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2015 ARTICLE IV CONSULTATION STAFF REPORT; PRESS RELEASE; 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 2015 Article IV consultation with Mongolia, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on April 3, 2015, following discussions that ended on February 18, 2015, 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 March 19, 2015.
- An **Informational Annex** prepared by the IMF.
- A **Debt Sustainability Analysis** prepared by the IMF and the World Bank.
- A **Staff Statement** of April 3, 2015, updating information on recent developments.
- A **Press Release** summarizing the views of the Executive Board as expressed during its April 3, 2015 consideration of the staff report that concluded the Article IV consultation with Mongolia.
- A **Statement by the Executive Director** for Mongolia.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

March 19, 2015

KEY ISSUES

Context. Medium- to long-term prospects are promising given Mongolia's large natural resources. Nonetheless, the country currently faces serious balance-of-payments (BOP) pressures on account of low FDI and weak commodity prices, as well as overly loose macro policies.

Current Outlook. Imports have started to taper off, and, with the first phase of the Oyu Tolgoi copper and gold mine now in operation, exports have picked up. The trade balance has thus improved, but with FDI and other financial-account flows still depressed, the overall BOP remains in substantial deficit. In addition, public debt has risen sharply, and bank vulnerabilities are growing. Barring a change in policies and/or major new developments in the real economy, these trends are likely to continue.

Policies. Recognizing these challenges, the new government has already taken some action, but further policy adjustment is required to stabilize the economy, and structural measures are needed to promote investment and ensure sustained growth. In particular:

- Credible fiscal consolidation, covering both the traditional budget and the Development Bank of Mongolia (DBM), is needed to reduce projected deficits, bring public debt under control, and moderate BOP pressure;
- All fiscal or quasifiscal activity currently undertaken by the DBM, the Bank of Mongolia (BOM), or other agencies should be conducted on-budget by the government;
- Some monetary tightening would be desirable, to moderate credit growth further and strengthen the BOP, while ensuring that banks remain adequately liquid;
- Exchange rate flexibility should be preserved, as a shock absorber for the economy;
- Banks' provisions and capital buffers should be bolstered, and supervisory and crisis preparedness frameworks strengthened;
- Governance reforms at the DBM and BOM would help strengthen these institutions;
- Steps should be taken to move ahead with major mining projects, improve the investment climate, boost FDI, and support growth; and
- Social safety nets should be strengthened and better targeted to the poor.

Approved By
Markus Rodlauer and Masato Miyazaki

Discussions were held in Ulaanbaatar during September 4–17, 2014, December 11–18, 2014, and February 9–18, 2015. The staff team included K. Mathai (head), F. Mochtar, N. Saker (incoming resident representative), and J. Yu (all APD), Y. Kinoshita (non-resident representative, OAP), B. Shang (FAD), O. Croitoru Nedelescu (MCM), P. Gupta (RES), and K. Svirydzenka (SPR). Mr. Rodlauer (APD) attended some of the meetings, as did Messrs. Togmid and Yoon (OED). The team was assisted by Mmes. Ardak, Khulan, and Selenge in the local IMF office. Mmes. Choi, Meng, and Tolentino (all APD) assisted in the preparation of this report.

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CONTEXT

1. **Mongolia has been one of the world's fastest growing economies as a result of large FDI in the mining sector.** In 2011–12, FDI averaged 40 percent of GDP and annual growth exceeded 15 percent, and over the past decade, growth averaged 9 percent. One project alone—the Oyu Tolgoi (OT) copper and gold mine—brought more than $6 billion (50 percent of GDP) in investment during its first phase of development, with another $5 billion planned for the second phase, and ongoing negotiations over the Tavan Tolgoi (TT) coal mine could potentially yield $4 billion in investment over the next five years (see Annex I). Per capita income has reached $4,000, and with mineral wealth estimated at $1 to $3 trillion for a population of just 3 million, the future looks bright. Within 5 years, when OT-2 comes into production, Mongolia should be in a position to start running large fiscal surpluses and accumulating savings for future generations.

2. **Mongolia's narrow economic base has, however, left the country highly vulnerable to shocks.** Minerals account for 90 percent of all exports, and 90 percent of these are bound for China. This lack of diversification has made the economy prone to repeated boom-bust cycles, with the balance of payments falling under intense pressure twice in the past five years, and public finances remaining vulnerable despite a fiscal framework intended to reduce procyclicality. Meanwhile, there have been symptoms of Dutch disease—the REER appreciated by nearly 30 percent from mid-2009 to mid-2013 (though this has now been reversed), and non-commodity exports have performed anemically.

3. **Over the past two years, the economy has faced sharp declines in FDI and coal exports.** FDI related to OT slowed as the first phase was completed and the second phase was caught up in a contentious dispute between the two main partners, Rio Tinto and the government. The dispute on the country's premier project also cast a pall on the general investment climate, which had already suffered a blow when a moratorium on new mining exploration licenses—since reversed—was introduced in 2010. As a result, FDI fell by half in 2013, and again in 2014. Compounding this situation were China's slowdown and weakness in the coal sector—prices are down almost two-thirds from their 2012 peak, and volumes are down 8 percent—and more recently copper prices have also fallen sharply. (These declines have been offset only partially by the decline in oil prices).

4. **In response to these shocks, the authorities resorted to expansionary policies to tide the economy over until FDI and exports could recover.** The fiscal expansion had already started in 2012 when the government implemented universal transfers to the population and the new Development Bank of Mongolia started to promote infrastructure development. When FDI inflows tumbled and coal prices fell in 2013, the authorities maintained expansionary fiscal policy in an effort to sustain growth as well as boost infrastructure spending to realize the country's potential. During 2012-14, combined on- and off-budget public capital expenditure averaged nearly 15 percent of GDP, the consolidated deficit averaged nearly 10 percent, and debt surged to more than 75 percent of GDP, most of it external and

nonconcessional.[1] Monetary policy was loosened substantially: the policy rate was cut by 275 basis points and easing programs amounting to 20 percent of GDP were introduced (at an average cost to banks of 4 percent while the policy rate was 10½ percent). Credit growth surged to 54 percent y/y by end-2013, keeping GDP growth above 11 percent and the current account deficit at around 25 percent of GDP, and sowing the seeds for banking asset-quality deterioration.

5. **The authorities' approach soon proved unsustainable.** With FDI falling, a growing share of the current account deficit has been financed by a drawdown of reserves. From more than $4 billion (almost 6½ months of imports) in early-2013, reserves are now down to $1¼ billion (two months) even after substantial drawing from a swap line provided by the People's Bank of China (PBOC). The currency has weakened against the U.S. dollar by almost 15 percent over the past year—and by more than 40 percent since 2013—and as a result, inflation was well into double digits during most of 2014. The credit boom has strained the financial system, with reported gross NPLs rising substantially and liquidity pressures emerging. These developments have been noted by global markets—Mongolia has suffered sovereign rating downgrades, and its spreads have widened sharply. Although growth has now slowed and the current account deficit has narrowed, the overall balance of payments remains under pressure.

6. **A durable solution to Mongolia's economic challenges requires significant macro policy adjustment.** The economy is still relatively small, and one or two developments—such as new FDI or portfolio inflows sparked by agreements on OT-2 or TT, offers of substantial, new financing from donors, and/or a sharp rise in commodity prices—could materially change the outlook, at least temporarily. But such developments cannot be counted upon, and the economy would, at any rate, remain vulnerable to future shocks. Instead, the centerpiece of any strategy to close financing gaps should be macro policies that keep the current account deficit at a sustainably financeable level, and that strengthen the fiscal position. Such policies would still promise prosperity, though perhaps at a somewhat slower pace, and with reduced risks of a crisis along the way.

7. **Political conditions are now more conducive to decisive economic policymaking, but they are still far from easy.** Following a long period of uncertainty, a new government took office in November 2014, vowing to fix the economy, and backed by a grand coalition of the major political parties. The authorities have already taken important steps to strengthen fiscal, monetary, and other policies, but further adjustment will be needed. The new Prime Minister's SMS-based referendum revealed public support for moving ahead with negotiations on large investment projects including OT and TT, but achieving the necessary political consensus, both for these deals and for further macro policy reforms, will remain challenging, with general elections scheduled for mid-2016.

8. **Against this backdrop, the Article IV discussions focused on policies needed to stabilize the economy and achieve sustained growth over the medium- to long-term.** Policy discussions centered

[1] The Fiscal Stability Law, which went into effect in 2013, required that the structural on-budget fiscal deficit be kept below 2 percent of GDP, but the government created the Development Bank of Mongolia (DBM), run by a new Ministry of Economic Development, and channeled an extra 8 percent of GDP in capital spending through it.

on an adjustment scenario, with a package of economic and financial-sector measures to eliminate financing gaps and stabilize the economy and banking sector. They also covered the medium-term fiscal policy framework, policies to boost FDI and support growth, and efforts to ensure that the most vulnerable in society are protected.

RECENT DEVELOPMENTS AND OUTLOOK

9. **A sharp investment slowdown has dampened economic growth.** Declining FDI, continued uncertainty about OT-2, problems in the coal sector, and the contractionary impact of depreciation (see below) have weighed on growth, which slowed from 11½ percent in 2013 to 7¾ percent last year. While investment has fallen, consumption has remained robust, growing at nearly 9 percent, reflecting continued loose policies. Growth is expected to slow further, to around 4 percent during 2015-17 as OT-1 enters a relatively mineral-poor layer of earth, and then pick up sharply, particularly from 2020, when OT-2 enters production**.** Inflation rose substantially in 2014, given currency depreciation and policy stimulus, peaking at over 15 percent in July, and while it has since eased, it remains substantially above the target of 7 percent.

10. **While the current account deficit has narrowed, the overall BOP remains weak.** Exports are up, largely on account of OT-1, which began production in mid-2013. At the same time, equipment imports have decreased sharply, tracking the continued decline of FDI. Other imports, however, have been robust despite currency depreciation—mirroring the strength of consumption—and building materials are up significantly, reflecting policy stimulus to the construction sector. Although a trade surplus was registered in 2014, the overall BOP stayed in substantial deficit on account of service account outflows related to OT and weak FDI. At end-2014, gross reserves at the BOM amounted to 3¼ months of imports, equivalent to 75 percent of short-term debt, 29 percent of broad money, and 62 percent of the IMF's risk-based metric.

11. **On existing policies, Mongolia's external finances are expected to stay under pressure** (see baseline scenario in Tables 1–4). Exports will likely weaken for a few years as the OT project faces unfavorable geological conditions, and imports are expected to rise on the start of OT-2 construction. There may also be difficulties in rolling over maturing public- and private-sector debts (around $2 billion in 2017 alone, excluding the PBOC swap line which also matures that year). Given continued easy macroeconomic policies, the current account deficit should average 15 percent of GDP over the medium term, and staff analysis suggests the currency is overvalued by 10 to 15 percent (see Annex II). The overall BOP is expected to remain in substantial deficit through 2017, implying continued pressure on reserves and the exchange rate.

12. **Fiscal deficits remain large.** With revenues falling short of target, the on-budget structural deficit registered 4¼ percent of GDP in 2014, exceeding the 2 percent limit laid out in the Fiscal Stability Law (FSL). In addition, the DBM undertook significant spending—much of it on fiscal activities such as public infrastructure projects— outside the budget, pushing the consolidated deficit to 11 percent of GDP (see Annex III). In 2015, a supplementary budget has brought much of the DBM's spending on budget and

targets a combined deficit of 5 percent. This, however, depends on several unrealistic assumptions, and it also excludes 2½ percent of GDP in so-called "commercial" DBM spending which should also be considered fiscal.[2] All told, the overall deficit is expected to approach 10 percent of GDP, only slightly down from 2014. The authorities are considering additional expenditure cuts on the order of 5 percent of GDP, and, if successful, these would move the fiscal accounts toward staff's "adjustment scenario" (see below).

13. **Public debt has risen sharply and is now extremely high.** On the authorities' definition—i.e., in NPV terms, and excluding the PBOC swap drawings—debt amounted to 55 percent of GDP at end-2014, in excess of the FSL's 40 percent limit. Subsequent FSL amendments laid out a path to return to the 40 percent debt limit by 2018 (and to the 2 percent deficit limit as well), while the recent Debt Management Law departed from international best practice by redefining debt to exclude state enterprise debt and certain government guarantees. On staff's definition—in nominal terms, and including the PBOC swap—public debt reached 76½ percent of GDP last year (for the entire public sector, including state enterprises) and, given ongoing deficits, is expected to peak at 92½ percent of GDP in 2017, before declining rapidly as mining growth picks up.[3] As detailed in the accompanying DSA, the key debt indicators exceed the relevant thresholds for a few years, and Mongolia is thus assessed to be at high risk of debt distress. At the same time, debt is not on an ever-increasing path, and it is relatively small compared to the country's resource wealth, if the latter can be realized.[4]

14. **Monetary conditions have tightened but are still too loose.** Over the past year, the BOM has hiked the policy rate by 250 basis points, to 13 percent, which is within the range suggested by a Taylor-rule analysis and substantially positive in real terms.[5] Reserve money growth has been close to zero, reflecting the decline in NFA. Structural liquidity in the banking system—excess reserves on MNT deposits plus amounts mopped up on a short-term basis—is tight. Credit growth, including securitized mortgages, has slowed substantially (though it was still high at 23 percent y/y at end-2014). And the exchange rate has continued to weaken, which is likely to be contractionary in an economy so dependent on imported inputs, and where the export sector is largely dollarized. Still, growth of NDA on the BOM's balance sheet has been substantial, on account of increasing net credit to government as well as unconventional easing programs, and with inflation and the BOP both remaining under pressure, further tightening is needed.

[2] Project and borrower selection criteria are difficult for staff to evaluate, and given the DBM's track record, a cautious approach is desirable. Moreover, standard statistical principles do not allow for a portion of an agency's spending to be carved out and treated differently.

[3] Even without OT-2—and thus with lower growth—debt would be on a declining path from 2018, as shown in an alternate scenario in the accompanying DSA.

[4] Mineral wealth—most of which, of course, has not been converted to financial wealth—has been estimated at up to $3 trillion, which would be nearly 150 times Mongolia's total external debt and more than 300 times its gross public debt.

[5] Because of the weakness of monetary transmission through the interest-rate channel, care should be taken in interpreting a Taylor rule for Mongolia.

15. **As the economy has cooled, banking-system vulnerabilities have become apparent.** Banks' balance sheets have doubled in just two years, driven by the BOM's large stimulus programs,[6] while foreign currency lending was substantial (a quarter of the banks' loans). On the back of weak underwriting standards, credit risks increased significantly. In 2014 nonperforming loans (NPLs) as well as loans past-due by less than 90 days were up by 48 percent and 131 percent y/y, respectively. Although the reported NPL ratio remains low at 3.1 percent, asset quality problems seem to be understated especially given the inadequate classification of loan restructurings at some banks. The real estate market is cooling, further increasing credit risk, and, as noted above, liquidity is becoming tight. Stress tests suggest that some banks are vulnerable to economic shocks and that capital buffers should be strengthened in recognition of the balance-sheet deterioration that has already occurred as well as possible future deterioration given the risky environment.

16. **Risks are to the downside**. Elevated BOP pressure constitutes a major threat to economic stability. Prolonged delay of OT-2 could further undermine business confidence, slow growth, and worsen both external and fiscal indicators. Banking-sector conditions could worsen. Externally, a further slowdown in China could reduce Mongolia's export demand, and surges in global volatility could also affect Mongolia's ability to borrow externally (see Annex IV).

Authorities' Views

17. **The authorities agreed that the economy had gone through a difficult period because of severe BOP shocks and argued that the policy response had stabilized the situation.** Some interlocutors argued that Mongolia had faced massive external shocks that could have led to a BOP crisis, a credit crunch, and economic contraction. These dire outcomes, however, were avoided on account of the countercyclical policy response, which helped the economy to achieve a "soft landing."

18. **As for the outlook, the authorities had a more benign view than staff.** While the baseline scenario was developed jointly by the IMF team and the technical staff of the MOF and BOM, the authorities expected that their policy responses (see below) would be sufficient to turn the situation around, combined with other options for managing BOP pressure, including additional borrowing from the international market as well as donors. Finally, they noted that about 50 percent of DBM spending, which includes the projects with government guarantees, was included in the budget and opined that DBM commercial spending should not be included.

[6] The loans under the BOM easing programs were exempted from capital charges (zero-risk weighted) and from limits on large exposures and industry concentrations.

POLICY DISCUSSIONS

A. Macroeconomic Policies

19. **Comprehensive policy adjustment is urgently required to address external and fiscal imbalances and stabilize the economy.** Public debt is too high and inflation above target, but the most pressing concern is the severe BOP pressure that the country continues to face. Fiscal and monetary tightening, along with exchange-rate flexibility, is needed. Much the same advice was offered during the 2013 Article IV consultation, with limited takeup (see Annex V). Policies on investment, social protection, and banking also need to be strengthened.

Summary of Key Policy Recommendations	
Budget / DBM	Cut consolidated deficit to 4½ percent of GDP in 2015 and to around 2 percent by 2017. Consolidate all DBM spending into budget and strengthen DBM governance.
Monetary	Slow credit growth. Transfer unconventional easing programs to budget. Limit deficit monetization. Strengthen BOM governance.
Exchange Rate	Keep XR flexible. Limit intervention to combating excessive volatility.
Investment	Implement structural measures to boost investment. Improve investment climate. Move ahead with major mining projects.
Social Protection	Ensure protection of most vulnerable in society, including through enhanced income-targeting of subsidies.
Banking	Enhance provisions and capital. Strengthen supervisory framework. Phase out forbearance.

20. **The authorities have taken policy steps in the right direction, but further measures are needed**:

- **2015 Supplementary Budget.** Facing likely revenue shortfalls, the authorities revised down the revenue target and correspondingly cut expenditure in a 2015 supplementary budget, passed in January. Non-commercial spending of DBM was brought on budget, and the consolidated deficit targeted at 5 percent of GDP. This target, however, will be difficult to reach as revenues are still over-estimated.
- **Amendments to Fiscal Stability Law.** Recognizing that public debt had exceeded the ceiling enshrined in the Fiscal Stability Law (FSL), the authorities in February 2015 amended the FSL and enacted a new Debt Management Law (DML) that narrowed the coverage of debt as previously defined in the FSL. The new legal framework also raised the debt ceiling and set a path to bring debt (albeit more narrowly defined) and the fiscal deficit down to the previous limits by 2018 (which will be hard to achieve on current policies).[7]

[7] To be precise, the FSL amendments and new DML implement the following: (1) non-commercial DBM spending is brought onto the budget and thus included in the calculation of the structural fiscal deficit; (2) structural fiscal deficit limits are temporarily raised (5 percent of GDP in 2015, 4 percent of GDP in 2016, and 3 percent of GDP in 2017) but kept at 2 percent of GDP for 2018 and beyond; (3) the definition of debt is narrowed from public to general government debt (with the new definition, SOE debt and government guarantees that are fully secured by government securities are excluded); and (4) debt limits are temporarily raised (58.3 percent in 2015, 55 percent in 2016 and 50 percent in 2017) but remain at 40 percent for 2018 and beyond.

- **CMAP.** Parliament on February 18, 2015 approved a "Comprehensive Macro Adjustment Plan" (CMAP), which comprises macro-financial adjustment and structural policies. CMAP retains the target fiscal path in the supplementary budget. It envisages phasing out the BOM's Price Stabilization Program (PSP) and transferring remaining PSP loans to the government. The CMAP does not, however, comprehensively transfer all of the BOM's easing programs—including funding for new mortgages and financial support at the request of commercial banks for their corporate clients—to the budget. On the structural front, CMAP calls for steps to strengthen social welfare, enhance the investment climate, facilitate FDI inflows, promote exports, and encourage import substitution.

21. **Staff recommended a stronger package of macro policy measures, as follows**:[8]

- **Fiscal policy:**

    - A new budget amendment for 2015 would be needed to bring the consolidated deficit (including all DBM spending) down to around 4½ percent of GDP this year. The deficit would continue to fall until reaching around 2 percent in 2017, and it would be possible to move toward fiscal surpluses a few years after that. (Staff analysis does not find grounds for loosening the long-term deficit target specified in the FSL (see Annex VI), nor do staff support the redefinition of debt in the DML.)

    - Within the overall budget envelope, total spending by the DBM (commercial and non-commercial) would be limited to around 2½ percent of GDP in 2015 and would decline thereafter. Furthermore, authority over the budget and the DBM—including its "commercial" spending—would be unified in the Ministry of Finance, and reporting would be consolidated. Reforms to strengthen governance of the DBM could also be enacted.

    - Capital expenditures are very high in international comparison, and while part of this is explained by existing infrastructure deficiencies and the country's low population density, substantial cuts nonetheless appear to be possible; moreover, given the openness of the economy, the associated fiscal multipliers are likely to be small.

    - At the same time, there is scope to cut current expenditure and raise revenue: large, untargeted subsidies should be phased out in favor of programs (like food stamps) that more directly reach the poor. Moreover, recent growth in the public wage bill could be addressed and procurement inefficiencies reduced. Some social benefits could be made taxable and customs duties increased.

    - Going forward, a new budget law amendment could be considered to restrain Parliament's ability to increase the aggregate budget envelope.

- **Monetary policy.** The stance should be tightened without delay, including by restricting deficit monetization, and credit growth should be further slowed, following the harmful credit boom in recent years (see Annex VI). The BOM's unconventional programs (PSP,

[8] The scenario also assumes that banking, structural, and social protection reforms are also undertaken—see below.

mortgages, and financial support at the request of commercial banks for their corporate clients) should be transferred to the budget, where—in a transparent manner and with Parliamentary oversight—they can compete with other spending priorities for limited resources. The nature of BOM operations should change—unconventional easing programs targeting particular industries or providing financial support at the request of commercial banks for their corporate clients should be ruled out, while open market operations may need to be enhanced to ensure sufficient liquidity in the banking system. Further BOM governance reforms should also be considered, such as giving Monetary Policy Committee members a vote on BOM decisions.

- **Exchange rate flexibility.** The BOM would limit its involvement in FX markets to preventing excessive market volatility, and as a result, the exchange rate would move more flexibly. The strategy is to contain further sharp depreciation through adequate macro policies, and to limit intervention to addressing excessive volatility.

22. **These policy efforts would help stabilize the economy, but reserve buffers would remain thin, suggesting the need for additional financing.** As shown in Tables 5-9 and Figure 5, growth in this adjustment scenario would slow somewhat in 2015 given the policy tightening, and inflation would rise by a moderate amount for several years, given exchange-rate pass-through. The fiscal adjustment would also put public debt on a more sustainable path. Imports would moderate, and strengthened policies would support market confidence and facilitate rollovers of several large bonds maturing in 2015 and 2017 (a total exceeding $2 billion).[9] As a result, foreign-exchange reserves would stabilize at around 1¾ months of imports for several years (before rising in 2019–20). This is substantially stronger than in the baseline but still lower than desirable, suggesting the need for additional financing in support of the adjustment effort.

23. **Looking ahead, prudent macroeconomic management must be maintained to ensure that resource wealth can be harnessed effectively.** Many resource-rich countries have failed to realize the promise of prosperity. Avoiding procyclical fiscal policy, saving resource revenues and investing them wisely, ensuring cautious monetary policy, and maintaining a competitive exchange rate to avoid the effects of Dutch Disease, are all essential components.[10] Mongolia has a relatively large resource endowment compared to some other resource-rich economies, and managing that wealth wisely is of critical importance.

Authorities' Views

24. **The authorities saw the benefits of additional fiscal adjustment.** They agreed that the fiscal path in the supplementary budget and CMAP faced risks and that further measures were thus needed. They expressed their intention to cut budget spending further via a government resolution, supported by another supplementary budget later in the year, and to reduce DBM spending as well, with total cuts amounting to around 5 percent of GDP. They also saw an important role for additional financing to bridge short-term BOP difficulties.

[9] The current account deficit narrows in dollar terms relative to the baseline scenario; but since the adjustment lowers GDP, the CAD in percent of GDP rises. Also, the CAD still worsens for a few years within the adjustment scenario, on account of OT's geological conditions and the start of OT-2 construction.

[10] For further background, see IMF Departmental Paper No. 13/2 (August 28, 2013), "Boom, Bust, or Prosperity? Managing Sub-Saharan Africa's Natural Resources Wealth."

25. **The authorities broadly shared staff's views on monetary policy going forward.** The BOM noted that they had intentionally been phasing out their unconventional programs, and the government also expressed its agreement with this objective. The BOM envisaged transferring the outstanding program loans to the government by end-June. They noted that the Price Stabilization Program had basically achieved its goals, as supply-driven inflation had continuously been low and stable over the past 26 months, and the economy had achieved a soft landing. They continued to see the mortgage program as highly beneficial, noting that it aimed to make households' expenditures more efficient and to boost middle-class savings. They believed that this program should be continued as part of the government's long-term saving policy, in conjunction with ongoing structural reforms of the pension fund. Finally, they suggested that it would be more appropriate to consider changes to the central bank law only after economic conditions had improved. On exchange rate policy, they noted that they are fully committed to the flexible exchange rate regime.

B. Structural Reforms and Social Policies

26. **Structural measures are needed to boost investment and growth, and an enhanced effort is needed to protect the poor.** To return the economy to a sustainable, rapid growth path, a focused effort is needed to improve the investment climate, which was harmed by previous policy changes, boost FDI, and move ahead with large mining projects. Many of these are included in the authorities' CMAP. Given resource constraints, subsidy programs should be targeted better to protect the poorest and most vulnerable in society.

27. **The authorities are redoubling efforts to boost investment.** The CMAP, now approved by Parliament, includes reaching agreement on OT and TT as key goals, and a former prime minister has been appointed minister in charge of "mega projects," charged with moving those negotiations forward. The government has also proposed a host of measures—under the CMAP and through other initiatives—to increase investment, boost exports, and support appropriate import substitution. Finally, the tax law is being amended to improve clarity and avoid conflicts in the judicial system with foreign investors.

28. **Special efforts must be made to ensure that the most vulnerable in society are adequately protected.** Compared to other similarly placed countries, Mongolia has a large budget for subsidies and transfers, amounting to some 8 percent of GDP. Most of these are targeted to different categories of the population—mothers, children, the elderly, the disabled, et al.—without regard to income. Economic adjustment policies, while necessary for medium-term growth and stability, will create short-term dislocations, and it is vital that policies be designed to protect the poor. In the short-term, the income-targeted food stamp program could be expanded, and looking forward, the proxy means-tested subsidy programs currently under design should be implemented expeditiously. The World Bank has done significant work in this area (see Informational Annex), and there exists sufficient technical capacity to improve targeting.

Authorities' Views

29. **The authorities noted that, as a policy matter, income targeting of subsidies is controversial in Mongolia.** They had proposed this in the first supplementary budget for 2015, but Parliament rejected many of the relevant measures. Cultural values prioritize children and the elderly, regardless of income level. That said, they firmly agreed on the need to protect the poorest, which may require difficult choices given hard budget constraints.

C. Financial Sector

30. **A comprehensive approach to addressing problems in the banking system is needed to contain systemic risks**. The BOM has taken some good steps, but more needs to be done (and the IMF stands ready to support the authorities with further TA, as needed). Risk weights for unhedged FX loans were increased in August 2014, and the 1-percent general provision for performing loans was restored, though only for new loans. Nevertheless, loan classification is heavily reliant on days overdue rather than on more qualitative assessments of borrowers' creditworthiness and future cash flows, while the prudential treatment of restructured loans is weak. The banking system has already seen balance-sheet deterioration, and it remains vulnerable to a further deterioration of economic conditions and the crystallization of hidden losses.

31. **As a priority, provisioning and capital buffers need to be reinforced** (see Annex VII for a detailed list of banking-sector recommendations). The level of provisions (70 percent of NPLs) appears to be low given the likely understatement of NPLs, the inadequate treatment of loan restructuring, the uncertain value of recoveries (certain Civil Code provisions make foreclosures difficult, and there is significant uncertainty regarding the valuation of collateral, and the cooling of the real estate market. Thus, current capital levels (e.g., a system-wide Tier 1 ratio of 12.5 percent) are likely overstated. The BOM should take immediate measures to increase provisions and capital across the banking system, and particularly for the most vulnerable banks. This could usefully be informed by an independent asset quality review of the major banks.

32. **The BOM should eliminate forbearance and strengthen risk recognition.** Asset-classification and provisioning regulations should be enhanced by introducing a stricter treatment and regular reporting of restructured loans. The rules should also be changed to embed more qualitative and forward-looking assessments of the borrower's condition, including hedging capacity against foreign-exchange risk. The 1-percent general provision should apply to the entire stock of performing loans, and the BOM should discontinue forbearance vis-à-vis loans made under the Price Stabilization Program (PSP). Capital requirements for systemically important banks should be raised—the Tier 1 ratio should be increased to 10.5 percent—and targeted additional capital requirements should be imposed on banks that have large concentrations (loan, deposit, and foreign exchange). The BOM should move quickly to resolve non-viable banks, if needed.

33. **The supervisory and the crisis preparedness frameworks need to be strengthened.** Legislative changes are needed to secure for the BOM flexible powers for early intervention. Current supervisory assessments (CAMELS) should be turned into robust and forward-looking tools for early identification of risks and prompt corrective action. Finally, the Supervisory Committee should be empowered as the key decision maker. Cooperation on financial stability and crisis preparedness matters should be strengthened via the Financial Stability Council, which should be expanded to include the Deposit Insurance Corporation. The legal framework should prevent the reversal of resolution actions and provide early and flexible intervention triggers as well as better safeguards against misuse of public funding. Emergency liquidity assistance should be provided only to solvent and viable banks, and should be priced at penalty rates.

34. **AML/CFT.** In 2011, the Financial Action Task Force (FATF) designated Mongolia as a jurisdiction not making sufficient progress in implementing the agreed action plan to enhance its Anti-Money-Laundering / Countering the Financing of Terrorism (AML/CFT) framework. Since then, with the support of ongoing IMF TA, Mongolia has strengthened its framework considerably, and it is no longer subject to the FATF's on-going global AML/CFT compliance process.

Authorities' Views

35. **The authorities welcomed staff's suggestions on strengthening the banking system.** They considered that the recent tightening of policies, including in the area of prudential regulations, would help contain the risks in the banking system. Looking ahead, the BOM agreed that further policy attention should be devoted to monitoring and pre-emptively responding to potential risks in the banking sector, and welcomed the recommendations of the recent Fund TA mission, which could be integrated into the Medium Term Supervisory Strategy.

D. Other Issues

36. **Article VIII.** There are two previously identified multiple currency practices, relating to the BOM's calculation and use of reference exchange rates. No action is planned.

STAFF APPRAISAL

37. **Mongolia has a bright future, but the next few years will be challenging.** If managed prudently, the country's massive resource wealth could spell prosperity for all Mongolians, nearly one-third of whom still live below the poverty line. These are not just fond hopes for a distant future; it could be as early as 2020 that OT-2's exports begin, boosting GDP dramatically and generating fiscal revenues to transform the economy, improve living standards, and build up an endowment for future generations. In light of its resource wealth, and assuming this can continue gradually to be realized, Mongolia is projected to be solvent given the strong projected revenues from mining over the long term. The country does, however, face serious liquidity pressures and

risks in the short run, before mining inflows ramp up. Until then, financing outsized prospective fiscal and BOP deficits will be difficult.

38. **Loose macro policies have helped create the difficulties the economy faces today.** Mongolia's present problems were driven in large part by major external shocks, to FDI and to coal exports. But policy errors also contributed. Policies were loosened first to share the benefits of prospective mineral wealth broadly, and then to buffer the economy from shocks. This succeeded—for a while—in maintaining high growth, but at the cost of exacerbating economic and financial vulnerabilities. Fiscal discipline was undermined by large off-budget spending, and monetary policy was eased dramatically. This stimulus fueled inflation, compounded BOP pressure, laid the seeds for asset-quality problems in the banking system, and generally undermined confidence at home and abroad.

39. **Policy adjustment is needed to provide a sustainable solution to Mongolia's economic challenges.** Macro policies need to be tightened to keep current account deficits at more manageable levels and to improve the fiscal position. If additional external financing can be marshaled in support of such policies, the adjustment will be less disruptive. At the same time, measures are needed to strengthen the banking system, and it is vital that steps be taken to improve the targeting of subsidies and thus ensure protection of the most vulnerable in society.

40. **The authorities have already taken a number of steps to strengthen the economy.** Part of DBM's spending has been brought on budget, and the consolidated fiscal deficit is expected to decline this year. A government resolution to cut spending administratively is envisaged, to be backed up by a second supplementary budget later in the year. The BOM has hiked the policy rate twice, slowed the pace of PSP and mortgage lending, and proposed transferring the existing stock of program loans to the government's balance sheet. The authorities have redoubled efforts to reach agreement with investors on large projects and introduced other structural measures to boost exports and reduce imports. Steps have been taken to strengthen the banks and to improve bank supervision and crisis preparedness.

41. **More, however, is needed:**

- The fiscal path needs to be secured with Parliamentary approval for measures to control spending, both on-budget and off, as part of a coherent, medium-term macro framework.
- The BOM should cease unconventional easing programs targeting particular industries or providing financial support at the request of commercial banks for their corporate clients, and should instead return to traditional central-banking functions; these programs should, if desired, by conducted by the government, competing with other spending priorities for funds within the budget.
- The monetary stance should be tightened further, to control credit growth and support the BOP.

- Foreign-exchange intervention should be limited to dealing with episodes of excessive volatility, and the exchange rate should be allowed to move flexibly.
- Banks' provisions and capital buffers should be bolstered, informed by an independent asset-quality review, and supervisory and crisis-preparedness frameworks enhanced.
- DBM and BOM governance should be strengthened.
- The investment climate should be enhanced, and progress made on mega-mining projects, so as to boost FDI.
- Especially important, social safety nets should be strengthened and better targeted.

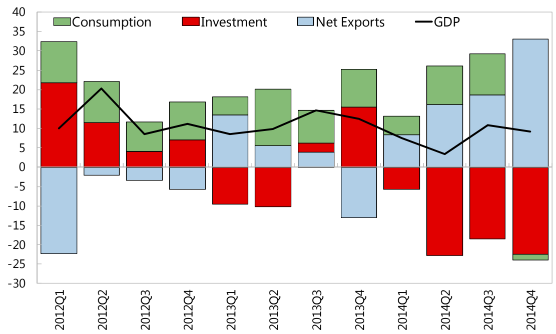
42. **With a comprehensive adjustment strategy in place, Mongolia will be well placed to realize its economic potential.** Today's challenges are serious but surmountable, and the country's medium-term prospects remain strong. With prudent management, Mongolia should be able to raise adequate external financing in support of its adjustment policies and build reserve buffers, while safeguarding external and public debt sustainability.

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

Figure 1. Real Sector Developments

Dragged by weak investment, growth has dipped to single digits.

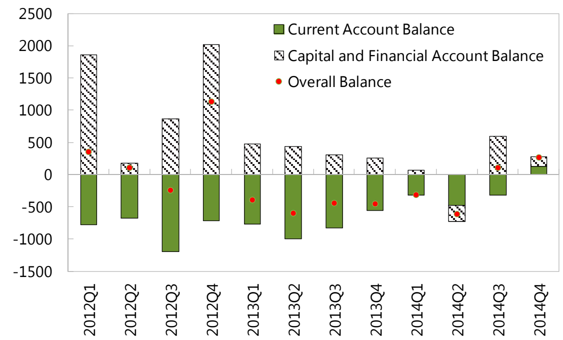
Real GDP Growth
(Contribution and year-on-year percentage change, 2012Q1-2014Q4)



Source: Mongolian authorities.

Current-account narrowing has, until very recently, been more than offset by financial account deterioration...

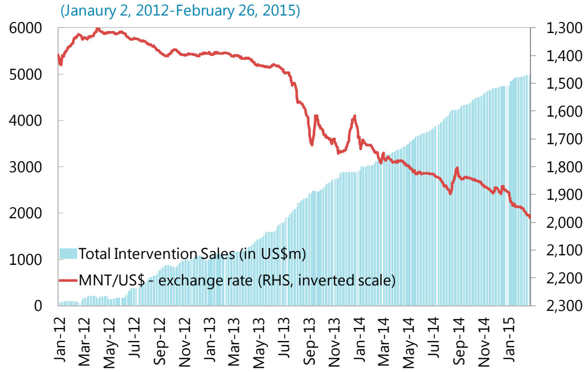
Current and Capital Accounts
(In million US$)



Source: Mongolian authorities.

...leading to a sharp drop of foreign exchange reserves and depreciation...

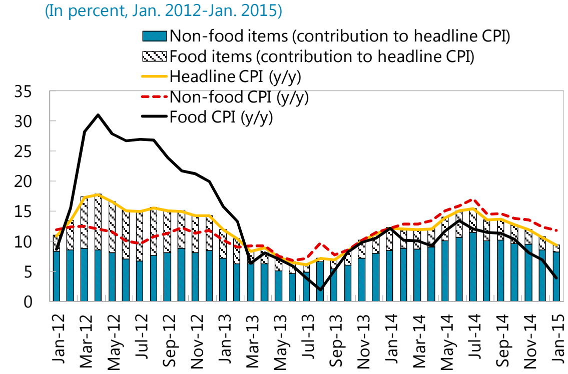
BOM FX Intervention and Exchange Rate
(Janaury 2, 2012-February 26, 2015)



Source: Mongolian authorities.

...which in turn has kept inflation at double digits until recently.

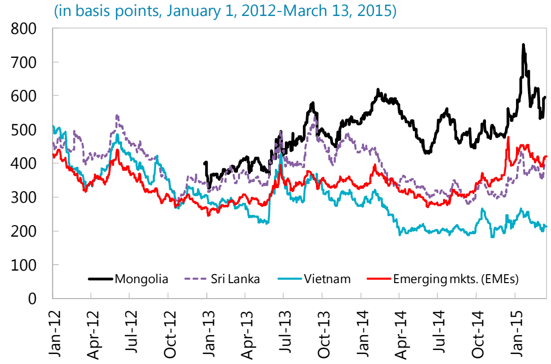
Consumer Price Inflation
(In percent, Jan. 2012-Jan. 2015)



Sources: Mongolian authorities; and IMF staff estimates.

Market sentiment has deteriorated, with sovereign spreads rising...

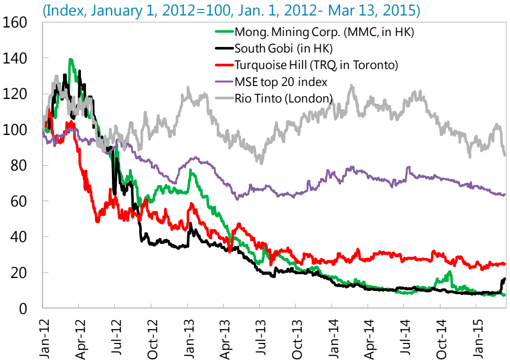
JP Morgan EMBI Global Sovereign Spreads
(in basis points, January 1, 2012-March 13, 2015)



Source: Bloomberg LP.

...and the stock prices of three mining companies listed abroad have slumped.

Stock Prices for Mining Companies
(Index, January 1, 2012=100, Jan. 1, 2012- Mar 13, 2015)

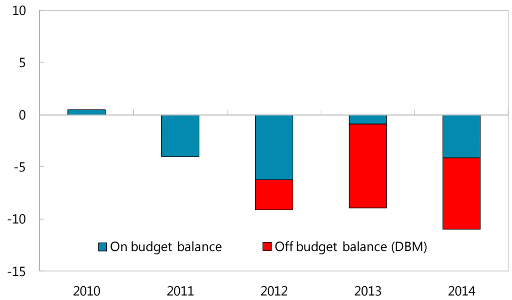


Sources: Bloomberg LP.; and IMF staff estimates.

Figure 2. Fiscal and Monetary Sector Developments

The consolidated deficit has remained large…

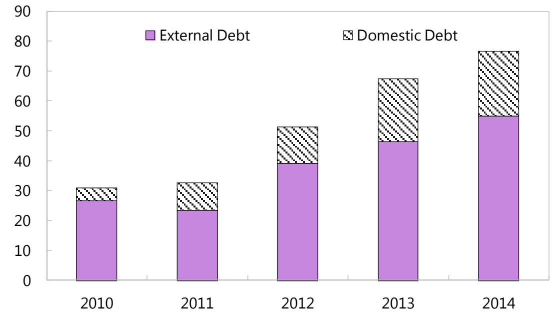
Mongolia: Fiscal Balance
(in percent of GDP)



Sources: Mongolian authorities; and IMF staff estimates.

…and debt levels have reached a record high.

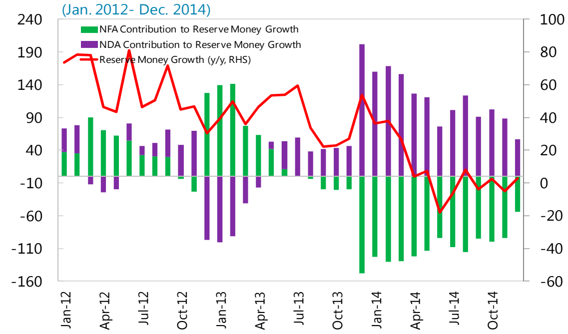
External and Domestic Debt 1/
(In percent of GDP)



Sources: Mongolian authorities; and IMF staff estimates.
1/ Debt coverage expanded from 2013 onward.

Reserve money growth has slowed owing to FX reserve loss.

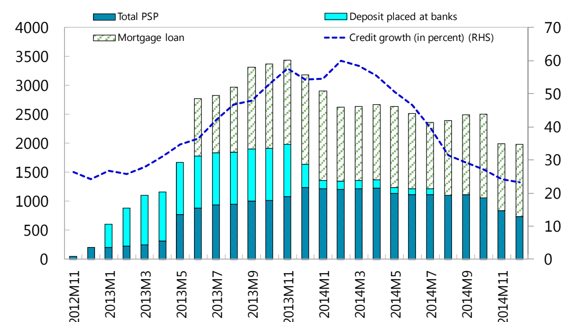
Reserve Money Growth and Contribution
(Jan. 2012- Dec. 2014)



Sources: Mongolian authorities; and IMF staff estimates.

The BOM has unwound some of its monetary easing, and credit growth has slowed.

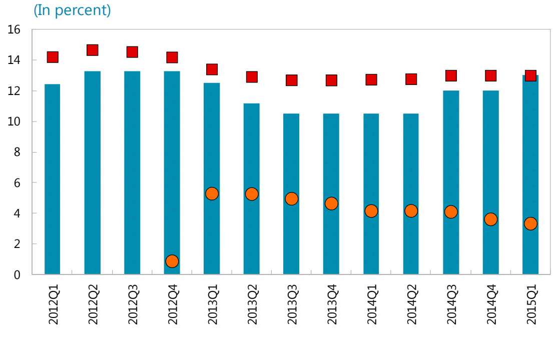
Credit Growth, PSP, Mortgage, and Deposit
(Billion togrogs; in percent)



Source: Mongolian authorities.

The policy rate is now in line with the range suggested by a Taylor-rule analysis.

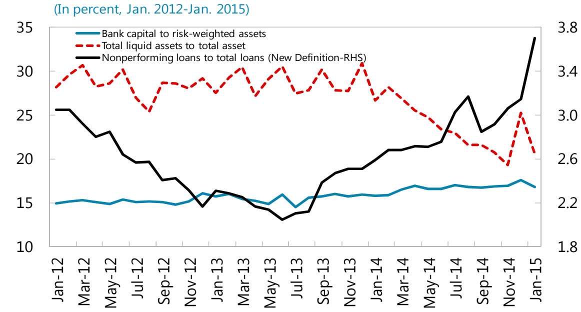
Actual and Implied Policy Rate
(In percent)



Sources: Mongolian authorities; and IMF staff estimates.

Nonperforming loans have risen significantly.

Bank Capitalization, Asset Quality and Liquidity
(In percent, Jan. 2012-Jan. 2015)

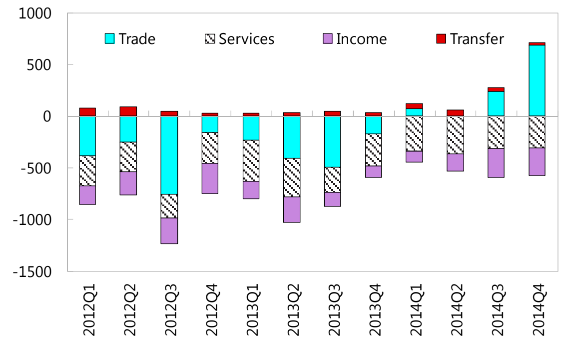


Sources: Mongolian authorities; and IMF staff estimates. Caution is needed in interpreting FSI indicators given pervasive forbearance and rapid credit growth.

Figure 3. External Sector Developments

The current account balance has improved on an improved trade balance.

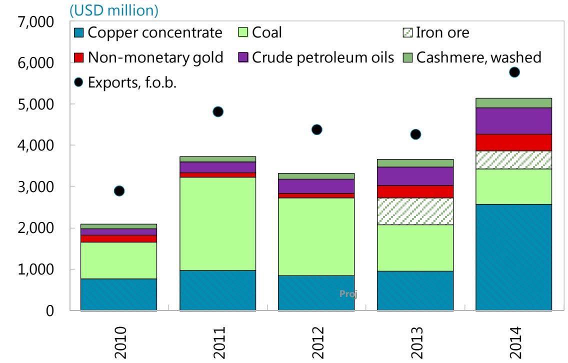
Current Account Balance
(In millions of USD)



Source: Mongolian autorities.

Copper exports have more than doubled thanks to OT-1's production…

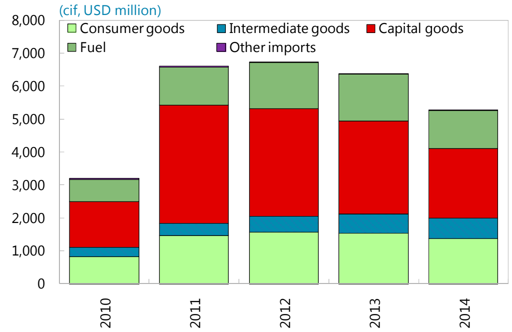
Exports
(USD million)



Sources: Mongolian authorities; and IMF staff estimates.

….while imports have declined on slowing investment.

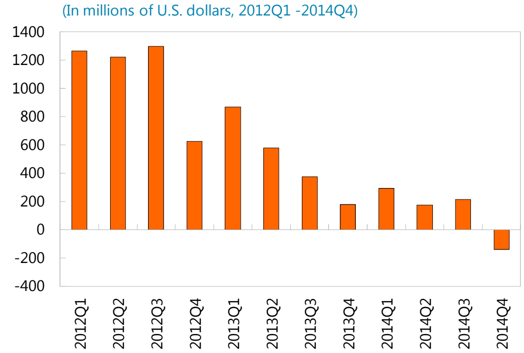
Imports
(cif, USD million)



Sources: Mongolian authorities; and IMF staff estimates.

FDI has dropped sharply…

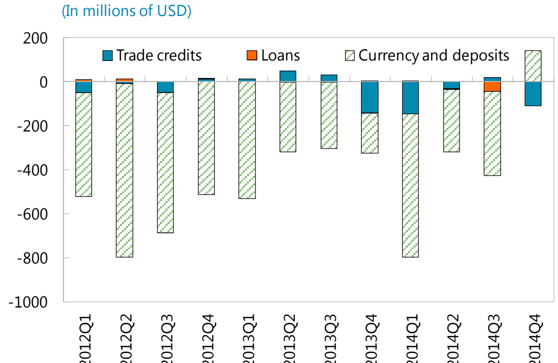
Foreign Direct Investment
(In millions of U.S. dollars, 2012Q1 -2014Q4)



Source: Mongolian authorities.

…and there have been large financial outflows.

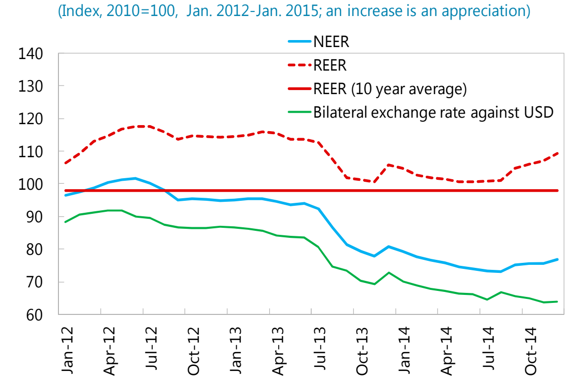
Financial Outflows
(In millions of USD)



Source: Mongolian authorities.

The REER appreciated strongly in the past few months, and EBA-lite analysis suggests the currency remains overvalued.

Exchange Rates of the Togrog
(Index, 2010=100, Jan. 2012-Jan. 2015; an increase is an appreciation)

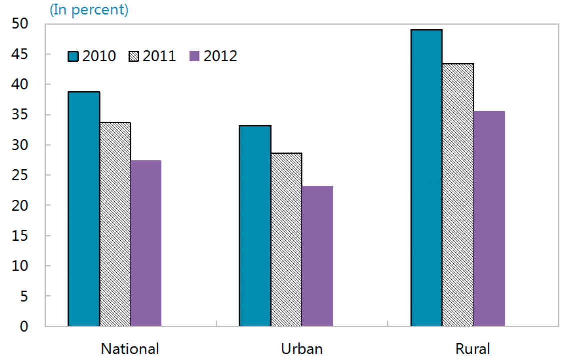


Sources: Mongolian authorities; and IMF staff estimates.

Figure 4. Inclusive Growth Indicators

Poverty remains widespread but has continued to decline…

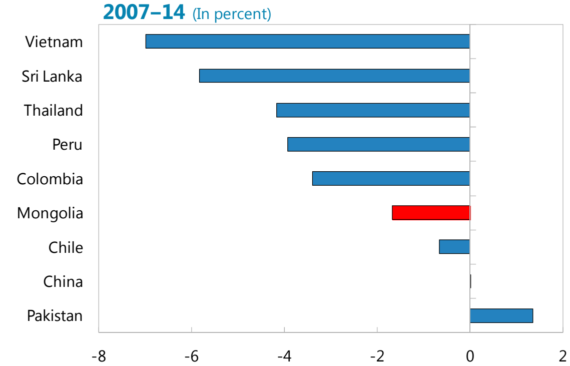
Mongolia: Poverty Headcount
(In percent)



Source: Mongolian authorities.

…as has unemployment.

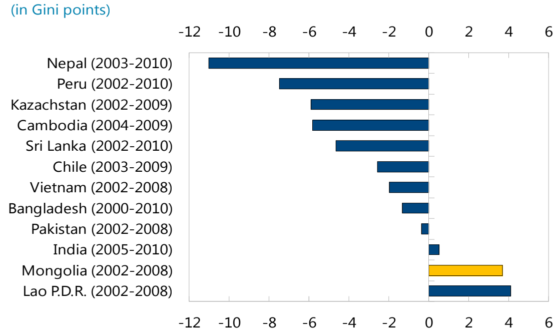
Change in Unemployment Rate, Average of 2007–14 (In percent)



Source: IMF, WEO database

Inequality, however, has been on the rise…

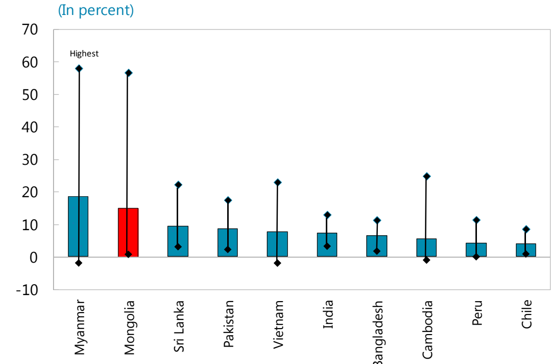
Change in Gini Index
(in Gini points)



Source: World Development Indicators.

…and inflation volatility is high, hurting the poor.

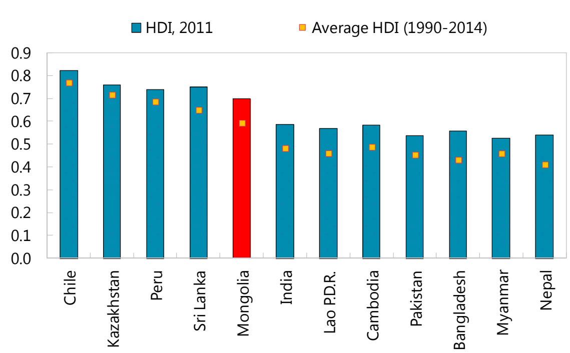
Change in Inflation, Average 1995-2014
(In percent)



Source: IMF, WEO database.

Mongolia scores relatively well in terms of human development…

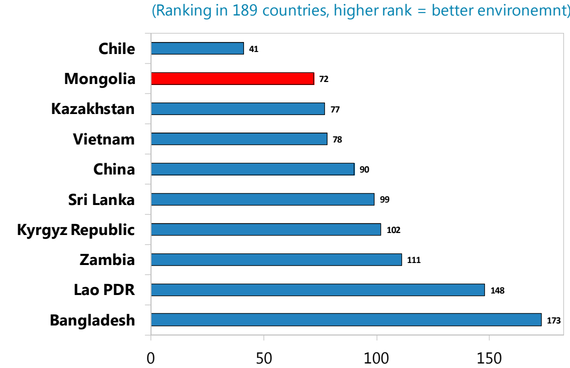
Human Development Index (HDI)



Source: Human Development Report 2014 (UNDP).

…and it has a reasonably attractive business environment.

Doing Business Index
(Ranking in 189 countries, higher rank = better environemnt)



Source: World Bank/IFC Doing Business Database, 2015 Report.

Table 1. Mongolia: Selected Economic and Financial Indicators, 2011–20 (Baseline)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Est.	Projections					
	(In percent of GDP, unless otherwise indicated)									
Real sector										
Nominal GDP (in billions of togrogs)	13174	16688	19118	21844	24315	27101	30144	34094	38525	44300
Real GDP growth (percent change)	17.3	12.3	11.6	7.8	4.4	4.2	3.8	6.2	6.4	9.2
Mineral real GDP growth	7.7	8.3	19.4	24.2	9.0	-0.5	-4.0	6.0	7.0	20.0
Non-mineral real GDP growth	19.9	13.3	9.8	3.6	3.0	5.8	6.2	6.2	6.2	6.3
GDP deflator (percent change)	15.1	12.8	2.6	6.0	6.6	6.9	7.1	6.5	6.2	5.3
Consumer prices (End-period; percent change)	9.4	14.2	11.2	10.7	8.0	7.4	7.1	6.8	6.6	6.5
Gross national saving	30.4	27.7	26.6	24.3	21.5	20.3	19.5	21.1	23.3	27.2
Public	9.4	3.3	7.5	4.1	1.4	0.3	0.9	2.3	3.1	3.1
Private	21.1	24.4	19.2	20.2	20.1	19.9	18.6	18.9	20.2	24.2
Gross capital formation	56.9	55.0	52.1	32.6	32.6	37.6	37.1	38.0	36.5	33.0
Public	13.4	12.4	16.4	15.1	11.2	8.2	7.5	7.5	7.3	7.3
Private	43.6	42.7	35.7	17.5	21.4	29.4	29.6	30.5	29.2	25.7
General government accounts										
Total revenue and grants	33.9	29.8	31.3	28.0	25.4	25.1	24.9	25.4	25.4	25.8
Mineral revenue	7.8	5.0	5.1	4.6	3.3	2.8	2.6	3.0	3.0	3.6
Non-mineral revenue	26.1	24.8	26.2	23.4	22.2	22.3	22.3	22.4	22.4	22.1
Total expenditure and net lending 1/	37.9	38.9	40.2	39.0	35.2	32.9	31.6	30.6	29.7	30.0
On-budget structural balance (excluding DBM spending)	...	...	-1.2	-4.3	-4.2	-4.0	-3.1	-3.0	-2.0	-2.0
DBM spending	...	2.8	8.0	6.8	5.7	3.7	3.3	2.0	2.0	2.0
On-budget plus DBM balance	-4.0	-9.1	-8.9	-11.0	-9.8	-7.8	-6.7	-5.3	-4.2	-4.2
	(In percent of GDP, unless indicated otherwise)									
Monetary sector										
Credit growth (percent change)	72.3	24.1	54.3	23.3	16.2	15.5	16.0	16.3	16.9	17.1
Reserve money growth (percent change)	75.3	30.5	54.0	2.7	-0.9	8.3	8.1	10.2	10.4	13.2
Balance of payments										
Current account balance	-26.5	-27.4	-25.4	-8.2	-11.1	-17.3	-17.6	-16.8	-13.2	-5.7
Debt indicators										
Total public debt 2/	32.7	51.3	67.3	76.5	81.5	87.6	92.6	89.1	84.9	80.1
Domestic public debt	9.1	12.3	21.1	21.6	25.6	25.2	32.3	30.8	28.8	26.1
External public debt	23.5	39.0	46.3	54.9	56.0	62.4	60.2	58.4	56.2	54.0
Memorandum items:										
Copper prices (US$ per ton)	8823.5	7958.9	7331.5	6863.4	5644.0	5602.8	5594.6	5581.6	5559.3	5545.5
Gold prices (US$ per ounce)	1568.6	1668.8	1411.1	1266.2	1276.6	1282.9	1295.0	1310.6	1329.5	1384.9

Sources: Mongolian authorities; and IMF staff projections.

1/ Includes DBM spending.

2/ Debt data reflects general government debt (including quasi-sovereign bonds issued by DBM) only before 2013, and starts to cover SOE debt from 2013 onwards.

Table 2. Mongolia: Summary Operations of the General Government, 2011–16 (Baseline)

				2014		2015		2016
	2011	2012	2013	Budget	Est.	Budget 1/	Proj.	Proj.
				(In billions of togrogs)				
Total revenue and grants	4,468	4,976	5,984	6,888	6,122	6,481	6,186	6,805
Current revenue	4,455	4,941	5,980	6,887	6,120	6,417	6,122	6,748
Tax revenue and social security contributions	3,909	4,291	5,120	6,257	5,248	5,430	5,309	5,830
Income taxes	919	895	1,117	1,284	1,098	1,151	1,080	1,211
Social security contributions	473	674	874	1,086	971	1,236	1,182	1,335
Sales tax and VAT	1,114	1,297	1,435	1,702	1,371	1,254	1,304	1,467
Excise taxes	294	312	449	598	454	666	621	673
Customs duties and export taxes	337	327	381	426	355	377	377	418
Other taxes	772	786	863	1,161	998	747	746	726
Non-tax revenue	545	650	861	630	872	987	813	918
Capital revenue and grants	14	35	3	0	2	64	64	56
Total expenditure and net lending	4,997	6,493	7,689	7,294	8,518	7,837	8,562	8,925
Current expenditure	3,236	4,428	4,553	5,326	5,227	5,823	5,848	6,711
Wages and salaries	802	1,197	1,402	1,583	1,567	1,806	1,831	2,236
Purchase of goods and services	702	855	990	1,068	1,031	1,094	1,094	1,149
Subsidies to public enterprises	123	127	176	201	178	100	100	100
Transfers	1,572	2,123	1,715	2,011	1,951	2,126	2,126	2,276
Interest payments	37	126	270	463	500	697	697	950
Capital expenditure and net lending 2/	1,761	2,065	3,136	1,968	3,292	2,015	2,715	2,214
Capital expenditure	1,281	1,783	2,517	2,006	2,382	2,015	2,115	1,764
Domestically-financed	1,229	1,428	1,237	1,808	1,506		1,014	594
Foreign-financed	51	355	1,280	198	875		1,101	1,170
o/w DBM/Chinggis bond social benefit projects		258	1,026		642		795	550
Net lending	480	282	619	-39	910	0	600	450
o/w DBM/Chinggis on-lending		217	498		845		600	450
On-budget balance (incl. grants)	-529	-1,042	-181	-406	-910	…	-982	-1,120
On budget structural balance (excluding DBM spending)	…	…	-228	-436	-950	…	-1,011	-1,084
DBM spending	…	475	1,524	…	1,487	…	1,395	1,000
On-budget plus DBM balance 3/	-529	-1,517	-1,705	…	-2,397	-1,356	-2,376	-2,120
Financing	529	1,517	1,705	…	2,397	…	2,376	2,120
Foreign (net)	199	3,062	226	…	1,539	…	790	1,461
Domestic (net)	329	-1,545	1,479	…	858	…	1,586	660
Privatization receipts (valuation adj.)	14	1	3	…	23	…	114	9
Domestic bank financing (net)	95	-1,835	1,599	…	1,226	…	1,816	614
Domestic non-bank financing (net)	461	376	-77	…	-470	…	-314	0
Stabilization fund accumulation	-241	-87	-47	-30	78	-30	-30	36
				(In percent of GDP)				
Total revenue and grants	33.9	29.8	31.3	31.5	28.0	26.7	25.4	25.1
Current revenue	33.8	29.6	31.3	31.5	28.0	26.4	25.2	24.9
Tax revenue and social security contributions	29.7	25.7	26.8	28.6	24.0	22.3	21.8	21.5
Non-tax revenue	4.1	3.9	4.5	2.9	4.0	4.1	3.3	3.4
Capital revenue and grants	0.1	0.2	0.0	0.0	0.0	0.3	0.3	0.2
Total expenditure and net lending	37.9	38.9	40.2	33.4	39.0	32.2	35.2	32.9
Current expenditure	24.6	26.5	23.8	24.4	23.9	23.9	24.0	24.8
Of which: Wages and salaries	6.1	7.2	7.3	7.2	7.2	7.4	7.5	8.3
Capital expenditure and net lending 2/	13.4	12.4	16.4	9.0	15.1	8.3	11.2	8.2
On-budget balance (incl. grants)	-4.0	-6.2	-0.9	-1.9	-4.2	…	-4.0	-4.1
On-budget structural balance (excluding DBM spending)	…	…	-1.2	-2.0	-4.3	…	-4.2	-4.0
DBM spending	…	2.8	8.0	…	6.8	…	5.7	3.7
On-budget plus DBM balance	-4.0	-9.1	-8.9	…	-11.0	-5.6	-9.8	-7.8
Financing	4.0	9.1	8.9	…	11.0	…	9.8	7.8
Foreign (net)	1.5	18.3	1.2	…	7.0	…	3.2	5.4
Domestic (net)	2.5	-9.3	7.7	…	3.9	…	6.5	2.4
Banking system (net)	0.7	-11.0	8.4	…	5.6	…	7.5	2.3
Non-bank	3.6	2.3	-0.4	…	-2.0	…	-0.8	0.0
Stabilization fund accumulation	-1.8	-0.5	-0.2	-0.1	0.4	-0.1	-0.1	0.1
Memorandum items (in percent of GDP unless defined otherwise):								
Mineral revenue	7.8	5.0	5.1	…	4.6	…	3.3	2.8
Non-mineral revenue (in percent of non-mineral GDP)	32.4	29.7	31.0	…	28.4	…	26.6	26.4
Total expenditure (in percent of non-mineral GDP)	47.0	46.6	47.6	…	47.3	…	42.3	39.1
Non-mineral overall balance (in percent of non-mineral GDP)	-14.6	-16.9	-16.6	…	-18.9	…	-15.7	-12.7
Nominal GDP (in billions of togrogs)	13,174	16,688	19,118	21,844	21,844	24,315	24,315	27,101
Copper price (Market, US$ per ton)	8,823	7,959	7,331	…	6,863	…	5,644	5,603
(Structural, US$ per ton)	5,727	5,888	5,793	…	5,754	…	5,777	5,837
Primary spending (change in percent)	63.2	28.4	16.5	-7.9	8.1	-10.9	-1.9	1.4

Sources: Mongolian authorities; and IMF staff projections.

1/ Reflects 2015 supplementary budget passed in January 2015, with privatization receipts reclassified below the line.

2/ Includes DBM spending.

3/ Only part of DBM spending is included in the 2015 supplementary budget

Table 3. Mongolia: Monetary Aggregates, 2011–17 (Baseline)

	2011	2012	2013	2014	2015	2016	2017
					Projection		
	(In billions of togrog, end of period)						
Monetary survey							
Broad money	6,412	7,617	9,451	10,636	12,025	13,510	15,163
Currency	517	603	582	499	495	536	580
Deposits	5,895	7,013	8,869	10,137	11,530	12,974	14,584
Net foreign assets	3,067	4,402	934	-1,702	-4,579	-6,192	-8,082
Net domestic assets	3,345	3,215	8,517	12,338	16,604	19,702	23,245
Domestic credit	4,289	3,986	9,792	13,364	17,316	20,375	26,228
Net credit to government	-1,370	-3,040	-1,048	3	1,789	2,440	5,425
Claims on non-banks (including MBS)	5,660	7,026	10,840	13,361	15,527	17,935	20,803
Other items, net	-944	-771	-1,275	-1,027	-712	-673	-2,983
Monetary authorities							
Reserve money	1,660	2,166	3,335	3,427	3,397	3,679	3,978
Net foreign assets	3,044	5,164	1,941	120	-2,673	-3,327	-3,468
Net domestic assets	-1,384	-2,999	1,394	3,307	6,070	7,006	7,445
Net credit to government	-714	-2,774	-1,685	-572	-760	-807	-971
Claims on deposit money banks	342	401	4,297	2,608	2,198	1,684	1,874
Minus: Central bank bills (net)	879	752	1,627	854	23	38	55
Other items, net 1/	-133	127	410	2,125	4,655	6,167	6,598
Memorandum items:	(In percent, unless otherwise indicated)						
Annual broad money growth	37.7	18.8	24.1	12.5	13.1	12.3	12.2
Annual reserve money growth	75.3	30.5	54.0	2.7	-0.9	8.3	8.1
Velocity	2.1	2.2	2.0	2.1	2.0	2.0	2.0
Claims on non-banks growth (including MBS)	72.3	24.1	54.3	23.3	16.2	15.5	16.0
Claims on non-banks (in percent of GDP)	43.0	42.1	56.7	61.2	63.9	66.2	69.0

Sources: Mongolian authorities; and IMF staff projections.

1/ Starting in 2014, some of the BOM's unconventional easing programs are reflected in OIN (e.g., mortgage loans have been securitized, and the corresponding mortgage-backed securities assumed by the BOM).

Table 4. Mongolia: Balance of Payments, 2011–20 (Baseline)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Projections					
	(In millions of U.S. dollars, unless otherwise indicated)									
Current account balance (including official grants)	-2,759	-3,362	-3,192	-985	-1,379	-2,268	-2,447	-2,539	-2,164	-1,036
Trade balance	-993	-1,553	-1,321	1,002	844	-9	-406	-372	117	1,338
Exports	4,817	4,385	4,269	5,775	5,155	4,916	4,491	4,795	5,569	6,751
Mineral export	4,302	4,032	4,050	5,196	4,615	4,385	3,984	4,313	5,087	6,258
Non-mineral export	515	353	219	579	540	530	508	482	482	493
Imports	-5,810	-5,938	-5,590	-4,773	-4,310	-4,924	-4,898	-5,167	-5,452	-5,413
of which : mining-related imports	-3,649	-3,484	-3,076	-2,388	-2,485	-2,743	-2,750	-2,804	-2,921	-2,807
Services, net	-1,161	-1,100	-1,314	-1,323	-1,312	-1,366	-1,211	-1,293	-1,381	-1,448
Income, net	-843	-948	-699	-829	-1,080	-1,066	-1,005	-1,054	-1,090	-1,128
Current transfers	244	237	129	162	168	171	175	180	190	202
General government	24	34	22	27	31	32	34	37	41	45
Other sectors	220	203	107	135	137	139	141	143	149	157
Of which: Workers remittances	58	41	22	50	50	50	50	51	55	61
Capital and financial account	2,864	4,929	1,438	813	-23	2,008	597	2,760	2,601	2,100
Capital account	114	120	126	126	131	138	146	158	172	190
Financial account	2,750	4,809	1,312	687	-154	1,871	451	2,602	2,429	1,910
Direct investment	4,620	4,408	2,098	542	1,069	2,326	1,901	2,580	2,525	2,184
Portfolio investment	77	2,325	-156	192	-238	-32	-1,230	158	138	142
Trade credits, net	-406	53	9	-180	-129	-90	-102	-57	-97	-226
Currency and deposits, net	-2,012	-2,473	-1,376	-663	-1,150	-834	-777	-743	-736	-731
Loans, net	469	496	737	743	294	501	658	664	599	540
Other, net	2	0	0	53	0	0	0	0	0	0
Errors and omissions	258	-71	-131	-422	0	0	0	0	0	0
Overall balance	364	1,497	-1,885	-594	-1,403	-260	-1,851	221	437	1,063
Memorandum items:										
Current account balance (in percent of GDP)	-26.5	-27.4	-25.4	-8.2	-11.1	-17.3	-17.6	-16.9	-13.2	-5.7
Copper price (in U.S. dollars per ton)	8,823	7,959	7,331	6,863	5,644	5,603	5,595	5,582	5,559	5,546
Oil price (in U.S. dollars per barrel)	104	105	104	96	51	59	64	67	68	68
Gold price (in U.S. dollars per troy oz.)	1,569	1,669	1,411	1,266	1,277	1,283	1,295	1,311	1,329	1,385

Sources: Mongolian authorities; and IMF staff projections.

Table 5. Selected Economic and Financial Indicators, 2011–20 (Adjustment Scenario)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Est.	Projections					
	(In percent of GDP, unless otherwise indicated)									
Real sector										
Nominal GDP (in billions of togrogs)	13174	16688	19118	21844	23660	26201	28988	32755	36732	42166
Real GDP growth (percent change)	17.3	12.3	11.6	7.8	2.9	4.2	3.9	6.5	6.6	9.3
Mineral real GDP growth	7.7	8.3	19.4	24.2	9.0	-0.5	-4.0	6.0	7.0	20.0
Non-mineral real GDP growth	19.9	13.3	9.8	3.6	1.0	5.8	6.4	6.6	6.5	6.3
GDP deflator (percent change)	15.1	12.8	2.6	6.0	5.3	6.3	6.5	6.1	5.2	5.0
Consumer prices (End-period; percent change)	9.4	14.2	11.2	10.7	9.6	8.6	8.2	7.2	6.9	6.5
Gross national saving	30.4	27.7	26.6	24.3	21.8	20.4	18.5	20.2	22.4	29.3
Public	9.4	3.3	7.5	4.1	3.8	5.3	5.8	5.9	6.1	6.3
Private	21.1	24.4	19.2	20.2	18.0	15.1	12.7	14.3	16.3	23.0
Gross capital formation	56.9	55.0	52.1	32.6	30.6	37.2	38.5	39.4	37.5	35.4
Public	13.4	12.4	16.4	15.1	8.4	8.0	8.1	8.2	8.4	8.5
Private	43.6	42.7	35.7	17.5	22.2	29.2	30.4	31.2	29.0	26.9
General government accounts										
Total revenue and grants	33.9	29.8	31.3	28.0	26.5	26.1	26.1	26.9	27.0	27.5
Mineral revenue	7.8	5.0	5.1	4.6	3.5	3.0	2.8	3.4	3.4	4.3
Non-mineral revenue	26.1	24.8	26.2	23.4	23.0	23.1	23.3	23.5	23.6	23.2
Total expenditure and net lending 1/	37.9	38.9	40.2	39.0	31.0	28.8	28.4	29.2	29.3	29.8
On-budget structural balance (excluding DBM spending)	…	…	-1.2	-4.3	-1.9	-2.0	-2.0	-2.0	-2.0	-2.0
DBM spending	…	2.8	8.0	6.8	2.8	0.5	0.0	0.0	0.0	0.0
On-budget plus DBM balance	-4.0	-9.1	-8.9	-11.0	-4.6	-2.7	-2.3	-2.3	-2.3	-2.3
	(In percent of GDP, unless indicated otherwise)									
Monetary sector										
Credit growth (percent change)	72.3	24.1	54.3	23.3	12.6	12.9	13.7	13.8	14.4	15.1
Reserve money growth (percent change)	75.3	30.5	54.0	2.7	-3.3	6.4	7.4	11.4	12.0	14.6
Balance of payments										
Current account balance	-26.5	-27.4	-25.4	-8.2	-8.8	-16.8	-20.0	-19.3	-15.0	-6.1
Debt indicators										
Total public debt 2/	32.7	51.3	67.3	76.5	81.3	81.8	81.4	76.5	72.5	67.4
Domestic public debt	9.1	12.3	21.1	21.6	23.5	21.8	19.7	17.7	16.0	14.5
External public debt	23.5	39.0	46.3	54.9	57.9	60.0	61.7	58.9	56.5	52.9
Memorandum items:										
Copper prices (US$ per ton)	8823.5	7958.9	7331.5	6863.4	5644.0	5602.8	5594.6	5581.6	5559.3	5545.5
Gold prices (US$ per ounce)	1568.6	1668.8	1411.1	1266.2	1276.6	1282.9	1295.0	1310.6	1329.5	1384.9

Sources: Mongolian authorities; and IMF staff projections.

1/ Includes DBM spending.

2/ Debt data reflects general government debt (including quasi-sovereign bonds issued by DBM) only before 2013, and starts to cover SOE debt from 2013 onwards.

Table 6. Mongolia: Summary Operations of the General Government, 2011–16 (Adjustment Scenario)

	2011	2012	2013	2014 Budget	2014 Est.	2015 Budget 1/	2015 Proj.	2016 Proj.
				(In billions of togrogs)				
Total revenue and grants	4,468	4,976	5,984	6,888	6,122	6,481	6,260	6,840
Current revenue	4,455	4,941	5,980	6,887	6,120	6,417	6,196	6,784
Tax revenue and social security contributions	3,909	4,291	5,120	6,257	5,248	5,430	5,411	5,904
Income taxes	919	895	1,117	1,284	1,098	1,151	1,111	1,241
Social security contributions	473	674	874	1,086	971	1,236	1,173	1,317
Sales tax and VAT	1,114	1,297	1,435	1,702	1,371	1,254	1,317	1,418
Excise taxes	294	312	449	598	454	666	603	647
Customs duties and export taxes	337	327	381	426	355	377	457	560
Other taxes	772	786	863	1,161	998	747	750	723
Non-tax revenue	545	650	861	630	872	987	785	880
Capital revenue and grants	14	35	3	0	2	64	64	56
Total expenditure and net lending	4,997	6,493	7,689	7,294	8,518	7,837	7,338	7,537
Current expenditure	3,236	4,428	4,553	5,326	5,227	5,823	5,356	5,441
Wages and salaries	802	1,197	1,402	1,583	1,567	1,806	1,711	1,671
Purchase of goods and services	702	855	990	1,068	1,031	1,094	1,047	1,084
Subsidies to public enterprises	123	127	176	201	178	100	100	70
Transfers	1,572	2,123	1,715	2,011	1,951	2,126	1,801	1,666
Interest payments	37	126	270	463	500	697	697	950
Capital expenditure and net lending 2/	1,761	2,065	3,136	1,968	3,292	2,015	1,983	2,096
Capital expenditure	1,281	1,783	2,517	2,006	2,382	2,015	1,652	2,030
Domestically-financed	1,229	1,428	1,237	1,808	1,506		1,005	1,290
Foreign-financed	51	355	1,280	198	875		646	740
o/w DBM/Chinggis bond social benefit projects		258	1,026		642		331	66
Net lending	480	282	619	-39	910	0	331	66
o/w DBM/Chinggis on-lending		217	498		845		331	66
On-budget balance (incl. grants)	-529	-1,042	-181	-406	-910	…	-416	-565
On budget structural balance (excluding DBM spending)	…	…	-228	-436	-950	…	-446	-525
DBM spending	…	475	1,524	…	1,487	…	662	133
On-budget plus DBM balance 3/	-529	-1,517	-1,705	…	-2,397	-1,356	-1,078	-697
Financing	529	1,517	1,705	…	2,397	…	1,078	697
Foreign (net)	199	3,062	226	…	1,539	…	158	500
Domestic (net)	329	-1,545	1,479	…	858	…	920	197
Privatization receipts (valuation adj.)	14	1	3	…	23	…	114	9
Domestic bank financing (net)	95	-1,835	1,599	…	1,226	…	1,149	148
Domestic non-bank financing (net)	461	376	-77	…	-470	…	-314	0
Stabilization fund accumulation	-241	-87	-47	-30	78	-30	-30	40
				(In percent of GDP)				
Total revenue and grants	33.9	29.8	31.3	31.5	28.0	27.4	26.5	26.1
Current revenue	33.8	29.6	31.3	31.5	28.0	27.1	26.2	25.9
Tax revenue and social security contributions	29.7	25.7	26.8	28.6	24.0	22.9	22.9	22.5
Non-tax revenue	4.1	3.9	4.5	2.9	4.0	4.2	3.3	3.4
Capital revenue and grants	0.1	0.2	0.0	0.0	0.0	0.3	0.3	0.2
Total expenditure and net lending	37.9	38.9	40.2	33.4	39.0	33.1	31.0	28.8
Current expenditure	24.6	26.5	23.8	24.4	23.9	24.6	22.6	20.8
Of which: Wages and salaries	6.1	7.2	7.3	7.2	7.2	7.6	7.2	6.4
Capital expenditure and net lending 2/	13.4	12.4	16.4	9.0	15.1	8.5	8.4	8.0
On-budget balance (incl. grants)	-4.0	-6.2	-0.9	-1.9	-4.2	…	-1.8	-2.2
On-budget structural balance (excluding DBM spending)	…	…	-1.2	-2.0	-4.3	…	-1.9	-2.0
DBM spending	…	2.8	8.0	…	6.8	…	2.8	0.5
On-budget plus DBM balance	-4.0	-9.1	-8.9	…	-11.0	-5.7	-4.6	-2.7
Financing	4.0	9.1	8.9	…	11.0	…	4.6	2.7
Foreign (net)	1.5	18.3	1.2	…	7.0	…	0.7	1.9
Domestic (net)	2.5	-9.3	7.7	…	3.9	…	3.9	0.8
Banking system (net)	0.7	-11.0	8.4	…	5.6	…	4.9	0.6
Non-bank	3.6	2.3	-0.4	…	-2.0	…	-0.8	0.0
Stabilization fund accumulation	-1.8	-0.5	-0.2	-0.1	0.4	-0.1	-0.1	0.2
Memorandum items (in percent of GDP unless defined otherwise):								
Mineral revenue	7.8	5.0	5.1	…	4.6	…	3.5	3.0
Non-mineral revenue (in percent of non-mineral GDP)	32.4	29.7	31.0	…	28.4	…	27.9	27.7
Total expenditure (in percent of non-mineral GDP)	47.0	46.6	47.6	…	47.3	…	37.7	34.6
Non-mineral overall balance (in percent of non-mineral GDP)	-14.6	-16.9	-16.6	…	-18.9	…	-9.8	-6.9
Nominal GDP (in billions of togrogs)	13,174	16,688	19,118	21,844	21,844	23,660	23,660	26,201
Copper price (Market, US$ per ton)	8,823	7,959	7,331	…	6,863	…	5,644	5,603
(Structural, US$ per ton)	5,727	5,888	5,793	…	5,754	…	5,777	5,837
Primary spending (change in percent)	63.2	28.4	16.5	-7.9	8.1	-10.9	-17.2	-0.8

Sources: Mongolian authorities; and IMF staff projections.

1/ Reflects 2015 supplementary budget passed in January 2015, with privatization receipts reclassified below the line.

2/ Includes DBM spending.

3/ Only part of DBM spending is included in the 2015 supplementary budget

Table 7. Mongolia: Monetary Aggregates 2011–17 (Adjustment Scenario)

	2011	2012	2013	2014	2015	2016	2017
						Projection	
	(In billions of togrog, end of period)						
Monetary survey							
Broad money	6,412	7,617	9,451	10,636	11,725	12,939	14,422
Currency	517	603	582	499	483	513	551
Deposits	5,895	7,013	8,869	10,137	11,242	12,426	13,871
Net foreign assets	3,067	4,402	934	-1,702	-3,373	-4,261	-4,840
Net domestic assets	3,345	3,215	8,517	12,338	15,098	17,200	19,262
Domestic credit	4,289	3,986	9,792	13,364	16,172	18,300	20,710
Net credit to government	-1,370	-3,040	-1,048	3	1,123	1,311	1,392
Claims on non-banks (including MBS)	5,660	7,026	10,840	13,361	15,049	16,989	19,318
Other items, net	-944	-771	-1,275	-1,027	-1,074	-1,100	-1,448
Monetary authorities							
Reserve money	1,660	2,166	3,335	3,427	3,312	3,524	3,783
Net foreign assets	3,044	5,164	1,941	120	-1,466	-1,523	-1,607
Net domestic assets	-1,384	-2,999	1,394	3,307	4,778	5,047	5,390
Net credit to government	-714	-2,774	-1,685	-572	-734	-773	-925
Claims on deposit money banks	342	401	4,297	2,608	1,298	928	901
Minus: Central bank bills (net)	879	752	1,627	854	19	29	39
Other items, net 1/	-133	127	410	2,125	4,233	4,920	5,453
Memorandum items:	(In percent, unless otherwise indicated)						
Annual broad money growth	37.7	18.8	24.1	12.5	10.2	10.4	11.5
Annual reserve money growth	75.3	30.5	54.0	2.7	-3.3	6.4	7.4
Velocity	2.1	2.2	2.0	2.1	2.0	2.0	2.0
Claims on non-banks growth (including MBS)	72.3	24.1	54.3	23.3	12.6	12.9	13.7
Claims on non-banks (in percent of GDP)	43.0	42.1	56.7	61.2	63.6	64.8	66.6

Sources: Mongolian authorities; and IMF staff projections.

1/ Starting in 2014, some of the BOM's unconventional easing programs are reflected in OIN (e.g., mortgage loans have been securitized, and the corresponding mortgage-backed securities assumed by the BOM).

Table 8. Mongolia: Balance of Payments, 2011–20 (Adjustment Scenario)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Projections					
	(In millions of U.S. dollars, unless otherwise indicated)									
Current account balance (including official grants)	-2,759	-3,362	-3,192	-985	-1,034	-1,955	-2,333	-2,375	-1,990	-895
Trade balance	-993	-1,553	-1,321	1,002	1,147	268	-303	-225	267	1,454
Exports	4,817	4,385	4,269	5,775	5,155	4,916	4,491	4,795	5,569	6,751
Mineral export	4,302	4,032	4,050	5,196	4,615	4,385	3,984	4,313	5,087	6,258
Non-mineral export	515	353	219	579	540	530	508	482	482	493
Imports	-5,810	-5,938	-5,590	-4,773	-4,008	-4,648	-4,794	-5,021	-5,302	-5,297
of which : mining-related imports	-3,649	-3,484	-3,076	-2,388	-2,485	-2,743	-2,750	-2,804	-2,921	-2,807
Services, net	-1,161	-1,100	-1,314	-1,323	-1,269	-1,326	-1,196	-1,274	-1,364	-1,437
Income, net	-843	-948	-699	-829	-1,078	-1,064	-1,004	-1,048	-1,075	-1,104
Current transfers	244	237	129	162	166	168	170	174	182	192
General government	24	34	22	27	29	29	29	31	33	36
Other sectors	220	203	107	135	137	139	141	143	149	156
Of which: Workers remittances	58	41	22	50	50	50	50	51	54	60
Capital and financial account	2,864	4,929	1,438	813	266	1,993	2,354	2,466	2,286	1,757
Capital account	114	120	126	126	124	123	123	129	139	153
Financial account	2,750	4,809	1,312	687	143	1,870	2,231	2,336	2,147	1,604
Direct investment	4,620	4,408	2,098	542	1,069	2,326	2,487	2,315	2,245	1,881
Portfolio investment	77	2,325	-156	192	58	-32	-36	158	138	142
Trade credits, net	-406	53	9	-180	-129	-90	-102	-57	-97	-226
Currency and deposits, net	-2,012	-2,473	-1,376	-663	-1,150	-834	-777	-743	-736	-731
Loans, net	469	496	737	743	294	501	659	663	597	537
Other, net	2	0	0	53	0	0	0	0	0	0
Errors and omissions	258	-71	-131	-422	0	0	0	0	0	0
Overall balance	364	1,497	-1,885	-594	-768	38	21	91	295	861
Memorandum items:										
Current account balance (in percent of GDP)	-26.5	-27.4	-25.4	-8.2	-8.8	-16.8	-20.0	-19.3	-15.0	-6.1
Copper price (in U.S. dollars per ton)	8,823	7,959	7,331	6,863	5,644	5,603	5,595	5,582	5,559	5,546
Oil price (in U.S. dollars per barrel)	104	105	104	96	51	59	64	67	68	68
Gold price (in U.S. dollars per troy oz.)	1,569	1,669	1,411	1,266	1,277	1,283	1,295	1,311	1,329	1,385

Sources: Mongolian authorities; and IMF staff projections.

Table 9. Mongolia: Baseline and Policy Adjustment Scenarios, 2013-20

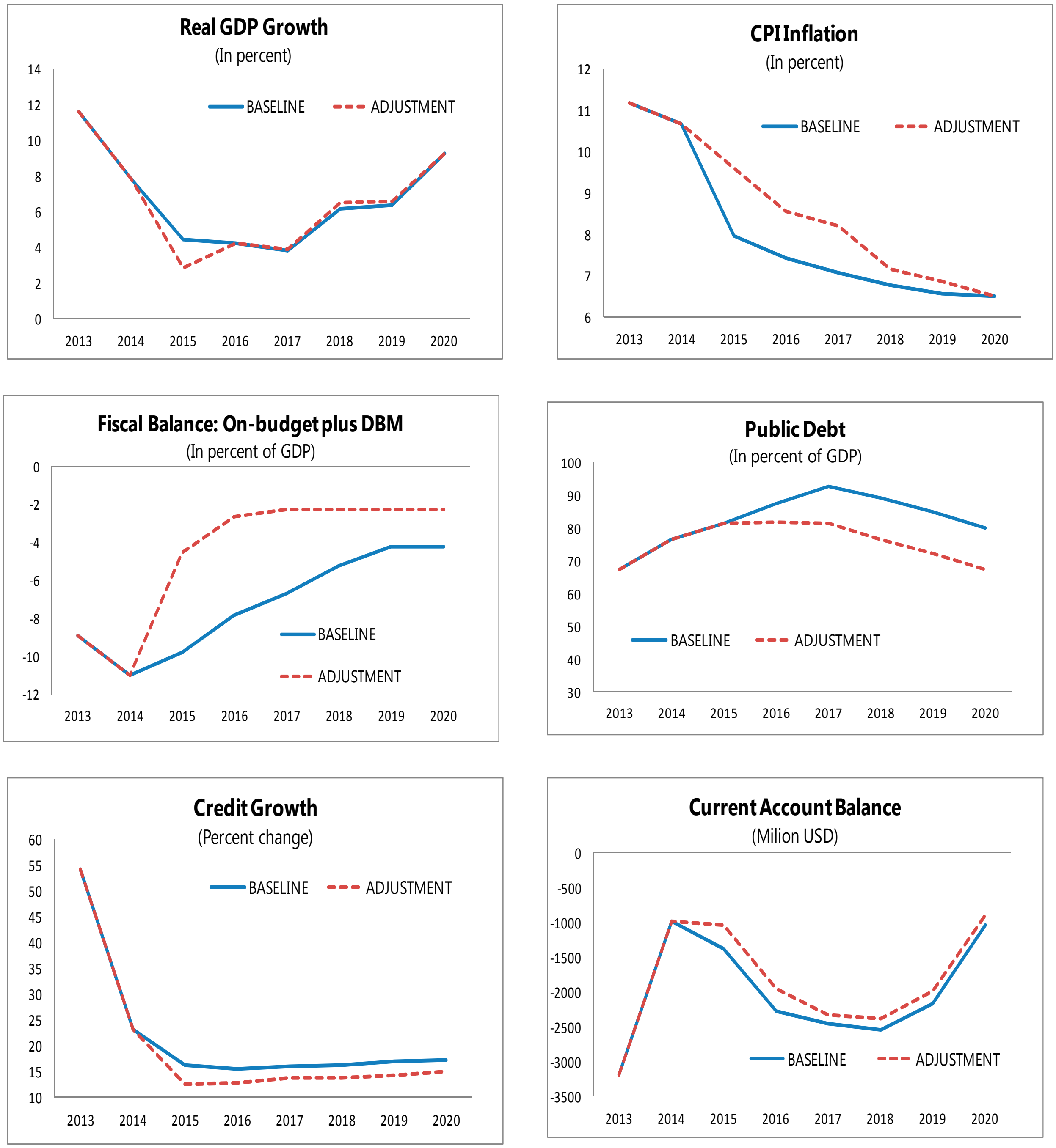
	Baseline								Policy Adjustment							
	2013	2014	2015	2016	2017	2018	2019	2020	2013	2014	2015	2016	2017	2018	2019	2020
Real sector (change in percent)																
Real GDP growth	11.6	7.8	4.4	4.2	3.8	6.2	6.4	9.2	11.6	7.8	2.9	4.2	3.9	6.5	6.6	9.3
Mineral growth	19.4	24.2	9.0	-0.5	-4.0	6.0	7.0	20.0	19.4	24.2	9.0	-0.5	-4.0	6.0	7.0	20.0
Nonmineral growth	9.8	3.6	3.0	5.8	6.2	6.2	6.2	6.3	9.8	3.6	1.0	5.8	6.4	6.6	6.5	6.3
Consumer prices (end-period)	11.2	10.7	8.0	7.4	7.1	6.8	6.6	6.5	11.2	10.7	9.6	8.6	8.2	7.2	6.9	6.5
Fiscal accounts (in percent of GDP, unless otherwise indicated)																
Revenue and grants	31.3	28.0	25.4	25.1	24.9	25.4	25.4	25.8	31.3	28.0	26.5	26.1	26.1	26.9	27.0	27.5
Expenditure and net lending 1/	32.2	32.2	29.5	29.2	28.2	28.6	27.7	28.0	32.2	32.2	28.2	28.3	28.4	29.2	29.3	29.8
Current expenditure	23.8	23.9	24.0	24.8	24.0	23.1	22.3	22.7	23.8	23.9	22.6	20.8	20.2	21.0	20.9	21.3
Capital expenditure and net lending 1/	8.4	8.3	5.4	4.5	4.2	5.5	5.3	5.3	8.4	8.3	5.6	7.5	8.1	8.2	8.4	8.5
On-budget structural balance (excluding DBM spending)	-1.2	-4.3	-4.2	-4.0	-3.1	-3.0	-2.0	-2.0	-1.2	-4.3	-1.9	-2.0	-2.0	-2.0	-2.0	-2.0
DBM spending	8.0	6.8	5.7	3.7	3.3	2.0	2.0	2.0	8.0	6.8	2.8	0.5	0.0	0.0	0.0	0.0
On-budget plus DBM balance	-8.9	-11.0	-9.8	-7.8	-6.7	-5.3	-4.2	-4.2	-8.9	-11.0	-4.6	-2.7	-2.3	-2.3	-2.3	-2.3
Total public debt (in percent of GDP)	67.3	76.5	81.5	87.6	92.6	89.1	84.9	80.1	67.3	76.5	81.3	81.8	81.4	76.5	72.5	67.4
Domestic debt	21.1	21.6	25.6	25.2	32.3	30.8	28.8	26.1	21.1	21.6	23.5	21.8	19.7	17.7	16.0	14.5
External debt	46.3	54.9	56.0	62.4	60.2	58.4	56.2	54.0	46.3	54.9	57.9	60.0	61.7	58.9	56.5	52.9
Monetary accounts (change in percent)																
Broad money	24.1	12.5							24.1	12.5						
Reserve money	54.0	2.7							54.0	2.7						
Credit to the private sector (including MBS)	54.3	23.3	16.2	15.5	16.0	16.3	16.9	17.1	54.3	23.3	12.6	12.9	13.7	13.8	14.4	15.1
External accounts 2/																
Current account balance (million USD)	-3192	-985	-1379	-2268	-2447	-2539	-2164	-1036	-3192	-985	-1034	-1955	-2333	-2375	-1990	-895
Current account balance (percent of GDP)	-25.4	-8.2	-11.1	-17.3	-17.6	-16.8	-13.2	-5.7	-25.4	-8.2	-8.8	-16.8	-20.0	-19.3	-15.0	-6.1
Overall balance (million USD)	-1885	-594	-1403	-260	-1851	221	437	1063	-1885	-594	-768	38	21	91	295	861
Memorandum items:																
Nominal GDP (billions of togrogs)	19,118	21,844	24,315	27,101	30,144	34,094	38,525	44,300	19,118	21,844	23,660	26,201	28,988	32,755	36,732	42,166

Sources: Mongolian authorities; and IMF staff calculations.

1/ Excludes DBM spending.

2/ The baseline scenario assumes no rollover of maturing bonds. The policy adjustment scenario assumes bond rollover of maturing sovereign debt ($500 million), DBM debt ($580 million) and MMC bonds ($600 million),as well as TDB bonds ($414 million).

Figure 5. Key Indicators in Baseline and Policy Adjustment Scenarios



Annex I. Economic Impact of Mongolia's Natural Resource Endowments

Mongolia is unusually rich in mineral resources. The population of 3 million inhabits a country with an estimated $1 to $3 trillion worth of copper, gold, coal, oil, and other resources, close to growing markets in China and elsewhere in Asia. To exploit these reserves, Mongolia has in the last several years attracted very large FDI inflows into the sector that now accounts for around 20 percent of GDP and close to 90 percent of exports. Joint ventures between Mongolian companies (both public and private) and multinationals account for a significant proportion of mining production. Currently almost all production is for export, and transport links—especially with China—are being substantially improved, which will allow unit costs to be reduced. A number of mega projects are underway that will significantly boost the mining sector and catalyze other investments. These include:

A. The Oyu Tolgoi copper and gold mine

- Mongolia is on track to become a globally significant copper and gold producer, with the Oyu Tolgoi (OT) mine one of the largest in the world. The project is jointly owned by the Government of Mongolia (34 percent stake) and Turquoise Hill Resources (THR). Rio Tinto has a 50 percent stake in THR and is the project manager. The first-phase open-pit mine began construction in 2010 with investment exceeding $6 billion, and production commenced in 2013. The second phase (OT-2) will be underground, and output will markedly increase once production comes on stream toward the end of this decade (associated FDI inflows are estimated at over $5 billion).

- The commencement of the OT-2 project has been delayed by ongoing negotiations between Rio Tinto and the authorities over a number of issues. These include the appropriate treatment of significant cost overruns in OT-1, resolution of outstanding tax issues, the exact specification of activities, government permits, and a number of social and environment issues. However, both sides have stated that they remain committed to the project, with the intention for the project to commence in 2015.

B. Tavan Tolgoi (TT) coal mine

- Coal reserves are estimated at well over 6 billion tons. Mongolia is already a major exporter of coal to China for both power generation and for use in the heavy industrial sector; South Gobi Resources (in which THR has a 47.9 per cent interest) and Energy Resources (a subsidiary of the Mongolian Mining Corporation (MMC)) are major producers currently. Production is set to increase sharply with the commencement of the TT coal mine. The tender has been won by a consortium that includes leading Mongolian, Chinese and Japanese companies (MMC, Shenhua Energy, and Sumitomo Corporation, respectively). Negotiations on the production modalities are reported to be at an advanced stage.

- The total investment in TT is expected to be $4 billion. The business model is based on the export of coal to China and third countries, with the value added increased through more domestic processing including washing and power generation. Related investments also include a new railway that will substantially improve export potential and a new power station that will supply power to OT and also to China.

The continued development of the mining sector will have a number of important macroeconomic implications.

- **Growth and development.** Mongolian extraction costs are among the lowest in the world, meaning that the sector should be relatively unscathed from current price falls and may benefit as marginal producers exit. And while logistics have traditionally been a challenge in this landlocked nation, transport links—especially with China—are being substantially improved, notably through the construction of a new railway. Mining exports to third countries will also benefit from recent agreement on duty-free access to Chinese ports. Over time, the intention is for more value-added processing to take place in Mongolia, creating potential for local employment growth and supporting the outlook for GDP.

- **Supporting the external position.** Resource wealth promises prosperity in the long run, but also substantial dividends in the next five years. OT-1 brought $6 billion of investment into a $10 billion economy over just a few years, during which time Mongolia was one of the world's fastest growing economies. That first phase went into production last year and led to a 30 percent y/y increase in mining exports. OT-2 would bring in another $5 billion in FDI over the next few years. It would start production within a few years, and even on conservative projections, mineral exports would increase by another 25 percent.

- **Strong mining prospects imply a fairly rapid improvement in fiscal and external imbalances.** From 2017 to 2020, rapid growth would bring the public debt ratio down sharply, from 92½ percent of GDP to 80 percent. While loans to Rio Tinto would have to be repaid, the fiscal balance could possibly move toward surplus and facilitate the accumulation of wealth for future generations in a planned sovereign wealth fund. The current account deficit is projected to narrow to just 6 percent of GDP in 2020, and pressure on reserves would steadily disappear. While this outlook would be less favorable if OT-2 remains undeveloped, macroeconomic imbalances would still be reduced substantially.

An important implication is that the national balance sheet will be strengthened as these resources are extracted. While Mongolia presently faces an acute liquidity problem, accompanied by sovereign stress, it is solvent given the strong projected revenues from mining over the long term. Assuming the commencement of the large projects in 2015, the impact on GDP growth and external accounts will allow debt to start to decline sharply after 2017. (And even without OT-2, debt would still decline from 2018, albeit more slowly.)

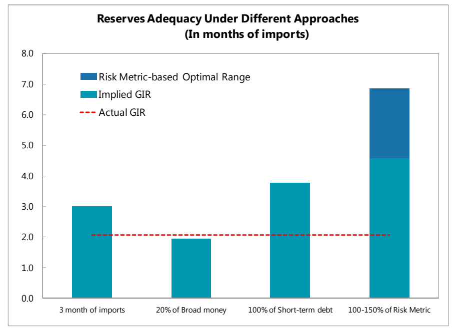
Annex II. External Sector and Exchange Rate Assessment

Mongolia's external position is weaker than desirable, and the togrog overvalued by 10 - 15 percent.

Balance of Payments, Exchange Rate Movements, and Reserve Adequacy

- The balance of payments has continued to face pressure. Despite substantial borrowing from abroad, GIR fell from 4 months of imports at end-2013 to around 2 months at end-February 2015.

- The nominal exchange rate depreciated by 14 percent in 2014, and while the REER initially depreciated somewhat, it later appreciated strongly, reflecting still high inflation and the BOM's FX intervention.



- By almost all indicators, gross reserves are too low—below the traditional 3-months-of-imports benchmark, below the "Greenspan-Guidotti" rule suggesting 100 percent coverage of short-term debt, and only just above 20 percent of broad money. And according to the IMF's risk-based metric, the optimal range of reserves is 4½ to 7 months of import cover.[1]

Estimate of Current Account Gap and Exchange Rate Misalignment

- **Methodology**. This assessment adopts the External Balance Assessment-lite (EBA-lite) approach for frontier economies in addition to the External Sustainability (ES) and Equilibrium Real Exchange Rate (ERER) approaches in the CGER framework. The EBA-lite methodology has been developed as a successor to the macro balance approach used under CGER. One key difference is that EBA-lite makes a sharper distinction between a positive (descriptive) understanding of current accounts and real exchange rates and normative evaluations. Another is that EBA-lite takes into account a much broader set of factors—including policies, cyclical conditions, and global capital market conditions—that may influence the current account and real exchange rate. As before, the ES approach measures the exchange rate adjustment needed to sustain a certain level of net foreign assets of the economy; the ERER approach is based on empirical studies of the exchange rate that would be consistent with the economy's productivity, fiscal soundness, external position, and other factors.

- **Result**. According to the EBA-lite approach, Mongolia's current account deficit is 4 percent of GDP above the level consistent with desirable policies. This implies overvaluation of 11 percent. The External Sustainability approach points to a current account gap of 6 percent, indicating real overvaluation of 13 percent. The ERER approach implies an overvaluation of 14 percent.

Estimates of Togrog Overvaluation

Approach	Current account gap (percent of GDP)	Overvaluation (in percent)	Real exchange rate elasticities
EBA-Lite	4%	11%	0.4
External Sustainability	6%	13%	0.4
Equilibrium Real Exchange Rate	--	14%	--

Source: IMF estimates

[1] For Mongolia, one should arguably focus only on non-mining imports (half the total), as mining imports come with their own FDI financing. From this perspective, the optimal range would be 2¼ to 3½ months of total imports, but being high in that range is advisable given the volatility of the mining sector, the extent of deposit dollarization, and the need to boost market confidence to facilitate debt rollovers in 2017/18

Annex III. Development Bank of Mongolia

The Development Bank of Mongolia (DBM) was established in 2011 as a state-owned, for-profit legal entity with the specific functions of conducting activities aimed at financing major projects and programs for the long-term development of Mongolia. One of the stated rationales is that domestic commercial banks have relatively high financing cost and their small sizes impose limits on the maximum amount of loans that can be granted to any single project.

Financing. Nearly all DBM financing is either directly provided by the government or obtained through external borrowings that are fully guaranteed by the government. In addition to its equity contribution, the government has also transferred the proceeds of the 2012 sovereign "Chinggis bond" to finance DBM operations. Though DBM hopes to borrow in the future on the strength of its own balance sheet, so far all of its bond issuances and loans have been government guaranteed. This includes the $580 million DBM bond in 2012, the JPY 30 billion samurai bond in 2013, a $162 million loan from China Development Bank, and a $300 million syndicated loan from Credit Suisse in 2014.

Spending. DBM broadly classifies its projects into two groups: those that are repayable from the state budget (i.e., non-commercial projects), and those that are self-financing, or commercial. The non-commercial projects include roads and other infrastructure and are implemented through line ministries, while the commercial projects include power plants, railway, aviation, housing finance, mining, housing construction, agriculture, light industry, and construction materials. The relative share of these two types of projects varies by year: in 2013, commercial projects accounted for around one-third of the total DBM spending; the share increased to nearly 60 percent in 2014; and it is expected to decline again, to less than half, in 2015. The projects DBM undertakes typically require parliament and government approval, and there is no clear link between the sources of financing and the types of projects.

Statistical treatment. International statistical manuals (GFSM 2014, SNA 2008 and BPM6), suggest an "institutional unit" approach under which all activities of an institutional unit should be allocated to one and only one institutional sector. In this case, all activities of DBM should be included in the (general) government sector since the majority of its activities are non-commercial/government in nature. In limited circumstances, international statistical manuals allow for commercial or market activities of general government units to be split out, but such "quasi-corporations" should be well defined units themselves, with separate accounts, separate management, and full autonomy of operation. The current commercial activities of DBM clearly do not satisfy these conditions.

Annex IV. Risk Assessment Matrix[1]

Sources of Risks	Likelihood	Potential Impact	Recommendation
External			
A surge in financial volatility	**H**	**H:** If markets reassess Mongolia's sovereign risk, filling the large external financing gap will be more challenging, and banking-sector funding and liquidity pressure could increase.	Maintain exchange rate flexibility and tighten macro policies; improve investment climate to attract FDI.
Sharp growth slowdown and financial risks in China	**L-M**	**H:** Exports could decline further, intensifying BOP pressure and fiscal revenue shortfalls.	Medium term: maintain exchange rate flexibility to preserve FX reserves; tighten macro policies. Long term: build resilience against external shocks; realize inclusive growth via diversification of the economy.
Domestic			
Further delay in OT-2	**H**	**H:** A delay in OT-2 would weaken growth prospects and worsen external and fiscal balances.	Run prudent macroeconomic policies; redouble efforts to improve investment climate and move ahead with other projects.
Accommodative fiscal policy	**H**	**H:** Loose fiscal policy could further intensify BOP pressure and add to debt burdens.	Undertake fiscal consolidation in line with goals of the FSL.
Loose monetary policy	**M-H**	**H:** Loose monetary policy could worsen BOP pressure and raise banking-sector risks.	Monetary policy should be tightened further and the BOM's unconventional easing programs discontinued.
Elevated banking fragilities	**H**	**H:** The buildup of credit and liquidity risks undermines financial stability, which in turn threatens macroeconomic stability.	Enhance provisions and capital; strengthen supervisory framework; phase out forbearance.
Uncertain business climate	**M-H**	**H:** The uncertain environment could impede FDI inflows and further weigh on investors' confidence.	Improve business climate, clarify tax issues, and enhance transparency.

[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 of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). 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 V. Implementation of Past IMF Recommendations

The authorities have agreed on the need for policy adjustment and responded to some of the recommendations made in past Article IV consultations.

Key recommendation	**Implementation**
Fiscal Policy	
Tighten fiscal policy so as to bring deficit gradually down to FSL limit.	The authorities targeted to keep the on-budget deficit below the FSL limit, but off-budget spending by DBM has been large. They recently brought DBM's noncommercial spending onto the budget, and aim to reduce the deficit to 2 percent of GDP by 2018.
Maintain the long-term debt limit of 40 percent of GDP and gradually bring debt ratio down to this level.	The authorities amended FSL and passed a new Debt Management Law (DML), loosening the definition of debt, temporarily raising debt limit, and setting a downward debt trajectory towards the original limit.
Monetary Policy	
Phase out unconventional easing programs at the BOM.	The BOM phased out its deposits at commercial banks and scaled back PSP lending. It plans to continue implementing the mortgage program, though at a slower rate. Meanwhile, the BOM introduced a program to provide financial support at the request of commercial banks for their corporate clients in late 2014.
Tighten monetary policy	BOM raised the policy rate twice in the past six months and, as noted above, committed to slowing its easing programs.
Maintain exchange rate flexibility	The nominal exchange rate depreciated by 14 percent in 2014, though the REER appreciated strongly in late 2014, reflecting still high inflation and the BOM's FX intervention.
Financial Policy	
Strengthen bank supervision, restrict FX loans to unhedged borrowers, and increase loan provisions.	Fund TA on bank supervision provided specific recommendations on bank supervision, which the BOM welcomed. The BOM raised risk weights for FX loans in 2014 and introduced a definition of "hedged" borrowers for prudential purposes. BOM also introduced a 1 percent general provision for newly issued performing loans.

Annex VI. Summaries of Background Analytical Work

A. Analyzing Alternative Fiscal Paths for Mongolia[1]

This paper uses a simple spreadsheet-based approach to analyze different long-term fiscal paths for Mongolia and shed light on the country's appropriate deficit and debt targets. It concludes that the country should be running small surpluses and that there is no justification to adjust the FSL's targets on a permanent basis.

1. **There has been considerable public debate about the right fiscal targets for Mongolia.** Short-term balance of payment pressures clearly suggests the need for consolidation, and good budgetary practice suggests that DBM spending should be brought on budget. But should the consolidated deficit be brought down to the FSL's target of 2 percent of GDP, or is this too tight to permit needed infrastructure investment? Also under debate is the appropriate debt limit—is the FSL's threshold of 40 percent of GDP too restrictive?

2. **This paper applies some basic fiscal concepts for resource-rich economies.** The permanent-income hypothesis (PIH) would suggest that revenues from exhaustible resources be shared equally with future generations, either in terms of constant dollars per capita, or in terms of a share of nonmineral GDP. But with current generations poorer than future ones, and thus likely to have a higher marginal utility of consumption, a modified PIH (MPIH) framework, which allows some frontloading of consumption and then a payback period of larger fiscal surpluses later, may be more attractive. It is also possible to take a broader perspective, and instead of focusing solely on the consumption-savings decision, to also consider the possibility of investment. Under the so-called "Fiscal Stability Framework" (FSF), spending can be frontloaded to develop infrastructure, and depending on the rate-of-return, the extent to which future fiscal surpluses are needed can be reduced or eliminated, without compromising future generations' welfare. The paper simulates fiscal paths for Mongolia under these three different frameworks using a spreadsheet template developed in conjunction with the 2012 Board papers on resource-rich developing countries.[2]

3. **Under reasonable parameter values, the PIH prescribes that Mongolia should currently be running a small fiscal surplus.** Table A1 summarizes a sensitivity analysis showing the appropriate fiscal balance for different assumptions about the value of Mongolia's mineral wealth, the rate at which minerals prices rise, and the government's tax take from the sector. As shown in the highlighted row, if mineral wealth is $1½ trillion, prices grow at 3 percent (broadly in line with historical averages), and the government earns 20 percent of exports in taxes, then delivering an equal share of nonmineral GDP to all generations would require a primary surplus this year of nearly 5 percent of GDP. This translates to an *overall surplus of 2 percent of GDP*. Even if the most optimistic parameters are chosen (wealth of $3 trillion, price growth of 5 percent, and a revenue take of 25 percent), the overall deficit should be no more than 3 percent of GDP. According to this analysis,

[1] Summarizes a paper under preparation by Baoping Shang (FAD) and Koshy Mathai (APD).

[2] "Macroeconomic Policy Frameworks in Resource-Rich Developing Countries," IMF Policy Paper, Aug 24, 2012. Also, "Fiscal Regimes for Extractive Industries: Design and Implementation," IMF Policy Paper, Aug 15, 2012.

Mongolia's current consolidated deficit of 10 percent of GDP is far out of line, and, most likely, even the 2 percent of GDP deficit allowed by the FSL is too large.

4. **An appeal to the MPIH framework does not change the conclusion that Mongolia's fiscal stance is currently too loose.** The top-right chart in Figure A1 presents alternative paths for the overall fiscal balance over time. While the PIH requires a surplus for the next fifty years or so (when resource revenues are strong) and a deficit only thereafter, it is possible to construct an MPIH path that features the 10 percent deficits that are currently observed; however, as shown in Figure A1, to allow such frontloaded consumption, the next generation would need to run substantially tighter fiscal policy to compensate—an unrealistic intergenerational social contract.

5. **Neither does the conclusion change under the FSF framework.** Observed deficits stem largely from heavy infrastructure spending, rather than from handouts/consumption. If spending is indeed devoted to investment, then no future payback period is needed under the FSF paths, and indeed, lifetime wealth is higher. However, even if it is assumed that the return on investment for infrastructure projects that are properly selected and managed could reach 25 percent in Mongolia, reflecting its pressing infrastructure needs, constraints on both absorptive capacity and capacity to borrow would substantially lower this return when spending is as high as observed in the past few years. As a result, an FSF path with more moderate frontloading is shown to deliver similar consumption (primary, current expenditure) but higher wealth for every generation.

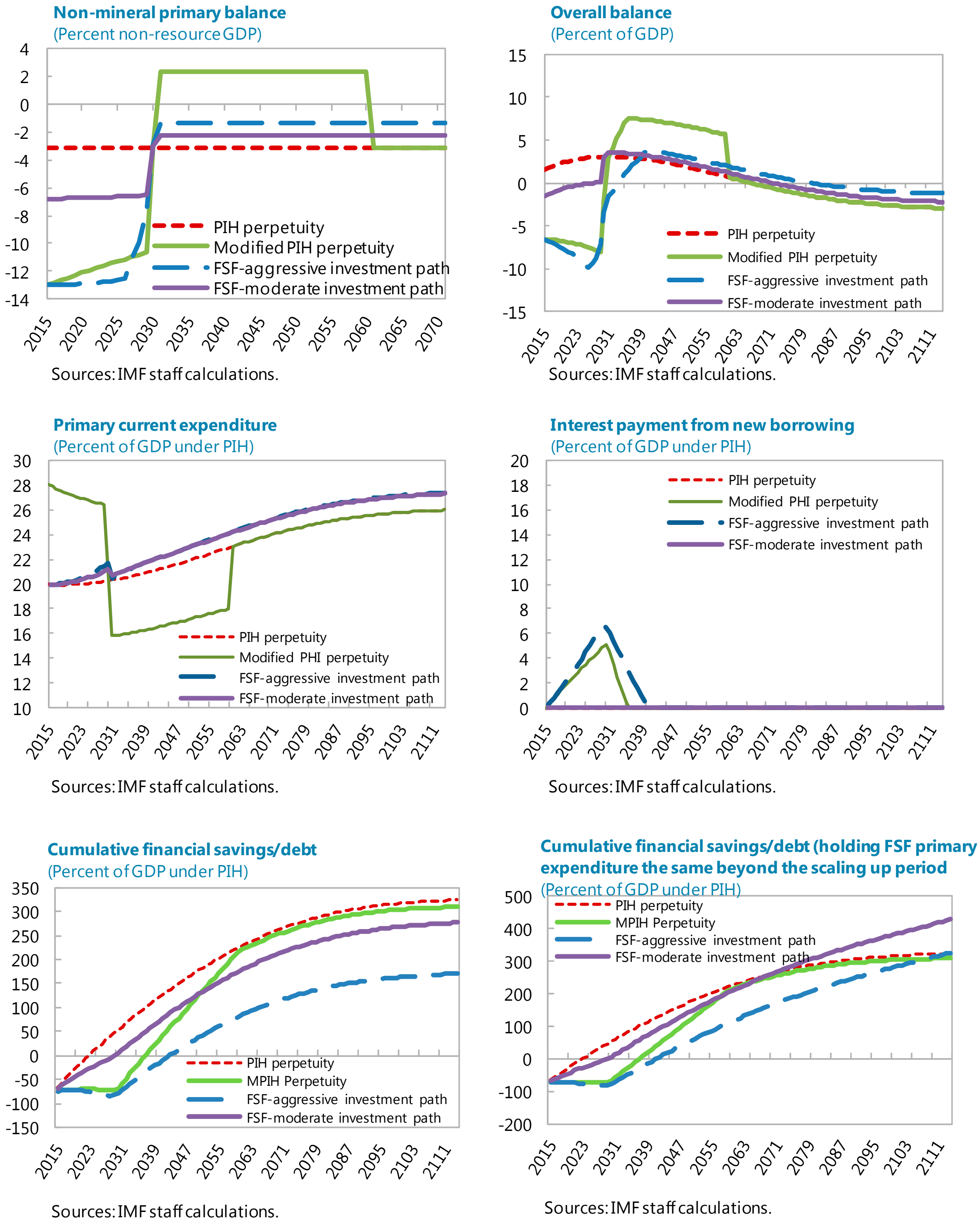
6. **Finally, even if there were a justification for temporarily running large deficits, permanent FSL limits should not be adjusted.** As shown in Figure A1, while certain constellations of parameters may support a path of heavy upfront investment, it would soon be expected that the fiscal balance would turn to substantial surplus, permitting the buildup of a large sovereign wealth fund. In other words, the fiscal deficit will naturally evolve over the lifecycle of the mines. The FSL, however, sets a single deficit limit for every year. This should not be loosened for all years just to permit a (hopefully) short-lived increase in deficits. Similarly, there appears to be little justification for raising the gross debt limit of 40 percent of GDP. As wealth is accumulated, there may still be a need for some gross debt, in order to allow fiscal maneuverability, but this would presumably be a small amount.

Table A1. Fiscal Balances Under PIH

Total resources at current prices	Mineral price growth rate (percent)	Government revenue share (percent)	Equal share of non-mineral GDP: Implied non-mineral primary balance (percent of non-mineral GDP)	Equal share of non-mineral GDP: Implied 2015 primary balance (percent of GDP)	Equal amount per capita in real terms: Implied 2015 non-mineral primary balance (percent of non-mineral GDP)	Equal amount per capita in real terms: Implied 2015 primary balance (percent of GDP)
$ 3 trillion	5	25	-12.0	0.0	-38.0	-21.0
$ 3 trillion	5	20	-9.6	0.0	-30.4	-16.8
$ 3 trillion	5	15	-7.2	0.0	-22.8	-12.6
$ 3 trillion	3	25	-6.3	4.4	-20.1	-6.8
$ 3 trillion	3	20	-5.1	3.5	-16.1	-5.4
$ 3 trillion	3	15	-3.8	2.6	-12.1	-4.1
$ 3 trillion	1	25	-3.8	6.3	-12.3	-0.5
$ 3 trillion	1	20	-3.1	5.0	-9.7	-0.4
$ 3 trillion	1	15	-2.3	3.8	-7.3	-0.3
$1.5 trillion	5	25	-6.7	4.0	-21.4	-7.9
$1.5 trillion	5	20	-5.4	3.2	-17.1	-6.3
$1.5 trillion	5	15	-4.1	2.4	-12.8	-4.7
$1.5 trillion	3	25	-3.9	6.2	-12.3	-0.7
$1.5 trillion	3	20	-3.2	4.9	-9.8	-0.6
$1.5 trillion	3	15	-2.3	3.7	-7.4	-0.4
$1.5 trillion	1	25	-2.5	7.1	-8.0	2.6
$1.5 trillion	1	20	-2.0	5.7	-6.4	2.1
$1.5 trillion	1	15	-1.5	4.3	-4.8	1.6
$1.0 trillion	5	25	-4.9	5.3	-15.5	-3.3
$1.0 trillion	5	20	-3.9	4.3	-12.4	-2.7
$1.0 trillion	5	15	-2.9	3.2	-9.3	-2.0
$1.0 trillion	3	25	-3.0	6.8	-9.4	1.5
$1.0 trillion	3	20	-2.4	5.4	-7.5	1.2
$1.0 trillion	3	15	-1.8	4.1	-5.6	0.9
$1.0 trillion	1	25	-2.0	7.4	-6.4	3.8
$1.0 trillion	1	20	-1.6	5.9	-5.1	3.0
$1.0 trillion	1	15	-1.2	4.4	-3.8	2.3

Source: IMF staff calculations.

Figure A1. Mongolia: Sustainability Assessment Indicators



B. A Sustainable Public Investment Path for Mongolia: A Model-Based Analysis[3]

This paper complements the first by looking at optimal fiscal paths, but using an entirely different methodology. Rather than a spreadsheet-based analysis focused on fiscal variables alone, this paper offers results from a DSGE model tailored to resource-rich economies. This permits an investigation of the implications of different fiscal policies for key fiscal and non-fiscal variables such as debt, consumption, investment, and the real exchange rate. This paper also finds that fiscal consolidation is needed and that the FSL limits should not be adjusted.

7. **This paper adopts a structural model-based analysis to help assess policy decisions regarding the management of natural resources in Mongolia.** The study uses a dynamic stochastic general equilibrium (DSGE) model with natural resource wealth in a small open economy. The model combines elements of frameworks developed in Araujo *et al.* (2013), Buffie *et al.* (2012), Berg *et al.* (2013), and Melina *et al.* (2013), in analyzing natural resource management for developing countries. The DIGNAR toolkit is used to analyze various public investment plans in Mongolia. The model captures the investment-growth nexus as well as investment efficiencies and absorptive capacity constraints.[4] It thus helps to inform the authorities about the tradeoffs involved in investing resource revenues to boost growth while maintaining fiscal sustainability and macroeconomic stability.

8. **The model captures the key features of resource-rich developing countries and is carefully tailored to Mongolia's particular circumstances.** It features two types of households, including poor households with no access to financial markets, and includes traded and non-traded sectors as well as a natural-resource sector. Public capital, subject to inefficiencies and absorptive capacity constraints, enters production functions in both the traded and non-traded sectors. The government has access to different types of debt (concessional, domestic, and external commercial) and a resource fund, which can be used to finance public investment plans. The resource fund can also serve as a buffer to absorb fluctuations of fiscal balances for given projections of resource revenues and public investment plans. Fiscal adjustments through tax rates and government non-capital expenditures—which may be constrained by ceilings and floors, respectively—may be triggered to maintain debt sustainability. The model is calibrated using historical data for Mongolia and parameters widely accepted in the literature.

9. **The model is estimated under two different public investment paths.** Under a fiscal consolidation path, the government restrains public investment so as to manage the debt. The aggressive investment path, by contrast, maintains currently observed investment levels to develop infrastructure and boost growth.

10. **Since uncertainty and volatility are intrinsic to resource economies, the public investment paths are each analyzed under a baseline scenario and an adverse scenario.**

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[3] Summarizes "From Natural Resource Boom to Sustainable Economic Growth: Lessons for Mongolia," forthcoming IMF working paper, prepared by Pranav Gupta, Grace Bin Li (both RES), and Jiangyan Yu (APD).

[4] The model includes only real variables and cannot be used to analyze monetary policy or inflation.

- *Baseline scenario*: Copper mining production is estimated to increase from 0.2 million tons in 2013 to around 1 million tons by 2020, when the second phase of OT goes into production. It is also assumed that political constraints make it impossible to increase consumption or labor taxes, and the government thus relies on external commercial borrowing.
- *Adverse scenario*: Resource revenues are hit by a negative shock—e.g., a further delay in OT-2, or a drop in copper prices similar to that observed in 2009.

11. **As shown in Figure A2, the aggressive investment path substantially increases fiscal risk.** While it yields faster growth than under fiscal consolidation, it also implies that public debt—and external, commercial debt in particular—rises substantially. And the situation is even worse if the adverse scenario obtains. Finally, rapid investment will quickly lead to investment inefficiencies (poor planning, higher-than-expected costs, bad governance, supply bottlenecks, lack of complementary infrastructure, etc.), further underscoring the need for fiscal restraint.

12. **The aggressive investment path would also put pressure on the external sector.** As shown in Figure A3, the togrog is currently overvalued and should be allowed to depreciate. Aggressive government investment would lead to overheating, bid up the relative price of nontradables, widen the current account deficit, and impede the pace of the required real depreciation.

13. **In sum, a DSGE-model-based analysis confirms earlier findings that frontloaded fiscal consolidation is needed.** The analysis in this paper stresses the benefits of adopting a comprehensive approach to enhancing absorptive capacity, managing natural resource wealth in a way that avoids Dutch disease, and sustaining the longer-term diversification of growth. In Mongolia, given the nontrivial role of the natural resources sector, it is particularly important to look beyond traditional metrics of investment pace. While the ambitious scaling up of public investment can generate higher non-mineral growth, it can also pose substantial challenges to debt sustainability and macroeconomic stability.

Figure A2: Resource Output, Revenues, and Fiscal Variables

Left column: Baseline Scenario; Right column: Adverse Scenario)

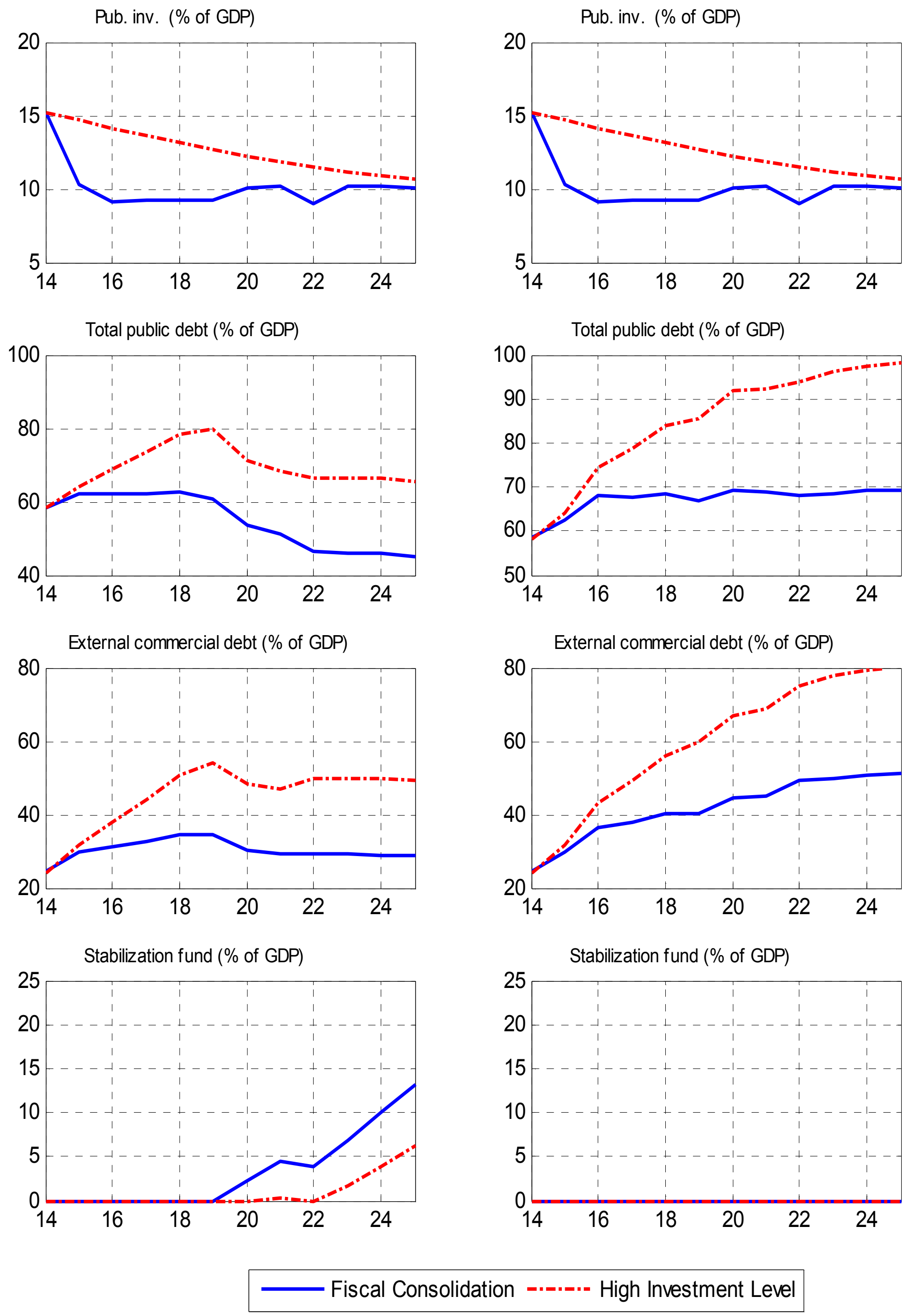
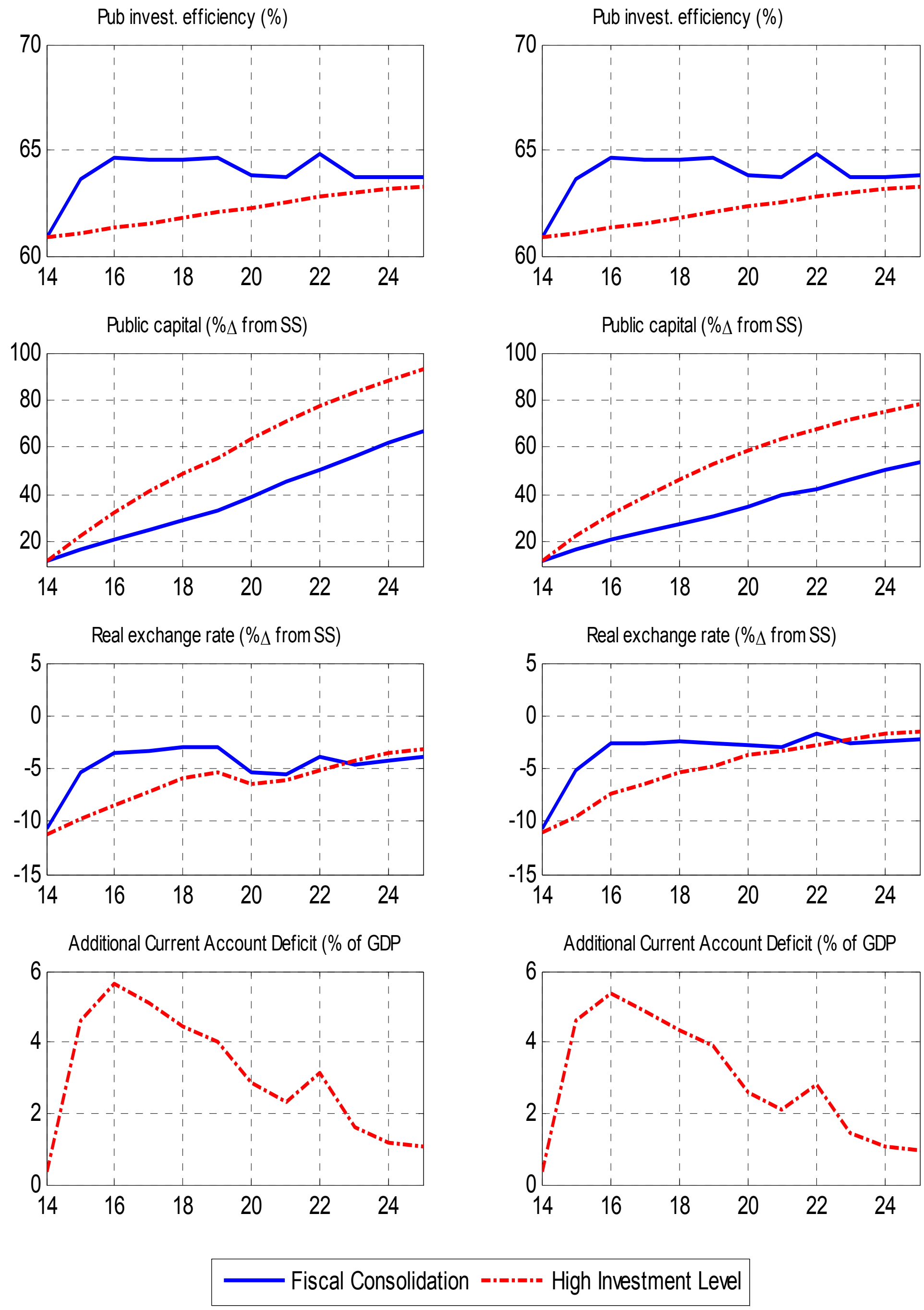


Figure A3: Fiscal and External Variables, and Growth

(Left column: Baseline Scenario; Right column: Adverse Scenario)

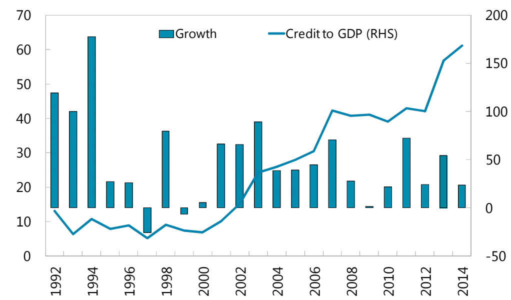


C. Mongolia—Risks of Rapid Credit Growth[5]

This paper uses techniques from the literature to conclude that Mongolia experienced a potentially harmful credit boom in 2013.

14. **Mongolia has seen strong credit growth in 2011-2013.** Credit grew by an average of 50 percent per year during 2011–13. In 2013, the strong growth was driven mostly by construction and real-estate loans, largely as a result of the central bank's easing programs. This led the banking sector's loan-to-deposit ratio to rise to 123 percent and the credit-to-GDP ratio to 57 percent in 2013. In 2014, credit growth decelerated, but the credit-GDP ratio rose further to 61 percent.

Mongolia: Credit to Private Sector
(In percent)



Sources: Mongolian Authority

15. **This paper analyzes whether the strong credit growth constitutes "a bad credit boom" and discusses the risks of such a boom.[6]** The paper takes a three-step approach. It first assesses the medium-term trend of credit, using various filtering techniques.[7] The second step is to calculate the "credit gap" obtaining from the difference between the actual credit and the medium term trend. Finally, it looks at whether the credit could represent a "bad" credit boom by estimating credit gap with respect to certain threshold.[8] The paper also uses the direct approach found in Dell'Ariccia and others (2012), where a 20 percent annual increase in the credit-to-GDP ratio is taken as the threshold of natural credit increase.

16. **The estimation concludes that Mongolia experienced harmful credit booms in 2011 and 2013.** In 2013, credit exceeded its threshold in all methodologies, with equilibrium credit in 2013 estimated at around 50 to 55 percent of GDP. Similarly, Mongolia experienced a credit boom in 2011 of about 3 to 5 percent of GDP higher than the appropriate levels. In 2014, credit (including mortgage-backed securities) remained above the threshold level.

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[5] Prepared by Firman Mochtar (APD).

[6] Given cross country data availability, the panel estimation employs the 2000–13 data series.

[7] One method is to use a rolling Hodrick-Prescott (HP) filter to find the potential and long-term credit-GDP trend (as applied by BIS (2010), Borio and Lowe (2002), Borio and Drehman (2009) as well as Hilbers and others (2006)). A second method follows Mendoza and Terrones (2008), who also applied the HP filter, but using the whole sample period rather than a rolling sample period. The third method (backward-looking, rolling, and cubic trend) is taken from Dell'Ariccia and others (2012). Finally, Gersl and Seidler (2011) use economic fundamentals to estimate the equilibrium credit-GDP ratio.

[8] Gersl and Seidler (2001) and BIS (2010) use the absolute credit gap about 2 percent of GDP as threshold, while Borio and Lowe (2002) use 4 percent of GDP. Others use relative credit gap to its long term trend and set 5 percent as the threshold credit gap (see Gourinchas and others, 2001 and Hilbers and others, 2005).

Table A2: Mongolia's Credit Gap and the Sign of Bad Boom across Method (% to GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Ad hoc threshold 1/	-6.8	46.1	48.8	60.3	7.3	7.8	9.1	38.5	-3.4	0.6	-4.9	30.8	-1.3	22.6
Backward-looking, rolling, cubic trend 2/														
- Absolute threshold 2 percent 4/	0.0	0.9	1.2	1.8	-1.3	-2.4	-2.4	1.5	-2.8	-3.6	-4.2	2.9	0.0	4.8
- Absolute threshold 4 percent 5/	0.0	0.9	1.2	1.8	-1.3	-2.4	-2.4	1.5	-2.8	-3.6	-4.2	2.9	0.0	4.8
- Relative treshold 5 percent 6/	-0.1	10.3	8.9	8.0	-4.9	-7.9	-7.2	3.6	-6.5	-8.0	-9.7	6.0	0.0	8.4
Hodrick Prescott Filter over entire series 3/														
- Absolute threshold 2 percent 4/	-5.5	-4.6	-2.4	3.7	2.1	0.6	-0.4	7.6	2.5	-0.9	-6.6	1.6	-2.9	4.5
- Absolute threshold 4 percent 5/	-5.5	-4.6	-2.4	3.7	2.1	0.6	-0.4	7.6	2.5	-0.9	-6.6	1.6	-2.9	4.5
- Relative treshold 5 percent 6/	-44.4	-31.2	-13.5	17.8	8.8	2.2	-1.4	22.1	6.7	-2.1	-14.5	3.2	-5.5	7.9
Hodrick Prescott Filter Rolling/Recursive 7/														
- Absolute threshold 2 percent 4/	-0.6	2.7	5.0	8.6	5.6	3.4	2.1	7.0	1.1	-1.7	-4.7	2.6	-1.0	4.5
- Absolute threshold 4 percent 5/	-0.6	2.7	5.0	8.6	5.6	3.4	2.1	7.0	1.1	-1.7	-4.7	2.6	-1.0	4.5
- Relative treshold 5 percent 6/	-8.2	37.2	48.9	55.4	27.6	14.0	7.4	19.7	2.7	-3.9	-10.8	5.4	-1.9	7.9
Structural Panel 8/														
- Absolute threshold 2 percent 4/	-10.1	-8.9	-5.3	-0.2	0.4	-0.5	-2.6	4.6	-0.7	2.6	-2.0	4.9	4.5	13.2
- Absolute threshold 4 percent 5/	-10.1	-8.9	-5.3	-0.2	0.4	-0.5	-2.6	4.6	-0.7	2.6	-2.0	4.9	4.5	13.2
- Relative treshold 5 percent 6/	-59.2	-46.7	-26.0	-0.7	1.8	-1.7	-8.0	12.1	-1.7	6.9	-4.8	10.7	9.8	27.2

Notes:

Credit boom by definition = Good = Bad

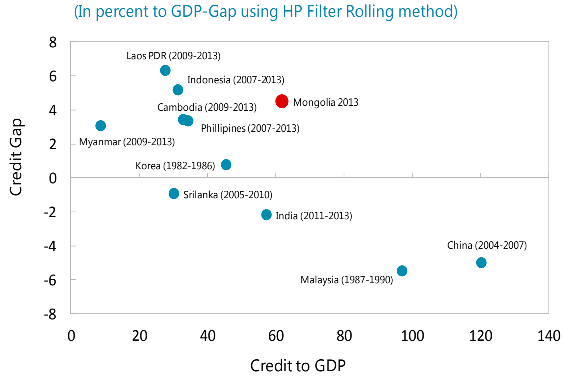
1/ Boom if credit to GDP ratio increase by more than 20 percent, in Dell'Aricia and others (2012).
2/ The deviation from trend is greater than 1.5 time standard deviation and annual growth credit exceeds 10% in Dell'Aricia and others (2012)
3/ Mendoza and Terrones (2008)
4/ Gourinchas and others (2001) and BIS (2010)
5/ Borio and Lowe (2002)
6/ Relative to its trend, in Gourinchas and others (2001) and Hilbers and others (2005)
7/ Borio and Lowe (2002), Borio and Drehman (2009), Hilbers and others (2006), and BIS (2010)
8/ Gersl and Seidler (2001)

Source: IMF Staff estimate

17. **The Mongolian credit boom in 2013 was higher than in other peer countries in the region.** Cross country data show that the Mongolian credit gap in 2013 was bigger than those of other countries in the region. The finding remains relevant when the credit gap is compared to historical levels of peer income countries in the region, except Indonesia and Lao PDR (Figure 3).

Historical Comparison : Credit Gap vs Credit

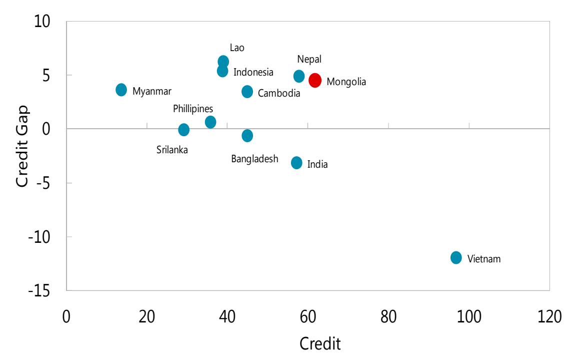
(In percent to GDP-Gap using HP Filter Rolling method)



Sources: IMF Staff estimate

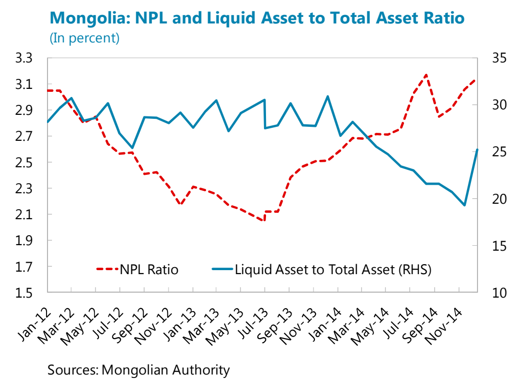
International Comparison: 2013 Credit Gap vs Credit

(In percent to GDP-Gap using HP Filter Rolling method)



Source: IMF staff estimates

18. **Many empirical papers conclude that excessive credit is harmful.** Credit booms can propagate excessive demand, generate economic overheating, and trigger asset price bubbles. Such unfavorable developments would reduce domestic competiveness, widen external imbalances, and foster depreciation. Rapid credit growth also raises banking and broader financial-sector vulnerabilities, given the typical deterioration of asset quality. This early warning seems relevant to the FSI data – Mongolia's credit quality has started to deteriorate since mid of 2013; and liquidity has tightened as reflected in the decreasing liquid asset ratio.



19. **Various country experiences also show that prolonged credit booms can lead to banking crises and substantial output losses.** Laeven and Valencia (2013) documented the impact of banking crises on output, debt, and asset quality. Hilbers and others (2005) pointed out that the cost of a credit boom to the economy will depend on the nature of credit, the rate of credit growth, the main providers of credit, the main borrowers, the sectoral loan composition, the currency composition of loans, and the maturity of loans.

Table A3: Banking Crises' Outcomes, 1970–2011

Country	Output Loss (% GDP)	Increase in Public Debt (% GDP)	Fiscal Cost (% GDP)	Peak NPLs (% of total loans)
All	23.2	12.1	6.8	25.0
Advance	32.4	23.6	4.2	5.0
Emerging	33.6	9.1	8.3	29.5
Developing	0.7	10.9	10.0	35.0

Source: Hilbers, Otker-Robe, Pazarbabosioglu, and Johnsen (2005)

20. **The policy implications are clear: credit should be managed properly to sustain the economy without risking a crisis.** Among others, Dell'Ariccia and others (2012) summarize the major policy recommendations to deal with credit booms. These include fiscal, monetary, and macroprudential tools. Policy coordination across different authorities and across borders may also need to be strengthened.

Annex VII. Policy Agenda for Strengthening the Banking Sector

Important legal and regulatory reforms have been passed, but bank supervision needs further upgrading. A recent TA mission outlined priority actions, as follows:

Improve the accuracy of risk recognition and management
Restructured loans should be subject to a stricter prudential treatment and reported on a regular basis to the BOM (ST—within 18 months).
The 1-percent general provision coefficient should apply to the entire stock of performing loans (ST).
Discontinue the current explicit regulatory forbearance vis-à-vis the loans provided under the PSP (ST).
Implement a more structured and forward-looking assessment of the borrower's condition, including its hedging capacity against foreign exchange risks (ST).
Perform a comprehensive asset quality review to assess comprehensively the real condition of the loan portfolio of banks (ST).
Strengthen the resilience of banks
Increase the Tier 1 capital for SIBs to 10.5 percent from the current 9 percent (ST).
Require targeted capital increases (Pillar 2 - like) in the banks that have high-risk profiles due to borrower, depositor, and foreign currency concentrations (ST).
Increase the intensity of supervisory oversight of the vulnerable banks (ST).
Introduce a capital countercyclical buffer considering the specific circumstances of external shocks and economic cycles in Mongolia (MT—within 3 years).
Improve the systemic oversight framework
Enhance the quality and frequency of macro-financial and supervisory stress tests (MT).
Enhance the BoM's capacity to link forward-looking analyses to the assessment of banks' capital adequacy and set bank-specific capital requirements (MT).
Enhance the early intervention framework
Provide clear legal powers to the BOM to take prompt action to correct problematic situations, even in the absence of violations to regulations (ST).
Improve the CAMELS methodology to make it more robust and forward looking and reorient it as a supervisory tool for early identification and prompt corrective action (ST).
Define list of specific minor and major actions, relating them to the redesigned CAMELS factors (ST).
Enhance the Supervisory Department's internal coordination and effectiveness, empowering the Supervisory Committee as the key decision maker (ST).
Improve crisis contingency and management
The Financial Stability Council should execute a Memorandum of Understanding for crisis preparedness and management, and prepare a work program that includes contingency planning (ST).
Amend the Banking Law to explicitly forbid any court reversals of actions initiated as part of Provisional Administration and Receivership (MT).
Amend the Banking Law triggers for Provisional Administration and Receivership to provide more flexibility and timeliness in intervention (MT).
The ability to use budget financing for bank reorganization and the ability to return the intervened bank to original shareholders should be eliminated from the Banking Law (MT).

INTERNATIONAL MONETARY FUND

MONGOLIA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

March 19, 2015

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

CONTENTS

FUND RELATIONS

(As of January 31, 2015)

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

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	51.10	100.00
Fund Holdings of Currency	52.88	103.49
Reserve Position in Fund	0.14	0.27
SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	48.76	100.00
Holdings	42.93	88.05
Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
Stand-by Arrangements	1.92	3.75

Latest Financial Arrangements:

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

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

	Forthcoming				
	2015	**2016**	**2017**	**2018**	**2019**
Principal	1.92				
Charges/interest	0.02	0.00	0.00	0.00	0.00
Total	1.93	0.00	0.00	0.00	0.00

Safeguards Assessments:

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

[1/] Formerly PRGF.

Exchange Arrangement:

On March 24, 2009, the BOM instituted a foreign exchange auction allowing the determination of the exchange rate mainly by market forces. The de facto and de jure exchange rate arrangements are currently both classified as floating, though the de facto exchange rate arrangement could potentially by reclassified to "crawl-like," pending further observation. (through end-May 2015).

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 it's further extension until March 15, 2012 or the next Article IV consultation whichever is earlier (Decision No. 14669 of June 23, 2010 and Decision No. 14365 of March 16, 2011). The MCP, however, could not be resolved by March 15, 2012, and would be continued as long as the multiple price foreign exchange auction mechanism remains in place. Therefore the MCP is unapproved, and since the criteria for approval of this MCP are not in place, staff does not recommend Executive Board approval of said measure. In addition, Mongolia has an official exchange rate (reference rate) that is mandatorily used for government transactions (as opposed to the commercial market rate). Therefore, by way of official action, the authorities have created a market segmentation. While Order #699 of the BOM issued on December 3, 2010, sets forth that the reference rate is determined based on the weighted average of market rates used from 4 PM of the previous day to 4 PM of the current day, staff is of the view that this Order does not eliminate the market segmentation and the multiplicity of effective rates arising from it. Accordingly, in the absence of a mechanism to ensure that the commercial rates and the reference rate do not deviate by more than 2 percent, the way the reference rate is used in government 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 2013 Article IV consultation (IMF Country Report No. 14/64) was concluded by the Executive Board on November 15, 2013. Mongolia is on a 12–month cycle.

ROSC Assessments:

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

Recent Financial Arrangements:

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

FSAP Participation:

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

Technical Assistance in 2014-2015:

Missions:

- Medium Term Budget Framework (FAD), March 2014 and January 2015
- Banking supervision (MCM), January - February 2015
- External sector statistics (STA), May, June and October 2014 and February 2015
- Strengthening LTO (FAD), May, June, August and September 2014 and January 2015
- Treasury operations (FAD), March and October 2014
- Cash management (FAD), April 2014
- AML/CTF (LEG), October 2014
- SDDS assessment (STA), October 2014
- Price statistics (STA), October 2014

Resident Representative:

The resident representative position was discontinued in September 2011, though the office remained open, staffed by local economists, and managed remotely by a non-resident representative—most recently, Ms. Yuko Kinoshita—who was based in the IMF's Regional Office for Asia and the Pacific in Tokyo. As of April 2014, Mr. Neil Saker will take up his assignment as resident representative based in Ulaanbaatar.

WORLD BANK-IMF COLLABORATION

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

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

- **IMF surveillance**. World Bank staff participates in Policy Consultation Meetings ahead of Article IV consultation missions and comments on staff reports. World Bank staff also participates in selected meetings of the Article IV mission team with the authorities. This facilitates the discussions, especially as regards policies in areas of mutual interest such as bank restructuring, social welfare reform, and fiscal policy.

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

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

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

- **Policy Outreach.** Both country teams jointly hosted a high-level conference on macro-economic outlook as a forum for discussing economic developments and key challenges with key policy makers.

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

- **Promoting long-term growth**. Managing the mineral wealth to ensure strong, sustainable, and equitable growth with low inflation. This includes the importance of avoiding the "resource curse" and the productive use of mineral wealth management.

- **Macro-economic stability**. This includes ensuring that the boom-bust policies of the past are not repeated. The Fiscal Stability Law adopted in 2010 with the support of the IMF and the World Bank is a key step, and it is critical that it be strictly adhered to from 2013, the first year the law is effective. At the same time, fiscal policy also has to be mindful of the macroeconomic policy mix and medium and long-term fiscal sustainability.

- **Monetary policy**. The Bank of Mongolia (BOM)'s large monetary stimulus, through its so-called "price stabilization program," mortgage program, and liquidity injection, distorts markets and is bound to ratchet up inflation. The stimulus program should be phased out and the BOM should focus on further strengthening the monetary policy framework. The flexible exchange rate regime should be maintained.

- **Protecting the poor**. The 2012 Social Welfare Law envisages replacing existing costly universal cash transfers with means-tested benefits that would reach the poorest households. Full implementation of the law would represent a big step forward in strengthening the social safety net and increasing fiscal flexibility. Concrete action following the adoption of the law is important from a socio-economic perspective as well as a fiscal perspective.

- **Strengthening the banking system.** Key steps include continued improvement in bank regulation and supervision, ramping up risk disclosure and management—especially given elevated systemic risks in the sector illustrated by the recent failure of Saving Bank—and strengthening the newly established Mongolian Deposit Insurance Corporation.

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

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

	Products	Expected Delivery Date
Bank Work Program	Analytical and Advisory Services • Semi-Annual Economic Update • Policy notes on selected economic topics • Financial Sector Monitoring and Policy Dialogue (banking supervision, deposit insurance, housing finance, payment system, financial capability and consumer protection, AML/ATF) • Capital Markets Strengthening and Development TA • Public Expenditure and Financial Accountability (PEFA) Report • TA on SWF • TA on improving debt management system Operational • Supervision missions multi-sectoral TA Credit (fiscal policy and public expenditure system, Banking, social welfare) • Preparation of Development Policy Credit Operation	• Ongoing • Ongoing • Ongoing • June 2016 • April 2015 • Ongoing • Ongoing • Ongoing • Ongoing
Fund Work Program	• Article IV-Board Meetings • Missions • STA: National account statistics, BOP statistics FAD: Tax administration for large taxpayers, mineral taxation regime	• November 2013, April 2015 • April, June, September, and December 2014; February 2015 • Ongoing • Ongoing

RELATIONS WITH THE ASIAN DEVELOPMENT BANK[2]

Mongolia became a member of the Asian Development Bank (AsDB) in February 1991. The AsDB has been Mongolia's largest source of multilateral development finance for more than two decades and since Mongolia joined AsDB, the country has received 60 loans totaling US$1.3 billion, 12 Asian Development Fund grants and 2 Japan Fund for Poverty Reduction (JFPR) grants for US$218 million. In addition, 184 TA and JFPR TA grant projects with total value of $110.9 million have been implemented and AsDB has supported trade through its Trade Finance Program, with a total value of $106 million. AsDB has also approved 2 ongoing financing facilities for urban development and urban transport, with up to $377 million currently available for drawdown.

In 2011, Mongolia gained access to AsDB's ordinary capital resources (OCR), alongside AsDB's concessional lending from ADF; however Mongolia no longer has access to ADF grant financing. Given its AAA credit rating, AsDB makes funding available for development projects on highly favorable terms. This change was welcomed by the Government of Mongolia as large amounts of capital are needed to finance infrastructure investments and, improvement of social services, and to address urgent environmental problems.

AsDB has provided financial, technical and policy support in areas ranging from urban infrastructure, agriculture, energy, finance, education, health, to social protection and transport. AsDB has also provided over $100m private sector financing for commercial banks.

The Mongolia Country Partnership Strategy (CPS) 2012−16 was approved by AsDB's board in April 2012. The CPS is prioritizing (i) transport, energy, and water supply infrastructure; (ii) access to education and health; and (iii) regional economic cooperation in order to support sustainable and inclusive growth of economy. In August 2014, reflecting changed government priorities and to meet AsDB's focus on employment creation and economic diversification, two strategic adjustments was made to the Interim CPS 2014–2016: (i) the inclusion of two additional sectors (agriculture, natural resources and rural development; and finance); and (ii) scaling up OCR resource allocations to meet pressing development needs, from $50m annually to $200m.

For 2015, AsDB has offered to provide loans for US$200 million and US$72 million from OCR and ADF funding sources, respectively. In addition, technical assistance worth US$11 million and JFPR grant worth US$10 will be provided.

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

Transport. Transport is the largest sector of AsDB operations in Mongolia. Under the Central Asia Regional Economic Cooperation (CAREC) program, for which AsDB acts as Secretariat, AsDB is financing construction of the country's two main international road corridors, connecting Mongolia

[2] Data provided by Asian Development Bank staff.

to the People's Republic of China and the Russian Federation. As a result, travel times from Ulaanbaatar (UB) to the PRC border have recently come down from 20 hours to 7 hours. With a view to boosting Mongolian exports, AsDB is also supporting Mongolia to harmonize cross-border transport procedures, under the CAREC program, and developing logistics infrastructure and systems in Zamyn-Uud on the border with the People's Republic of China. AsDB also plans to support a public transport system for UB, based on bus rapid transit.

Urban Development. AsDB is helping to improve living conditions and greater access to basic services, including water, sanitation, and heating, to poor people in urban areas across the country, including UB, provincial capitals and smaller towns in the mineral-rich Gobi area, where communities are coping with a large population influx in response to new mining operations. AsDB plans to extend basic urban infrastructure and construct socio-economic facilities in peri-urban areas of UB city, home of nearly half of the population, to upgrade existing sub-centers for improved economic, housing, and employment opportunities, and reduced environmental pollution. AsDB recently approved the $320 million Ger Area Development Programme, with $160m financing from AsDB, Euro 50m from the European Investment Bank and the remainder financed by the Government.

Energy. Insufficient and unreliable power and heating are becoming bottlenecks to growth and threaten livelihoods. AsDB aims improve energy efficiency and capacity in UB, through upgrading electrical transmission and distribution networks, by increasing efficiency of existing energy sources, and preparing to finance the country's first major $1.3 billion public–private partnership to construct a new energy efficient combined heating and power plant in UB with proper emission reduction equipment. AsDB will pilot the application of different renewable energy sources, including solar thermal heating in remote districts.

Education. AsDB has supported the government's efforts to reform and develop the education system in all subsectors (pre-primary, primary, secondary, tertiary, technical and vocational education and training). To meet pressing labor market demands, AsDB currently supports reform of higher education has recently approved substantial financial support modernize vocational training, as well as promoting PPPs in pre-primary and primary education

Health and Social Protection. AsDB has made major investments to improve primary health services and supports policy reforms and investments in the hospital sector, drug and blood safety and hospitals hygiene. AsDB assisted the government in introducing proxy means testing to target the poor, reformation of several universal benefits, introduction of the food stamp program as the first poverty-targeted benefit in the country, and passage of the amended Social Welfare Law in January 2012 that legalized the reforms. AsDB will continue to support the efficiency and transparency of the delivery of social welfare and insurance services. Another planned area of support is the improvement of access to education, employment and health care for disabled persons, who tend to be left aside from the basic services.

Agriculture, Natural Resources and Rural Development. Recognizing the significant potential of agriculture for employment creation, Mongolia needs to diversify the economy by developing value chains for high-quality, locally made agricultural products. Establishing genuine Mongolian brands, and developing rigorous quality control and standardization of products would help Mongolian companies to penetrate overseas markets. AsDB has been and will continue supporting this potential through the development of agro-processing companies, and establishing brands. Sanitary and phytosanitary measures are essential for Mongolia to boost its trade of agriculture products and AsDB supports the country to upgrade these to international standards. Mongolia faces severe development challenges in terms of sustainable growth, such as, grasslands desertification, water scarcity, and a growing number of climate change-related disasters. AsDB will support the sustainable management of natural resources (i.e., water, land, forests, and peatlands); water security and information management; protected area management; climate change adaptation; institutional strengthening; and rural renewable energy and livelihood improvement. AsDB aims to strengthen natural disaster risk management. Working with private sector banks, AsDB has made over $80m available for the development of micro, small and medium enterprises, especially in agribusiness.

Finance. While almost 90% of registered businesses in Mongolia are SMEs, most of them have limited access to finance and are unable to contribute sufficiently to diversification of the economy, employment creation, and economic growth. The expected outcome of AsDB's interventions in the financial sector is the increased use of more efficient financial intermediation by private sector enterprises and individuals to support diversification of the economy and employment creation, in particular in the agriculture sector. AsDB will help safeguard financial sector stability, improve access to finance for SMEs through the support of financial infrastructure, and support long-term financing for investments in infrastructure and green development.

STATISTICAL ISSUES

(As of March 3, 2015)

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 compiles and publishes annual and quarterly GDP by production and expenditure approaches. Estimates are broadly in line with the *1993 SNA* and are based on various census/surveys and administrative data sources. Annual GDP data are available for 1990–2013. The constant price estimates use the base year 2005. The NSO has recently improved the quality of national accounts data, but weaknesses remain, including in the estimation of capital formation, imputed rent estimates, estimation of GDP in constant prices, and coverage of the informal sector and small-scale activity (especially in the services sector). The NSO is currently finalizing a supply-use table (SUT) for 2010 at current prices based on the *2008 SNA* methodology and has plans for implementing SUT as an integral part of the annual compilation process, in current and constant prices. The SUT represents an important tool for the improvement of national accounts estimates in Mongolia.
Price Statistics: The consumer price index (CPI) was rebased in January 2008 with expenditure-derived weights from the 2005 Household Income and Expenditure Survey. The NSO has published a national CPI for Ulaanbaatar and 21 aimags (provinces) since January 2008, and a housing price index since October 2008. CPI compilation can further be improved by expanding the sample to include more varieties and financial services and appropriate treatment of missing observations. The NSO also publishes a producer price index (PPI). The major shortcoming with the currently compiled PPI for industry continues to be the lack of imputation for missing prices—both temporarily and permanently missing prices.
Government Finance Statistics: Currently, the concepts, classifications, and definitions used to compile sub-annual and annual fiscal statistics for the consolidated general government operations series used in APD generally follow the guidelines of the *GFSM 1986*. The authorities have indicated an intention to adopt a migration path to the *GFSM 2001* methodology. STA assists the authorities compile and disseminate monthly and annual (cash-based) general government series in the *GFSM 2001*-based Statement of Sources and Uses of cash (Revenue, Expenditure, Transaction in Assets and Liabilities). A 2015 GFS TA mission will seek to compile a complete an annual (and quarterly) balance sheet and integrated presentation of stock and flows for the consolidated general government sector using the accrual (IPSAS-based) accounts maintained by the Ministry of Finance. The mission will also seek to encourage the reporting of public sector debt statistics (PSDS), as these are not reported systematically to the World Bank for dissemination on the PSDS Website.
Monetary and Financial Statistics: BOM's monetary and financial statistics conform to the concepts and definitions of the *Monetary and Financial Statistics Manual (MFSM)* methodology as the authorities implemented recommendations of the latest monetary and financial statistics (MFS) missions. In particular, the monetary data were improved by the proper classification of repurchase agreements, accrued interest, and financial derivatives. The coverage of monetary statistics was expanded beginning in February 2010 to include data of Savings and Credit Cooperatives (SCCs) that collect deposits; and since May 2010 data for some other financial corporations (OFIs) have been disseminated in the BOM's *Monthly Statistical Bulletin*. The September 2009 mission provided recommendations to reconcile the BOM and the Ministry of Finance data on government financing,

and finalized the standardized report forms for the data of the BOM and other depository corporations for publication in *International Financial Statistics* beginning in November 2009. The July/August 2011 mission discussed the quality of data of the nonbank financial institutions (NBFIs), insurance companies, and securities companies that are reported to the Financial Regulatory Commission (FRC) and recommended their use in the compilation of monetary statistics. However, due to insufficient coordination among various agencies, this recommendation has not been implemented.
Financial sector surveillance: With regard to financial soundness indicators (FSIs), Mongolia currently does not report data to the Fund for dissemination on the Fund website.
External Sector Statistics: For compilation of external sector statistics (ESS), the Bank of Mongolia (BOM) follows the statistical framework of the fifth edition of the *Balance of Payment Manual (BPM5)* and expects to begin compiling and reporting ESS using the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* during the first half of 2015. The coverage of the balance of payments statistics has been broadened by extending the International Transaction Reporting System (ITRS) to nonbank financial institutions and by increasing the number of direct reporting private enterprises. Since May 2014, BOM has produced 2012-annual international investment position data for submission to STA. Priorities for improvement are to (1) submit quarterly external debt statistics to the World Bank's Quarterly External Debt Statistics (QEDS) database in collaboration with the Ministry of Finance; (2) release the first quarter data for 2014 using the *BPM6* statistical framework; and (3) assess the State Registry Office's database on all enterprises registered in Mongolia to determine whether all relevant enterprises with direct investment are included in the BOM's ESS surveys.

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

Mongolia—Table 2. Common Indicators Required for Surveillance

(As of February 25, 2014)

	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	02/25/15	02/25/15	D	D	D		
International reserve assets and reserve liabilities of the Monetary Authorities[1]	02/25/15	02/25/15	D	D	M		
Reserve/base money	01/31/15	02/23/15	M	M	M	O, LO, LO, LO	O, O, O, O, LNO
Broad money	01/31/15	02/23/15	M	M	M		
Central bank balance sheet	01/31/15	02/23/15	M	M	M		
Consolidated balance sheet of the banking system	01/31/15	02/23/15	M	M	M		
Interest rates[2]	12/31/14	01/16/15	M	M	M		
Consumer price index	01/31/15	02/18/15	M	M	M	O, LO, O, O	LO,LO,LO,O,O
Revenue, expenditure, balance and composition of financing[3] – general government[4]	12/31/14	01/16/15	M	M	M	LO, LNO, LO, O	LO, O, LO, LO, LNO
Revenue, expenditure, balance and composition of financing[3]– central government	12/31/14	01/16/15	M	M	M		
Stocks of central government and central government-guaranteed debt[5]	12/31/14	02/08/15	A	A	A		
External current account balance	12/31/14	02/03/15	M	M	M	O, O, O, LO	LO, O, LO, LO, LO
Exports and imports of goods	12/31/14	02/03/15	M	M	M		
GDP/GNI	2014Q4	02/2015	Q	Q	Q	O, LNO, O, LO	O, LO, LO, LO, LNO
Gross external debt	2014Q3	01/16/15	Q	Q	Q		

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

MILLENNIUM DEVELOPMENT GOALS

	1995	2000	2010	2012/13
Goal 1: Eradicate extreme poverty and hunger				
Employment to population ratio, 15+, total (%)	56	57	57	60
Employment to population ratio, ages 15–24, total (%)	38	38	30	33
GDP per person employed (constant 1990 PPP $)	..	..	..	..
Income share held by lowest 20%	7	7	..	..
Malnutrition prevalence, weight for age (% of children under 5)	8	12	5	..
Poverty gap at $1.25 a day (PPP) (%)	..	..	..	..
Poverty headcount ratio at $1.25 a day (PPP) (% of population)	..	..	..	..
Vulnerable employment, total (% of total employment)	..	57	56	..
Goal 2: Achieve universal primary education				
Literacy rate, youth female (% of females ages 15–24)	..	98	99	..
Literacy rate, youth male (% of males ages 15–24)	..	97	98	..
Persistence to last grade of primary, total (% of cohort)	68	89	93	..
Primary completion rate, total (% of relevant age group)	75	87	114	130
Adjusted net enrollment rate, primary (% of primary school age children)	81	93	99	98
Goal 3: Promote gender equality and empower women				
Proportion of seats held by women in national parliaments (%)	8	11	4	15
Ratio of female to male primary enrollment (%)	103	101	98	97
Ratio of female to male secondary enrollment (%)	133	124	107	103
Ratio of female to male tertiary enrollment (%)	227	179	154	145
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	46	49	52	50
Goal 4: Reduce child mortality				
Immunization, measles (% of children ages 12–23 months)	85	92	97	97
Mortality rate, infant (per 1,000 live births)	63	49	29	26
Mortality rate, under-5 (per 1,000 live births)	85	65	36	32
Goal 5: Improve maternal health				
Adolescent fertility rate (births per 1,000 women ages 15–19)	34	26	19	19
Births attended by skilled health staff (% of total)	..	97	99	..
Contraceptive prevalence (% of women ages 15–49)	57	67	55	..
Maternal mortality ratio (modeled estimate, per 100,000 live births)	120	120	74	68
Pregnant women receiving prenatal care (%)	..	97	99	..
Unmet need for contraception (% of married women ages 15–49)	..	..	14	..
Goal 6: Combat HIV/AIDS, malaria, and other diseases				
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	..	..	..	..
Condom use, population ages 15–24, female (% of females ages 15–24)	..	..	..	..
Condom use, population ages 15–24, male (% of males ages 15–24)	..	..	..	..
Incidence of tuberculosis (per 100,000 people)	314	253	214	181
Prevalence of HIV, female (% ages 15–24)	0.1	0.1	0.1	0.1
Prevalence of HIV, male (% ages 15–24)	0.1	0.1	0.1	0.1
Prevalence of HIV, total (% of population ages 15–49)	0.1	0.1	0.1	0.1
Tuberculosis case detection rate (%, all forms)	39	51	77	84
Goal 7: Ensure environmental sustainability				
CO2 emissions (kg per PPP $ of GDP)	1.3	1.0	0.7	..
CO2 emissions (metric tons per capita)	3.4	3.1	4.2	..
Forest area (% of land area)	7.8	7.5	7.0	6.9
Improved sanitation facilities (% of population with access)	47	49	55	56
Improved water source (% of population with access)	63	68	82	85
Marine protected areas (% of territorial waters)	..	..	..	..
Net ODA received per capita (current US$)	91	91	112	160
Goal 8: Develop a global partnership for development				
Debt service (PPG and IMF only, % of exports of goods, services and primary income)	10	7	4	3
Internet users (per 100 people)	0	1	10	18
Mobile cellular subscriptions (per 100 people)	0	6	93	124
Telephone lines (per 100 people)	3	5	7	6
Fertility rate, total (births per woman)	3	2	2	2
Other				
GNI per capita, Atlas method (current US$)	460	470	1900	3770
GNI, Atlas method (current US$) (billions)	1.1	1.1	5.2	10.7
Gross capital formation (% of GDP)	26.8	29.0	40.8	61.4
Life expectancy at birth, total (years)	61.2	62.9	66.9	67.3
Literacy rate, adult total (% of people ages 15 and above)	..	97.8	98.3	..
Population, total (millions)	2.29	2.39	2.71	2.84
Trade (% of GDP)	82.1	121.9	117.1	112.2

Source: World Bank, World Development Indicators database.

MAIN DATA WEBSITES

National Statistics Office (www.nso.mn)

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

Bank of Mongolia (www.mongolbank.mn)

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

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

- Government Budgetary Operations

National Development and Innovation Committee (www.ndic.gov.mn)

- Long- and medium-term development strategy
- Economic and social policies
- Investment policy coordination
- Development Bank of Mongolia

Financial Regulatory Commission (www.frc.mn)

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

MONGOLIA

March 19, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

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

Based on the LIC-DSA analytical framework and a broader coverage of public debt than previously used, this debt sustainability analysis (DSA) concludes that Mongolia is at high risk of public debt distress under the baseline scenario.[1] *This is not because debt is on an ever-increasing path over the medium-term, but rather because key debt indicators are currently elevated and, while expected to decline over time, would still remain above the relevant thresholds for a number of years. This assessment shows a significant deterioration of debt dynamics since the 2013 Article IV, which suggested a moderate risk under a "strong policy scenario." In 2014, the fiscal deficit ceiling set forth under the Fiscal Stability Law (FSL) was breached, DBM borrowed large amounts at commercial terms, and the BOM continued to draw down its swap line established with the People's Bank of China (PBC). Public debt could rise further in the near term as the newly passed Debt Management Law allows more room for the government to contract debt and guarantees.*[2]

[1] The low-income country debt sustainability framework (LIC DSF) recognizes that better policies and institutions allow countries to manage higher levels of debt, and thus the threshold levels are policy-dependent. Mongolia's policies and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA), place it as a "medium performer", with an average rating of 3.43 during 2011-13. The relevant indicative thresholds for this category are: 40 percent for the NPV of debt-to-GDP ratio, 150 percent for the NPV of debt-to-exports ratio, 250 percent for the NPV of debt-to-revenue ratio, 20 percent for the debt service-to-exports ratio, and 20 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed external debt.

[2] This DSA is based on end-2014 debt data. The fiscal year for Mongolia is January–December. The 2013 DSA (see IMF Country Report No. 14/64) was based on end-2013 debt data.

A. Background

1. Based on the LIC-DSA framework and a broad coverage of public debt, this DSA concludes that Mongolia faces a high risk of debt distress under the baseline scenario. This DSA assesses public debt, including general government debt, Euro bonds issued by the Development Bank of Mongolia, the drawing of the PBOC swap line by the Bank of Mongolia (BOM), and also borrowing by, and government guarantees for SOEs, which were not included in the previous DSA as such data were not reliably available at the time.[3] External public and publicly guaranteed (PPG) debt reached more than 56 percent of GDP by end-2014, and key external debt indicators have breached, or are projected to breach, the relevant indicative thresholds; debt-service ratios spike in various years when external bonds mature, and some of these breaches are significant in magnitude and persist for extended periods under both baseline and stress tests. Public debt stood at 77 percent of GDP, and will stay above the benchmark for almost the entire projection period (2015-2035).[4] Total external debt rose to 170 percent of GDP—reflecting, in large part, intercompany lending in the mining sector—undermining the economy's resilience to external shocks. The elevated debt ratios have also raised market concern—credit rating agencies have downgraded Mongolia's sovereign rating several times since the issuance of Eurobonds in late 2012 and have maintained a negative outlook, and Mongolia's sovereign spreads are among the highest of all frontier economies.

2. Debt dynamics have worsened since the 2013 DSA, mainly reflecting a substantial increase in domestic public debt and external PPG debt. The "strong policy scenario" of the 2013 DSA, which envisaged significant fiscal restraint and monetary tightening, did not take place. Instead, the 2014 on-budget deficit reached 4¼ percent of GDP compared to the FSL limit of 2 percent, and off-budget spending by the Development Bank of Mongolia (DBM) amounted to 6¾ percent of GDP, keeping the consolidated fiscal deficit at 11 percent of GDP, similar to 2013. Debt dynamics have deteriorated substantially, reflecting extensive borrowing by the DBM, further drawing of the swap line by BOM, and large amounts of domestic bonds issued close to end-2014 (see table 1). Moreover, exchange rate depreciation caused external debt to increase further relative to GDP. The expansion of public debt coverage to include borrowings by, and government guarantees for, SOEs, raises the reported debt ratio by 8¾ percent of GDP in 2013.[5] But the elevated debt risk is mainly attributable to aggressive borrowing rather than this expansion of coverage. On the authorities' definition—i.e., in NPV terms, and excluding the PBOC swap drawings—public debt amounted to 55 percent of GDP at end-2014, in excess of the FSL's 40 percent limit.

3. The institutional framework of debt management has also been altered. Even the authorities' estimate—i.e., considering their calculation of debt NPV with the Bank of Mongolia's

[3] The authorities' definition of public debt excludes the BOM swap line. And debt as defined under the FSL and DML has recently been changed to exclude SOE debt and secured government guarantees. Moreover, the authorities consider debt in NPV, not nominal, terms.

[4] The public debt benchmark is derived on an empirical basis, and varies among countries with their respective CPIA score.

[5] This broad coverage is in line with the DSA Guidance Note (2013).

swap line excluded—shows public debt amounted to 54.7 percent of GDP at end-2014 and thus far exceeded the 40 percent threshold enshrined in the FSL. Recent amendments to the FSL and a new Debt Management Law narrowed the definition of debt to government debt only by excluding SOE borrowing and government guarantees secured by government securities. This legal framework also laid out a path for bringing the deficit and government debt back to the original limits within a few years. The new laws will thus provide additional room for the government to contract debt and provide guarantees in the near term. Staff does not support the narrowing of public debt coverage, nor the temporary increase of debt ceiling. Staff also explained the need to include all DBM spending and BOM swap line drawing in public debt for the following reasons:

- DBM spending. All DBM activities should be included in the statistics (revenue, expenditure, deficit, and financing) of general government for Mongolia. This practice reflects the institutional unit approach as stated by international statistical manuals (GFSM 2014, SNA 2008 and BPM6). Although in limited circumstances international statistical manuals allow for commercial or market activities of general government units to be split out, but the current activities undertaken by DBM clearly do not satisfy the requirements.

- BOM swap. Since this DSA covers the entire public sector, BOM's liability relating to the swap should be included.

Composition of Public Debt (percent of GDP)

	2013	2014
Government External Debt	32	31
Government Domestic Debt	12	14
Government Guarantees (incl. DBM Debt)	6	12
Non-Guaranteed SOE Debt	9	7
BOM Foreign Liability	9	13
Total Public Debt (% of GDP)	67	77

4. Mongolia's long-term prospects remain bright, but liquidity risks are high in the near term. The country's resource wealth is estimated at $1 trillion to $3 trillion, and this is assumed to continue being realized gradually. Mongolia is thus projected to be solvent given the strong projected revenues from mining over the long term. It does, however, face serious liquidity pressures and risks in the short run, before mining exports ramp up. Until then, financing outsized prospective fiscal and BOP deficits will be difficult, and thus policies should be focused to avoid building up excessive debt and manage BOP pressure.

5. The authorities have embarked on policy tightening, but more needs to be done. Part of DBM's spending has been brought on budget, and the consolidated fiscal deficit is expected to decline this year. The authorities target ambitious deficit reduction (to 5 percent of GDP this year, and 2 percent by 2018, excluding "commercial" DBM spending) but this is not likely to materialize on current policies. (Responding to these concerns, the authorities envisage a government resolution to cut spending administratively, to be backed up by a second supplementary budget later in the year). The BOM has hiked the policy rate twice, slowed the pace of PSP and mortgage lending, and proposed transferring the existing stock of PSP loans to the government's balance sheet; nonetheless, credit growth is higher than desirable. The authorities have redoubled efforts to reach agreement with investors on large projects and introduced other structural measures to boost exports and reduce imports. Steps have been taken to strengthen the banks and to improve bank supervision and crisis preparedness. Nevertheless, these policy adjustments may not be sufficient to ensure macro-stability. Under the baseline, the consolidated fiscal deficit (including all DBM spending) would decline but remain above the FSL limit (2 percent of GDP). A large BOP financing gap, estimated at about $2 billion over the next three years (discussed below), will be financed at least partly by public borrowing or debt contracted with government guarantees.[6]

6. Baseline assumptions differ significantly from those in the "strong policy scenario" used in the previous DSA:

- The previous DSA projected the fiscal deficit to fall below 2 percent of GDP in 2016, while here it drops to 4 percent from 2019.
- The previous DSA projected a complete phaseout of unconventional monetary easing programs, which helped to bring credit growth down to around 13½ percent, while here some of these programs continue, albeit on a smaller scale, and credit growth is around 16 percent.
- Reflecting updated information on OT-1 output, mining growth is revised down from an average of 5½ percent to 3½ percent, while nonmineral growth is revised down from 6½ percent to 5½ percent, on account of weakened near-term investor confidence. Given weaker activity, this DSA also revises CPI inflation down from a medium-term average of 7½ percent to 7 percent. The real exchange rate is assumed to remain constant.
- Finally, while there was no BOP financing gap in the previous DSA, the current BOP envisages a financing gap (relative to zero reserves) of $2 billion mainly because of weaker capital and financial inflows.[7] It is assumed that 62 percent of the financing gap will be filled by government borrowing or debt with government guarantees—this ratio is consistent with the share of public external debt in total external debt (excluding intercompany lending). This borrowing also reflects additional borrowing space created by the revised legal framework (the revised FSL and the new DML).

B. Debt Sustainability under Baseline Scenario

7. Debt is not on an ever-increasing path under the baseline scenario. Both external and public debt scaled by GDP would fall after an initial period.[8] This reflects promising prospects of the mining sector in outer years and fiscal adjustment measures enshrined in the legal system. Nevertheless, the debt path is sensitive to external shocks. Meanwhile, disputes surrounding OT-2,

[6] The financing gap is defined as the shortfall of BOP financing after FX reserves fall to zero. Considering the need to build up FX reserves, the financing needs could be even larger.

[7] An important difference is that the current DSA baseline assumes no rollover of the maturing sovereign and quasi-sovereign bonds in 2017, while the previous DSA assumes a full rollover of these debts.

[8] Residuals reflect large capital outflows under "currency and deposits" and change of FX reserves.

which is assumed to be addressed by end-2015 under the baseline, add to economic uncertainty. Should it be further delayed, growth prospects would be dampened, fiscal risk would rise, and BOP financing gap could be wider, but the debt path would still trend down slowly. To put the debt trajectory on a more sustainable footing, more needs to be done. Below is a summary of the debt indicators under the baseline scenario:

External DSA

8. Mongolia's external PPG debt indicators have all breached, or are projected to breach, the thresholds, and will remain above these thresholds, in some cases for a prolonged time. The detailed results are as follows:

- The present value of external PPG debt reached 57 percent of GDP by end-2014, far above the indicative threshold of 40 percent.[9] It is expected to peak at 64½ percent of GDP in 2016, and gradually moderate to below the threshold in 2025 onwards.
- The present value of external PPG debt would peak at 170½ percent of exports in 2017, and stay above the threshold of 150 percent in about half of the projection period.
- The present value of external PPG debt in relation to revenue would slightly breach the threshold only in 2016–17. It would peak at 259¼ percent in 2017, and decline steadily, falling to 113 percent in 2035.
- Debt service indicators, i.e. debt service-to-exports and debt service-to-revenue, would briefly breach the thresholds several times (each time for just one year), including in 2017 and 2022, when the Chinggis bonds mature.

9. Meanwhile, these debt indicators are susceptible to various standard shocks such as a sharp exchange rate depreciation and decline of BOP inflows. Given a one-time 30 percent exchange rate depreciation, the present value of external PPG debt would peak at 89½ percent of GDP in 2017 and stay above the indicative threshold for almost the entire projection period; the present value of external debt-to-revenue would peak at 359 percent and stay above the threshold for seven years; and debt service-to-revenue would peak at 70percent in 2017 and stay above its threshold until 2027. In the case of a one-standard deviation shock to non-debt creating BOP flows, the present value of debt-to-exports would peak at 235¼ percent in 2017 and stay above the threshold through the whole projection period; and debt service-to-exports would breach its threshold in 14 out of the 21-year projection period.

10. The standard "historical scenario"—where key variables follow historical paths and debt ratios thus decline rapidly—does not seem to represent a possible outcome. For example, FDI inflows peaked at more than $4 billion per year in 2011-12, and have since dropped sharply to just $542 million in 2014. Even if OT-2 is launched soon, FDI would likely peak at only $2½ billion in the next few years. By the same token, real GDP growth would also be more moderate in the future barring the investment boom observed in 2011–12.

[9] The discount rate is 5 percent, according to the DSA guidelines.

Public DSA

11. Public ratios would remain elevated across the projection period. The present value of public debt-to-GDP ratio peaks at 95¾ percent of GDP in 2017 and then falls gradually, to 53 percent by end-2035. This ratio has been far above the benchmark (56 percent), and is expected to decline below the benchmark only in 2032 onward. The present value of public debt-to-revenue ratio would peak at just below 400 percent in 2017, and thereafter falls gradually to just above 200 percent in 2035. The debt service-to-revenue ratio would spike several times, peaking in 2017 at 71 percent and hovering around 40 percent in most of the projection period. Debt could rise further if some banks need to be recapitalized, and if this requires fiscal resources.

12. The alternative scenarios and bound tests indicate that the projected paths of debt indicators are sensitive to alternative assumptions. In particular, the scenario in which the primary balance is fixed at the level prevailing in 2014 illustrates a steadily rising trend of debt ratios, underscoring the urgent need for fiscal consolidation.

13. The uncertainty surrounding OT-2 represents an important downside risk, but debt ratios would still decline steadily even if the project were delayed by three years. In this context, the present value of external PPG debt would peak at 70¾ percent of GDP in 2017, and decline thereafter steadily, to 27 percent of GDP at the end of the projection period; meanwhile, the present value of public debt would reach 103 percent of GDP, and then decline consistently, to 53 percent of GDP by 2035. The present value of external PPG debt would stay above its threshold for 10 years, and the most severe shock would cause this ratio to peak at 98¼ percent of GDP in 2017, though it would fall over time, to below the threshold close to the end of the projection period. Spikes of external debt service ratios would be more severe than under the baseline assumption of no delay in OT-2.

C. Debt Sustainability under Policy Adjustment Scenario

14. Macro policies need to be tightened to keep current account deficits at more manageable levels and to improve the fiscal position. One possible adjustment scenario is summarized below:

- **Fiscal.** The fiscal path needs to be secured with Parliamentary approval for measures to control spending, both on-budget and off, as part of a coherent, medium-term macro framework. In the adjustment scenario, all DBM spending is brought on-budget and the fiscal deficit would be reduced to 2 percent of GDP in 2017 onward.

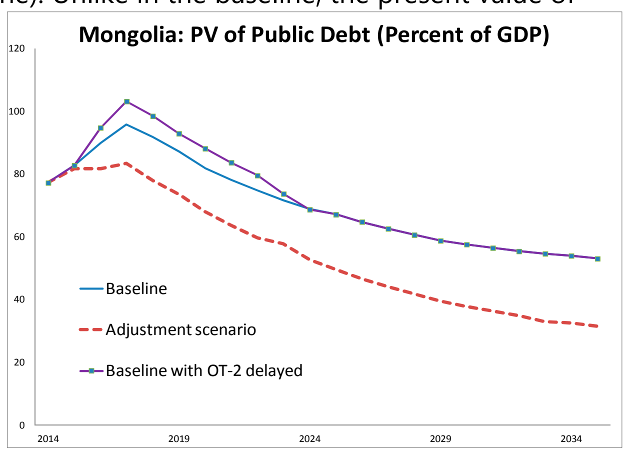
- **Monetary.** The BOM should cease all unconventional easing programs targeting particular industries or involving direct lending to the private sector, returning to traditional central-banking functions; these programs should, if desired, by conducted by the government, competing with other spending priorities for funds within the budget. The monetary stance should be tightened further, to control credit growth and support the BOP. Credit growth slows to about 12 percent (y/y) in the adjustment scenario.

- **Exchange rate policy.** Foreign-exchange intervention should be limited to dealing with episodes of excessive volatility, and the exchange rate should be allowed to move flexibly.

- **Growth and inflation.** Given the policy tightening, non-mining growth would initially slow to 1 percent in 2015 and then gradually pick up to 6½ percent over the medium term. Real exchange rate is assumed to depreciate by 4 percent per year in 2015-17 barring BOM intervention. The exchange rate depreciation will have pass-through effects on inflation, which would stay high at 9½ percent in 2015 and gradually moderate to 6½ percent.

- **Balance of payments.** Macro policy tightening, lower growth and real exchange rate depreciation will all help compress imports. Current account deficit will decline by about $800 million in the next three years, compared to the baseline. As a consequence, the balance of payments will have no financing gap and FX reserves will stand at 1¾ months of imports by end-2017.

15. Debt dynamics improve significantly under the policy adjustment scenario. The present value of external PPG debt would peak at 63¾ percent of GDP in 2017, and decline to below its threshold in 2023 (compared to 2025 in the baseline). Unlike in the baseline, the present value of debt-to-export and debt-to-revenue will not breach their relevant thresholds under the policy adjustment scenario. Debt service ratios would still breach their thresholds several times, but by a smaller margin than under the baseline. The present value of public debt would peak at 83½ percent of GDP in 2017 (compared to 95¾ percent in the baseline), and falls steadily thereafter, to below the benchmark in 2024 onward.



D. Authorities' Views

16. The authorities generally concurred with this assessment, but highlighted a few observations. First, they doubted whether the BOM swap line should be included in the public debt, wondered if this practice is broadly applied, and noted that, as a swap, and not an outright loan, there is a counterpart asset in togrog. They noted that public debt as defined in the FSL does not include the central bank's debt, and that public debt is calculated in NPV terms. Second, their calculation of public debt in NPV terms differs from staff's estimate. Third, the budget only includes non-commercial activity of the DBM, while staff include all DBM lending. As a consequence, staff's estimates of the fiscal deficit and of debt are larger than those presented by the authorities.

E. Conclusion

17. This DSA concludes that Mongolia suffers from high risk of debt distress. In recent years, the authorities have embarked on borrowing to finance rapidly growing budget and off-budget spending. External PPG debt has almost doubled from around 30 percent of GDP to just below 60 percent in the past four years. Public debt stood at below 80 percent of GDP by end-2014, and could further increase given the lax fiscal policy and loosening of borrowing limits offered by the DML. Although debt indicators, mainly external and public debt scaled by GDP, would decline steadily under the baseline, they would remain elevated for prolonged periods.

18. The debt dynamics exhibit a high vulnerability to shocks and bound tests. External PPG debt ratios would rise dramatically in the case of a sharp exchange rate depreciaiton or negative shocks to BOP inflows. Public debt would be on an ever-increasing trajectory should the primary deficit remain at the level prevailing in 2014. Moreover, total external debt, both public and private, has reached about 140 percent of GDP, and this has made the macro-financial stability highly susceptible to exchange rate movements and flucutation of BOP flows.

19. These risks call for immediate policy actions. Although some fiscal adjustment measures have been announced, they are not sufficient to safeguard macro-financial stability and to ensure debt sustainability in case of adverse shocks. Staff suggests more pronounced policy tighening instead. Under a policy adjustment scenario, debt indicators improve significantly—external debt indicators either do not breach their thresholds, or breach them with a smaller margin; public debt as a share of GDP would fall below the benchmark more quickly than under the baseline.

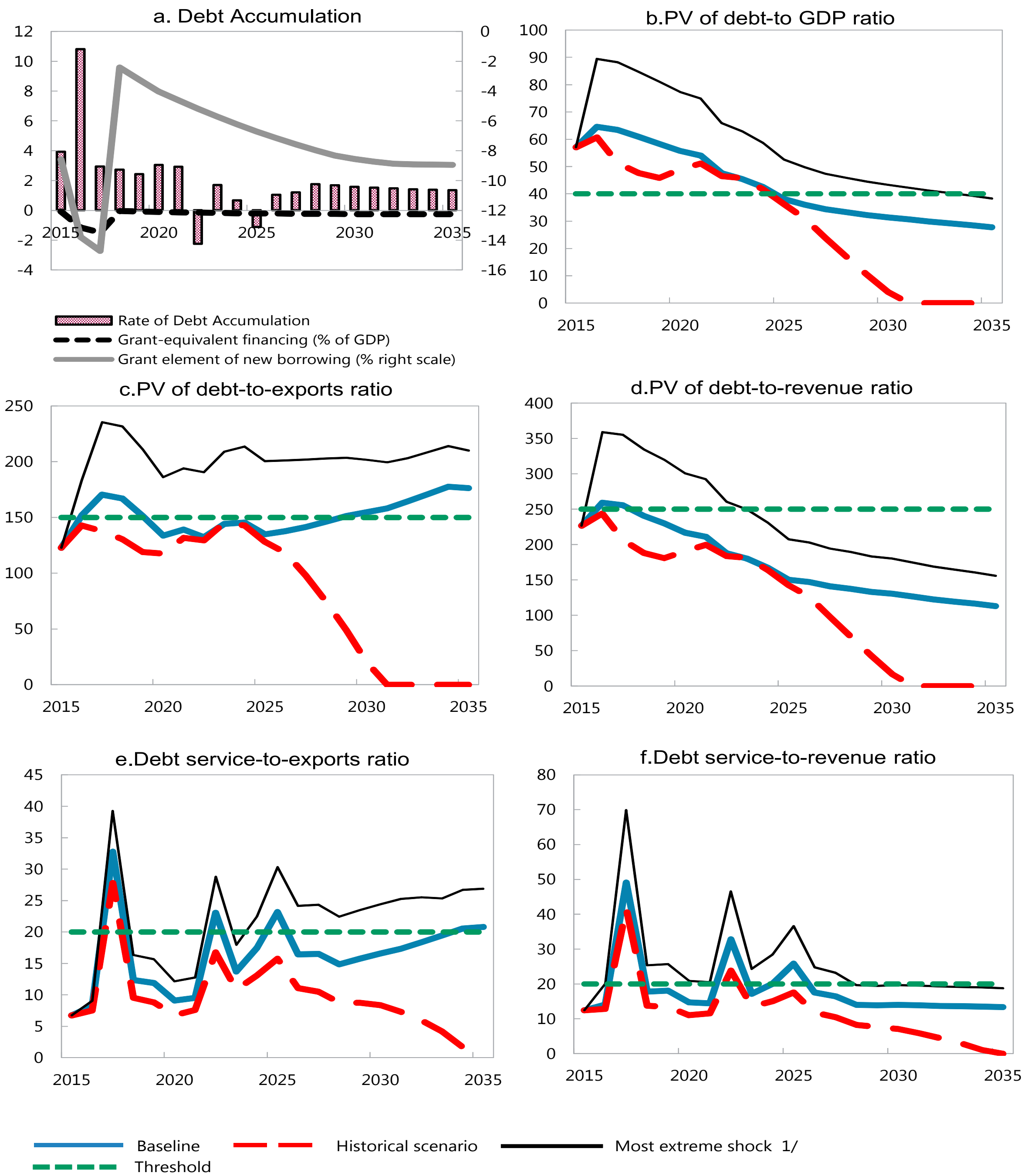
Macroeconomic Assumptions

The baseline scenario assumes the authorities' current policies, including those proposed under the CMAP framework (but not the latest fiscal cuts that are under consideration). The details are summarized below:

- **Real sector.** It is assumed that OT-2 will start construction from late 2015 and begin operation in 2020.
- **Fiscal**. The authorities target the fiscal deficit at 5 percent of GDP for 2015, and aim to bring the deficit down to 2 percent of GDP by 2018. However, given certain unrealistic assumptions and the need to reflect all DBM spending in the budget, staff project the fiscal deficit to remain close to 10 percent of GDP in 2015, and gradually to decline to 4 percent of GDP from 2019 onward.
- **Monetary**. While the BOM has raised the policy rate twice in recent months and scaled down some monetary easing programs, other unconventional programs have continued and expanded. Given these developments, staff project credit growth at about 16 percent over the medium term.
- **Balance of payments.** The current account deficit is projected to average 13½ percent of GDP over the medium term, before OT-2 starts to export mining commodities in 2020. FDI would average about 2½ billion per year on account of OT-2 related investment. In 2017, maturing debt of more than $1½ billion would exert heavy pressure on the BOP. A large financing gap is expected to emerge, and it is assumed that about two-thirds of this gap will be filled by public borrowing.
- **Exchange rate.** Staff project a constant real exchange rate, along with declining reserves.

The adjustment scenario instead assumes that: (i) the fiscal deficit, with all DBM spending brought on budget, is brought down to 2 percent of GDP from 2017 onward; (ii) unconventional easing programs at the BOM are transferred to the budget or discontinued altogether, and credit growth drops to 12 percent; (iii) the exchange rate is allowed to move flexibly; and (iv) market rollovers are easier. With these assumptions, BOP financing gaps are closed.

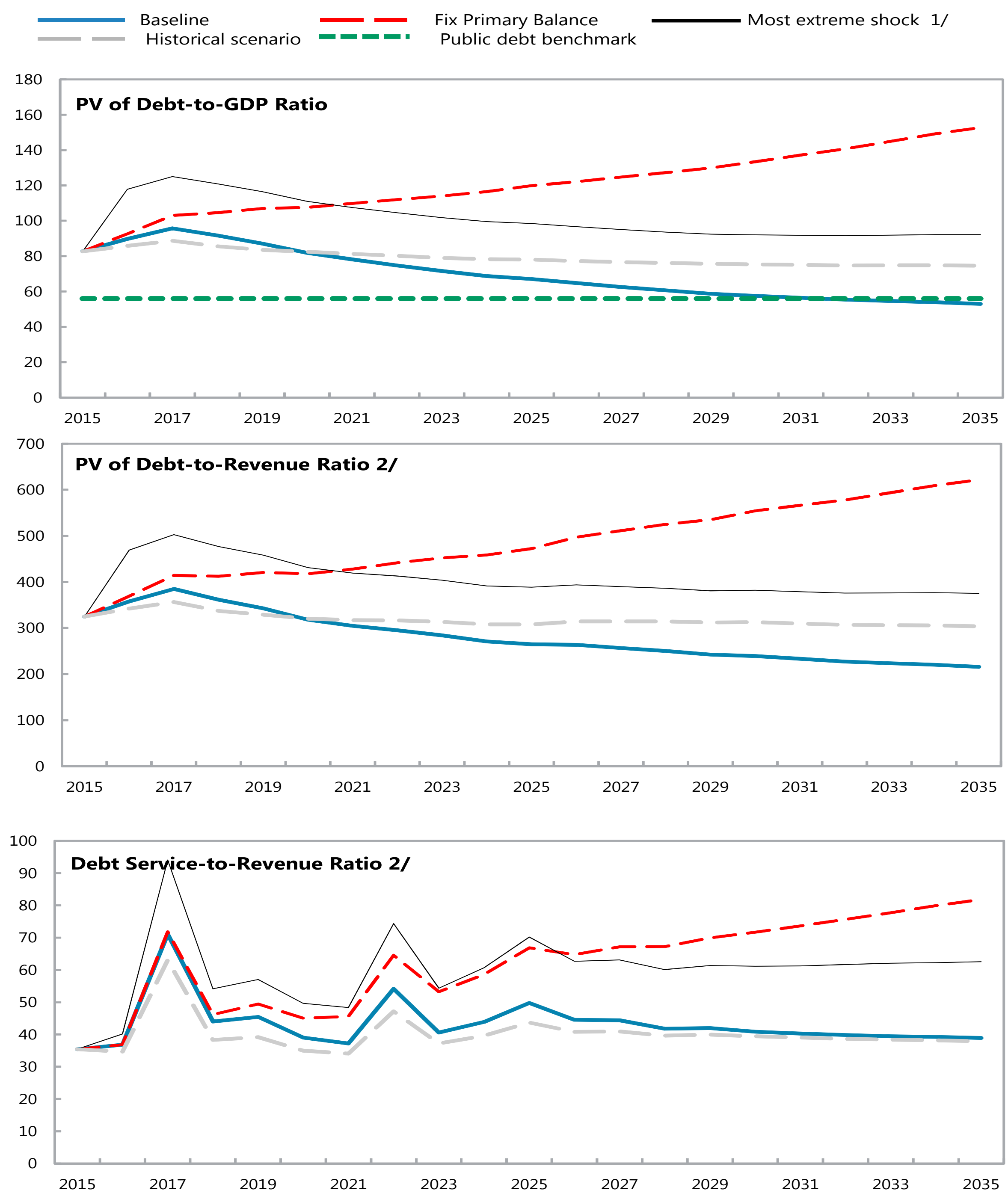
Figure 1. Mongolia: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2015-2035 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Non-debt flows shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Mongolia: Indicators of Public Debt under Alternative Scenarios, 2015-2035 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.
2/ Revenues are defined inclusive of grants.

Table 1. Mongolia: External Debt Sustainability Framework, Baseline Scenario, 2012-2035 1/
(in percent of GDP, unless otherwise indicated)

	Actual			Historical [6/] Average	Standard [6/] Deviation	Projections									
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-2020 Average	2025	2035	2021-2035 Average
External debt (nominal) 1/	**99.3**	**148.4**	**187.8**			**185.5**	**187.8**	**181.7**	**173.3**	**164.3**	**153.8**		**97.8**	**58.5**	
of which: public and publicly guaranteed (PPG)	39.0	46.3	54.9			56.0	62.4	60.2	58.4	56.2	54.0		37.9	28.9	
Change in external debt	38.6	49.1	39.4			-2.3	2.3	-6.1	-8.4	-9.0	-10.5		-10.4	-2.5	
Identified net debt-creating flows	-17.7	6.9	10.8			-5.5	-7.8	-2.8	-10.5	-12.3	-20.1		-12.0	-1.6	
Non-interest current account deficit	**25.7**	**22.4**	**2.7**	**13.0**	**11.6**	**4.8**	**10.5**	**10.2**	**9.6**	**6.3**	**-0.3**		**0.5**	**4.2**	2.3
Deficit in balance of goods and services	21.6	21.0	2.7			3.8	10.5	11.6	11.1	7.7	0.6		2.1	6.5	
Exports	43.5	39.7	53.4			46.5	42.6	37.2	36.5	38.5	41.7		28.2	15.8	
Imports	65.1	60.7	56.0			50.3	53.0	48.9	47.6	46.3	42.4		30.4	22.2	
Net current transfers (negative = inflow)	-0.7	-0.6	-0.7	-1.4	1.1	-0.7	-0.7	-0.6	-0.6	-0.6	-0.5		-0.3	-0.3	-0.3
of which: official	-0.3	-0.2	-0.2			-0.2	-0.2	-0.2	-0.2	-0.2	-0.2		-0.1	-0.2	
Other current account flows (negative = net inflow)	4.8	2.0	0.7			1.7	0.6	-0.8	-0.9	-0.9	-0.4		-1.3	-1.9	
Net FDI (negative = inflow)	**-35.9**	**-16.7**	**-4.5**	**-19.1**	**14.2**	**-8.6**	**-17.8**	**-13.7**	**-17.1**	**-15.4**	**-12.1**		**-8.7**	**-4.2**	-6.8
Endogenous debt dynamics 2/	**-7.5**	**1.2**	**12.6**			**-1.7**	**-0.6**	**0.7**	**-3.0**	**-3.2**	**-7.6**		**-3.9**	**-1.5**	
Contribution from nominal interest rate	1.8	3.2	5.7			6.3	6.9	7.5	7.3	7.0	6.1		3.0	1.8	
Contribution from real GDP growth	-6.3	-11.3	-12.2			-8.0	-7.5	-6.8	-10.3	-10.2	-13.8		-6.9	-3.3	
Contribution from price and exchange rate changes	-3.0	9.3	19.1			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**56.4**	**42.2**	**28.6**			**3.2**	**10.1**	**-3.3**	**2.1**	**3.3**	**9.6**		**1.6**	**-0.9**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	188.4			186.7	190.0	184.9	175.9	166.5	155.6		98.0	57.4	
In percent of exports	...	...	353.1			401.3	446.4	496.9	481.8	431.9	372.7		346.9	364.5	
PV of PPG external debt	**...**	**...**	**55.6**			**57.1**	**64.6**	**63.4**	**61.0**	**58.3**	**55.8**		**38.1**	**27.8**	
In percent of exports	**...**	**...**	**104.1**			**122.8**	**151.8**	**170.5**	**167.0**	**151.3**	**133.6**		**134.8**	**176.4**	
In percent of government revenues	**...**	**...**	**198.3**			**226.8**	**259.3**	**255.6**	**240.9**	**230.0**	**216.9**		**150.2**	**113.1**	
Debt service-to-exports ratio (in percent)	**8.5**	**16.3**	**19.2**			**26.1**	**28.9**	**54.1**	**33.8**	**31.6**	**25.5**		**34.6**	**25.2**	
PPG debt service-to-exports ratio (in percent)	**2.2**	**5.9**	**4.6**			**6.7**	**8.2**	**32.8**	**12.4**	**11.9**	**9.1**		**23.2**	**20.8**	
PPG debt service-to-revenue ratio (in percent)	**3.2**	**7.5**	**8.8**			**12.5**	**14.1**	**49.1**	**17.8**	**18.1**	**14.7**		**25.8**	**13.3**	
Total gross financing need (Millions of U.S. dollars)	-433.3	2107.9	1617.8			1850.0	1398.0	2998.9	1376.9	1163.5	316.7		1638.6	5469.7	
Non-interest current account deficit that stabilizes debt ratio	-13.0	-26.7	-36.7			7.1	8.2	16.3	18.0	15.3	10.1		10.9	6.7	
Key macroeconomic assumptions															
Real GDP growth (in percent)	12.3	11.6	7.8	10.8	7.4	4.4	4.2	3.8	6.2	6.4	9.2	5.7	6.9	5.8	6.5
GDP deflator in US dollar terms (change in percent)	5.1	-8.6	-11.4	3.9	16.4	-0.5	0.9	2.1	2.2	2.1	1.0	1.3	1.5	1.8	1.5
Effective interest rate (percent) 5/	3.4	3.2	3.6	2.1	1.4	3.5	3.9	4.2	4.4	4.4	4.1	4.1	3.0	3.1	3.0
Growth of exports of G&S (US dollar terms, in percent)	-1.7	-6.9	28.4	17.7	30.5	-9.4	-3.8	-7.3	6.5	14.7	19.5	3.4	4.9	5.5	1.4
Growth of imports of G&S (US dollar terms, in percent)	5.4	-4.8	-11.8	22.5	44.4	-6.8	11.0	-2.4	5.6	5.7	1.0	2.4	5.2	5.5	3.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	-8.6	-13.8	-14.7	-2.4	-3.2	-4.0	-7.8	-6.7	-9.0	-7.5
Government revenues (excluding grants, in percent of GDP)	29.7	31.3	28.0			25.2	24.9	24.8	25.3	25.4	25.7		25.3	24.6	24.7
Aid flows (in Millions of US dollars) 7/	44.0	22.2	34.6			64.8	46.6	35.1	36.1	37.2	38.3		45.5	68.3	
of which: Grants	18.2	0.0	0.0			32.1	26.4	8.5	8.1	7.8	7.5		6.1	4.2	
of which: Concessional loans	25.9	22.2	34.6			32.8	20.2	26.7	28.0	29.4	30.9		39.4	64.2	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			-0.1	-1.1	-1.5	0.0	-0.1	-0.1		-0.2	-0.3	-0.2
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			-1.8	-11.5	-14.1	-1.1	-2.0	-2.9		-6.0	-8.7	-6.9
Memorandum items:															
Nominal dollar GDP growth	18.1	2.1	-4.5			4.0	5.1	6.0	8.5	8.6	10.4	7.1	8.5	7.7	8.1
PV of PPG external debt (in Millions of US dollars)			6422			6893	8239	8622	9000	9364	9861		10181	15899	
(PVt-PVt-1)/GDPt-1 (in percent)						3.9	**10.8**	2.9	2.7	2.4	3.0	4.3	-1.1	1.3	1.1
Gross workers' remittances (Millions of US dollars)	41.0	21.7	49.5			49.8	50.0	50.3	50.5	54.9	60.6		91.5	175.6	
PV of PPG external debt (in percent of GDP + remittances)	...	...	55.3			56.9	64.3	63.2	60.8	58.1	55.6		37.9	27.7	
PV of PPG external debt (in percent of exports + remittances)	...	...	103.3			121.7	150.4	168.9	165.4	150.0	132.6		133.3	173.1	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	4.6			6.7	8.2	32.5	12.2	11.8	9.0		22.9	20.4	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Mongolia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012-2035
(in percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2012	2013	2014	Average 5/	Standard Deviation 5/	2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	51.3	67.3	76.5			81.5	87.6	92.6	89.1	84.9	80.1		67.0	54.1	
of which: foreign-currency denominated	43.7	50.1	56.4			56.0	62.4	60.2	58.4	56.2	54.0		37.9	28.9	
Change in public sector debt	18.7	16.0	9.2			5.0	6.1	5.0	-3.5	-4.2	-4.9		-1.5	-0.8	
Identified debt-creating flows	2.1	9.8	8.6			5.3	1.8	0.3	-3.2	-3.9	-4.6		-2.2	-0.8	
Primary deficit	8.2	6.2	7.9	3.9	3.8	5.4	2.8	1.4	0.2	-1.1	-0.6	1.3	0.0	0.3	0.0
Revenue and grants	29.8	31.3	28.0			25.4	25.1	24.9	25.4	25.4	25.8		25.4	24.6	
of which: grants	0.1	0.0	0.0			0.3	0.2	0.1	0.1	0.0	0.0		0.0	0.0	
Primary (noninterest) expenditure	38.0	37.5	35.9			30.8	27.9	26.3	25.6	24.3	25.1		25.3	24.9	
Automatic debt dynamics	-6.1	3.6	0.8			0.0	-0.5	-1.0	-3.4	-2.8	-4.0		-2.2	-1.1	
Contribution from interest rate/growth differential	-3.9	-4.1	-4.0			-0.9	-0.8	-0.6	-3.1	-2.6	-4.6		-2.3	-1.2	
of which: contribution from average real interest rate	-0.3	1.2	0.9			2.4	2.5	2.7	2.2	2.7	2.6		2.1	1.8	
of which: contribution from real GDP growth	-3.6	-5.4	-4.9			-3.3	-3.3	-3.2	-5.4	-5.3	-7.2		-4.4	-3.0	
Contribution from real exchange rate depreciation	-2.2	7.7	4.8			0.9	0.3	-0.4	-0.3	-0.2	0.6		...	...	
Other identified debt-creating flows	0.0	0.0	-0.1			-0.1	-0.4	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	-0.1			-0.1	-0.4	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	16.5	6.2	0.6			-0.3	4.2	4.6	-0.2	-0.3	-0.2		0.7	0.0	
Other Sustainability Indicators															
PV of public sector debt	...	...	77.2			82.7	89.8	95.8	91.7	87.1	81.9		67.1	53.0	
of which: foreign-currency denominated	...	...	57.0			57.1	64.6	63.4	61.0	58.3	55.8		38.1	27.8	
of which: external	...	...	55.6			57.1	64.6	63.4	61.0	58.3	55.8		38.1	27.8	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	10.3	12.2	16.0			14.4	12.0	19.1	11.4	10.4	9.4		12.6	9.9	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	275.3			325.0	357.6	385.0	361.7	342.9	317.9		264.7	215.8	
PV of public sector debt-to-revenue ratio (in percent)	...	...	275.3			328.3	360.5	386.0	362.4	343.5	318.4		264.9	215.8	
of which: external 3/	...	...	198.3			226.8	259.3	255.6	240.9	230.0	216.9		150.2	113.1	
Debt service-to-revenue and grants ratio (in percent) 4/	7.1	19.4	28.8			35.4	36.8	71.1	44.0	45.5	39.1		49.8	38.9	
Debt service-to-revenue ratio (in percent) 4/	7.1	19.4	28.8			35.8	37.1	71.3	44.1	45.6	39.1		49.8	38.9	
Primary deficit that stabilizes the debt-to-GDP ratio	-10.5	-9.8	-1.3			0.4	-3.3	-3.6	3.7	3.1	4.2		1.5	1.1	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	12.3	11.6	7.8	10.8	7.4	4.4	4.2	3.8	6.2	6.4	9.2	5.7	6.9	5.8	6.5
Average nominal interest rate on forex debt (in percent)	0.7	2.8	3.1	1.5	1.1	4.8	5.7	5.9	6.0	5.9	5.9	5.7	6.0	6.6	6.3
Average real interest rate on domestic debt (in percent)	8.8	20.0	4.2	11.0	8.1	3.5	2.2	1.3	-0.3	2.0	2.3	1.8	1.9	2.3	2.2
Real exchange rate depreciation (in percent, + indicates depreciation)	-8.8	19.8	10.2	1.1	13.3	1.6	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	12.8	2.6	6.0	9.7	7.6	6.6	6.9	7.1	6.5	6.2	5.3	6.4	5.5	5.8	5.5
Growth of real primary spending (deflated by GDP deflator, in percent)	13.4	10.0	3.3	3.9	5.5	-10.4	-5.6	-2.2	3.3	1.2	13.0	-0.1	7.7	6.3	6.4
Grant element of new external borrowing (in percent)	...	...	...	...	...	-8.6	-13.8	-14.7	-2.4	-3.2	-4.0	-7.8	-6.7	-9.0	...

Sources: Country authorities; and staff estimates and projections.

1/ Debt data reflects general government debt (including quasi-sovereign bonds issued by DBM) only before 2013, and starts to cover SOE debt from 2013 onwards.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 3. Mongolia: Sensitivity Analysis for Key Indicators of Public Debt, 2015-2035

	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
PV of Debt-to-GDP Ratio								
Baseline	83	90	96	92	87	82	67	53
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	83	86	89	86	84	82	78	75
A2. Primary balance is unchanged from 2015	83	93	103	105	107	108	120	153
A3. Permanently lower GDP growth 1/	83	92	100	99	97	95	103	171
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	83	91	98	94	90	85	71	60
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	83	95	108	104	99	93	77	62
B3. Combination of B1-B2 using one half standard deviation shocks	83	91	99	93	87	80	58	32
B4. One-time 30 percent real depreciation in 2016	83	118	125	121	116	111	98	92
B5. 10 percent of GDP increase in other debt-creating flows in 2016	83	101	107	103	98	92	76	61
PV of Debt-to-Revenue Ratio 2/								
Baseline	325	358	385	362	343	318	265	216
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	325	342	357	337	329	320	308	304
A2. Primary balance is unchanged from 2015	325	369	414	413	421	418	473	622
A3. Permanently lower GDP growth 1/	325	365	403	390	382	369	406	695
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	325	361	392	370	352	328	280	243
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	325	379	435	409	389	362	305	252
B3. Combination of B1-B2 using one half standard deviation shocks	325	362	397	367	342	312	230	128
B4. One-time 30 percent real depreciation in 2016	325	469	503	477	458	431	388	375
B5. 10 percent of GDP increase in other debt-creating flows in 2016	325	402	430	404	385	358	301	249
Debt Service-to-Revenue Ratio 2/								
Baseline	35	37	71	44	45	39	50	39
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	35	35	63	38	39	35	44	38
A2. Primary balance is unchanged from 2015	35	37	72	46	49	45	67	82
A3. Permanently lower GDP growth 1/	35	37	74	47	49	44	65	90
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	35	37	72	45	46	40	51	42
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	35	37	72	48	50	43	55	43
B3. Combination of B1-B2 using one half standard deviation shocks	35	36	68	44	46	39	47	29
B4. One-time 30 percent real depreciation in 2016	35	40	94	54	57	50	70	63
B5. 10 percent of GDP increase in other debt-creating flows in 2016	35	37	74	48	49	43	54	43

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

Table 4. Mongolia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015-2035

(in percent)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
PV of debt-to GDP ratio								
Baseline	57	65	63	61	58	56	**38**	28
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	57	61	51	48	46	49	**36**	0
A2. New public sector loans on less favorable terms in 2015-2035 2	57	65	66	64	62	60	**46**	42
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	57	63	63	60	58	55	**37**	27
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	57	67	73	70	67	64	**45**	30
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	57	72	83	80	77	73	**50**	36
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	57	78	88	85	81	78	**57**	33
B5. Combination of B1-B4 using one-half standard deviation shocks	57	68	64	62	59	56	**38**	28
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	57	89	88	85	81	77	**53**	38
PV of debt-to-exports ratio								
Baseline	123	152	170	167	151	134	**135**	176
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	123	143	138	131	119	117	**128**	0
A2. New public sector loans on less favorable terms in 2015-2035 2	123	152	176	175	161	144	**163**	270
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	123	148	167	163	148	130	**131**	171
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	123	175	230	226	205	181	**189**	220
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	123	148	167	163	148	130	**131**	171
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	123	183	235	232	211	186	**201**	210
B5. Combination of B1-B4 using one-half standard deviation shocks	123	147	139	136	123	108	**108**	143
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	123	148	167	163	148	130	**131**	171
PV of debt-to-revenue ratio								
Baseline	227	259	256	241	230	217	**150**	113
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	227	244	207	188	181	191	**143**	0
A2. New public sector loans on less favorable terms in 2015-2035 2	227	260	264	253	245	234	**181**	173
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	227	254	253	238	228	214	**148**	111
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	227	271	293	277	265	250	**179**	120
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	227	291	336	317	302	284	**196**	147
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	227	313	353	334	321	302	**223**	135
B5. Combination of B1-B4 using one-half standard deviation shocks	227	274	260	245	233	220	**150**	115
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	227	359	355	335	320	301	**208**	156

Table 4. Mongolia: Sensitivity for Key Indicators of Public and Publicly Guaranteed External Debt, 2015-2035 (continued)

(in percent)

Debt service-to-exports ratio								
Baseline	7	8	33	12	12	9	**23**	21
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	7	8	28	10	9	7	**16**	0
A2. New public sector loans on less favorable terms in 2015-2035 2	7	8	32	12	12	9	**20**	29
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	7	8	33	12	12	9	**23**	21
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	7	9	39	16	16	12	**30**	27
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	7	8	33	12	12	9	**23**	21
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	7	8	35	16	15	12	**31**	26
B5. Combination of B1-B4 using one-half standard deviation shocks	7	8	28	10	10	8	**20**	17
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	7	8	33	12	12	9	**23**	21
Debt service-to-revenue ratio								
Baseline	12	14	49	18	18	15	**26**	13
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	12	13	42	14	13	11	**18**	0
A2. New public sector loans on less favorable terms in 2015-2035 2	12	14	47	18	18	15	**22**	19
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	12	14	50	18	18	15	**26**	13
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	12	14	50	20	20	17	**29**	15
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	12	16	66	24	24	20	**35**	18
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	12	14	52	23	23	20	**34**	17
B5. Combination of B1-B4 using one-half standard deviation shocks	12	14	53	19	19	15	**28**	14
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	12	20	70	25	26	21	**37**	19
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	-14	-14	-14	-14	-14	-14	**-14**	-14

Sources: Country authorities; and staff estimates and projections.

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

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

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Statement by the Staff Representative on Mongolia
April 3, 2015

This statement summarizes additional information on economic developments and policies that have become available since the staff report was issued. This information does not alter the thrust of the staff appraisal.

1. **The most recent economic data have been broadly as envisaged.** Inflation has continued to moderate, dropping to 9¼ percent in February. The economy registered a trade surplus in the first two months of the year, with exports up 27 percent over 2014, and imports down 25 percent, but the overall balance of payments remains in deficit. Fiscal revenue has stayed weak, with collections in the first two months of the year accounting for 11 percent of the annual budget.

2. **The authorities have confirmed their agreement with many of the key Article IV recommendations and are in the process of implementing policy changes.** In a letter shared with staff on March 26, 2015, they outlined their policy intentions, including their commitment to a medium-term fiscal consolidation path, and detailed their recent policy efforts. In particular:

- The authorities are targeting a fiscal deficit of 5 percent of GDP in 2015, including the "non-commercial" spending of the Development Bank of Mongolia (DBM), and intend to reduce this gradually to 2 percent of GDP by 2018.

- The authorities have linked the payment of civil-service wage increases—about ½ percent of GDP, and restricted to lower-income workers—to budget revenue performance and scheduled such payments for the end of the year. They are also considering the possibility of freezing DBM spending.

- Remaining loans under the Price Stabilization Program (PSP) will be transferred to the government balance sheet by end-June. Working groups have been set up to analyze the appropriate future for PSP and mortgage lending.

- A comprehensive set of measures is envisaged to strengthen DBM governance. In particular, an independent assessment—possibly with assistance from the World Bank—will be conducted to determine the bankability of the DBM's "commercial projects," and the DBM will be brought under supervision of the Bank of Mongolia (BOM).

- The authorities consider measures to protect the most vulnerable as a high priority and are considering options to strengthen the effectiveness of existing social programs with high impact on the poor (such as child allowances and food stamps).

- The authorities are committed to exchange-rate flexibility.

- In order to strengthen the banking system, the BOM intends, over 2015–17, to: increase loan loss provisions; tighten requirements for recognition of nonperforming loans; increase the minimum paid-in capital of banks; raise the Tier-1 capital adequacy ratio (CAR) to 10½ percent for systemically important banks; incorporate PSP loans into banks' CAR calculations; increase sectoral risk weights; and impose additional capital requirements on banks with higher risk profiles.

- The authorities are working on a range of steps, including tax measures, to improve the investment climate.

3. **The authorities' efforts to strengthen policies are welcome, although additional steps will be needed, and full and early implementation will be critical.**

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2015 Article IV Consultation with Mongolia

On April 3, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the 2015 Article IV Consultation[1] with Mongolia.

Medium- to long-term prospects are promising given Mongolia's large natural resources. In the near term, however, the country continues to face balance-of-payments (BOP) pressures on account of low foreign direct investment (FDI) and weak commodity prices, as well as expansionary macro policies. Imports have now started to taper off, and, with the first phase of the Oyu Tolgoi copper and gold mine now in operation, exports have picked up. The trade balance has thus improved, but with FDI and other financial-account flows still depressed, the overall BOP remains weak. In addition, public debt has risen sharply, and the banking sector should be watched closely in the wake of the rapid credit expansion over the past two years. Barring a change in policies and/or major new developments in the real economy, these trends are likely to continue. Risks are to the downside, and relate to possible difficulties in securing agreement on major investment projects, as well as to the possibilities of a further slowdown in China or a surge in global financial market volatility.

Recognizing these challenges, the new government has already taken some policy action. It has implemented a "Comprehensive Macro Adjustment Plan" which targets a substantial reduction in the fiscal deficit, phases out some of the Bank of Mongolia's unconventional easing programs, and introduces a number of structural measures to boost exports and substitute for imports. However, additional measures—now under discussion—are needed to underpin the fiscal deficit targets, strengthen monetary and banking-sector policies, and ensure the most vulnerable are protected from the impact of the necessary macro adjustment.

Executive Board Assessment

Executive Directors noted that Mongolia's economic prospects remain promising over the medium to long term given its natural resource wealth, although the country faces substantial macroeconomic challenges in the near term. Directors welcomed the policy adjustment envisaged by the authorities and called for further adjustment to strengthen the balance of payments and public finances, safeguard financial stability, and strengthen social safety nets.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies.
On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors agreed that an ambitious consolidation approach would be needed to strengthen the fiscal position. They welcomed the steps already taken and the authorities' readiness to undertake additional fiscal reforms. Directors saw scope for further cuts in public spending, including that of the Development Bank of Mongolia (DBM), complemented with measures to raise revenue, protect the poor, and improve the effectiveness of subsidies and other social programs. They looked forward to the passage of a supplementary budget that includes these measures. Directors also supported the authorities' intention to phase out unconventional easing programs by the central bank and encouraged them to bring all DBM spending onto the budget.

Directors agreed on the need for some monetary tightening, while ensuring that banks remain adequately liquid, to help control credit growth and strengthen the balance of payments. They also encouraged the central bank to limit deficit financing. These steps should be complemented with continued efforts to enhance governance at the central bank and the DBM. Noting the role of exchange rate flexibility as a shock absorber for the economy, Directors agreed that foreign exchange intervention should be limited to smoothing excessive volatility.

Directors recommended a comprehensive approach to addressing risks in the banking system. They considered it a priority to bolster banks' provisions and capital buffers, eliminate forbearance, strengthen risk recognition, and enhance supervisory and crisis preparedness frameworks. Directors commended the authorities for the progress in strengthening the regime against money laundering and terrorism financing.

Directors supported ongoing efforts to foster high, inclusive growth, by improving the investment climate, enhancing competitiveness, and promoting economic diversification. More broadly, they emphasized that prudent management of natural resources is critically important for lasting growth and inter-generational equity.

It is expected that the next Article IV consultation with Mongolia will be held on the standard 12-month cycle.

Mongolia: Selected Economic and Financial Indicators, 2011–15 (Baseline Scenario)

	2011	2012	2013	2014	2015 Proj.
Real sector (percent change)					
Real GDP growth	17.3	12.3	11.6	7.8	4.4
Mineral	7.7	8.3	19.4	24.2	9.0
Non-mineral	19.9	13.3	9.8	3.6	3.0
Consumer prices (end-period)	9.4	14.2	11.2	10.7	8.0
GDP deflator	15.1	12.8	2.6	6.0	6.6
General government budget (in percent of GDP)					
Revenue and grants	33.9	29.8	31.3	28.0	25.4
Expenditure and net lending 1/	37.9	38.9	40.2	39.0	35.2
On-budget balance (incl. grants)	-4.0	-6.2	-0.9	-4.2	-4.0
On-budget structural balance (excluding DBM spending)	...	...	-1.2	-4.3	-4.2
DBM spending	...	2.8	8.0	6.8	5.7
On-budget plus DBM balance	-4.0	-9.1	-8.9	-11.0	-9.8
Money and credit (percent change)					
Broad money	37.7	18.8	24.1	12.5	13.1
Private credit 2/	72.3	24.1	54.3	23.3	16.2
Interest rate on 7-day central bank bills, end-period (percent)	12.3	13.3	10.5	12.0	…
Balance of payments (in millions of US$)					
Current account balance (including official transfers)	-2759	-3362	-3192	-985	-1379
(In percent of GDP)	-26.5	-27.4	-25.4	-8.2	-11.1
Trade balance	-993	-1553	-1321	1002	844
Exports	4817	4385	4269	5775	5155
Imports	-5810	-5938	-5590	-4773	-4310
Foreign direct investment	4620	4408	2098	542	1069
Public and publicly guaranteed debt (in percent of GDP)					
Total public debt 3/	32.7	51.3	67.3	76.5	81.5
Domestic debt	9.1	12.3	21.1	21.6	25.6
External debt	23.5	39.0	46.3	54.9	56.0
Exchange rate					
Togrogs per US$ (end-period)	1396.4	1392.1	1659.3	1888.4	…
Togrogs per US$ (period average)	1265.5	1357.6	1523.9	1817.9	…
Nominal effective exchange rate (end-period; percent change)	-10.6	-2.0	-14.7	-4.9	…
Real effective exchange rate (end-period; percent change)	-5.8	9.0	-7.5	3.4	…
Nominal GDP (in billions of togrogs)	13174	16688	19118	21844	24315

Sources: Mongolian authorities; and IMF staff estimates.

1/ Includes DBM spending.

2/ Includes securitized mortgage loans.

3/ Debt data reflects general government debt (including quasi-sovereign bonds issued by DBM) only before 2013, and starts to cover SOE debt from 2013 onwards. External debt includes drawing of central bank swap line.

Statement by Barry Sterland, Executive Director for Mongolia and Dorjkhand Togmid Advisor to Executive Director April 3, 2015

On behalf of the Mongolian authorities, we would like to thank the mission team for their candid policy consultation and the effective engagement. The current Government was formed in November 2014 and has set about dealing with the macroeconomic challenges it inherited. Mongolian Authorities are in broad agreement with staff's analysis and policy recommendations, especially on the strengthening fiscal position, maintaining prudent monetary policy, bolstering financial stability and improving the investment climate. The Authorities have commenced concrete actions to adjust macroeconomic and financial policies in response to all the broad areas of weakness identified by the staff. They express their willingness to address the macroeconomic and development challenges facing Mongolia through continued cooperation with the Fund.

Economic Outlook

Mongolia has made strong development progress in recent years, retains enormous long-run economic potential, but faces challenges in ensuring sustained and stable growth in the short to medium-term. Economic growth of Mongolia remained at 7.8 percent and per capita income reached $4,000 in 2014, but growth is expected to slow in the next few years. The economy remains vulnerable to boom-bust cycles and has faced sharp declines in FDI over the past few years.

Mongolia faced a severe balance of payment shock in late 2012 throughout 2013 and 2014 though measures were taken to achieve a soft landing. Commodities super cycle turned down, capital flows toward emerging markets and developing economies reversed, and net foreign direct investment to GDP ratio substantially declined from 45 percent to only 5 percent over the last three years. The balance of payment shock was particularly intense in 2013 though authorities consider the impacts on trade, the current account, and economic activity were significantly lessened in 2014 as a result of policy adjustments. Real GDP growth gradually slowed down from 12.3 percent in 2012 to 11.6 percent in 2013 and 7.8 percent in 2014.

Inflation has decreased gradually in past years and appears broadly under control, and actions have been taken to slow credit and money growth. Annual CPI inflation decreased from 14.0 percent in 2012 to 9.3 percent as of February 2015. Supply-driven inflationary pressure has been substantially decreased. The Bank of Mongolia (BOM) has gradually tightened its monetary policy stance by increasing the policy interest rate twice, 1.5 percentage points in July 2014 and 1.0 percentage point to 13 percent in January 2015. Real interest rates are now strongly positive and money and credit growth have slowed significantly. These decisions have reduced aggregate demand and the current account deficit, curbed inflationary pressure, and promoted macroeconomic and financial stability.

Uncertainty in the balance of payment outlook still remains a concern, and the authorities are pursuing a range of options to reduce risks on this front. The baseline forecast indicates that overall balance of payment could face a 1.4 billion dollars financing deterioration in 2015 due to mainly unfavorable external environment for the mineral exports and a sharp fall of the FDI inflows in the past two years. We note that recent import data has been weaker than the assumptions of this baseline which, if this weakness persists, may assist in ameliorating financing needs. However, authorities accept that a range of actions must be explored to deal with this challenge. They are working closely with a range of international financial organizations and bilateral partners on the possible options for external financing to fill this gap, including the extension of the local currency swap facility between the BOM and PBOC that has been playing a crucial role in mitigating the impacts of the shocks. The authorities have indicated that the PBOC has reaffirmed that it is fully committed to continuing the facility and willing to extend the swap line. Ongoing close consultation with the IMF and responsiveness to its recommendations will assist in this process of engagement with other financing partners. Furthermore, efforts are ongoing to advance negotiations on major projects with a significant potential impact on development and FDI flows. Finally, authorities stand ready to take additional corrective action, if required, to deal with unfolding risks, by adjusting import-intensive spending or fiscal policy.

Fiscal Policy

The authorities are committed to significant reductions in structural deficit targets, including limiting off-budget and reducing quasi-fiscal operations and integrating them into the Budget. In order to strengthen Mongolia's fiscal position, the authorities have secured Parliamentary approval of the Amendment to the Fiscal Stability Law (FSL), Debt Management Law (DML), and the Comprehensive Macroeconomic Adjustment Program (CMAP). As a result, the authorities will achieve a 2015 fiscal deficit of 5 percent of GDP, including non-commercial Development Bank of Mongolia (DBM) investment, decreasing the deficit by 1 percentage point for each year to reach the deficit target of 2 percent of GDP by 2018 and implement a cost-saving regime in the budget through prioritizing spending.

Concrete measures have been introduced to cut budget expenditures and increase the revenue in line with these fiscal objectives. Budget resources earmarked for civil servants' wage increase have been decreased by 60 percent and targeted at maintaining real wages of low wage earners, equivalent to a reduction in spending by 0.6 percent of GDP. Authorities are considering ways of targeting non-social welfare related subsidies. On the revenue side, the authorities increased the customs duties and excise tax rates on imported oil, in response to the recent declines of oil prices.

The Government of Mongolia has started implementing recommendations of international financial organizations to limit off-budget and quasi-fiscal operations and

integrate them to the budget. The parliament has agreed to the integration of off-budget 'quasi fiscal' spending into the central budget. This includes several programs currently operated by the Bank of Mongolia. A comprehensive set of actions are being undertaken to improve the legal environment and governance structure of the DBM to match international principles and standards and to ensure the successful operation of the bank in international financial markets. As a first step, the authorities are planning to transfer non-commercial lending activities in the pipeline of the DBM to the budget after conducting an independent assessment on the portfolio. While commercial DBM spending is not being fully integrated with central budget at this stage controls are being greatly enhanced to ensure these investments are driven by market considerations. The Minister of Finance will now approve financing of projects and activities included in the 2015 budget, to ensure consistency with the budget deficit and macroeconomic conditions (including BOP requirements). Furthermore, the DBM shall now obtain the Finance Minister's opinion when taking on a direct or contingent liability **or any other explicit or implicit financial obligations** regarding the consistency of any such liabilities with the FSL. Controls are being put in place to prevent political intervention in decision making processes, and more generally, improve governance and oversight. **Another key element regarding control is that the Finance Minister and the Governor of the Bank of Mongolia will jointly approve supervision rules on DBM operations, effectively putting the DBM under the BOM supervision.** Amendments along these lines will be introduced to Parliament in the Spring Session. The authorities are also investigating the potential to transfer key social programs currently in the Future Heritage Fund to the central budget.

The authorities will keep fiscal settings under review to ensure public debt is managed appropriately. The Medium-term Debt Management Strategy and the Comprehensive External Debt Servicing Plan have been revised in accordance with the newly adopted Debt Management Law and the CMAP was approved by the Financial Stability Committee on March 13 of this year. Under this approach, the authorities will initiate active debt and liability management operations to ensure further debt is serviced or rolled over in a way that is consistent with macroeconomic stability.

The authorities are taking step to underpin Mongolia's long time fiscal future through the establishment of a sovereign wealth fund. The draft Law on Future Heritage Fund is expected to be reviewed and passed during the 2015 Spring Session of the Parliament. The fund would be designed consistent with international best practices. The aim is to 'ring fence' a certain portion of mining revenues to support future development needs, while also supporting the realization of counter-cyclical policies.

Monetary and Exchange Rate Policy

Supply-driven inflationary pressure has been substantially decreased and inflation appears broadly under control. There has been a positive change in the composition of inflation since

2013, with ‘supply shock inflation’ being significantly reduced. The BOM considers that this positive development is due to the PSP and a range of measures reducing headline inflation. The inflation outlook consistent with the Bank of Mongolia’s medium-term target of 7 percent, and real interest rates are now strongly positive. **Monetary policy will continue to be managed in a prudent way to control inflationary pressures.**

The BOM considers unconventional monetary policy measures have assisted in achieving a soft landing and is now phasing out programs as planned in the context of the broader macroeconomic adjustment program. The BOM considers its unconventional monetary policy measures, including the price stabilization program (PSP), as instrumental in achieving a soft-landing for the economy, mitigating impacts in the balance of payment shock on the economy and risks of a potential economic crisis, reducing supply-driven pressures on inflation, and ensuring financial sector stability. With the implementation of the CMAP, measures are being taken to normalize unconventional aspects of the monetary policy and the BOM has been intentionally phasing out the program as planned. Remaining PSP loans shall be transferred to the Government by the end of the 1st half of 2015, and this process has already commenced. The Government and the BOM are jointly examining the Sustainable Mortgage Financing Program including how it aligns with long term efforts to boost domestic savings and possible response options.

The Bank of Mongolia remains committed to a flexible exchange rate regime. If necessary, the Bank of Mongolia intends to intervene only for the purpose of smoothing out excessive exchange rate volatility.

The Bank of Mongolia will look for opportunities to enhance monetary policy decision making frameworks at an appropriate time.

Structural Reforms

The authorities are committed to improving the investment climate to assist growth and contribute to the resolution of BOP challenges. The authorities have submitted Parliament draft amendments to simplify tax laws and enhance their contribution to private sector growth, including by reducing inconsistencies and ambiguities. The authorities proposed amendments to the VAT to reduce the informal sector, support small businesses, and simplify the administrative procedures. They have also prepared an amendment to the corporate income tax law to support non-mining business activities.

Financial Sector

The Bank of Mongolia is taking action to strengthen the banking sector, enhance banking system safety, proactively address potential systemic risks, and ensure financial stability. The Bank of Mongolia received IMF technical assistance (TA) on enhancing systemic oversight and crisis preparedness capabilities in February 2015. The Bank of Mongolia has already started implementing the recommended actions provided by the TA by reflecting them in its Medium term strategy on banking supervision, including phasing in measures to ensure better risky loan recognition, improve provisioning and capital buffers, and improve risk weights among other actions. These actions will be implemented progressively.

Conclusion

The Mongolian authorities are committed to taking decisive action to ensure macroeconomic stability, thus laying a sound basis for longer term development. They are implementing measures across a wide range of areas, including those identified by Fund staff, and understand the need to further transition policy if circumstances require. Authorities greatly value ongoing engagement with the Fund and will keep staff recommendations under close review.