard stability and improve bank soundness. Specifically, perform an independent AQR on all banks, followed by a process of recapitalization, restructuring, and resolution of banks, as needed | Limited progress.<br>- The AQR was completed in January 2018 and identified capital shortfalls in six banks of about 3 percent of GDP. BOM communicated the shortfall to banks in May and gave them until end-2018 to raise the capital.<br>- So far, one non-systemic bank has been resolved but the other six banks have not raised sufficient capital or there are questions about the source of the capital raised by the banks. |
| Strengthen bank supervision and enhance banking regulation | Some progress.<br>The banking law was amended, and key regulations have been improved. But more progress is needed on implementing Basel II/III standard, improving asset classification, and strengthening supervisory capacity. |
| Facilitate NPL resolution | Limited progress.<br>While BOM has adopted a new regulation on NPL resolution, it needs to be accompanied by other legislative amendments to be fully effective, including reforms on creditor right and the bankruptcy law. |

# Annex III. Selected Priority Recommendations for Better Governance

| Area | Recommendations |
|---|---|
| ***Corruption*** | • Ensure that the existing legal framework against corruption is effectively enforced.<br>• Implement recommendations identified in 2019 OECD-ACN Monitoring Report particularly regarding income and asset declarations by PEPs with follow-up on potential violations. |
| ***Bribery*** | • Ensure that all public-sector spending falls under the e-procurement system and strengthen safeguards for whistleblowers.<br>• Strengthen asset disclosure frameworks and work with WB's StAR project.<br>• Strengthen EITI framework including through better transparency over mining contracts. |
| ***Rule of Law*** | • Strengthen key institutions, especially the Independent Authority Against Corruption (IAAC), the Judiciary and the General Prosecutor's Office, and guarantee their independence and that they are adequately resourced.<br>• Improve contract enforcement including by strengthening the capabilities of the judiciary relating to commercial issues and debt resolution. |
| ***Fiscal Governance*** | • Improvements need to be made in line with TA recommendations on revenue mobilization (no more tax amnesties), tax expenditures, and public financial management.<br>• SOEs should follow procurement controls and improve transparency and governance. PPPs should be better monitored and controlled.<br>• Governance and transparency at government funds should be urgently improved. This is especially important for the Future Heritage Fund. |
| ***Fiscal Transparency*** | • Strengthen the Fiscal Council with more autonomy and resources.<br>• Improve accounting and transparency frameworks and implement GFS. |
| ***Financial Sector Oversight*** | • The regulators should strengthen the financial sectors' corporate governance and ensure proper implementation of international best standards. Ensure full transparency in terms of beneficial ownerships of financial sector institutions and require that they maintain arms-length relationship in dealing with shareholders, directors, and intra group entities.<br>• Upgrade credit risk management and improve financial sector infrastructure including professional skills such as accounting and auditing, and valuations. |
| ***Central Bank Governance*** | • In line with IMF TA, a number of measures need to be taken to strengthen the governance of the BOM. These include strengthening its institutional autonomy, clarifying its mandate, and greater protection of its management and staff. |
| ***AML/CFT*** | • Recent IMF TA indicates that there needs to be continuous political will, more commitment, and prompt decisive action to ensure effective implementation of AML/CFT measures.<br>• Strengthen risk-based supervisory activities, notably onsite examinations by the BOM, the FIU, and the FRC with focus on high-risk areas such as implementation of requirements relating to targeted financial sanctions (TFS), beneficial ownership, and political exposed persons and high-risk sectors such as banks, real estate and other designated non-financial businesses and professions.<br>• Increasing resources for the FIU, BOM, FRC, and law enforcement agencies is needed with adequate inter-agency coordination. |

# Annex IV. Public Debt Sustainability Analysis

*While public debt remained high at around 73 percent of GDP at end-2018, the public debt ratio is expected to fall significantly under the baseline to around 57 percent by 2024. 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, and to a realization of contingent liabilities from the financial system.*

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, while inflation is expected to remain roughly at the target of at the 8 percent target.

- The external position is weaker than implied by fundamentals, and the nominal exchange rate is expected to depreciate over the forecast horizon.

- Financing assumes concessional budget support and project loans in line with current commitments, mainly over 2019 and 2020.

- And lastly, the primary balance is projected to remain in the range of -0.5 to 3 percent between 2019 and 2024.

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 16 percentage points between end-2018 and end-2024. 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 2020. The average effective nominal interest rate of public debt is currently 4.4 percent and projected to fall to about 3 percent by 2024.

3. **Historically, Fund staff forecasts have been somewhat 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 and the boom bust analysis, and the magnitude of errors is 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 recent efforts to improve the fiscal framework in Mongolia (including under the EFF 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 2020.

4. **The public debt and financing needs projections are particularly sensitive to shocks to growth, exchange rate, and financial sector contingent liability.**

- *Growth shock*. Slower growth remains a key risk to debt sustainability, given the high volatility and commodity-dependence of the Mongolian economy. If growth declined by one standard deviation in 2020 and 2021, the debt-to-GDP-ratio is forecast to reach just below 85 percent in 2021, reversing the improvements in debt dynamics in the preceding three years. It would also sizably increase gross financing needs in 2021 to 18 percent of GDP compared to about 11 percent of GDP in the baseline.

- *Exchange rate shock*. An exchange rate depreciation also poses significant risk to the public debt, given that almost all of the public debt is foreign-currency denominated. A real exchange rate depreciation of 25 percent in 2020, would increase debt to about 85 percent of GDP, compared to about 70 percent projected under the baseline.

- *Financial sector contingent liability shocks.* Given vulnerabilities in the banking system, resolution of banks could lead to fiscal costs. To examine the effect of this scenario it is assumed that (i) there is a one-time increase in expenditure equivalent to 15 percent of banking sector assets (higher than the standard shock size of 10 percent), (ii) combined with a real GDP growth shock (same as above). The debt path is particularly vulnerable to such a shock, with about a 15 ppt of GDP increase in debt levels (peaking at 86 percent).

- *Primary balance shock*. The DSA considers a primary balance shock equivalent to half of the 10-year historical standard deviation combined with an increase in interest rates of 25bps for every 1 percent of GDP worsening in the primary balance. This effectively means a cumulative shock impact of 4.8 percent of GDP spread evenly over 2020 and 2021 and an increase in interest rates by 60bps in each year. Under this scenario, public debt trajectory worsens but the impact is limited with public debt not breaching 75 percent of GDP over the horizon.

5. **The fan charts show significant uncertainty around the baseline.** The width of the symmetric fan chart, estimated at about 60 percent of GDP over the medium term, 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, driven by Mongolia's large current account deficit, are above the upper-risk assessment benchmark—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 (93 percent vs. 60 percent). Looking into the medium-term, Mongolia does face large bond maturities starting in 2021-24 equal to roughly half of international reserves.

7. **Robust growth and access to concessional financing and commercial borrowing at favorable terms mitigate risks to debt sustainability to some extent.** Growth performance continues to be strong. The authorities have rolled-over external bonds maturing in 2017 and 2018 at lower interest rates, private and official inflows have boosted gross reserves significantly, and the authorities face no external maturities on international bonds until 2021.

**8. However, given the history of boom bust cycles, the authorities need to remain vigilant to debt sustainability risks.** Crisis episodes, as recently as 2016-17, have repeatedly tipped debt and financing needs beyond safe limits. The underlying vulnerabilities, especially arising from exposure to commodity price volatility, the large external debt position, and broader contingent liabilities (including from private sector debt) warrant continued attention to maintaining adequate fiscal and external buffers. In addition, more work needs to be done to fully grasp the risk profile by improving data on collateralized public debt, publicly-guaranteed borrowings, and implicit government guarantees.

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

(in percent of GDP unless otherwise indicated)

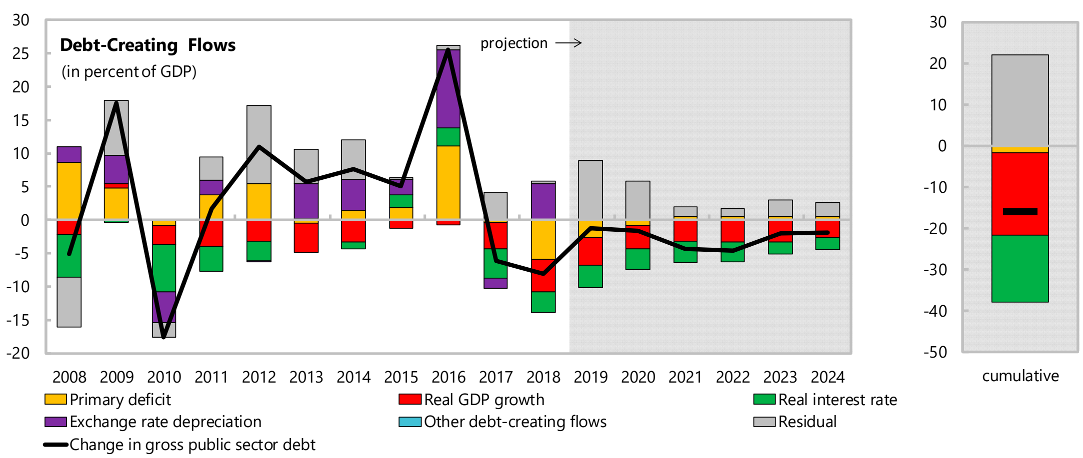
### Debt, Economic and Market Indicators [1/]

| | Actual | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2008-2016 [2/] | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| Nominal gross public debt | 49.2 | 81.4 | 73.3 | 72.1 | 70.4 | 66.0 | 61.4 | 59.3 | 57.4 |
| Public gross financing needs | 6.1 | 5.2 | 5.3 | 3.1 | 6.0 | 10.4 | 12.9 | 15.7 | 11.6 |
| Real GDP growth (in percent) | 7.3 | 5.3 | 6.9 | 6.5 | 5.4 | 5.1 | 5.6 | 6.0 | 5.0 |
| Inflation (GDP deflator, in percent) | 9.7 | 10.5 | 7.7 | 8.6 | 7.6 | 7.4 | 6.9 | 5.5 | 6.0 |
| Nominal GDP growth (in percent) | 20.1 | 16.4 | 15.1 | 15.7 | 13.4 | 12.9 | 12.9 | 11.8 | 11.3 |
| Effective interest rate (in percent) [4/] | 3.3 | 5.5 | 4.6 | 3.8 | 3.1 | 2.7 | 2.2 | 2.6 | 2.8 |

| 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 | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2008-2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | cumulative | debt-stabilizing primary balance [9/] |
| Change in gross public sector debt | 5.7 | -6.2 | -8.1 | -1.2 | -1.6 | -4.4 | -4.6 | -2.1 | -1.9 | -15.9 | |
| Identified debt-creating flows | 2.8 | -10.3 | -8.4 | -10.2 | -7.4 | -5.9 | -5.8 | -4.6 | -4.0 | -37.9 | |
| Primary deficit | 4.0 | -0.4 | -5.9 | -2.7 | -0.9 | 0.5 | 0.5 | 0.5 | 0.5 | -1.6 | -4.5 |
| Primary (noninterest) revenue and grants | 29.4 | 28.5 | 31.4 | 30.6 | 29.9 | 29.9 | 29.6 | 30.0 | 30.1 | 180.1 | |
| Primary (noninterest) expenditure | 33.4 | 28.2 | 25.5 | 28.0 | 29.0 | 30.4 | 30.1 | 30.5 | 30.6 | 178.5 | |
| Automatic debt dynamics [5/] | -1.1 | -9.9 | -2.6 | -7.5 | -6.5 | -6.4 | -6.3 | -5.1 | -4.5 | -36.3 | |
| Interest rate/growth differential [6/] | -4.2 | -8.4 | -8.0 | -7.5 | -6.5 | -6.4 | -6.3 | -5.1 | -4.5 | -36.3 | |
| Of which: real interest rate | -1.9 | -4.4 | -3.2 | -3.4 | -3.1 | -3.2 | -3.0 | -1.8 | -1.9 | -16.3 | |
| Of which: real GDP growth | -2.4 | -4.0 | -4.9 | -4.1 | -3.4 | -3.2 | -3.3 | -3.3 | -2.7 | -20.0 | |
| Exchange rate depreciation [7/] | 3.1 | -1.5 | 5.5 | … | … | … | … | … | … | … | |
| 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/] | 2.9 | 4.1 | 0.3 | 9.0 | 5.8 | 1.5 | 1.2 | 2.5 | 2.1 | 22.0 | |




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 $r - \pi(1+g)$ 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.

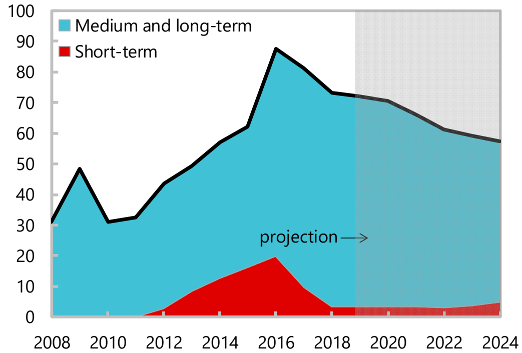
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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

### Composition of Public Debt

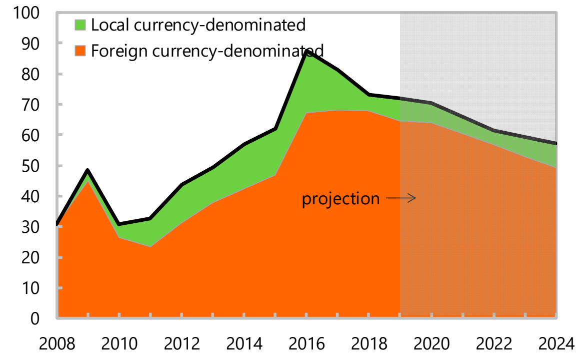
**By Maturity**

(in percent of GDP)




**By Currency**

(in percent of GDP)

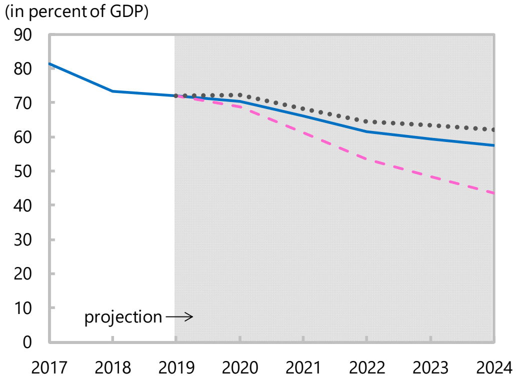



### Alternative Scenarios

Baseline Historical Constant Primary Balance

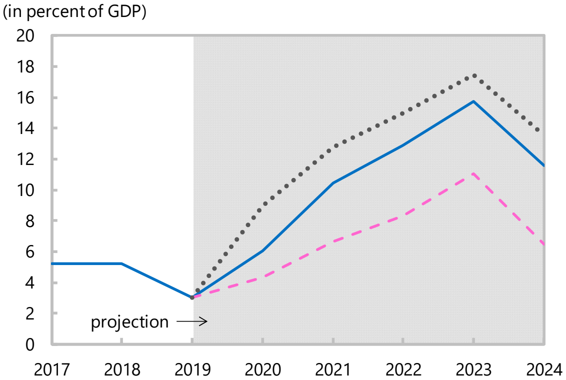
**Gross Nominal Public Debt**

(in percent of GDP)




**Public Gross Financing Needs**

(in percent of GDP)




### Underlying Assumptions

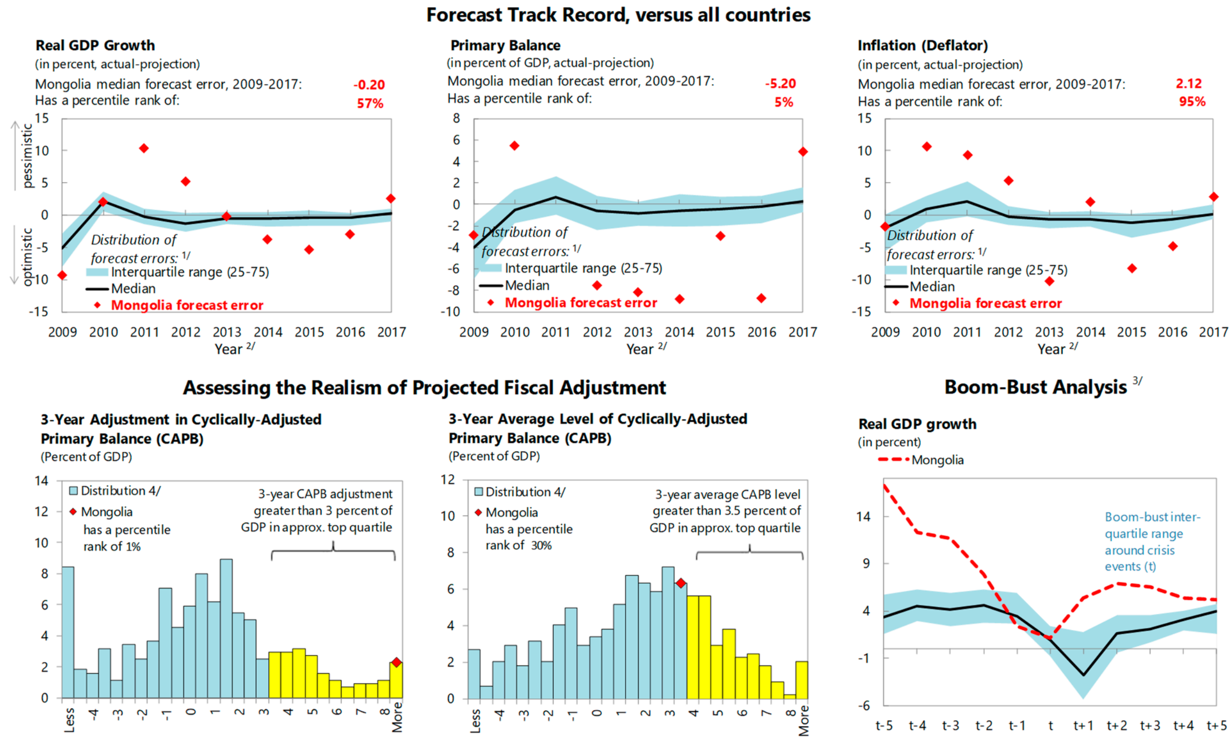
(in percent)

| Baseline Scenario | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|
| Real GDP growth | 6.5 | 5.4 | 5.1 | 5.6 | 6.0 | 5.0 |
| Inflation | 8.6 | 7.6 | 7.4 | 6.9 | 5.5 | 6.0 |
| Primary Balance | 2.7 | 0.9 | -0.5 | -0.5 | -0.5 | -0.5 |
| Effective interest rate | 3.8 | 3.1 | 2.7 | 2.2 | 2.6 | 2.8 |
| **Constant Primary Balance Scenario** | | | | | | |
| Real GDP growth | 6.5 | 5.4 | 5.1 | 5.6 | 6.0 | 5.0 |
| Inflation | 8.6 | 7.6 | 7.4 | 6.9 | 5.5 | 6.0 |
| Primary Balance | 2.7 | 2.7 | 2.7 | 2.7 | 2.7 | 2.7 |
| Effective interest rate | 3.8 | 3.1 | 2.7 | 2.0 | 2.3 | 2.5 |

| Historical Scenario | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|
| Real GDP growth | 6.5 | 7.0 | 7.0 | 7.0 | 7.0 | 7.0 |
| Inflation | 8.6 | 7.6 | 7.4 | 6.9 | 5.5 | 6.0 |
| Primary Balance | 2.7 | -2.1 | -2.1 | -2.1 | -2.1 | -2.1 |
| Effective interest rate | 3.8 | 3.1 | 2.7 | 2.3 | 2.8 | 3.1 |

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.

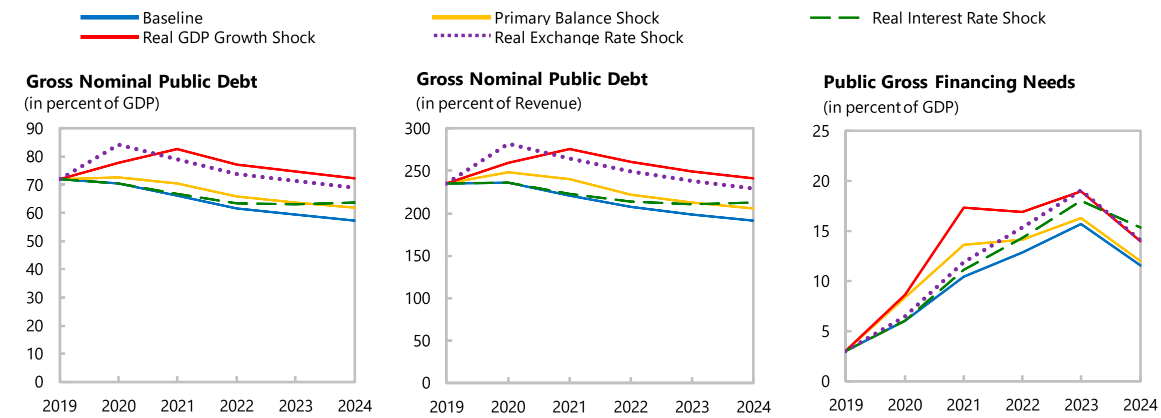
2/ Projections made in the spring WEO vintage of the preceding year.

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

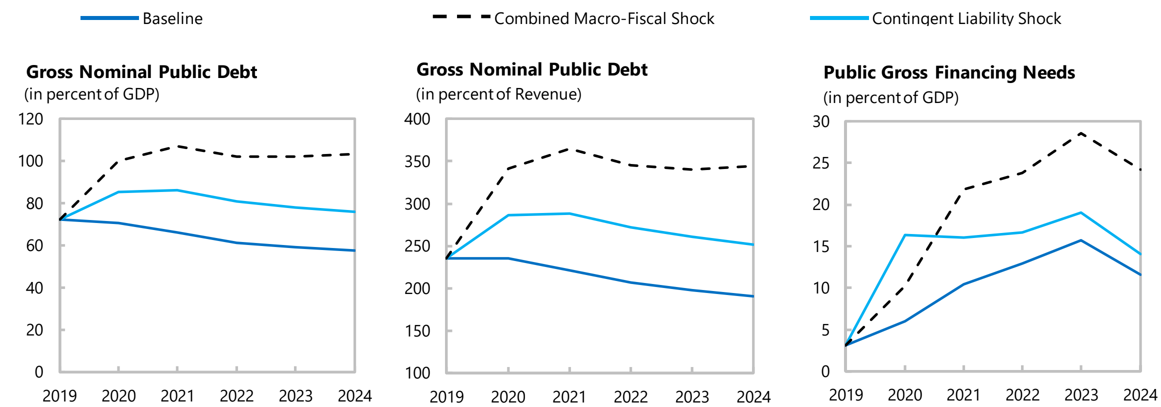
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

## Figure 4. Mongolia: Public DSA – Stress Tests

### Macro-Fiscal Stress Tests




### Additional Stress Tests




### Underlying Assumptions
(in percent)

| Primary Balance Shock | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|
| Real GDP growth | 6.5 | 5.4 | 5.1 | 5.6 | 6.0 | 5.0 |
| Inflation | 8.6 | 7.6 | 7.4 | 6.9 | 5.5 | 6.0 |
| Primary balance | 2.7 | -1.4 | -2.8 | -0.5 | -0.5 | -0.5 |
| Effective interest rate | 3.8 | 3.1 | 2.8 | 2.4 | 2.8 | 3.0 |
| **Real Interest Rate Shock** | | | | | | |
| Real GDP growth | 6.5 | 5.4 | 5.1 | 5.6 | 6.0 | 5.0 |
| Inflation | 8.6 | 7.6 | 7.4 | 6.9 | 5.5 | 6.0 |
| Primary balance | 2.7 | 0.9 | -0.5 | -0.5 | -0.5 | -0.5 |
| Effective interest rate | 3.8 | 3.1 | 3.8 | 4.1 | 5.9 | 8.0 |
| **Combined Shock** | | | | | | |
| Real GDP growth | 6.5 | -0.4 | -0.6 | 5.6 | 6.0 | 5.0 |
| Inflation | 8.6 | 6.2 | 6.0 | 6.9 | 5.5 | 6.0 |
| Primary balance | 2.7 | -1.7 | -5.6 | -0.5 | -0.5 | -0.5 |
| Effective interest rate | 3.8 | 4.0 | 3.8 | 4.6 | 6.3 | 8.3 |

| Real GDP Growth Shock | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|
| Real GDP growth | 6.5 | -0.4 | -0.6 | 5.6 | 6.0 | 5.0 |
| Inflation | 8.6 | 6.2 | 6.0 | 6.9 | 5.5 | 6.0 |
| Primary balance | 2.7 | -1.2 | -5.0 | -0.5 | -0.5 | -0.5 |
| Effective interest rate | 3.8 | 3.1 | 2.8 | 2.6 | 2.9 | 3.2 |
| **Real Exchange Rate Shock** | | | | | | |
| Real GDP growth | 6.5 | 5.4 | 5.1 | 5.6 | 6.0 | 5.0 |
| Inflation | 8.6 | 15.8 | 7.4 | 6.9 | 5.5 | 6.0 |
| Primary balance | 2.7 | 0.9 | -0.5 | -0.5 | -0.5 | -0.5 |
| Effective interest rate | 3.8 | 4.0 | 2.6 | 2.1 | 2.6 | 2.8 |
| **Contingent Liability Shock** | | | | | | |
| Real GDP growth | 6.5 | -0.4 | -0.6 | 5.6 | 6.0 | 5.0 |
| Inflation | 8.6 | 6.2 | 6.0 | 6.9 | 5.5 | 6.0 |
| Primary balance | 2.7 | -8.6 | -0.5 | -0.5 | -0.5 | -0.5 |
| Effective interest rate | 3.8 | 3.5 | 3.2 | 2.6 | 3.0 | 3.2 |

Source: IMF staff.

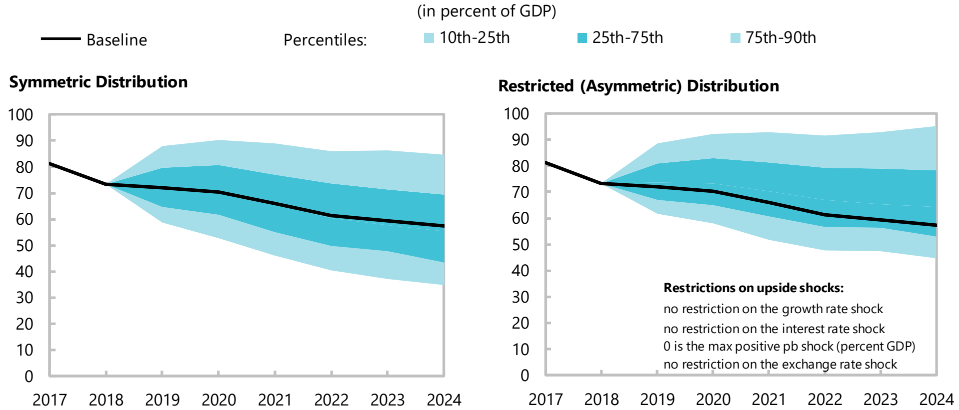
## Figure 5. Mongolia: Public DSA – Risk Assessment

### 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 |

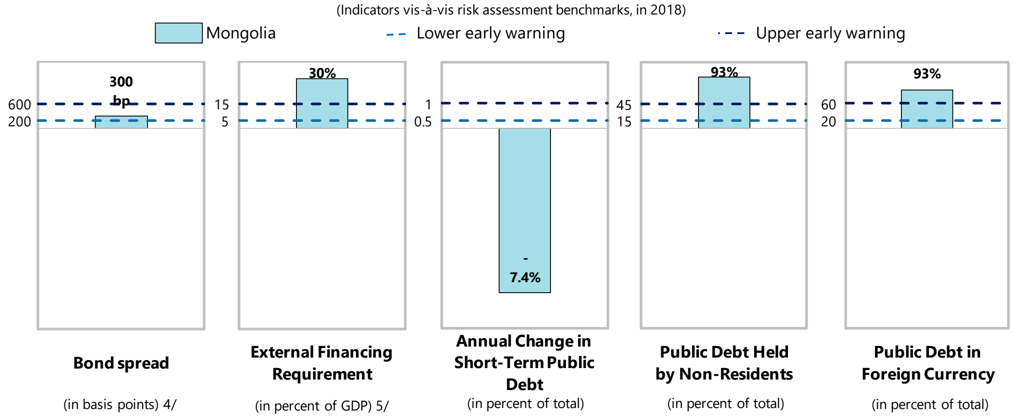
### Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)




### Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)




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.

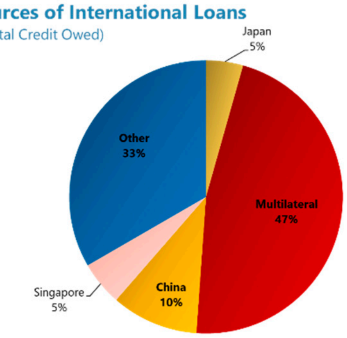
# Annex V. External Debt Sustainability Analysis

*External debt of Mongolia is 220 percent of GDP—extremely high. It reflects the combination of (i) large capital needs by the mining sector; (ii) loose fiscal and monetary policy over much of the past; and (iii) reliance on external non-core funding by some commercial banks, and a central bank swap. The external debt ratio fell by 20 percent of GDP in 2018.*

1. **Mongolia's external debt ratio rose six-fold over the past decade.** This reflects high investment rates, driving large current account deficits (on average close to 20 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. **It fell in 2018.** Government deleveraging and robust economic growth helped. External debt of the general government fell slightly, as non-concessional external borrowing is bound by the IMF program. Total external debt increased by 4 percent in dollar terms—due almost entirely to an increase in intercompany loans—but dropped as a ratio of GDP. It is expected to stabilize around $33 billion by end-2021 (from $29 billion in 2018), while falling steadily as a percentage of GDP.

**Major Sources of International Loans**
(Percent of Total Credit Owed)




Notes: Largest lender among "Other" is the USA, with 2.4 percent.

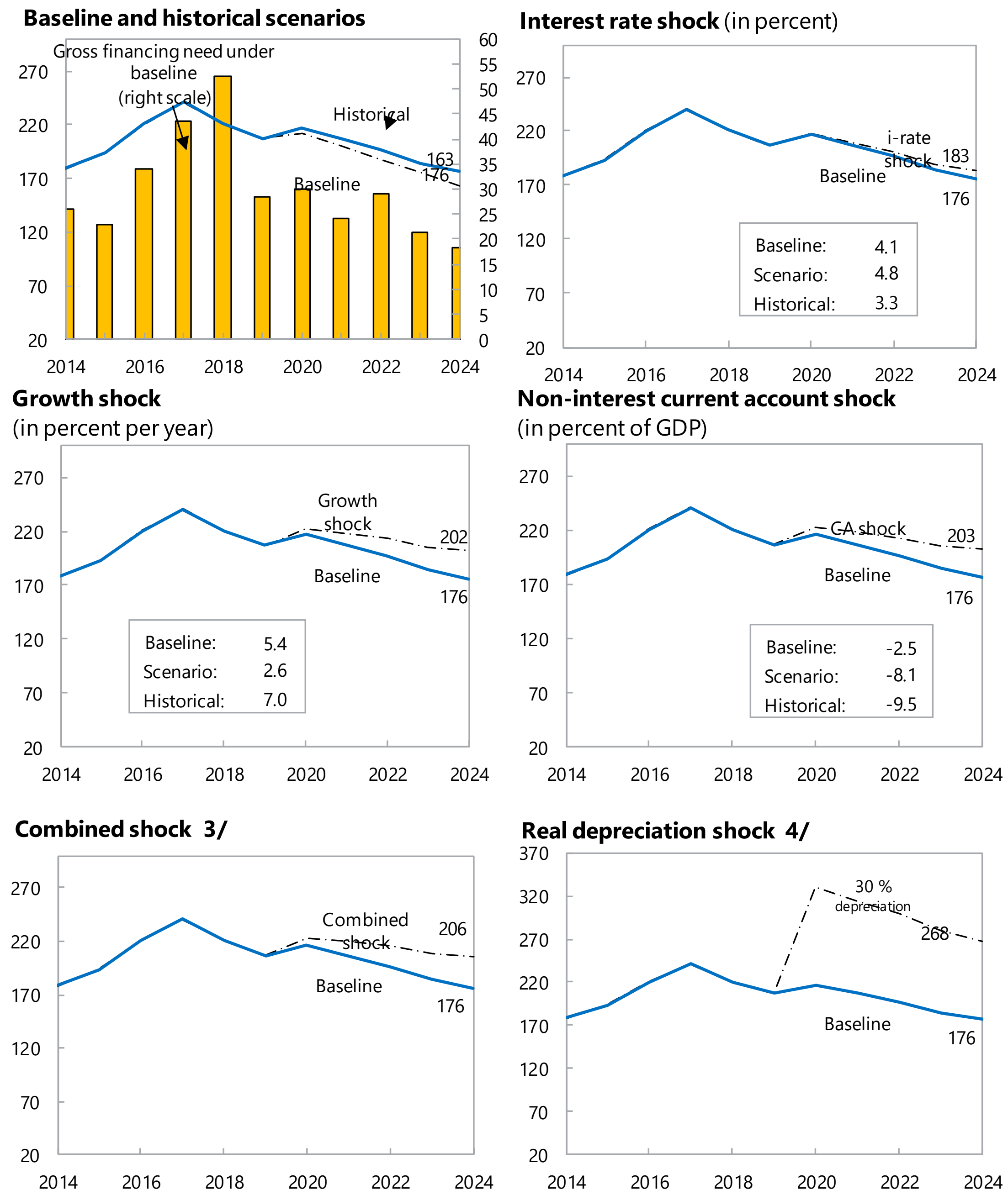
Source: Mongolian Authorities

3. **Mongolia's external debt is overwhelmingly in foreign currency; but long-term, and FDI**. External debt denominated in domestic currency is less than one percent of the total. Short-term debt by original maturity is ten percent of total. Spikes in amortizations are driven by the maturity profile of medium and long-term bonds; the external financing need is large.

4. **Large mining companies and government are the biggest external borrowers.** The sectoral breakdown is as follows: $9.2 billion of FDI intercompany loans, almost entirely in the mining sector (that's one-third of the total); $8 billion from other sectors, mainly corporate borrowing (28 percent of total, a mix of mining and construction/real estate); $7.2 billion of government external debt (25 percent of total), roughly evenly split into concessional loans from the official sector and international bonds; $2.3 billion owed by banks, which increased non-core funding rapidly in the half-decade leading to 2016; and $2 billion by the Central Bank, of which $1.7 billion is a liability from the swap with the PBOC.

5. **Some external leverage is justifiable, but its extent leaves Mongolia at risk.** Mining firms had to borrow externally to raise the export potential of the sector. Much of this was done via intercompany loans, which helps contain the rollover risks. (Risks due to currency mismatch are higher for non-FDI debt.) The recent increase in government borrowing on concessional terms to replace high cost and short-term domestic debt also lowers overall risks. However, at 220 percent of GDP, external borrowing has also financed excessive domestic demand and runs the risk of a correction in future years.

**Figure 1. Mongolia: 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 2019.

### Table 1. Country: External Debt Sustainability Framework, 2014-2024
(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | 10-Year | 10-Year | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 | Historical Average | Standard Deviation | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Debt-stabilizing non-interest current account 6/ |
| **Baseline: External debt** | 178.7 | 193.3 | 220.7 | 240.6 | 220.7 | | | **206.9** | **216.7** | **206.7** | **196.6** | **184.4** | **176.3** | **-7.1** |
| Change in external debt | 21.1 | 14.6 | 27.3 | 20.0 | -19.9 | | | -13.8 | 9.8 | -10.0 | -10.1 | -12.2 | -8.1 | |
| Identified external debt-creating flows (4+8+9) | 13.6 | 10.3 | 53.9 | -7.7 | -22.8 | | | -5.3 | -2.4 | -5.4 | -4.5 | -10.1 | -3.9 | |
| Current account deficit, excluding interest payments | 5.0 | -3.7 | -3.0 | -1.1 | 6.7 | | | 4.6 | 4 | 3 | 2 | 1 | 2 | |
| Deficit in balance of goods and services | 4.6 | -2.7 | 0.0 | -2.4 | 10.0 | | | 4.9 | 3.5 | 3.6 | 1.0 | 0.3 | -0.2 | |
| Exports | 51.9 | 45.2 | 50.2 | 59.5 | 58.9 | | | 59.3 | 56.7 | 57.2 | 57.0 | 58.6 | 59.0 | |
| Imports | 56.5 | 42.4 | 50.2 | 57.1 | 69.0 | | | 64.2 | 60.3 | 60.7 | 58.0 | 58.9 | 58.8 | |
| Net non-debt creating capital inflows (negative) | -2.3 | -0.9 | 37.4 | -12.7 | -10.4 | | | -6.1 | -4.5 | -6.4 | -3.3 | -7.8 | -4.0 | |
| Automatic debt dynamics 1/ | 10.9 | 15.0 | 19.5 | 6.1 | -19.0 | | | -3.9 | -1.9 | -2.4 | -3.6 | -3.6 | -1.5 | |
| Contribution from nominal interest rate | 6.3 | 7.7 | 9.3 | 11.2 | 10.3 | | | 9.8 | 8.5 | 7.9 | 7.2 | 7.5 | 7.2 | |
| Contribution from real GDP growth | -12.8 | -4.4 | -2.4 | -11.5 | -14.6 | | | -13.7 | -10.3 | -10.3 | -10.7 | -11.1 | -8.7 | |
| Contribution from price and exchange rate changes 2/ | 17.4 | 11.7 | 12.6 | 6.4 | -14.7 | | | ... | ... | ... | ... | ... | ... | |
| Residual, incl. change in gross foreign assets (2-3) 3/ | 7.5 | 4.3 | -26.6 | 27.6 | 2.9 | | | -8.5 | 12.2 | -4.6 | -5.6 | -2.1 | -4.2 | |
| External debt-to-exports ratio (in percent) | 344.1 | 428.1 | 439.3 | 404.3 | 374.5 | | | 348.8 | 381.9 | 361.7 | 344.9 | 314.9 | 298.9 | |
| **Gross external financing need (in billions of US dollars) 4/** | 3.2 | 2.7 | 3.8 | 5.0 | 6.8 | | | 3.9 | 4.4 | 3.8 | 5.0 | 3.9 | 3.5 | |
| in percent of GDP | 25.9 | 22.9 | 34.0 | 43.7 | 52.4 | | | 28.5 | 29.9 | 24.2 | 29.2 | 21.2 | 18.2 | |
| **Scenario with key variables at their historical averages 5/** | | | | | | | | **206.9** | **211.6** | **200.4** | **187.4** | **175.5** | **162.9** | **-19.2** |
| **Key Macroeconomic Assumptions Underlying Baseline** | | | | | | | | | | | | | | |
| Real GDP growth (in percent) | 7.9 | 2.4 | 1.2 | 5.3 | 6.9 | 7.0 | 5.7 | 6.5 | 5.4 | 5.1 | 5.6 | 6.0 | 5.0 | |
| GDP deflator in US dollars (change in percent) | -9.9 | -6.1 | -6.1 | -2.8 | 6.5 | 1.1 | 14.1 | -1.6 | 2.1 | 2.5 | 1.9 | 0.5 | 1.0 | |
| Nominal external interest rate (in percent) | 3.9 | 4.1 | 4.5 | 5.2 | 4.9 | 3.3 | 1.4 | 4.7 | 4.4 | 3.9 | 3.7 | 4.1 | 4.1 | |
| Growth of exports (US dollar terms, in percent) | 27.5 | -16.4 | 5.6 | 21.3 | 12.8 | 12.7 | 27.2 | 5.5 | 2.9 | 8.5 | 7.3 | 9.5 | 6.8 | |
| Growth of imports (US dollar terms, in percent) | -9.3 | -27.8 | 12.4 | 16.4 | 37.5 | 14.1 | 37.5 | -2.4 | 1.0 | 8.5 | 2.9 | 8.1 | 5.9 | |
| Net non-debt creating capital inflows | 2.3 | 0.9 | -37.4 | 12.7 | 10.4 | 11.9 | 22.1 | 6.1 | 4.5 | 6.4 | 3.3 | 7.8 | 4.0 | |

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

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

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

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

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

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

# Annex VI. External Sector Assessment

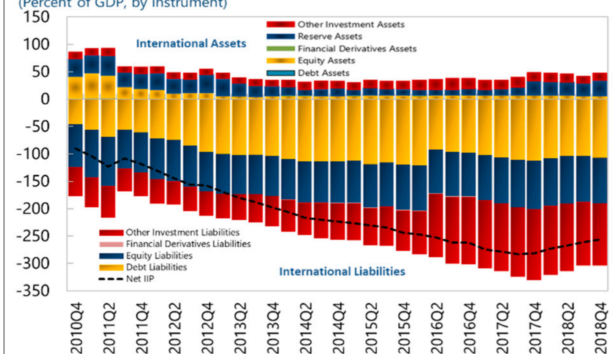
*Mongolia's external position in 2018 was substantially weaker than implied by fundamentals and desirable policy settings. The CA deficit deteriorated, external liabilities remain excessively high and international reserves are inadequate. Exchange rate policy has to shift away from FX interventions that unrealistically stabilize the exchange rate—incentivizing unhedged FX borrowing, keeping the real exchange rate overvalued, delaying adjustment—and towards boosting (gross and net) international reserves, fast. Tight and counter-cyclical fiscal, monetary and macro-prudential stances are advisable, to build buffers in good times; as is development of transport infrastructure to allow expansion of mineral export capacity.*

**1. The international investment position is precarious.** Gross foreign assets—48 percent of GDP, more than half of which (57 percent) are official reserves—are eclipsed by gross liabilities of 309 percent of GDP. The net international investment position (NIIP) deteriorated in absolute terms (from -$32 billion in 2017, to -$33 billion in 2018); but improved as a percentage of GDP, from -280 in 2017 to near -260 percent in 2018. This improvement was mainly due to a reduction in Other Investment liabilities, from 129 to 115 percent of GDP (foreign loans are down from 106 to 95 percent of GDP); and growth. Mongolia's ratio of net foreign liabilities to GDP (a significant crisis predictor) is among the largest.

**2. The weight of direct investment is a partial mitigating factor**. Half of all liabilities are direct investment claims, split evenly between equity and inter-company loans. These are mainly investments in the mining sector. The other half of liabilities consist almost entirely of debt. Foreign loans (the bulk of Other Investment) rose sharply in 2016, due to the conversion of $4.1 billion in FDI intercompany loans. But this bucket also reflects some banks' heavy reliance on non-core liabilities (see External DSA). Portfolio liabilities—12 percent of total (38 percent of GDP)—are almost exclusively debt securities, mainly issued by the government which has reduced external borrowing. (Debt and debt-like liabilities are 73 percent of total; equity claims explain the rest.) Raising the NIIP requires a

**IIP Assets and Liabilities**

(Percent of GDP, by instrument)

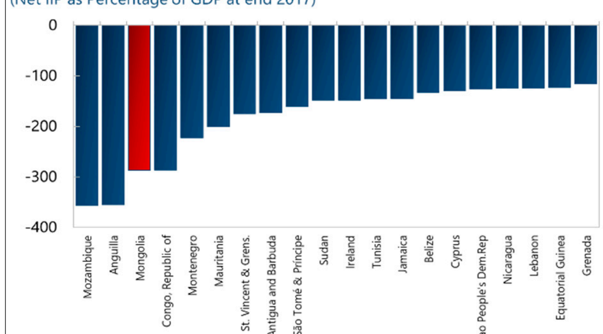



Source: Haver Analytics.

Note: Equity assets include DI and portfolio equities. Debt liabilities include DI and portfolio debt.

**Largest Net Foreign Liability Positions**

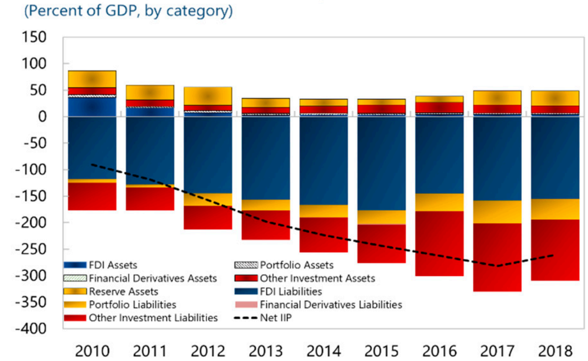
(Net IIP as Percentage of GDP at end 2017)




Sources: IMF, Lane and Milesi-Ferretti dataset. Largest 20 of 182 countries for which data were available.

**IIP Assets and Liabilities: Weight of FDI**

(Percent of GDP, by category)



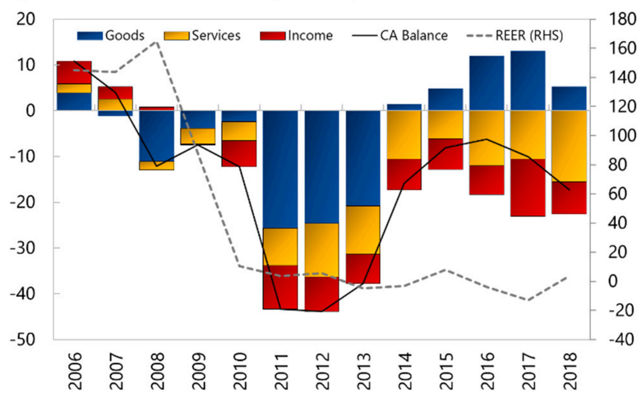

Sources: Haver Analytics.

mix of strong export-led growth and tight demand management. Macroprudential measures (and exchange rate flexibility) to discourage FX indebtedness; and development of hedging instruments to manage existing FX exposures is also advisable.

**3. The large current account deficit reflects a small surplus in goods trade, and persistently large service and income deficits.** The balance of trade in goods contracted by 60 percent in 2018, after six years of uninterrupted annual gains—from a nadir of -25.6 percent of GDP in 2011, to a surplus of 13.1 percent in 2017. While exports-to-GDP was nearly flat in 2018, goods imports rose by 7 percent of GDP. This reflects large FDI-related imports (capital goods) and a surge in partly credit-fueled imports of consumer durables, likely in anticipation of tighter prudential requirements effective from January 2019. A nearly 5 percent of GDP fall in net income outflows was offset by an increase of about the same size in the services deficit. As a result, the fall in net exports of goods took the CAB to -16.9 percent of GDP (from -10.1 in 2017). Since 2014 however, the combined services and income balances far exceed the contribution of the goods balance to the current account. (See chart.) Freight costs, which are closely tied to mineral exports, explain about one-third of the services deficit; while the large net foreign liability position causes systematically large interest and dividend net outflows.

**Current Account**

(In Percent of GDP; annual change in REER)



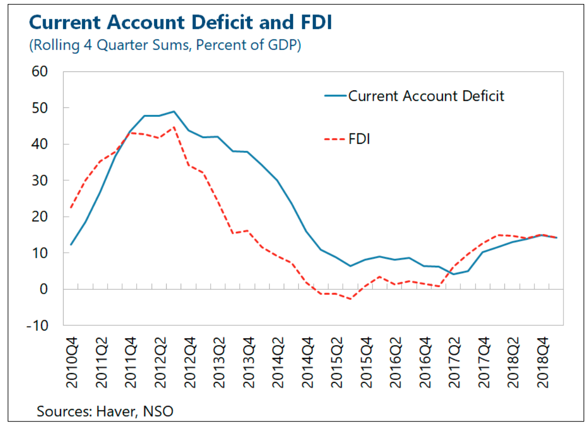

Source: Haver Analytics.

**4. The external position weakened.** Due to Mongolia's large external stock imbalances, the assessment draws on the EBA-Lite External Sustainability (ES) approach which calculates the external adjustment needed to stabilize the NIIP. The model implies a current account gap of -4 percent of GDP and a real effective exchange rate (REER) overvaluation of 9 percent. The IMF's EBA-Lite CA model, in turn, suggests a CA gap of -10.8 percent, only one percent of which is due to policy gaps. (This gap is the difference between the actual CA and its 'norm,' which is a measure of the steady-state CA given the country's fundamentals and staff's view of desirable policy settings.) The implied over-valuation of the REER is 24 percent. Mongolia's very large additional investment needs suggest a possibly lower CA norm, than the model estimate, calling for caution when applying the CA model. In sharp contrast, the EBA-Lite REER model points to an REER undervalued by 16 percent (largely attributable to unexplained residuals); a result influenced by the sharp drop in the REER in 2016, and at odds with recent developments of Mongolia's overall external position. Given the exposure to such a large and negative NIIP, staff's assessment is anchored by the ES approach. However, due to the magnitude of net foreign liabilities, the adjustment implied by the ES model should be viewed as a minimum. Staff accordingly assess the

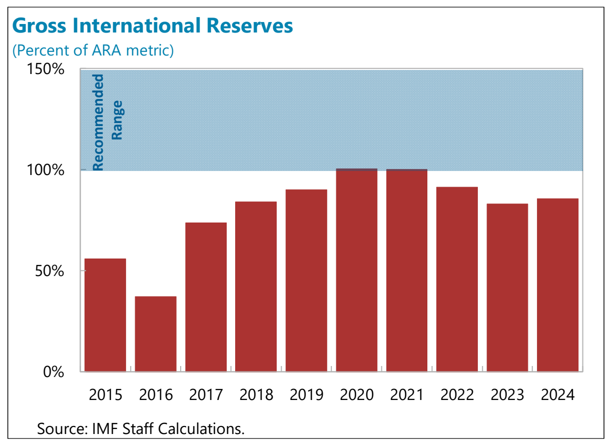
| CA Assessment | |
|---|---|
| Actual CA | -16.9 |
| Cyclically Adjusted CA | -17.5 |
| EBA-Lite CA norm, multilat. Consistent | -6.7 |
| EBA-Lite CA gap | -10.8 |
| EBA-lite ES gap | -4 |
| Staff CA gap | [-6,-4] |

external position as substantially weaker than implied by fundamentals and desirable policy settings, with a CA gap between -6 and -4 percent.

**5. FDI is now the dominant source of CA financing**. Net direct investment inflows were 14.8 percent of GDP in 2018, up from 13 percent in 2017, and are now by far the main source of financing for the large current account deficit. The bulk of FDI inflows to Mongolia represent claims on mining operations (esp. copper and coal). The current dominance of FDI, relative to portfolio and other investment in the composition of gross inflows, is a welcome mitigating factor.




**6. Reserves rose but remain inadequate; yet FX intervention has been substantial**. Gross international reserves increased by approximately half-a-billion USD over 2018, to $3.5 billion. This corresponds to 27 percent of GDP and 5 months of prospective imports of goods and services, but gross reserves remain below the lower bound of the recommended range of 100-150 percent of the IMF's reserve adequacy metric. (In 2017, gross reserves were $3.0 billion at year-end, or 80 percent of ARA.) The increase in reserves relied on donor inflows, gold purchases, and over-the-counter purchases of FX from export firms. It could have been larger: BOM sold (net) USD 855m through spot FX auctions with banks. Importantly, Mongolia's international reserves are heavily funded by FX liabilities.




**7. Predetermined net drains on reserves weigh heavily (on- and off-balance-sheet).** As of May-2019, the monetary authority and central government faced short-term contractual obligations in FX, to residents and non-residents, equal to around $3 billion (more than four-fifths of gross reserve assets). In addition, net reserves have been partly financed through roughly $1.2 billion in non-deliverable FX swaps which are settled in local currency. Although these do not trigger explicit FX obligations for BOM, the ultimate source of the foreign currency is external borrowing by BOM's swap counterparties. Settlement by the latter with their foreign lenders is may cause eventual further drains on reserves. Given Mongolia's low reserves—especially once adjusted for FX liabilities—and BOP pressures, FX intervention should be rigorously limited to opportunistic purchases to build international reserves; and to preventing exceedingly disorderly market conditions.

**Data Template on International Reserves and Foreign Currency Liquidity**
(USD Billions, End-May 2019)

| | |
|---|---|
| Gross Foreign Assets | 3706 |
| Pre-Determined Short-Term Drains on Foreign Currency | -3076 |
| Loans, Securities and Deposits | -2441 |
| Forwards and Futures | -635 |
| Memo | |
| Financial Instruments Denominated in FX but Settled in Local Currency | -1206 |
| Long Term FX Liabilities | -163 |

Source: Bank of Mongolia

INTERNATIONAL MONETARY FUND

# MONGOLIA

August 2, 2019

## STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

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

## CONTENTS

# FUND RELATIONS

(As of May 31, 2019)

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

| **General Resources Account**: | **SDR Million** | **Percent Quota** |
|---|---|---|
| Quota | 72.30 | 100.00 |
| Fund Holdings of Currency | 224.11 | 309.98 |
| Reserve Position in Fund | 5.44 | 7.52 |

| **SDR Department**: | **SDR Million** | **Percent Allocation** |
|---|---|---|
| Net cumulative allocation | 48.76 | 100.00 |
| Holdings | 37.66 | 77.24 |

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

**Latest Financial Arrangements**:

| **Type** | **Approval Date** | **Expiration Date** | **Amount Approved (SDR Million)** | **Amount Drawn (SDR Million)** |
|---|---|---|---|---|
| EFF | 05/24/2017 | 05/23/2020 | 314.51 | 157.25 |
| Stand-by | 04/01/2009 | 10/01/2010 | 153.30 | 122.64 |
| ECF [1] | 09/28/2001 | 07/31/2005 | 28.49 | 12.21 |
| ECF [1] | 07/30/1997 | 07/29/2000 | 33.39 | 17.44 |

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

| | **Forthcoming** | | | | |
|---|---|---|---|---|---|
| | **2019** | **2020** | **2021** | **2022** | **2023** |
| Principal | | | 2.33 | 17.91 | 26.21 |
| Charges/interest | 1.96 | 3.89 | 3.88 | 3.67 | 2.96 |
| Total | 1.96 | 3.89 | 6.21 | 21.58 | 29.17 |

**Safeguards assessment:** Safeguards assessments of the BOM were conducted in 2002, 2003, 2009, and 2017. The 2017 assessment found limited progress in strengthening the safeguards and governance frameworks at the central bank. While financial accountability and transparency practices were found to be robust, other areas, such as operational and financial autonomy, collegial decision making, oversight of central bank operations and audit mechanisms, and internal audit needed to be strengthened. The BOM has taken steps to address key recommendations from the 2017 safeguards assessment. These include amending the central bank law to improve the governance frameworks, autonomy of the BOM, and collegial decision-making, establishing an MoU with the Ministry of Finance to limit the central bank's involvement in the mortgage program, and

[1/] Formerly PRGF.

setting up a working group to review the veracity of program monetary data. At the same time, the BOM has drafted a new charter for the Internal Audit Department and established a quarterly reporting mechanism of the function to the Supervisory Board. However, some important recommendations remain. 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. 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.

**Exchange Arrangement**:

On March 24, 2009, the BOM instituted a foreign exchange auction allowing the determination of the exchange rate mainly by market forces. The de jure exchange rate arrangement is floating. The de facto exchange rate arrangement was reclassified twice: (1) retroactively to crawl-like from floating, effective September 18, 2017, and (2) to other managed from crawl-like, effective April 11, 2018.

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

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

**Article IV Consultation**:

The 2017 Article IV consultation (IMF Country Report No. 17/140) was concluded by the Executive Board on May 24, 2017. Mongolia is on a 24–month cycle.

**ROSC Assessments**:

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

**Recent Financial Arrangements**:

A 36-month Extended Fund Facility in an amount of equivalent to SDR 314.5054 million (435 percent of quota) was approved on May 24, 2017. The Executive Board completed the fifth review on October 31, 2018.

**FSAP Participation**:

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

**Technical Assistance in 2017–2019:**

**Missions**:

- Tax review, (FAD) May 2017
- CB law amendment, (LEG) June 2017
- e-GDDS, (STA) June - July 2017
- Tax policy, (FAD) September 2017
- NPL resolution, (MCM) September – October 2017
- FX law amendment, (LEG) October 2017
- Appraisal industry, (MCM) October 2017
- Bank recapitalization reform, (MCM) October 2017
- Macro-Fiscal modeling, (FAD) November – December 2017
- AML/CFT, (LEG) December 2017
- Public investment management, (FAD) December 2017
- Bank business plan, (MCM) December 2017
- FRC needs assessment, (MCM) December 2017

- Effective bank resolution framework, (MCM) February – March 2018
- AML/CFT, (LEG) April 2018
- Improving taxpayer compliance, (FAD) May 2018
- Tax administration, (FAD) June 2018
- Residential property price index, (STA) July 2018
- Appraisal industry, (MCM) July - August 2018
- National accounts, (STA) August – September 2018
- Macroprudential surveillance, (MCM) October 2018
- Accounting and Reporting, (FAD) September – October 2018
- Public investment management, (FAD) October – November 2018
- Tax administration, (FAD) November 2018
- Appraisal industry, (MCM) November - December 2018
- DICOM, (MCM) December 2018
- AML/CFT, (LEG) January 2019
- Banking regulation, (MCM) January – February 2019
- Macro-Fiscal modeling, (FAD) March 2019
- Tax administration, (FAD) March 2019
- Government finance statistics, (STA) April 2019
- FARI financial modeling and revenue forecasting, (FAD) Apr – May 2019
- AML/CFT, (LEG) April 2019
- Cyber security, (MCM) May 2019
- Tax administration, (FAD) June 2019
- Banking regulation, (MCM) June – July 2019
- PPP/concession, (FAD) June – July 2019
- Residential property price index, (STA) July 2019

**Resident Representative**:

Since July 2019, Mr. SeokHyun Yoon has been the resident representative based in Ulaanbaatar.

# RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

**World Bank:** https://www.worldbank.org/en/country/mongolia

**Asian Development Bank:** https://www.adb.org/countries/mongolia/main

# STATISTICAL ISSUES

(As of July 2019)

| I. Assessment of Data Adequacy for Surveillance |
|---|
| **General:** Data provision to the Fund is broadly adequate for surveillance, but some shortcomings exist in the estimation of GDP and treatment of missing observations in price indices. The priority areas for improvement are national accounts and price statistics, and also the migration of government finance statistics to a new methodology. |
| **National Accounts:** The National Statistics Office (NSO) currently publishes annual and quarterly GDP using the production and expenditure approaches. Annual supply-use tables are compiled and represent a significant quality improvement as part of Mongolia's implementation of 2008 SNA. A rebase from 2010 to 2015 is planned to take place during 2019. A recent mission (August – September 2018) recommended making further use of tax data to supplement/replace survey collections; and to improve volume estimates of taxes and subsidies on products. |
| **Price Statistics:** CPI estimates use a base year of 2010 using the 2010 household survey. The NSO publishes a producer price index (PPI) and uses the imputation of missing prices. The NSO compiles a quarterly residential property price index for Ulaanbaatar following a mix-adjustment by stratification methodology and is receiving TA to implement an enhance index compilation methodology and to improve data sources in the longer-term. |
| **Government Finance Statistics:** Currently, the concepts, classifications, and definitions used to compile sub-annual and annual fiscal statistics for the consolidated general government operations series used by APD for surveillance generally follow the guidelines of the GFSM 1986. The authorities have indicated an intention to adopt a migration path to the GFSM 2001/2014 methodology. STA has been providing assistance (funded by Japan) aimed at developing a benchmark annual GFSM 2014-based series, 2016-forward. A June 2019 GFS TA mission compiled a financial balance sheet and integrated presentation of stock and flows for the consolidated general government sector using the accrual (IPSAS-based) accounts maintained by the Ministry of Finance. In December 2018 the authorities began reporting of public sector debt statistics (PSDS) to the World Bank for dissemination on the PSDS Website. |
| **Monetary and Financial Statistics:** The BoM reports regular monetary data using the IMF's recommended Standardized Report Forms (SRFs), covering the central bank balance sheet (SRF 1SR) and other depository corporations (SRF 2SR). Mongolia's monetary and financial statistics (MFS) conform to the concepts and definitions of the *Monetary and Financial Statistics Manual and Compilation Guide (MFSMCG)*. The BoM does not currently compile and report data for the other financial corporations sector through the Standardized Report Forms (SRFs).<br>The BOM also reports some basic data to the IMF's Financial Access Survey including mobile and internet banking and the two indicators adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (commercial bank branches per 100,000 adults and ATMs per 100,000 adults). |
| **Financial sector surveillance:** Mongolia does not currently report Financial Soundness Indicators (FSIs) to the Fund for dissemination on the Fund's external website. The BoM is quite advanced in the |

| |
|---|
| compilation of FSIs, but needs to finalize their action plan related to the submission of the data and metadata to the IMF for external dissemination. |
| **External Sector Statistics:** For compilation of external sector statistics (ESS), the Bank of Mongolia (BOM) follows the statistical framework of the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6). Priorities for improvement includes addressing persistent negative net errors and omissions. Mongolia participates in the IMF's Coordinated Direct Investment Survey (CDIS) and Coordinated Portfolio Investment Survey (CPIS). Mongolia has also started compiling external debt statistics and the Reserves Data Template. |
| **II. Data Standards and Quality** |
| In April 2019, Mongolia graduated to the Fund's Special Data Dissemination Standard (SDDS), which sets high standards for the timeliness and periodicity of dissemination of economic and financial data. |

## Table 2. Mongolia: Common Indicators Required for Surveillance

(As of July 2019)

| | Date of Latest Observation | Date Received | Frequency of Data[6] | Frequency of Reporting[6] | Frequency of Publication[6] | Memo Items: | |
|---|---|---|---|---|---|---|---|
| | | | | | | Data Quality-Methodological soundness[7] | Data Quality – Accuracy and Reliability[8] |
| Exchange rates | 05/31/19 | 05/31/19 | M | M | M | | |
| International reserve assets and reserve liabilities of the Monetary Authorities[1] | 05/2019 | 07/2019 | M | M | M | | |
| Reserve/base money | 05/2019 | 07/2019 | M | M | M | O, LO, LO, LO | O, O, O, O, LNO |
| Broad money | 05/2019 | 07/2019 | M | M | M | | |
| Central bank balance sheet | 05/2019 | 07/2019 | M | M | M | | |
| Consolidated balance sheet of the banking system | 05/2019 | 07/2019 | M | M | M | | |
| Interest rates[2] | 05/2019 | 07/2019 | M | M | M | | |
| Consumer price index | 2019M6 | 07/2019 | M | M | M | O, LO, O, O | LO, LO, LO, O, O |
| Revenue, expenditure, balance and composition of financing[3] – general government[4] | 05/2019 | 06/2019 | M | M | M | LO, LNO, LO, O | LO, O, LO, LO, LNO |
| Stocks of general government and general government-guaranteed debt[5] | 2019Q1 | 05/31/19 | Q | Q | Q | | |
| External current account balance | 2019Q1 | 07/18/19 | Q | Q | Q | O, O, O, LO | LO, O, LO, LO, LO |
| Exports and imports of goods | 2019Q1 | 07/18/19 | Q | Q | Q | | |
| GDP/GNI | 2019Q1 | 05/15/19 | Q | Q | Q | O, LNO, O, LO | O, LO, LO, LO, LNO |
| Gross external debt | 2019Q1 | 05/31/19 | Q | Q | Q | | |
| International investment position | 2019Q1 | 7/18/19 | Q | Q | Q | | |

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

# MAIN DATA WEBSITES

**National Statistics Office** (www.1212.mn)

- National Accounts
- Consumer Price Inflation
- Agricultural and Industrial Production
- Petroleum Imports
- Electricity Production and Consumption
- Coal Production
- Retail Prices
- Employment
- Exports and Imports
- Securities Market Data

**Bank of Mongolia (**www.mongolbank.mn)

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

**Ministry of Finance (**www.mof.gov.mn)

- Government Budgetary Operations

**National Development Agency** (www.nda.gov.mn)

- Long- and medium-term development strategy
- Economic and social policies
- Investment policy coordination

**Financial Regulatory Commission** (www.frc.mn)

- FRC decisions
- Total assets of regulated entities (insurance companies, securities and broker firms, non-bank financial institutions, savings and credit unions)
- Consolidated income statements of regulated entities (insurance companies, securities and broker firms, non-bank financial institutions, savings and credit unions)

**Statement by the IMF Staff Representative**
**September 11, 2019**

*This statement contains information that has become available since the staff report was circulated to the Executive Board. It does not alter the thrust of the staff appraisal.*

1. **The latest available data confirm that recent macroeconomic developments are broadly in line with staff's expectations.**

- Following particularly strong growth in 2019Q1 (8.6 percent), real GDP growth decelerated to 6.5 percent in 2019Q2 reflecting a slowdown in external demand.
- Annual consumer price index inflation (7.7 percent y-o-y in July) continues to hover around the Bank of Mongolia's (BOM's) target of 8 percent.
- The year to date primary balance reached 4.7 percent of GDP in July (in line with the performance during the same period in 2018) largely due to strong revenues.
- Credit growth continued to decelerate, reaching 17.1 percent in July, down from 26.5 percent at end-2018.
- Foreign exchange reserves fell in July ($167 million in net terms) before stabilizing in August. According to the Bank of Mongolia, the primary reason was a seasonal increase in foreign exchange demand.

**Statement by Nigel Ray, Executive Director for Mongolia,**
**Chris White, Alternate Executive Director,**
**Laura Johnson, Senior Advisor to Executive Director,**
**Gantsogt Khurelbaatar, Advisor to Executive Director**
**September 11, 2019**

Our Mongolian authorities appreciate the continued engagement with the Fund as well as the candid and constructive discussions during the Article IV mission. Most structural reforms envisaged at the beginning of the EFF program have been implemented. These reforms are supporting the recovery of the economy and providing a strong basis for future economic reforms. Unfortunately, some of the implementation of the post asset quality review (AQR) actions in the banking sector raised some concerns and consequently delayed the EFF program. The authorities recognize the importance of the Fund's EFF arrangement to reform the country's economy and are strongly committed to the continuation of the EFF program.

## Economic Outlook

The economy has performed strongly since 2017 supported by the Fund's EFF arrangement and a buoyant mining sector. The economic outlook is positive, thanks to increased investment into the mining sector and to improved business confidence. The economy is projected to grow at an average annual rate of 5 percent over the medium term. Gross international reserves nearly tripled during the last two years and inflation remained stable within the central bank's target range of 8 percent. In the medium-term, inflationary pressures persist and this is one of the challenging areas for the authorities to balance with optimal growth policies.

## Fiscal policy

The combination of a strong fiscal consolidation and upbeat mining sector led to a reduction in the primary balance from a deficit of 11.2 percent of GDP in 2016 to a surplus of 5.9 percent of GDP in 2018. Over the last two years, public debt has reduced significantly by 13 percentage points of GDP. It is worthwhile to note that two-thirds of the overall adjustment came from reduced expenditure.

The authorities have prepared the medium-term budget framework for 2020-23 which prioritizes the reduction of public debt. The budget for 2020 is currently being prepared. The authorities are committed to passing the budget for 2020 with a primary budget surplus of 1 percent of GDP, within the agreed parameters from the Fund program.

The current fiscal rules were prepared during the economic crisis of 2009 with the assistance of Fund experts. There was widespread public support for enacting a rules-based framework to transfer wealth to future generations. The authorities agree with staff that the current fiscal rules may need to be improved. However, a thorough assessment of the current fiscal rules will need to be carefully undertaken. Any change to the fiscal framework will also need to carefully manage public expectations.

**Financial markets and monetary policy**

Inflation for the first half of this year is 7.4 percent, close to the central bank's target. The exchange rate has remained stable, and the monetary policy rate is unchanged since December 2018. The macroprudential measure to introduce a debt service to income ratio of 60 percent has provided positive results, reducing the pace of credit growth and protecting households from indebtedness. The central bank will continue with a cautious monetary policy stance and will take every opportunity to build foreign reserves.

The lack of quality time-series data and robust formal studies of the monetary transmission mechanism and the role of exchange rate flexibility in Mongolia creates challenges for the authorities to implement policy actions effectively. The authorities are keen to work with the Fund in conducting more studies on these areas to improve capability to undertake policy actions by the central bank.

The authorities are working to address AML/CFT deficiencies identified by the Asia Pacific Group. The possibility of grey listing and withdrawal of correspondent banking relationships may impact the economic environment dramatically, and the authorities are committed to resolving remaining issues identified by the AML/CFT framework. Further work remains to be done, including increasing the supervision of non-bank financial institutions and high-risk entities and improving criminal investigation into possible cases of money laundering.

**Program performance**

The 6th review of the EFF program is delayed, due to a lack of progress on completion of two financial sector actions. Quantitative targets for previous reviews were met continuously and in some cases met with big margins. On structural reforms, numerous fiscal, monetary and financial markets reforms have been undertaken since the start of the program, and these reforms provide a strong foundation for building a resilient economy.

The remaining major structural reform is strengthening the banking sector. The AQR concluded in 2018 and showed that a number of banks were required to increase their capital. These banks raised their required capital by December of 2018, however some capital-raising transactions raised some concern in terms of consistency with local laws and international best practice.

As requested by the staff, a specialist firm completed a forensic audit between June to August of this year into these capital-raising transactions. The forensic audit has revealed a number of irregularities in the transactions aimed at recapitalizing banks following the AQR. The authorities are analyzing the findings of the audit and, in consultation with staff, considering what steps to take.

The authorities are committed in taking all necessary actions to implement the remaining items of the post-AQR in the banking sector and complete the 6th review of the program.

**Selected issues papers**

We thank staff for providing selected issues papers on the principal governance challenges and achieving green and inclusive growth in Mongolia. The authorities broadly agree with the main findings and recommendations of papers. Improving governance, reducing poverty, achieving green and inclusive growth are challenging issues which need attention from the authorities. The main recommendations from these papers, such as using tax policy to resolve overgrazing and climate issues, tackling corruption, improving fiscal and central bank governance, are important and the analysis will be useful in future reform packages.

**Conclusion**

The economy of Mongolia performed strongly, averted financial crisis and recovered over the last two years thanks to the EFF program and a positive external environment. Despite these positive developments the authorities are keenly aware that current buffers are not adequate, the country is still vulnerable to external shocks and Mongolia should continue with structural reforms and to build fiscal buffers and reserves.

The Fund's continued engagement through the EFF program and support from development partners are vital in achieving macroeconomic stability.