



# MONGOLIA

July 2018

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

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

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 27, 2018, following discussions that ended on May 17, 2018, with the officials of Mongolia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on June 8, 2018.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Mongolia.

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

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INTERNATIONAL MONETARY FUND



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June 27, 2018

International Monetary Fund  
Washington, D.C. 20431 USA

## **IMF Executive Board Completes Fourth Review under the Extended Arrangement for Mongolia and Approves US\$ 36.91 Million Disbursement**

On June 27, 2018, the Executive Board of the International Monetary Fund (IMF) completed the fourth review of Mongolia's performance under the program supported by a three-year extended arrangement under the Extended Fund Facility (EFF). Completion of the review enables Mongolia to draw the equivalent of SDR 26.2088 million (about US\$ 36.91 million), bringing total disbursements under the arrangement to SDR 131.0366 million (about US\$ 184.55 million).

Mongolia's performance under the program remains strong. The combination of strong policy implementation and a supportive external environment has helped the authorities over-perform on all end-March 2018 quantitative targets under the program. Progress has also been made on structural reforms, albeit with some delays.

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

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

"Mongolia is making good progress under the Fund-supported program. Helped by a favorable external environment and strong program implementation, growth has picked up and there has been a considerable improvement in fiscal substantiality, debt dynamics, and external buffers.

"All end-March 2018 quantitative targets under the program were met. Fiscal accounts showed robust performance posting a primary surplus, mainly reflecting a sharp increase in revenue. Meanwhile, international reserves have more than doubled since the start of the program.

“Reforms to strengthen the financial sector are ongoing with a focus on the follow-up to the asset quality review completed in January. Banks are in the process of raising capital to address any identified shortfalls. In addition, the authorities passed a law outlining when and how public funds can be used to preserve banking sector stability.

“Notwithstanding this progress, Mongolia remains vulnerable to external and internal shocks. It is therefore critical to take advantage of the current favorable economic environment to continue building fiscal and foreign exchange buffers, strengthen the banking sector, and improve the investment climate. A steadfast implementation of the authorities’ reform program is key to build resilience against shocks and ensure continued strong and inclusive growth.”



# MONGOLIA

June 8, 2018

## FOURTH REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

### EXECUTIVE SUMMARY

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

**Recent developments.** After growth of 5.1 percent in 2017, the economy accelerated further in the first quarter of 2018, rising 6.1 percent y.o.y., helped by a strong construction sector. Fiscal performance also continues to be robust, with a 2.1 percent of GDP primary surplus in Q1 2018. However, after strong capital inflows in 2017, the balance of payments has moderated in recent months due to an acceleration in imports, decline in donor flows, temporary border bottlenecks for coal exports, and bond repayments.

**Program performance.** The authorities met all quantitative performance criteria (QPCs) for end-March. Regarding structural reforms, they have submitted two tax administration laws originally due last February. Of the structural benchmarks due since the last board meeting, amendments to the Bank of Mongolia law were passed, the authorities plan to pass the Recapitalization Law, and approval and publication of the NPL resolution strategy is in progress but not complete.

**Policy discussions.** On fiscal policy, the authorities plan on continued budgetary restraint and strengthening tax administration. In addition, the authorities are taking steps to improve public financial management particularly with respect to concessions, public investment, and the Development Bank of Mongolia. With respect to monetary policy, the authorities are committed to remaining vigilant against inflation and supporting further accumulation of reserves. In the financial sector, the authorities are moving ahead with the follow-up to the recently completed Asset Quality Review; banks that are undercapitalized will have until end-December to meet regulatory requirements.

**Program risks.** Despite substantial progress, significant risks remain. Increasing political pressure could result in premature easing in macro policies, external shocks to mining could slow growth, and challenges in the follow-up to the AQR could undermine financial stability.

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

Discussions were held in Ulaanbaatar during May 2 to May 17, 2018. The team included Geoff Gottlieb (head), Neil Saker (resident representative), Ruchir Agarwal, Rui Xu (all APD), Wendell Daal (FAD), Pragyan Deb (SPR), Pierpaolo Grippa, and Laszlo Butt (both MCM). The team was supported by Mmes. Selenge Sandagsuren, Ardak Bazarbai, and Khulan Buyankhishig (all economists in the res. rep. office), as well as Mmes. Medha Madhu Nair and Livia Tolentino (both APD). Mr. Gantsogt Khurelbaatar (OED) participated in some of the discussions. The mission met Finance Minister Ch. Khurelbaatar, Bank of Mongolia Governor N. Bayartsaikhan, and other senior officials as well as private sector representatives.

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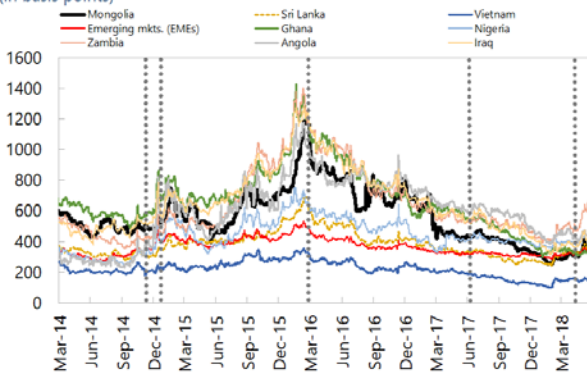
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## CONTEXT

**1. One year into the program, macro performance continues to be strong though vulnerabilities remain high.** The authorities have used the benign external environment and strong growth at home to over-perform on fiscal targets, refinance outstanding debt at lower interest rates and build foreign exchange reserves. That said, more progress is needed to durably reduce Mongolia’s core vulnerabilities. In addition to high commodity dependence, public debt remains high, reserves are not yet at adequate levels, and the banking system needs additional capital and tighter supervision. The outlook for continued strong growth – buoyed by high commodity prices and mining-related investments – will provide a critical window to address these vulnerabilities. A key concern is that rising pressures to stimulate the economy in the run-up to the next parliamentary election in 2020, may result in premature easing in policies and delayed structural reforms.

**EMBI Global Sovereign Spreads**

(In basis points)

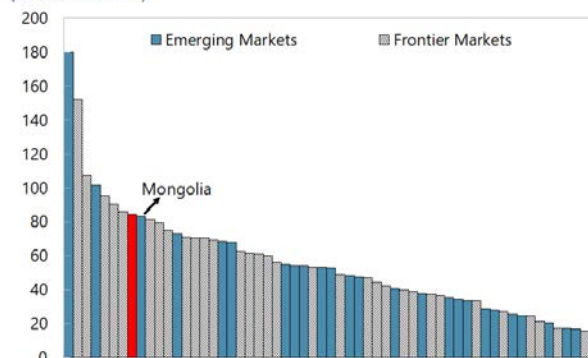


Source: Bloomberg L.P.

Note: Vertical dotted lines depict sovereign bond issuances.

**General Government Debt, 2017**

(In Percent of GDP)



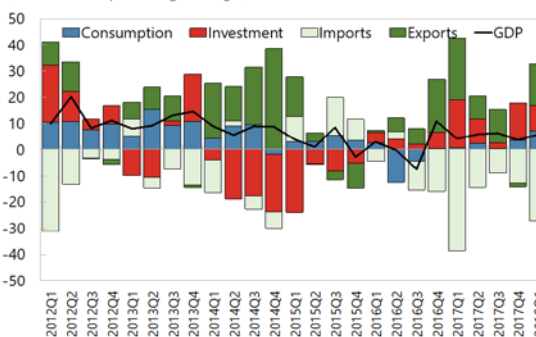
Sources: WEO and MSCI.

## RECENT DEVELOPMENTS

**2. The economy continues to post strong growth.** Real GDP grew 5.1 percent in 2017, up from 1.2 percent the year before, due to a sharp recovery in FDI, household credit growth and mineral exports. Despite weak coal exports in January and February, the economy accelerated further in the first quarter of 2018, rising 6.1 percent y.o.y., helped by strong output in the construction sector.

**Contribution to Growth**

(Year-on-Year percentage change)

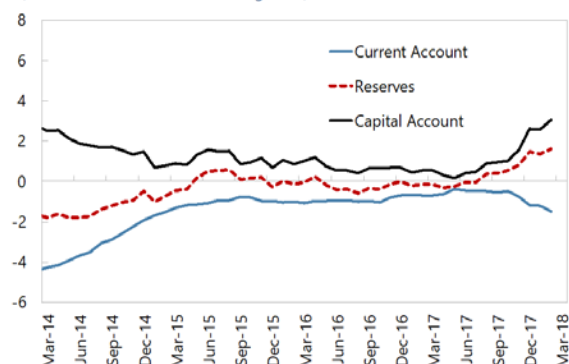


Sources: Haver Analytics; IMF staff calculations

**3. After strong capital inflows in 2017, the balance of payments has moderated in recent months.** The current account deficit rose to over 10 percent of GDP in 2017 (up from 4 percent in 2015), reflecting strong investment-driven import demand and rising dividend repatriation from the mining sector. Large Oyu Tolgoi (OT)-related FDI, donor inflows, and other foreign currency inflows more than offset this deterioration, allowing reserves to rise by \$1.7 billion (15 percent of GDP) over the course of the year. In recent months, however, progress in building reserve buffers has slowed due to an acceleration in consumer- and investment-related imports, a decline in scheduled donor flows, temporary border bottlenecks for coal exports, and portfolio outflows related to maturities on public debt.

#### Balance of Payments

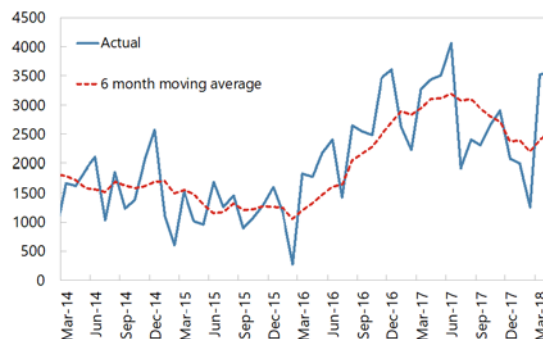
(In billions of USD, 12 month rolling sums)



Sources: Haver Analytics

#### Coal, Volume of Exports

(In thousand tons)

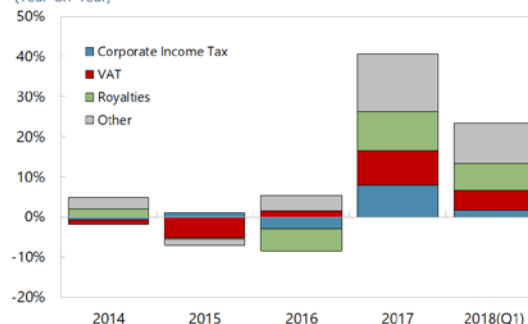


Sources: Haver Analytics and CEIC

**4. The fiscal accounts continue to be strong.** The primary balance in 2017 improved by 15 percentage points to reach a surplus of 2 percent of GDP. Two-thirds of this adjustment was expenditure contraction from excessive 2016 levels. Revenues also improved, due to a boom in both commodity exports (corporate income tax, royalties) and mining related-imports (VAT, customs). The robust fiscal performance has continued in the first quarter of 2018 with a 2.1 percent of GDP primary surplus, due largely to a 23 percent rise y.o.y. in revenues and large loan repayments to the Development Bank of Mongolia (DBM).

#### Revenue Growth

(Year-on-Year)



Sources: Mongolian authorities; and IMF Staff Estimates.

**5. After a sharp rise in 2017, inflation has stabilized in recent months.** A mixture of one-off factors (changes to the CPI basket, higher tax rates), higher imported fuel prices, and a recovery in demand raised inflation to 7.2 percent in 2017, up from less than one percent the year before. This acceleration has moderated in the first 4 months of 2018 with inflation remaining below the

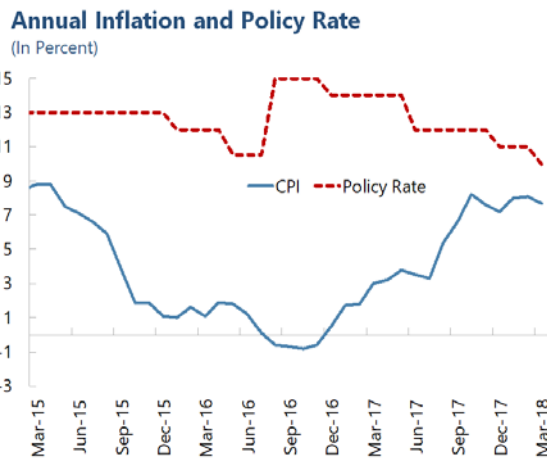


8 percent target. On this basis, the Bank of Mongolia cut the policy rate by 100 basis points in March, bringing the cumulative cuts to 500 basis points and completing the reversal of the 2016 emergency hike.

**6. The AQR has been completed and banks have begun to address the outstanding capital shortfall.**

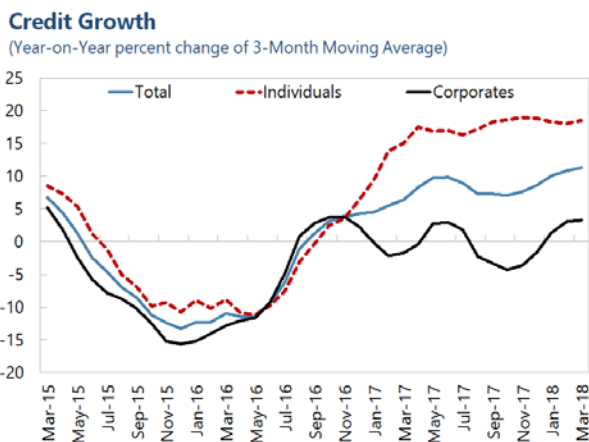
The identified capital shortfall in the AQR as of the third quarter of 2017 was 1.9 percent of GDP. To determine capital needs for end-2018, BOM analyzed banks’ business plans and updated the AQR results accordingly.

In May, BOM communicated the final capital shortfalls to banks that must be met by end-December 2018. In addition, BoM informed banks in May (**prior action for this review**) that they must formally book the provisioning gap identified by the AQR results by end-June. Meanwhile, to provide an important backstop for financial stability, Parliament will pass a Recapitalization Law which outlines when and how public-sector funds can be used to support systemic banks in the event of a capital shortfall (**prior action for this review**).

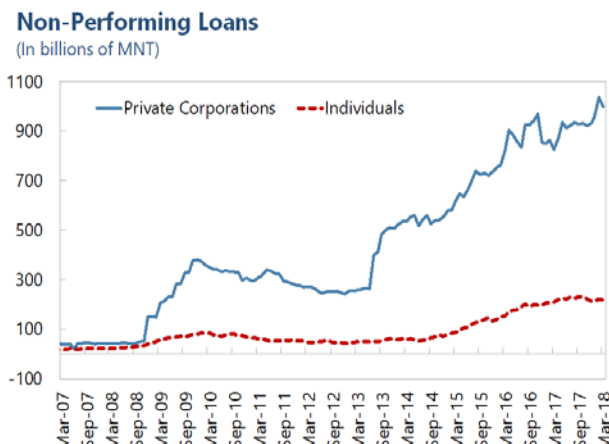


Sources: Haver Analytics

**7. Bank lending accelerated throughout the last year.** Despite high interest rates (17 percent in nominal terms on average) and the uncertainty during the AQR, credit growth rose from 7 percent in 2016 to 11 percent last year, driven by non-mortgage lending to households who borrowed to maintain purchasing power after the 25-percent depreciation of the Togrog in 2016. While credit to corporates remained largely flat in 2017, in part due to relatively weaker quality of credit exposures, there are some signs of recovery in recent months.



Sources: Haver Analytics



Sources: Haver Analytics  
Note: Data has not been adjusted to reflect AQR results

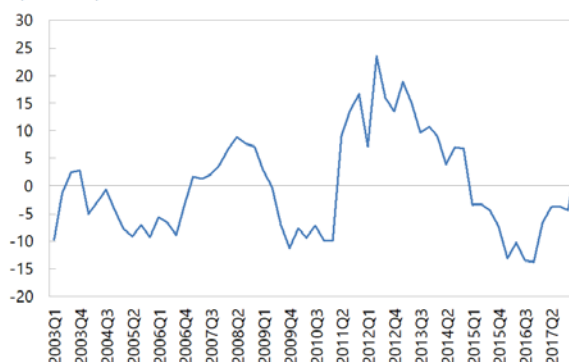
## OUTLOOK AND RISKS

### 8. Despite some deterioration in the external environment for emerging markets, the near-term outlook for Mongolia remains favorable.

An increase in OT-related FDI and an acceleration in credit will compensate for moderate real mining exports, higher oil prices and rising global interest rates, allowing growth to remain at 5 percent this year. With this growth, staff estimates that the output gap in the non-mining sector, which is more relevant for policy settings, will be slightly positive in 2018. Nonetheless, inflation is expected to remain around 8 percent, reflecting the cessation of one-off domestic factors. Gross international reserves are expected to remain broadly unchanged due to delays in prior actions for some donor loans and continued strong import growth.

**Output Gap: Non-Mining Sector**

(In Percent)



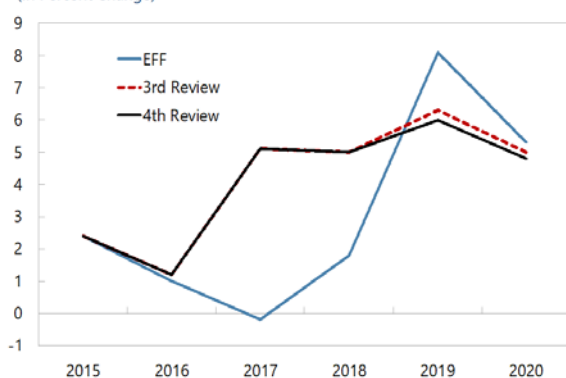
Sources: IMF Staff Estimates

### 9. Growth and the balance of payments are expected to remain strong in the medium term, helping build reserves and reduce public debt.

The growth path is anchored by assumptions related to two large construction projects. First, FDI will be supported by continued OT-related investments and the start of several projects related to the Tavan Tolgoi (TT) coal mine. Second, in 2021-22, the second phase of the OT copper mine will start production, boosting exports. This strong growth, accompanied by continued fiscal consolidation, will help public debt reach about 71 percent of GDP in 2020 (vs. 97 percent projected in the original EFF) and return to 2015 levels of 55 percent by 2023. Although the expectation of sustained strong domestic demand has resulted in a deterioration in the current account deficit, strong FDI and exports will still bring reserves to \$4.7 billion, or 7 months of imports by 2020 (vs. \$4 billion projected in the original EFF).

**Medium Term Growth: Real GDP Growth**

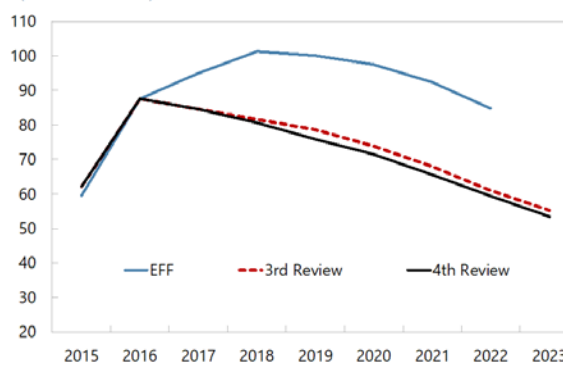
(In Percent Change)



Sources: Imf Staff Estimates

**Debt-to-GDP Ratio**

(In Percent of GDP)



Sources: IMF Staff Estimates

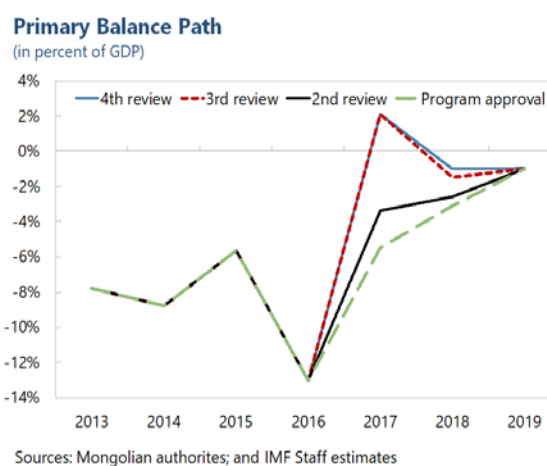
**10. Downside risks continue to outweigh upside risks.** By eliminating the primary deficit, almost tripling foreign exchange reserves, and removing all external sovereign bond maturities between now and 2021, the authorities have substantially reduced the risk of renewed crisis in the next few years. Nonetheless, three key risks persist:

- Increasing political pressure could result in premature easing in monetary and fiscal policies, a slowdown in structural reforms, or changes to the investment climate which undermine key growth drivers (e.g. OT).
- Several developments in the mining sector could undermine the recovery including a fall in prices due to a slowdown in Chinese or global demand, renewed bottlenecks at the border (that can significantly impact coal exports), or a change in China's environmental policy which has boosted its reliance on imported coal.
- Challenges in the follow up to the AQR process (e.g. liquidity pressures, or banks unable to raise needed capital by end-December) could undermine financial stability and/or slow the economic recovery, underscoring the importance of close monitoring and, if needed, decisive action by the Bank of Mongolia.

## PROGRAM DISCUSSIONS

### A. Fiscal Policy

**11. Revenues are on track to over-perform but some risks have emerged on capital spending.** The Q1 outturn and current projections for the year suggest revenues are likely to exceed previous estimates on the back of strong trade and high commodity prices. The authorities have indicated that they intend to save all of this revenue over-performance (up from the earlier commitment to save half). On this basis, the fiscal target has been tightened to -1 percent of GDP (from -1.6 percent at the time of the last review and -2.6 percent of GDP in the 2018 budget passed by parliament) while leaving future program targets unchanged. This fiscal stance is appropriately tighter than the debt stabilizing primary balance of -5 percent, implying further progress in reducing Mongolia's still high public debt (85 percent of GDP). However, commitments on concessional foreign-financed capital spending have exceeded budget ceilings by an estimated 2.2 percent of GDP. The over-run stems from a sharp increase in available concessional financing, a low ceiling on such spending in the 2018 budget, and inadequate coordination during the change in government late last year. Nonetheless, the authorities have committed to implement offsetting measures (e.g. prioritization of other capital spending or lower non-essential current spending) as



necessary to meet the agreed deficit target and will strengthen the public financial management to prevent this from happening again.

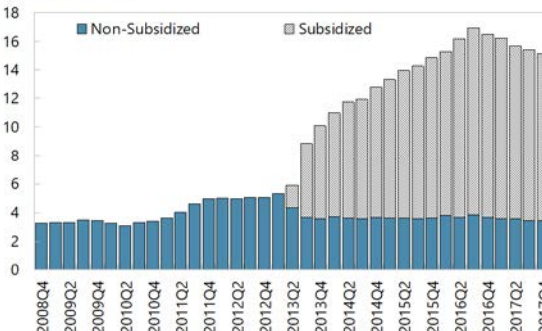
**12. Though headline fiscal performance has been strong under the program, the structure of the budget needs to improve further to support sustained adjustment.**

- *Fuel Price and Tax*—The authorities currently fix the retail price of the most widely-used gasoline. However, during periods of particularly high world prices, the retail price is not adequate for importers to make profits, leading to fuel shortages. The authorities have committed to moving away from this system by the start of 2019. Working with Fund staff, the authorities intend to adopt a formula which (i) ensures sufficient corporate profits to prevent shortages, (ii) increases the flexibility of the consumer price, (iii) and gradually re-introduces an excise tax to reach a target level over a three-year period (**end-December structural benchmark**).
- *Social Spending*—The level of social assistance spending in Mongolia is relatively high at over 2 percent of GDP and has been successfully protected under the program, as intended, amid substantial fiscal adjustment. However, the composition of that spending has deviated from the original program which had intended to change the Child Money assistance from universal coverage to the poorest 40 percent of children and use the resulting savings to scale up spending on programs targeted at the poorest households. Instead, the authorities have reduced coverage to the poorest 80 percent of children and reversed much of the planned increase in other targeted programs to finance this higher coverage. Moreover, there is ongoing pressure to reverse even this modest narrowing of the Child Money program and return to universal coverage. While this mix of policies will not undermine macroeconomic stability, it will reduce assistance to the most vulnerable and it departs from key commitments in the Asian Development Bank and World Bank programs. Going forward, if the authorities wish to have universal or near universal programs, it is important to ensure that the budget more broadly continues to address inequality concerns, such as through progressive income taxation.
- *Infrastructure Concessions*—In recent years, previous governments signed a series of non-transparent “build-transfer agreements” to invest in infrastructure. The unpaid fiscal commitments in the associated projects, which are in varying degrees of completion, total roughly 5 percent of GDP. To limit fiscal risks, the authorities are in the process of auditing the completed concessions to assess the precise cost and legality of the projects. Once the audit is complete and a payment schedule finalized, the authorities will include these obligations in the 2019 budget and the next Medium-Term Budget Framework (**end-August structural benchmark**). No new build-transfer agreements have been signed since early 2017 and the authorities have confirmed that the practice is now forbidden.
- *Mortgage Program*—Between 2013 and 2016, there was a surge in subsidized mortgages financed by the Bank of Mongolia which dominated the market, accounting for 80 percent of outstanding mortgages. Since 2016, the Ministry of Finance has been solely responsible for all net new subsidized mortgage lending but has limited the aggregate size of the subsidy it will

provide to 0.4 percent of GDP per year; as a result, mortgage growth overall has slowed and the stock is falling relative to GDP. Going forward, the authorities have committed in a Memorandum of Understanding signed in late 2017 to transfer the stock of subsidized mortgages on the BOM balance sheet to the government. Staff will also work with the authorities to find ways to better target subsidies to the most vulnerable.

**Mortgage Loans**

(In Percent of GDP)



Sources: Haver Analytics

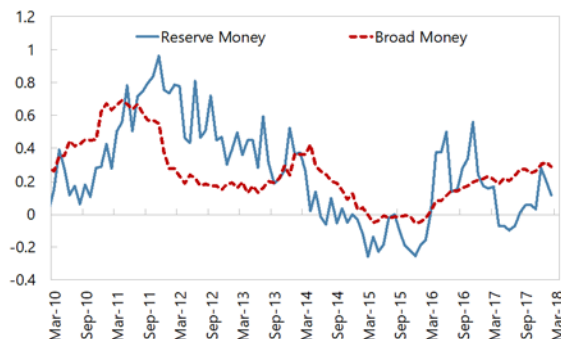
- *Development Bank of Mongolia (DBM)*—Before the program, DBM was a key source of off-budget fiscal spending with net lending of 3 percent of GDP per year. To address this, the program took two steps. First, it expanded the fiscal coverage of the general government to include DBM net lending. Thus far, this approach has successfully curtailed fiscal risks and DBM had net repayments of 0.5 percent of GDP in 2017. Second, the program called for an audit of its activities since 2012 to assess the degree to which DBM has operated largely as an extension of fiscal spending or rather as a more commercial enterprise. The board of DBM has now approved this audit and it is expected to be completed by mid-November 2018. Once done, more work will be necessary to assess the proper role for DBM going forward, balancing fiscal and governance risks against genuine development needs.

## B. Monetary and Exchange Rate Policy

**13. The next move in the policy rate should await clear evidence on the direction of inflation and the balance of payments.** While inflation has stabilized just below the 8 percent target in recent months, upside risks remain as credit growth is strong and the output gap has turned positive. Also, while gross reserves are significantly higher than expected at the time of program approval, they remain at only 80 percent of the IMF ARA metric (a ratio between 100–150 percent is considered adequate). Therefore, the authorities should keep monetary policy on hold and stand ready to hike if inflation surprises negatively or the balance of payments fail to strengthen. The authorities’ plan to tighten macroprudential measures in coming months; while mainly aimed at financial stability concerns, this may also help tighten the stance and reduce domestic absorption (see para 17 below).

**Monetary Aggregates**

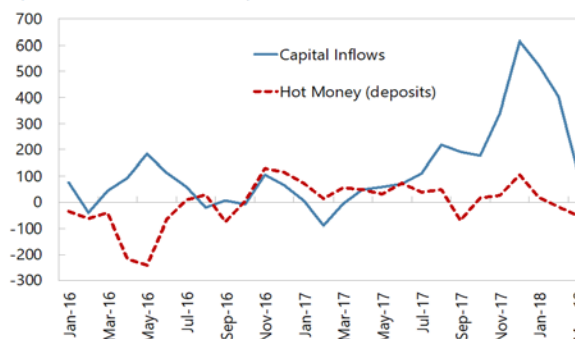
(Year-on-Year Percent Change)



Sources: Haver Analytics

**Net capital and deposit inflows**

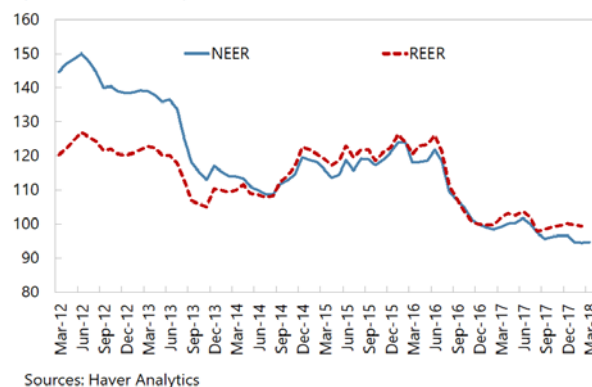
(in millions of US dollars, 3mma)



Sources: Haver Analytics

**14. The external position remains broadly in line with fundamentals.** In 2016, the Togrog (in nominal and real and nominal effective terms) depreciated by nearly 25 percent. Since then, it has been broadly stable amid substantial reserve accumulation. This large change in relative prices has not generated a correction in the current account deficit (indeed it has widened) due to a surge in FDI-related capital goods imports and dividend repayments. In addition, households reacted to the loss of foreign currency purchasing power by sharply increasing borrowing, which has led to an acceleration of consumer imports. To some degree, large current account deficits are inevitable during this capital-intensive phase of Mongolia's development. At the same time, overall external debt is now very high at 240 percent of GDP (see external DSA) while foreign assets are still low. To maintain external stability going forward, it will be important to rein in consumer credit and ensure that the investment climate is sufficiently strong to increase Mongolia's export potential.

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



### C. Financial Sector Policy

**15. The next 6 months is a critical period in the follow-up to the AQR.** Banks are now expected to address the capital shortfall identified by BOM. By end-December, the banking system should be fully capitalized and well-positioned to support the ongoing economic recovery. If any bank is unable to raise the needed capital by end-December, the authorities now have the powers to intervene in a manner that safeguards financial stability (**end January-2019 structural benchmark**). Specifically, in the case of systemic banks that are unable to fully meet the shortfall with private capital, the authorities can use the soon-to-be passed recapitalization law to inject public funds under strict conditions. In the case of a non-systemic institution, BOM can use the revised banking and DICOM laws to resolve the bank and protect depositors as appropriate. That said, even though BOM now has such powers, additional contingency planning and scenario analysis is still needed to ensure that, if needed, BOM can effectively and safely intervene. In particular, BOM, in cooperation with MOF, should map out hypothetical transaction details and identify the needed public resources.

**16. The authorities are starting to focus on improving the legal and regulatory framework for NPL resolution, while strengthening prudential regulation.** Mongolian banks' inability to efficiently resolve non-performing loans – through restructuring or enforcement of collateral – hurts economic growth because it impairs their balance sheet and puts upward pressure on interest spreads. To address this, the authorities had planned to draft and publish a detailed NPL resolution strategy (**end-May structural benchmark**) but this has taken longer than expected and will be completed in coming months. Implementation of this strategy - including reforms related to collateral enforcement (**end-November structural benchmark**), reformed corporate bankruptcy

law (**end-March 2019 structural benchmark**), taxation, judicial process (**end-April 2019 structural benchmark**), and real estate data (**end-April 2019 structural benchmark**)—is expected to start in the Fall. Meanwhile, the authorities are still considering whether creating an Asset Management Company could help resolve the current large stock of NPLs which is a legacy of the previous downturn. Due to governance and fiscal concerns, the authorities have confirmed that in the event an AMC is established, the Mongolian public stake would be limited to a small minority stake, and no public entity will lend or issue guarantees to the AMC. In addition, the authorities aim to adopt new prudential regulations by revising the structure of risk weights, introducing a definition of capital and capital buffers aligned with international standards, and detailing the criteria for restricting dividend and coupon payments when needed (**end-December structural benchmark**).

**17. Adoption of macro-prudential measures aimed at household loans would support financial stability and consumer protection.** Though reported non-performing loans remain low, more than 40 percent of household loans now have debt service-to-income ratios above 60 percent. For the most part, the loans are “collateralized” by household wages or pensions which notionally reduces the risk to lenders. However, such high debt levels increase the risk to growth and public welfare if households are using disproportionate shares of their income to repay debts on which they cannot default. To prevent this risk from materializing, it is important to broaden the coverage of macro-prudential measures on lending to households from only mortgages to also include consumer loans (given recent strong growth in non-mortgage consumer credit). The authorities aim to put in place a limit on the debt service to income ratio on new household lending in coming months to address financial stability risks (**end-September structural benchmark**). Going forward, it will be important to improve the institutional framework regarding macro-prudential measures to clarify the analytical framework and decision-making process of the macro-prudential toolkit.

**18. The authorities have strengthened their AML/CFT framework but further work remains.** In 2017, the Asia Pacific Group (APG) released a critical assessment of Mongolia’s AML/CFT regime, finding deficiencies in both the underlying legal framework and enforcement of existing laws. This finding has resulted in closer international scrutiny and a reduction in correspondent banking relationships. In April, Mongolia took concrete steps to address some of the deficiencies identified by the APG, amending both the AML/CFT law and the Law on Infringements. Going forward, it is critical that the authorities demonstrate progress with respect to the implementation of AML/CFT regulations and targeted financial sanctions on financing of proliferation of weapons of mass destruction. In addition, it will be important to step up risk-based offsite and onsite supervision of banks, non-bank financial institutions, and other high-risk entities. The Financial Action Task Force may consider Mongolia’s status (i.e. potential “grey listing”) in June and the APG will assess Mongolia’s progress with respect to the AML/CFT framework in July.

**19. Progress has been made in implementing safeguards assessment recommendations.** The BOM has drafted a new charter for the Internal Audit Department, established a quarterly reporting mechanism of the function to the Supervisory Board, and discussions are underway with another central bank on conducting a peer review of internal audit

and aspects of controls. The new central bank law provides for an independent oversight body to oversee the audit and control mechanisms.

## D. Program Modalities

**20. Performance on program conditionality has been strong.** The authorities have met all quantitative performance criteria (QPCs) for end-March. With respect to structural reforms, the authorities have submitted two tax administration laws which were originally due last February. With respect to structural benchmarks due since the last board date (end-March to end-May) the authorities passed amendments to the Bank of Mongolia law, and will pass a Recapitalization Law, while approval and publication of the NPL resolution strategy has been delayed.

**21. Looking forward, QPCs have been updated to reflect revisions in the macro-framework while new structural benchmarks have been added.** For 2018, the primary balance was tightened to reflect revenue over-performance and the end-year NIR target has been revised downward, primarily to reflect delays in donor funding. Monetary targets were adjusted accordingly. Several new structural benchmarks have been added in fiscal policy (fuel price mechanisms and taxation, tax administration compliance) and banking (booking AQR results, new macro-prudential limit on household lending, and several measures related to strengthening the NPL resolution framework).

**22. The program remains fully financed despite some envisioned delays in donor funding.** The size and phasing of program funding at the time of board approval was designed to both ensure public debt sustainability and restore external balance. While donor funds have largely disbursed as expected, the program has overperformed on its two goals, primarily reflecting better than expected external conditions. Public debt at end-2017 was ten percentage points of GDP lower than originally projected and this over-performance is expected to become 20 percentage points by end-year. Meanwhile, NIR as of end-March 2018 was \$1.5 billion higher than the initial targets but the margin will moderate somewhat by year end due to delays in donor funding. The delays in donor funding are largely because the authorities need more time to complete several prior actions—which are expected to be done by early 2019. However, given the over-performance to date, the delay in NIR accumulation can be accommodated within the program. Nonetheless, with public debt still high and reserves not yet at adequate levels, significant risks remain as noted in para 10 above.

## STAFF APPRAISAL

**23. The authorities have successfully averted a debt crisis, but challenges remain.** Driven by strong external demand combined with expenditure restraint, macroeconomic outcomes have exceeded expectations. The fiscal and reserve targets under the program have been met with considerable margins. While compliance with structural conditionality has been mixed, important progress has been made and going forward the authorities have committed to implementing key structural reforms in banking and fiscal areas. However, risks to the program remain, including from



lower external demand for commodities, rising domestic pressures, adverse changes to the investment climate, and resistance from vested interests.

**24. A key challenge is continued fiscal discipline while improving the structure of the budget to support sustained adjustment.** As the 2020 elections near, spending pressures are rising. With public debt still high at around 85 percent of GDP and the economy exposed to global commodity developments, it is crucial that the authorities maintain the strong commitment to the program. On fiscal policy, priority should be given to continued expenditure restraint and strengthening of the tax administration, while protecting social spending. In addition, efforts to improve public financial management—particularly with respect to concessions, public investment, and the operations of the DBM—are needed.

**25. Maintaining policies to support buildup of international reserves will be critical to help insulate the economy from external shocks.** The authorities are committed to maintaining a monetary policy stance that is vigilant against inflation and supporting further improvement in the balance of payments. While gross reserves are significantly higher than expected, they remain at only 80 percent of the ARA metric—and are expected to remain flat in 2018. It will be important that the authorities keep monetary policy on hold and stand ready to raise rates if the balance of payments fails to strengthen or if inflation surprises negatively. In this context, sustained replacement of costly domestic-financed capital spending with concessional foreign-financed lending, and curbing the rapid increase in non-mortgage consumer credit, will also help.

**26. Another key challenge will be the successful completion of the bank recapitalization process.** The authorities are moving ahead with strengthening the banking system in line with the planned follow-up to the recently completed Asset Quality Review. Banks that are undercapitalized will have until end-December to raise capital. Ensuring that the banks are fully capitalized, will be crucial to restore confidence in the financial sector. This will need to be supported by enhancing banking supervision, making legislative and regulatory changes to address non-performing loans, and strengthening the AML framework.

**27. On the basis of progress to date and the authorities' continuing commitment to the program, staff supports the request for modification of performance criteria and recommends completion of the fourth review.**

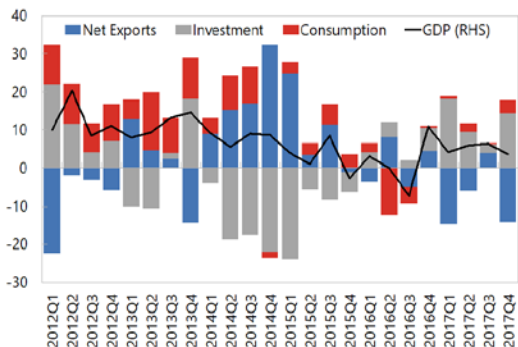
**Figure 1. Real Sector Developments**

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

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

**Real GDP Growth: Expenditure Side**

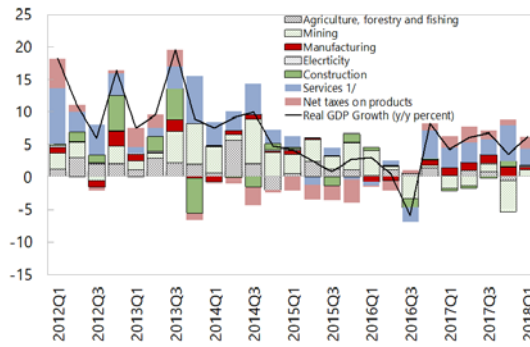
(Contribution; Year-on-Year Percentage Change)



Sources: IMF Staff Estimates

**Real GDP Growth: Supply Side**

(Contribution; Year-on-Year Percentage Change)



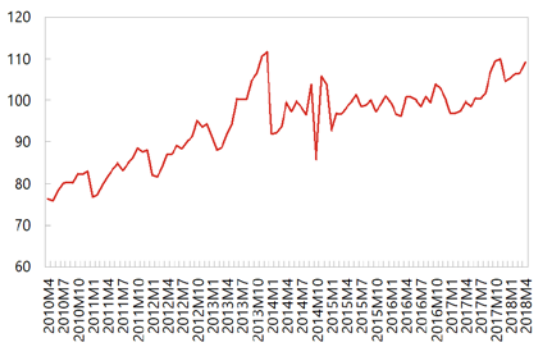
Sources: BOM and IMF staff estimates  
1/ includes trade, transportation, and information and communication

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

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

**Employment**

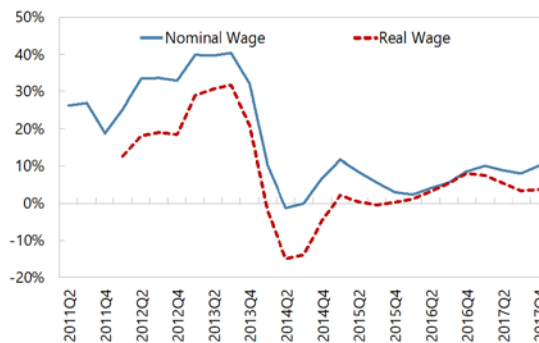
(Index, 2016=100)



Sources: Haver Analytics

**Nominal and Real Wage Growth**

(In Percent, Year-on-Year)



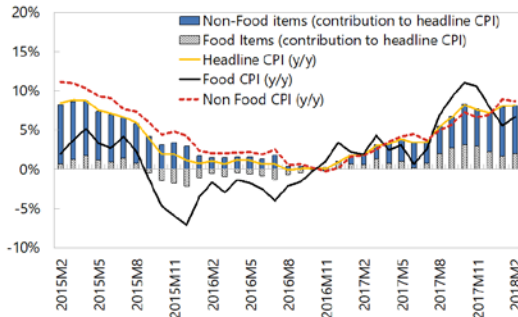
Sources: CEIC, Haver Analytics and IMF Staff Calculations

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

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

**Consumer Price Inflation**

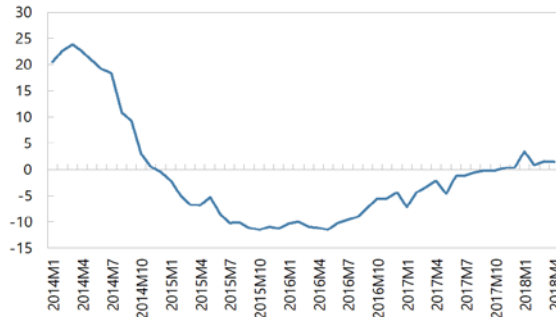
(In Percent)



Sources: Mongolian Authorities; and IMF staff calculations

**Housing Prices**

(In Percent, Year-on-Year)

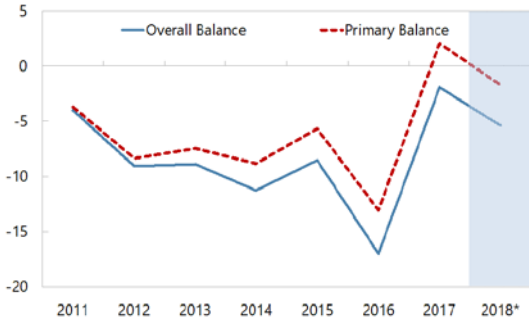


Sources: Haver Analytics; and IMF Staff Calculations

**Figure 2. Fiscal Sector Developments**

*Fiscal performance improved substantially in 2017...*

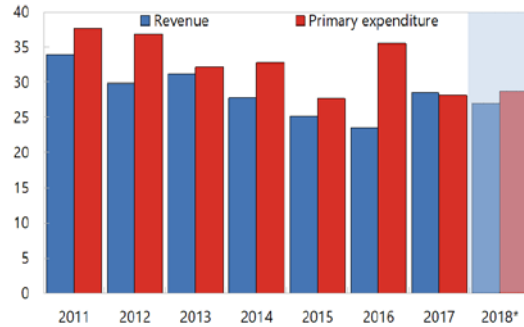
**Fixed Balance**  
(In Percent of GDP)



Sources: Mongolian Authorities and IMF staff calculations  
Note: 2018 is an estimate

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

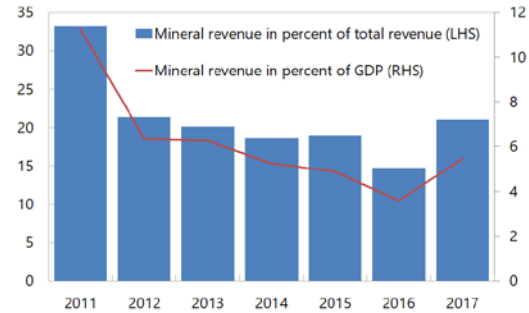
**Revenue and Primary Expenditure**  
(In Percent of GDP)



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

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

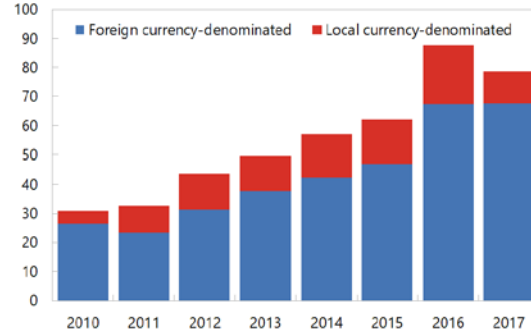
**Mining Revenues**  
(In Percent)



Sources: Mongolian Authorities; IMF staff estimates

*The public debt ratio has now started to decline...*

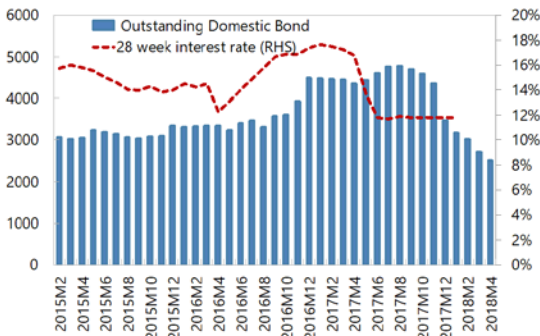
**Public Debt**  
(In Percent of GDP)



Sources: Mongolian Authorities, IMF Staff Estimates

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

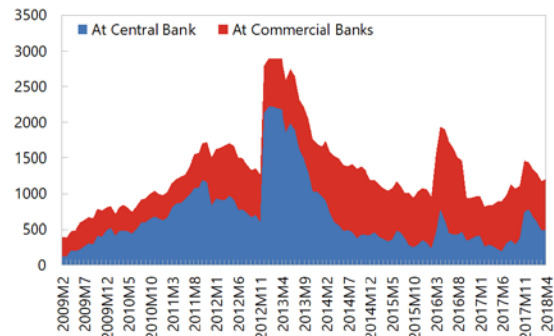
**Government Securities**  
(MNT billions and in percent)



Sources: Ministry of Finance

*...and build deposits.*

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



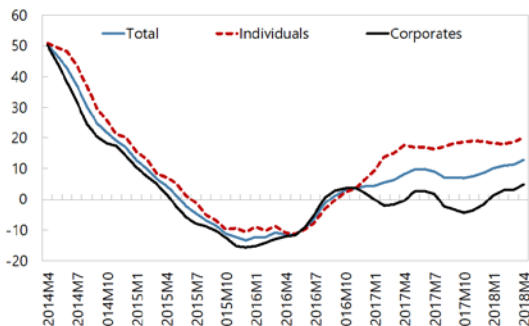
Sources: Haver Analytics

**Figure 3. Financial Sector Developments**

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

**Credit Growth**

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

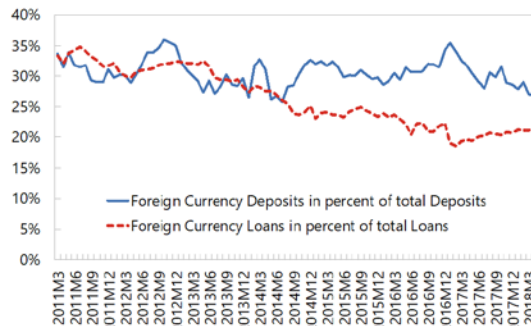


Sources: Haver Analytics and IMF staff calculations

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

**Loans and Deposits in FX**

(In Percent)

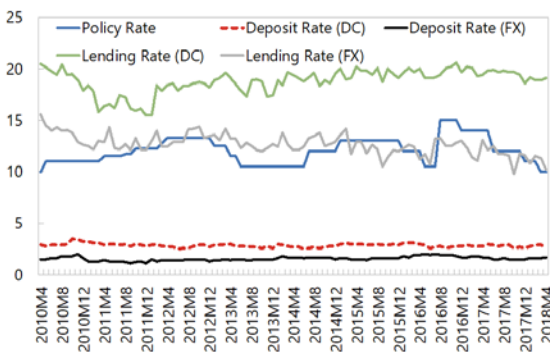


Sources: CEIC and IMF Staff Calculations

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

**Interest Rates**

(In Percent)

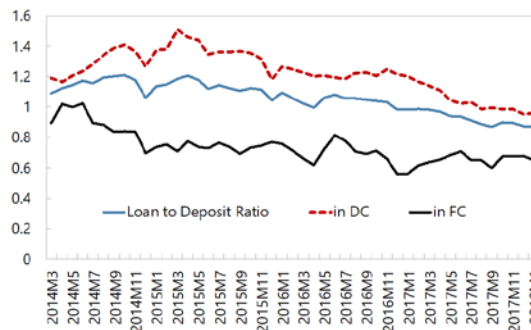


Sources: CEIC and Haver Analytics

Loan-to-Deposit ratios continue to trend down.

**Loan to Deposit**

(Ratio)

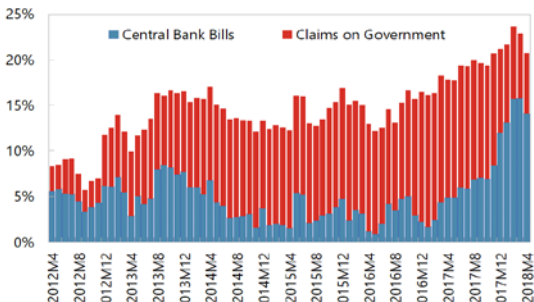


Sources: IMF Staff Calculation

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

**Government and Central Bank Bills held by Banks**

(In Percent of Total Assets)

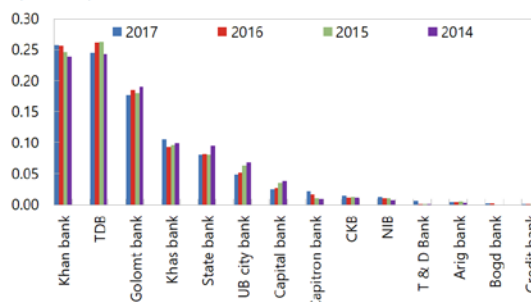


Sources: Haver Analytics

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

**Market Share by Bank**

(In Percent)



Sources: FSI

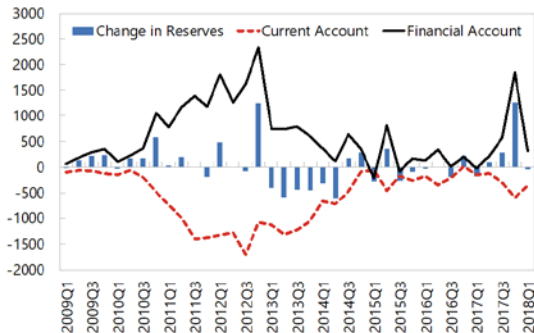
Note: TDB stands for Trade and Development Bank; CKB stands for Chinggis Khan Bank; T&D Bank stands for Transport and Development Bank; NIB stands for National Investment Bank

**Figure 4. External Sector Developments**

Overall, the external accounts improved significantly in 2017.

**Balance of Payments**

(In millions of US dollars)

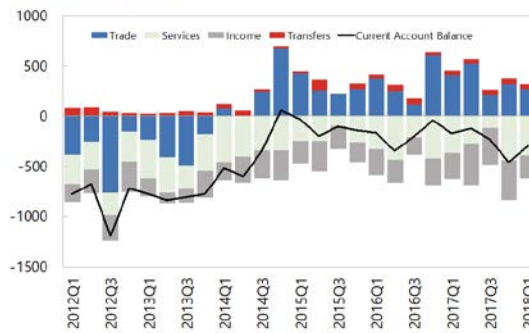


Sources: Haver Analytics

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

**Current Account Balance**

(In millions of US dollars)

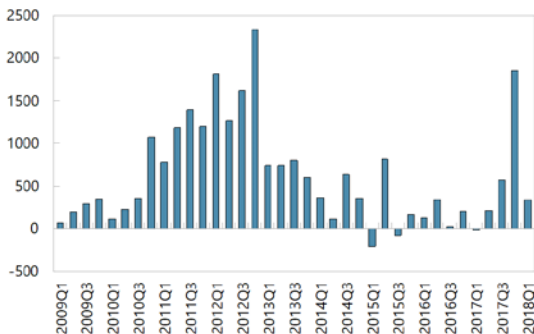


Sources: Haver Analytics

...there was a significant recovery in total capital inflows...

**Net Capital Inflows**

(In millions of US dollars)

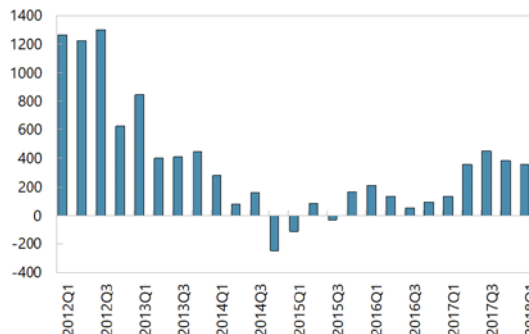


Sources: Haver Analytics

...which included rising FDI.

**Foreign Direct Investment**

(In millions of US dollars)

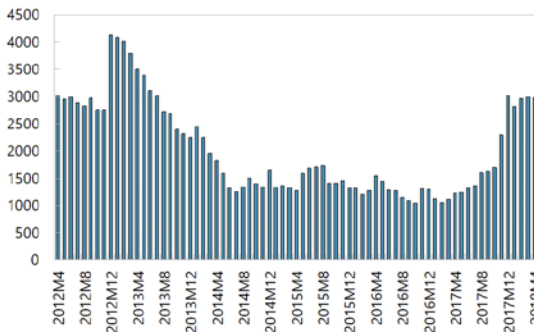


Sources: Mongolian authorities

The authorities have used the strengthening external sector for reserve accumulation...

**Gross International Reserves**

(In millions of US dollars)

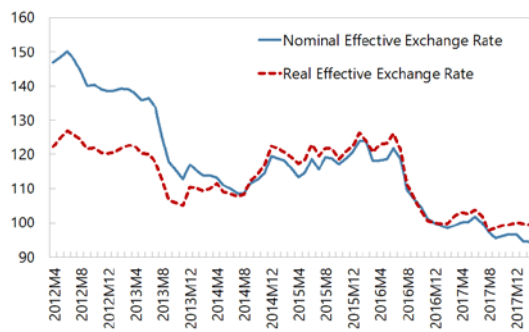


Sources: Mongolian authorities

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

**Exchange Rates of the Tugrog**

(Index, Dec. 2016=100)



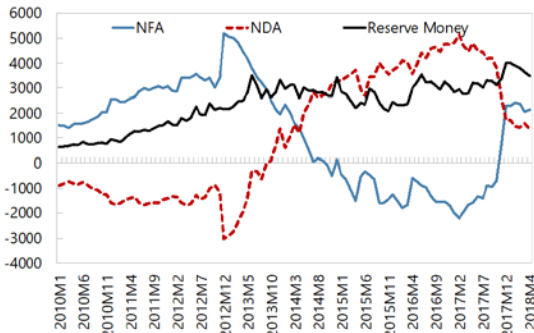
Sources: Haver Analytics

**Figure 5. Monetary Sector**

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

**BOM NFA, NDA and Reserve Money**

(In billions of togrog)

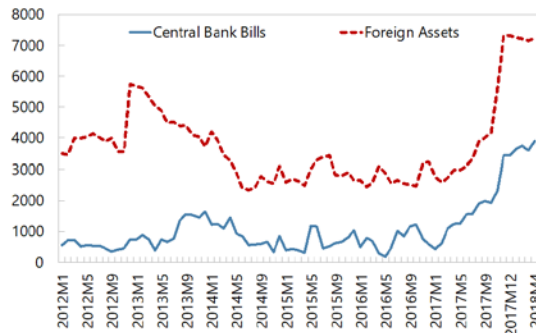


Sources: BOM

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

**BOM Foreign Assets and Central Bank Bills**

(In billions of togrog)

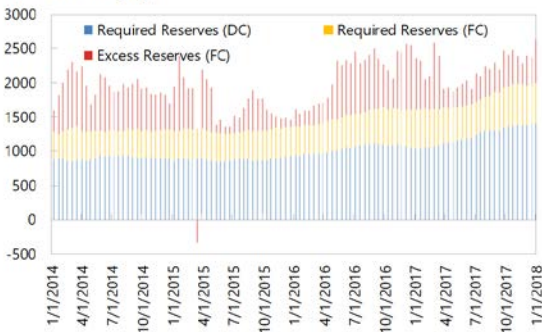


Sources: BOM

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

**Required and Excess Reserves**

(In billions of togrog)

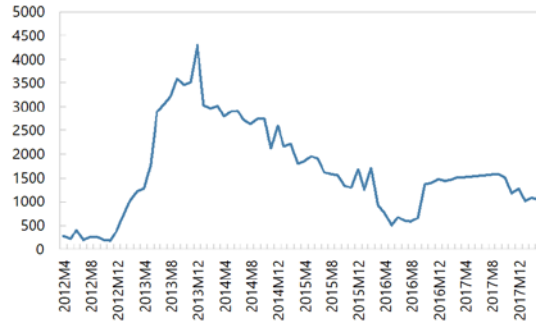


Sources: BOM

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

**BOM Claims on Banks**

(In billions of togrog)

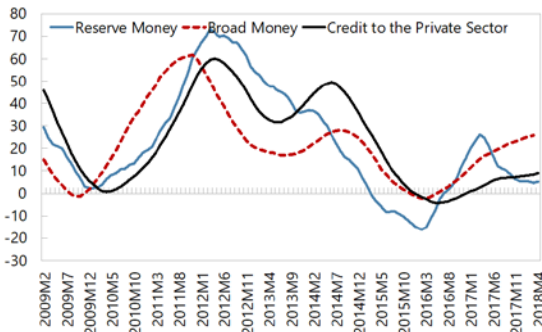


Sources: BOM

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

**Reserve Money, Broad Money and Private Credit**

(Year-on-Year growth of 12 months moving average)

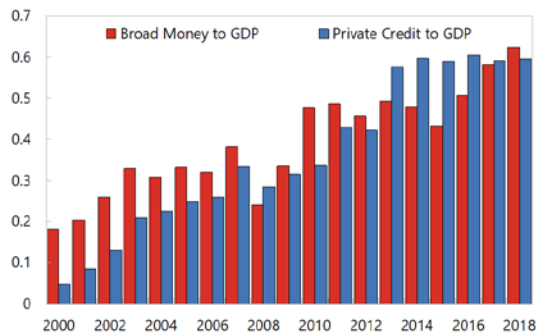


Sources: BOM, Staff Calculations

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

**Broad Money and Private Credit**

(In Percent of GDP)

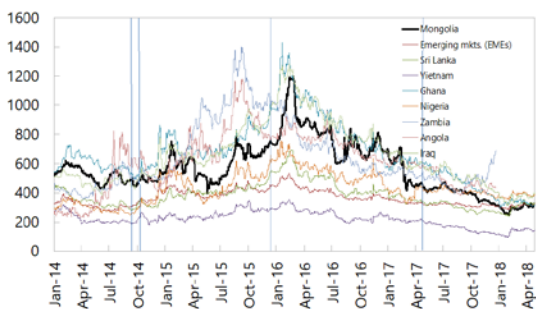


Sources: BOM Staff Calculations

**Figure 6. Markets**

Since the program, Mongolian sovereign spreads have tracked other emerging markets...

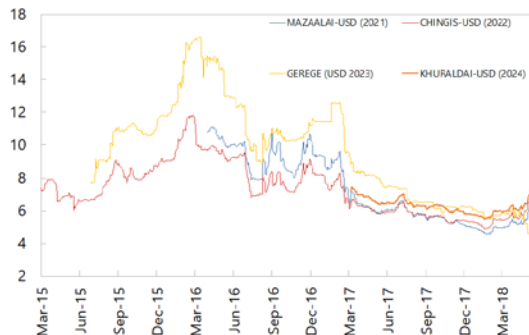
**EMBI Global Sovereign Spreads**  
(In basis points)



Sources: Bloomberg LP  
Note: Vertical lines depict sovereign bond issuances.

...and recently in line with peers, its sovereign yields on the secondary markets have seen a modest increase

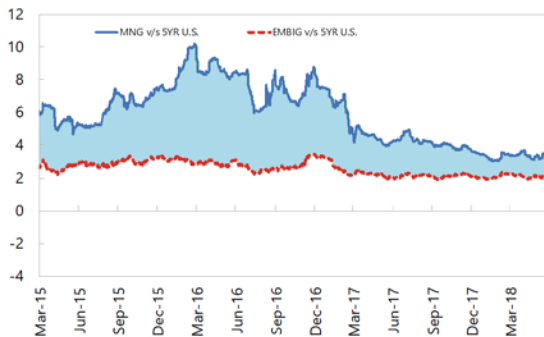
**Outstanding Govt. Bonds**  
(Yield-to-Maturity)



Sources: Bloomberg LP

Corresponding, there has been a move in the Mongolian spreads vis-à-vis the U.S. treasuries.

**Mongolia Spread Analysis**  
(In percent)



Sources: Bloomberg LP

After an increase in 2017, commodity prices of key Mongolian exports have been stable in recent months...

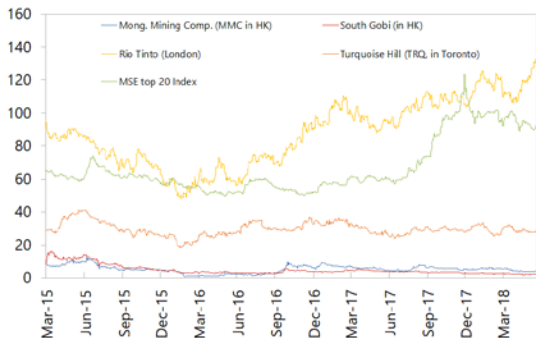
**Commodity Prices: Gold, Copper & Coal**  
(Index, Jan. 2, 2012=100)



Sources: Bloomberg LP

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

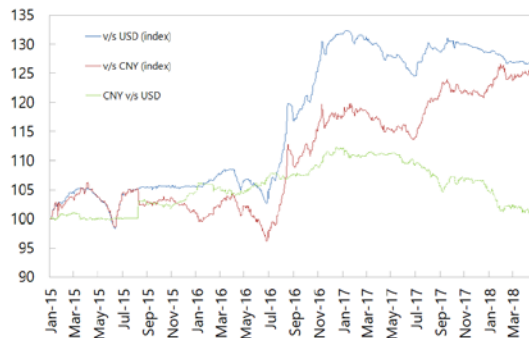
**Stock Prices: Mining Companies**  
(Index, Jan. 3, 2012=100)



Sources: Bloomberg LP; IMF staff estimates

After experiencing a sharp depreciation in 2016-17, the currency has remained relatively stable.

**Exchange Rate: Tugrog**  
(Spot Rate)

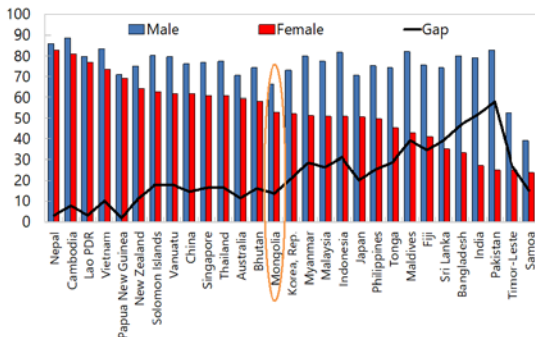


Sources: Bloomberg LP

**Figure 7. Gender**

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

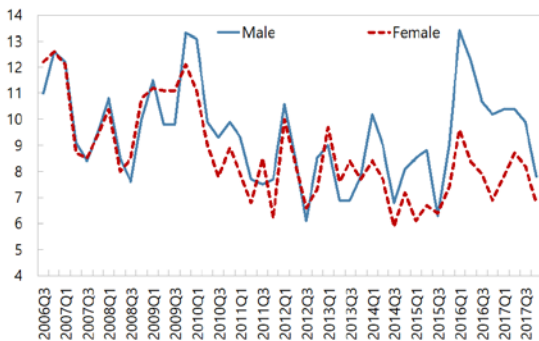
**Labour Force Participation in Asia**  
(In Percent of Male and Female Population Respectively)



Sources: World Development Indicators

The female unemployment rate, however, is less cyclical than the male unemployment rate.

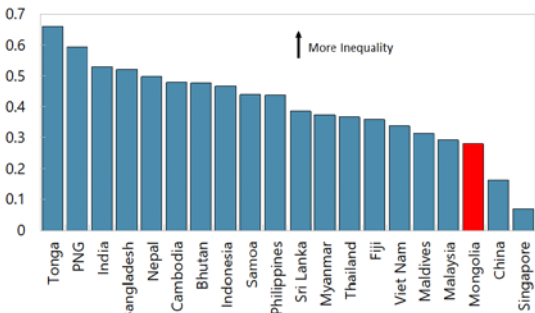
**Unemployment**  
(In Percent)



Sources: National Statistics Office and World Development Indicators

While Mongolia ranks high in the region on the gender inequality index...

**Gender Inequality Index**  
(Index)

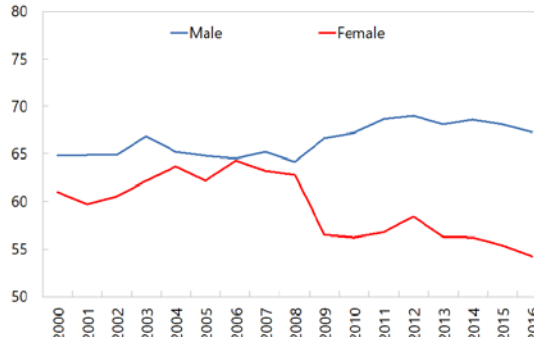


Sources: UNDP

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

...but has deteriorated over the past decade, while at the same time male participation rates have improved.

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



Sources: National Statistics Office and World Development Indicators

The female enrollment ratio at the primary level has remained relatively higher.

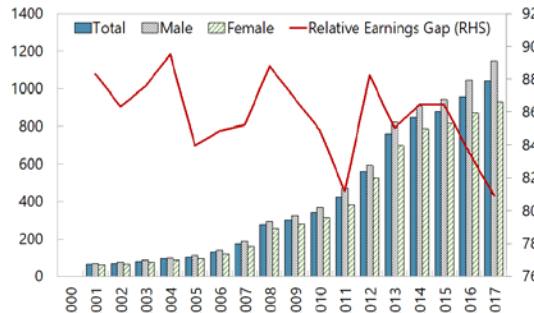
**Gross Enrollment Ratio**  
(Primary Level, In Percent)



Sources: National Statistics Office and World Development Indicators

...the relative gender earnings gap remains sizable and has widened in recent years.

**Monthly Average Real Earnings**  
(In thousands of MNT on LHS, Female in Percent of Male on RHS)



Sources: National Statistics Office and World Development Indicators  
Note: Relative Earnings Gap is calculated as female earnings as a percent of male earnings



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

	2015	2016	2017		2018		2019	2020	2021	2022	2023	
	Act.		EFF	Act.	EFF	3rd review	Proj.		Proj.			
(In percent of GDP, unless otherwise indicated)												
<b>Real sector</b>												
Nominal GDP (in billions of togrogs)	23150	23936	26047	27167	27688	30662	30830	34941	39153	43727	49127	55457
Real GDP growth (percent change)	2.4	1.2	-0.2	5.1	1.8	5.0	5.0	6.0	4.8	5.0	5.2	5.9
GDP deflator (percent change)	1.7	2.1	9.3	7.9	4.4	7.5	8.1	6.9	6.9	6.4	6.8	6.6
Consumer prices (End-period; percent change)	1.1	0.8	6.1	7.2	6.1	7.8	8.1	8.2	7.1	7.2	6.9	7.1
Gross national saving	20.7	26.0	30.3	26.9	30.1	31.9	29.2	31.6	33.7	36.6	40.8	45.4
Public	0.4	-4.2	-3.4	3.4	-1.5	2.4	2.9	4.3	5.4	5.8	5.4	5.7
Private	20.3	30.3	33.8	23.5	31.6	29.5	26.3	27.3	28.4	30.8	35.5	39.7
Gross capital formation	26.4	29.4	34.8	37.3	39.6	38.3	37.2	39.9	41.4	41.2	42.1	42.6
Public	6.0	9.9	7.7	6.1	7.5	6.5	6.5	7.8	6.8	5.5	5.0	5.1
Private	20.4	19.5	27.1	31.2	32.2	31.8	30.7	32.1	34.6	35.7	37.1	37.5
General government accounts												
Total revenue and grants	25.1	23.5	24.7	29.2	26.3	27.0	27.1	27.5	27.0	27.0	26.9	26.7
Total expenditure and net lending 1/	33.6	40.5	35.3	31.1	34.8	32.3	32.1	31.9	29.3	27.2	26.6	26.3
Overall balance (IMF definition) 2/	-8.5	-17.0	-10.6	-1.9	-8.5	-5.3	-4.7	-4.2	-2.3	-0.6	-0.5	-0.2
Primary balance (IMF definition)	-5.6	-13.0	-5.5	2.1	-3.1	-1.5	-1.0	-1.0	0.3	1.5	1.5	1.5
<b>Monetary sector</b>												
Broad money growth (percent change)	-5.5	21.0	16.1	30.5	13.3	21.1	21.5	13.3	12.1	11.7	12.4	12.9
Reserve money growth (percent change)	-28.2	24.6	21.8	30.5	19.3	19.5	19.5	16.6	12.6	17.3	14.0	17.4
Credit growth (percent change)	3.6	6.7	9.0	11.1	10.3	13.6	12.5	14.0	14.0	14.0	14.0	14.0
<b>Balance of payments</b>												
Current account balance	-4.0	-6.3	-4.4	-10.4	-9.5	-6.4	-8.0	-8.3	-7.7	-4.7	-1.3	2.8
Excluding mining-related imports	8.2	-1.1	2.2	-4.6	-2.0	-0.3	-1.7	-2.4	-1.6	1.4	2.6	5.4
Exports of goods (y/y percent change)	-20.1	4.1	2.0	21.4	-15.3	7.8	10.4	2.9	-0.1	8.1	8.2	15.1
Imports of goods (y/y percent change)	-28.1	0.8	4.8	25.3	-8.5	5.2	13.2	9.2	1.4	3.5	1.5	6.0
Gross official reserves (in USD millions) 3/	1324	1297	1692	3012	2515	3595	3150	4299	4755	5406	5380	5807
(In months of imports)	2.8	2.4	3.4	5.0	4.4	5.5	4.9	6.6	7.0	7.9	7.4	7.6
<b>Debt indicators 4/</b>												
General government debt	62.1	87.6	94.9	84.6	101.3	81.7	79.4	75.7	70.7	64.9	58.8	52.8
Domestic	15.2	20.2	21.4	13.6	19.4	12.6	13.6	8.6	4.0	3.0	2.1	2.0
External	46.9	67.5	73.4	71.0	81.9	69.0	65.8	67.0	66.7	61.9	56.7	50.9
GFN	10.7	18.0	22.4	3.6	21.5	18.5	13.6	5.6	9.9	2.9	9.7	3.7
Exchange rate												
Togrog per U.S. dollar (eop)	1996	2490	...	2427	...	...	...	...	...	...	...	...
Nominal Effective Exchange Rate 5/	101.9	85.4	...	82.7	...	...	...	...	...	...	...	...
Real Effective Exchange Rate 5/	100.0	82.3	...	83.4	...	...	...	...	...	...	...	...
<b>Memorandum items:</b>												
Copper prices (US\$ per ton)	5510	4868	5722	6170	5733	7075	7132	7228	7242	7237	7232	7232
Gold prices (US\$ per ounce)	1160	1248	1212	1257	1225	1344	1340	1375	1421	1460	1500	1542
Oil price (in U.S. dollars per barrel)	50.8	42.8	54.9	52.8	55.7	65.2	62.3	58.2	55.6	54.1	53.6	53.6
Population in million (eop)	3.1	3.1	3.1	3.2	3.2	3.2	3.2	3.3	3.4	3.4	3.5	3.6

Sources: Mongolian authorities; and Fund staff projections.

1/ Includes DBM spending.

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

3/ Gross official reserves includes drawings from

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

5/ December 2014 = 100

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

(In billions of togrogs)

	2015	2016	2017		2018		2019	2020	2021	2022	2023	
	Act.	EFF	Act.	EFF	3rd review	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	
Total revenue and grants	5807	5635	6431	7922	7279	8281	8450	9685	10567	11643	12829	14483
Current revenue	5752	5556	6285	7868	7169	8170	8339	9560	10426	11486	12652	14284
Tax revenue and social security contributions	5121	4875	5523	6986	6346	7337	7486	8643	9399	10339	11363	12829
Income taxes	1171	1043	1120	1610	1292	1510	1693	1941	2055	2283	2542	2944
CIT	688	520	520	962	556	863	977	1200	1225	1356	1501	1769
PIT	482	523	600	648	735	647	716	741	830	927	1042	1176
Social security contributions	1018	1034	1199	1314	1410	1481	1448	1685	1984	2203	2458	2775
VAT	1050	1141	1279	1619	1434	1682	1755	1977	2110	2276	2433	2672
Excise taxes	592	630	487	520	659	645	664	752	843	940	1048	1184
Customs duties and export taxes	321	328	417	512	476	568	553	617	639	674	696	721
Other taxes	970	698	1020	1411	1076	1452	1373	1671	1767	1963	2185	2533
Non-tax revenue	631	682	762	882	823	833	853	917	1027	1147	1289	1455
Capital revenue and grants	54	78	146	54	110	111	111	126	141	157	177	199
Total expenditure and net lending	7781	9699	9183	8448	9640	9895	9908	11147	11467	11897	13050	14567
Current expenditure	5656	6571	7178	6948	7574	7440	7453	8069	8325	8970	10015	11139
Wages and salaries	1710	1747	1764	1775	1796	1853	1853	2002	2234	2495	2803	3164
Purchase of goods and services	1092	1386	1426	1337	1497	1455	1455	1602	1759	1965	2207	2492
Subsidies	110	229	233	261	245	236	236	234	294	317	356	402
Transfers	2075	2265	2431	2477	2522	2758	2758	3112	3027	3285	3691	4166
Interest payments	668	943	1324	1098	1514	1139	1151	1119	1011	909	958	915
Capital expenditure and net lending 1/	2126	3128	2005	1500	2066	2454	2454	3077	3142	2926	3035	3428
Capital expenditure	1397	2360	1607	1646	1623	1991	1991	2719	2672	2426	2473	2822
Domestically-financed	1151	1664	949	1093	816	1184	1184	1759	1901	1568	1522	2024
o/w DBM noncommercial spending	431	240	173	0	0	0	0	0	0	0	0	0
Foreign-financed	246	696	658	553	807	807	807	960	771	858	952	798
Net lending	729	768	398	-146	443	463	463	358	470	500	562	606
o/w DBM commercial spending 2/	706	247	150	-475	159	253	253	173	194	217	244	275
o/w Mortgage program net lending	0	0	111	0	120	120	120	130	140	152	170	184
Overall balance (IMF definition)	-1975	-4065	-2753	-526	-2361	-1614	-1458	-1461	-901	-253	-221	-83
Primary balance (IMF definition)	-1306	-3121	-1428	572	-846	-475	-306	-342	110	656	737	832
Financing	1975	4065	2753	168	2361	1614	1458	1461	901	253	221	83
External	384	1214	2024	1716	2560	1167	845	2604	2257	419	377	-66
Disbursement	505	1350	2646	1881	3268	2914	1764	2884	2635	2162	3496	2601
Amortization	-121	-136	-622	-165	-708	-1747	-919	-280	-379	-1742	-3118	-2667
Domestic (net)	1591	2850	729	-1548	-199	447	613	-1143	-1356	-166	-156	149
Government bonds (net issuance)	366	2454	1069	-1306	-274	346	613	-1143	-1356	-166	-156	149
Privatization	54	1	100	0	75	101	0	0	0	0	0	0
Other	1170	396	-440	-242	0	0	0	0	0	0	0	0
<b>Memorandum items:</b>												
Mineral revenue (in percent of GDP)	4.4	2.5	3.7	5.1	3.7	3.9	4.1	4.3	4.0	3.9	3.9	4.0
Non-mineral revenue (in percent of GDP)	20.7	21.1	20.9	24.0	22.6	23.1	23.3	23.4	23.0	22.7	22.2	22.1
Total expenditure (in percent of non-mineral GDP)	40.5	50.7	46.4	39.8	45.9	41.2	39.2	38.9	35.7	33.2	32.4	32.0
Non-mineral overall balance (in percent of non-mineral)	-15.5	-24.4	-25.5	-9.0	-23.4	-11.7	-10.8	-10.4	-7.6	-5.5	-5.3	-5.1
Primary spending (change in percent)	-12.5	23.1	-10.5	-16.1	3.4	19.1	19.1	14.5	4.3	5.1	10.1	12.9

Sources: Mongolian authorities; and Fund staff projections.

1/ Includes DBM spending.

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

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

(In percent of GDP)

	2015	2016	2017		2018		2019	2020	2021	2022	2023	
	Act.		EFF	Act.	EFF	3rd review	Proj.		Proj.			
Total revenue and grants	25.1	23.5	24.7	29.2	26.3	27.0	27.4	27.7	27.0	26.6	26.1	26.1
Current revenue 1/	24.8	23.2	24.1	29.0	25.9	26.6	27.0	27.4	26.6	26.3	25.8	25.8
Tax revenue and social security contributions	22.1	20.4	21.2	25.7	22.9	23.9	24.3	24.7	24.0	23.6	23.1	23.1
Income taxes	5.1	4.4	4.3	5.9	4.7	4.9	5.5	5.6	5.2	5.2	5.2	5.3
CIT	3.0	2.2	2.0	3.5	2.0	2.8	3.2	3.4	3.1	3.1	3.1	3.2
PIT	2.1	2.2	2.3	2.4	2.7	2.1	2.3	2.1	2.1	2.1	2.1	2.1
Social security contributions	4.4	4.3	4.6	4.8	5.1	4.8	4.7	4.8	5.1	5.0	5.0	5.0
VAT	4.5	4.8	4.9	6.0	5.2	5.5	5.7	5.7	5.4	5.2	5.0	4.8
Excise taxes	2.6	2.6	1.9	1.9	2.4	2.1	2.2	2.2	2.2	2.1	2.1	2.1
Customs duties and export taxes	1.4	1.4	1.6	1.9	1.7	1.9	1.8	1.8	1.6	1.5	1.4	1.3
Other taxes	4.2	2.9	3.9	5.2	3.9	4.7	4.5	4.8	4.5	4.5	4.4	4.6
Non-tax revenue	2.7	2.8	2.9	3.2	3.0	2.7	2.8	2.6	2.6	2.6	2.6	2.6
Capital revenue and grants	0.2	0.3	0.6	0.2	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Total expenditure and net lending	33.6	40.5	35.3	31.1	34.8	32.3	32.1	31.9	29.3	27.2	26.6	26.3
Current expenditure	24.4	27.5	27.6	25.6	27.4	24.3	24.2	23.1	21.3	20.5	20.4	20.1
Wages and salaries	7.4	7.3	6.8	6.5	6.5	6.0	6.0	5.7	5.7	5.7	5.7	5.7
Purchase of goods and services	4.7	5.8	5.5	4.9	5.4	4.7	4.7	4.6	4.5	4.5	4.5	4.5
Subsidies	0.5	1.0	0.9	1.0	0.9	0.8	0.8	0.7	0.8	0.7	0.7	0.7
Transfers	9.0	9.5	9.3	9.1	9.1	9.0	8.9	8.9	7.7	7.5	7.5	7.5
Interest payments 2/	2.9	3.9	5.1	4.0	5.5	3.7	3.7	3.2	2.6	2.1	2.0	1.7
Capital expenditure and net lending 3/	9.2	13.1	7.7	5.5	7.5	8.0	8.0	8.8	8.0	6.7	6.2	6.2
Capital expenditure	6.0	9.9	6.2	6.1	5.9	6.5	6.5	7.8	6.8	5.5	5.0	5.1
Domestically-financed	5.0	7.0	3.6	4.0	2.9	3.9	3.8	5.0	4.9	3.6	3.1	3.7
o/w DBM noncommercial spending	1.9	1.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign-financed	1.1	2.9	2.5	2.0	2.9	2.6	2.6	2.7	2.0	2.0	1.9	1.4
Net lending	3.1	3.2	1.5	-0.5	1.6	1.5	1.5	1.0	1.2	1.1	1.1	1.1
o/w DBM commercial spending 4/	3.1	1.0	0.6	-1.7	0.6	0.8	0.8	0.5	0.5	0.5	0.5	0.5
o/w Mortgage program net lending	0.0	0.0	0.4	0.0	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.3
Overall balance (IMF definition)	-8.5	-17.0	-10.6	-1.9	-8.5	-5.3	-4.7	-4.2	-2.3	-0.6	-0.5	-0.2
Primary balance (IMF definition)	-5.6	-13.0	-5.5	2.1	-3.1	-1.5	-1.0	-1.0	0.3	1.5	1.5	1.5
Financing	8.5	17.0	10.6	0.6	8.5	5.3	4.7	4.2	2.3	0.6	0.5	0.2
External	1.7	5.1	7.8	6.3	9.2	3.8	2.7	7.5	5.8	1.0	0.8	-0.1
Disbursement	2.2	5.6	10.2	6.9	11.8	9.5	5.7	8.3	6.7	4.9	7.1	4.7
Amortization	-0.5	-0.6	-2.4	-0.6	-2.6	-5.7	-3.0	-0.8	-1.0	-4.0	-6.3	-4.8
Domestic (net)	6.9	11.9	2.8	-5.7	-0.7	1.5	2.0	-3.3	-3.5	-0.4	-0.3	0.3
Government bonds (net issuance)	1.6	10.3	4.1	-4.8	-1.0	1.1	2.0	-3.3	-3.5	-0.4	-0.3	0.3
Privatization	0.2	0.0	0.4	0.0	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Other	5.1	1.7	-1.7	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Memorandum items:</b>												
Mineral revenue (in percent of GDP)	4.4	2.5	3.7	5.1	3.7	3.9	4.1	4.3	4.0	3.9	3.9	4.0
Non-mineral revenue (in percent of GDP)	20.7	21.1	20.9	24.0	22.6	23.1	23.3	23.4	23.0	22.7	22.2	22.1
Total expenditure (in percent of non-mineral GDP)	40.5	50.7	0.2	39.8	0.2	41.2	39.2	38.9	35.7	33.2	32.4	32.0
Non-mineral overall balance (in percent of non-mineral GDP)	-15.5	-24.4	20.8	-9.0	22.4	-11.7	-10.8	-10.4	-7.6	-5.5	-5.3	-5.1
Primary spending (change in percent)	-12.5	23.1	-17.9	-16.1	-2.7	19.1	19.1	14.5	4.3	5.1	10.1	12.9

Sources: Mongolian authorities; and Fund staff projections.

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

2/ The 2017 budget revenue estimates are understated because accumulations to the FSF and FHF are not included.

3/ Includes DBM spending.

4/ Not on the budget, using instead Fund projections.

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

	2015		2016		2017		2018		2019	2020	2021	2022	2023
	Act.		EFF	Act.	EFF	3rd review	Proj.		Proj.				
(In millions of U.S. dollars, unless otherwise indicated) 1/													
Current account balance (including official grants)	-469	-700	-456	-1155	-1004	-804	-1000	-1161	-1171	-782	-241	584	
Trade balance	1178	1338	1266	1490	968	1584	1525	1258	1179	1524	2029	2862	
Exports	4616	4804	4898	5834	4943	6277	6443	6627	6622	7159	7747	8920	
Mineral export	4099	3999	4314	5162	4351	5598	5747	5920	5916	6429	6992	8116	
Non-mineral export	517	805	584	672	592	678	696	707	707	730	755	804	
Imports	-3438	-3466	-3632	-4345	-3975	-4692	-4918	-5369	-5443	-5636	-5718	-6058	
Services, net	-857	-1338	-1017	-1212	-1174	-1262	-1288	-1234	-1221	-1237	-1220	-1295	
Income, net	-966	-911	-937	-1613	-1033	-1357	-1428	-1392	-1355	-1313	-1295	-1250	
Current transfers	205	176	231	181	234	230	192	208	225	243	245	267	
General government	56	20	31	22	32	65	26	28	30	33	17	18	
Other sectors	148	156	200	159	202	166	166	180	195	210	228	250	
Of which: Workers remittances	76	117	88	134	88	125	125	139	152	167	184	205	
Capital and financial account	382	916	91	2068	785	693	839	1593	839	1329	109	-17	
Capital account	114	104	114	78	117	213	85	101	111	122	125	129	
Financial account	268	812	-23	1990	667	481	754	1492	728	1208	-16	-146	
Direct investment	110	-4171	995	1446	1547	1533	1659	2164	1990	2023	1511	1071	
Portfolio investment	274	487	-94	493	0	-273	-296	0	-500	0	-412	-273	
Trade credits, net	-302	-221	-45	-44	-45	-106	-106	-123	-91	-107	-107	-102	
Currency and deposits, net	-233	-204	-886	489	-663	-198	-158	-282	-259	-317	-293	-322	
Loans, net	347	4920	7	-394	-171	-475	-345	-267	-412	-392	-715	-520	
Other, net	72	0	0	0	0	0	0	0	0	0	0	0	
Errors and omissions	-181	-221	0	-56	0	-144	-140	-145	-149	-142	-126	-140	
Overall balance	-268	-5	-365	857	-220	-254	-301	287	-481	405	-258	426	
Change in reserves 2/	-324	-27	395	1715	823	583	138	1149	455	651	-25	426	
Financing Gap	0	0	760	717	1043	837	439	862	936	246	233	0	
Fund credit	n.a.	n.a.	113	113	135	135	135	142	35	0	0	0	
Donor support	n.a.	n.a.	647	603	908	703	305	720	901	246	233	0	
<b>Memorandum items:</b>													
Current account balance (in percent of GDP)	-4.0	-6.3	-4.4	-10.4	-9.5	-6.4	-8.0	-8.3	-7.7	-4.7	-1.3	2.8	
Gross official reserves (end-period) 3/	1324	1297	1692	3012	2515	3595	3150	4299	4755	5406	5380	5807	
(In months of next year's imports of goods and services)	2.8	2.4	3.4	5.0	4.4	5.5	4.9	6.6	7.0	7.9	7.4	7.6	
Copper price (in U.S. dollars per ton)	5510	4868	5722	6170	5733	7075	7132	7228	7242	7237	7232	7232	
Oil price (in U.S. dollars per barrel)	51	43	55	53	56	65	62	58	56	54	54	54	
Gold price (in U.S. dollars per troy oz.)	1160	1248	1212	1257	1225	1344	1340	1375	1421	1460	1500	1542	
Sources: Mongolian authorities; and Fund staff projections.													
1/ Structural break in series: 2013-2015 reported on the basis on BPM5, while 2016 onwards in on BPM6.													
2/ Changes in reserves reflect valuation adjustments.													
3/ Gross official reserves includes drawings from swap line.													

Table 4. Mongolia: Monetary Aggregates, 2015–23

	2015	2016	2017		2018		2019	2020	2021	2022	2023	
	Act.		EFF	Act.	EFF	3rd review	Proj.		Proj.			
	(In billions of togrog, end of period)											
Reserve Money	2460	3064	3734	3939	4457	4782	4793	5432	6087	6798	7638	8622
Broad money	10049	12159	13967	15861	15822	19127	19269	21838	24471	27329	30705	34660
Currency	459	563	656	612	743	745	963	1092	1224	1366	1535	1733
Deposits	9590	11596	13311	15249	15079	18382	18305	20746	23247	25963	29169	32927
Net foreign assets	-4158	-4580	-4176	-1541	-2037	-92	-293	-445	-914	-1593	-2249	-2889
BOM	-1278	-1260	...	2283	...	...	2777	5890	7260	9214	9366	10749
Other Depository Corporations	-2880	-3320	...	-3824	...	...	-3070	-6335	-8174	-10806	-11614	-13638
Net domestic assets	14207	16739	18143	17402	17859	19219	19562	22283	25385	28922	32953	37549
Net Domestic credit	15129	17363	18252	16958	19640	18351	19071	21792	24895	28431	32463	37059
Net claims on government	661	1851	2044	-366	1770	100	-366	-366	-366	-366	-366	-366
BOM	-496	-350	...	-1111	...	...	-1111	-1111	-1111	-1111	-1111	-1111
Other Depository Corporations	1157	2200	...	745	...	...	745	745	745	745	745	745
Net claims on private sector	11798	13014	16208	14217	17870	18251	15994	18233	20785	23695	27013	30794
Net claims on other financial corporation	2437	2437	...	3061	...	...	3443	3925	4475	5101	5816	6630
Other items, net	-689	-563	-109	491	-1780	868	491	491	491	491	491	491
<b>Memorandum items:</b>												
Annual broad money growth	-5.5	21.0	16.1	30.5	13.3	21.1	21.5	13.3	12.1	11.7	12.4	12.9
Velocity of Broad Money	2.3	2.0	1.9	1.7	1.8	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Credit outstanding (Domestic credit+MBS) (In MNT bn) /1	13929	14866	16208	16521	17870	18251	18586	21188	24154	27536	31391	35785
Credit to GDP ratio	60.2	62.1	62.2	60.8	64.5	59.5	60.3	60.6	61.7	63.0	63.9	64.5
Credit growth (percent)	3.6	6.7	9.0	11.1	10.3	13.6	12.5	14.0	14.0	14.0	14.0	14.0
1/Includes mortgage-backed securities.												
Sources: Mongolian authorities; and Fund staff projections.												

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

(In millions of U.S. dollars)

	2015	2016	2017	Projections					
				2018	2019	2020	2021	2022	2023
Gross financing requirements	935	2,067	3,628	3,022	3,907	3,594	3,441	3,412	2,609
External current account deficit (excl. official transfers)	497	756	1,176	1,025	1,188	1,202	815	258	-566
Amortization	427	689	1,212	1,359	1,067	1,519	1,483	2,715	2,251
Public sector	64	62	259	655	292	148	712	1,219	1,562
o/w bonds	0	0	0	273	0	0	500	1,000	1,073
o/w loans	58	62	259	382	292	148	212	219	489
Private sector	363	627	952	704	775	1,371	771	1,496	689
Repayment of arrears	0	0	0	0	0	0	0	0	0
Gross reserves accumulation (increase = +)	-324	-27	1,715	138	1,149	455	651	-25	426
IMF repurchases and repayments	3	0	0	0	0	0	0	0	0
Other net capital outflows 1/	332	648	-474	499	502	418	491	464	498
	0	0	0	0	0	0	0	0	0
Available financing	935	2,067	2,911	2,583	3,045	2,658	3,195	3,179	2,609
Grants	28	56	20	26	28	30	33	17	18
Disbursements to public sector	255	1,133	755	575	468	141	627	1,129	1,265
o/w bonds	0	500	433	0	0	0	500	1,000	800
o/w loans	255	633	322	575	468	141	127	129	465
Disbursements to private sector	543	5,049	691	323	384	496	511	522	256
Foreign direct investment	110	-4,171	1,446	1,659	2,164	1,990	2,023	1,511	1,071
Financing need	0	0	717	439	862	936	246	233	0
Financing	0	0	717	439	862	936	246	233	0
IMF 2/	0	0	113	135	142	35	0	0	0
Other IFI	0	0	320	304	392	448	0	0	0
Identified bilateral support	0	0	283	1	328	453	246	233	0
PBOC swap (additional drawing)	0	0	0	0	0	0	0	0	0
PBOC swap rollover (net zero)			1,805			1,805			

Sources: Mongolian authorities; and Fund staff projections.

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

2/ SDR/USD = 0.73924 exchange rate was used.

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

(In millions of SDR, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023
Existing and prospective Fund arrangements							
Disbursements	83.87	99.59	104.84	26.21			
Stock 1/	83.87	183.45	288.29	314.51	312.18	294.27	259.32
Obligations 2/	0.64	2.50	6.14	9.35	12.04	27.43	44.93
Principal (repayments/repurchases)					2.33	17.91	34.94
Charges and interest	0.64	2.50	6.14	9.35	9.71	9.52	9.99
Stock of existing and prospective Fund credit 1/	83.87	183.45	288.29	314.51	312.18	294.27	259.32
In percent of quota	116.00	253.74	398.75	435.00	431.78	407.01	358.68
In percent of GDP	1.01	1.97	2.81	2.80	2.52	2.10	1.66
In percent of exports of goods and services	1.65	3.37	5.05	5.35	4.95	4.38	3.63
In percent of gross usable reserves	2.78	5.10	6.05	6.34	5.37	5.05	4.16
Obligations to the Fund from existing and prospective Fund arrangements	0.64	2.50	6.14	9.35	12.04	27.43	44.93
In percent of quota	0.89	3.46	8.49	12.93	16.65	37.94	62.14
In percent of GDP	0.00	0.03	0.06	0.08	0.09	0.19	0.28
In percent of exports of goods and services	0.00	0.05	0.10	0.15	0.18	0.40	0.62
In percent of gross usable reserves	0.01	0.07	0.12	0.18	0.20	0.46	0.72
Sources: IMF Finance Department; and Fund staff estimates and projections.							
1/ End of period.							
2/ Repayment schedule based on scheduled debt service obligations.							

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

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

1/ The first and second reviews were combined.



Table 8. Mongolia: Summary of Financial Stability Indicators, 2010-18

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

Source: Mongolian authorities.

## Annex I. Public Debt Sustainability Analysis

*While still high at around 85 percent of GDP, the public debt ratio has come down and is expected to improve further under the baseline. This improvement reflects projections of high nominal growth, concessional financing, and strong fiscal performance under the program. However, this trajectory is vulnerable to changes in the path of growth and the exchange rate.*

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

- Real GDP growth is expected to remain anchored around 5-6 percent
- Inflation is expected to remain at or below the target of 8 percent
- The exchange rate is broadly in line with fundamentals and expected to remain so over the forecast horizon
- Financing assumes concessional budget support and project loans in line with original program commitments.
- The primary balance is projected to gradually improve from -1 percent to 1.5 percent of GDP between 2018 and 2023.

**2. The improving debt outlook is mainly shaped by the projected path of the interest rate-growth differential.** The public debt-to-GDP ratio is forecast to decline by about 30 percentage points between end-2017 and end-2023. This decline is almost entirely due to benign “automatic” debt dynamics in the form of low interest rates and high economic growth. At present, 40 percent of public debt is on concessional terms and this is expected to rise to about 60 by the end of the program. The average effective interest rate of public debt is currently 5.4 percent and projected to fall to about 4 percent by 2020.

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

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

- *Growth shock.* Slower growth remains a key risk to debt sustainability, given the high volatility and commodity-dependence of the Mongolian economy. Assuming a decline in growth by one standard deviation in 2019 and 2020, the debt-to-GDP-ratio is forecast to reach 90 percent in 2020, reversing the improvements in debt dynamics in the preceding three years. It would also sizably increase gross financing needs in 2020 to about 18 percent of GDP compared to about 12 percent of GDP in the baseline.
- *Exchange rate shock.* An exchange rate depreciation also poses significant risk to the public debt, given that roughly 84 percent of the debt is foreign-currency denominated. A real exchange rate depreciation of 25 percent in 2019, would increase debt to 90 percent of GDP, compared to about 76 percent projected under the baseline.
- *Primary balance shock.* The DSA considers a particularly large primary balance shock—a 20 percent of GDP worsening in the primary balance relative to the baseline over 2020 and 2021—given the very loose fiscal stance observed immediately before the program in 2015 and 2016 (-5.6 and -13 percent of GDP respectively). Under this scenario, public debt reaches 87 percent in 2021, and gross financing needs reach almost 20 percent of GDP.

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

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

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

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

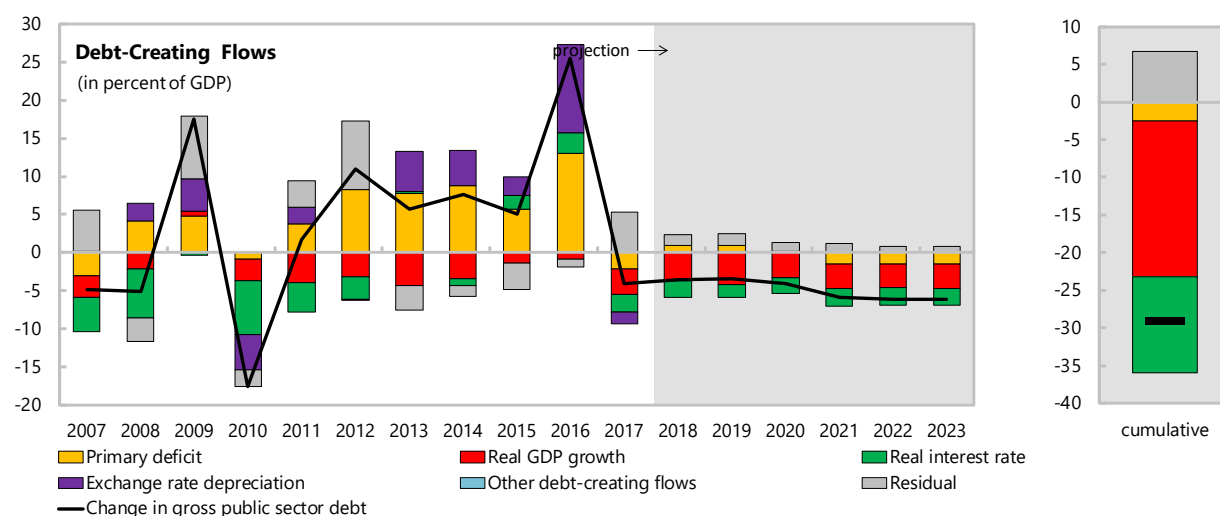
(in percent of GDP unless otherwise indicated)

### Debt, Economic and Market Indicators <sup>1/</sup>

	Actual			Projections						As of April 01, 2018	
	2007-2015 <sup>2/</sup>	2016	2017	2018	2019	2020	2021	2022	2023	Sovereign Spreads	
Nominal gross public debt	43.5	87.6	83.5	79.9	76.5	72.4	66.6	60.5	54.4	EMBIG (bp) <sup>3/</sup>	290
Public gross financing needs	6.0	18.0	3.6	16.5	7.7	11.8	4.3	11.5	6.1	5Y CDS (bp)	258
Real GDP growth (in percent)	8.2	1.4	4.3	5.0	6.0	4.8	5.0	5.2	5.9	Ratings	Foreign Local
Inflation (GDP deflator, in percent)	10.9	2.1	7.9	8.1	6.9	6.9	6.4	6.8	6.6	Moody's	B3 B3
Nominal GDP growth (in percent)	22.3	3.4	13.5	13.5	13.3	12.1	11.7	12.4	12.9	S&Ps	B- B-
Effective interest rate (in percent) <sup>4/</sup>	2.7	6.6	5.2	5.4	4.9	4.2	3.3	3.2	3.0	Fitch	B- B-

### Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance <sup>9/</sup>
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023		
Change in gross public sector debt	2.4	25.5	-4.1	-3.6	-3.4	-4.1	-5.8	-6.1	-6.1	-29.2	
Identified debt-creating flows	0.9	26.6	-9.4	-4.9	-5.0	-5.2	-7.0	-7.0	-6.9	-35.9	
Primary deficit	4.4	13.0	-2.1	1.0	1.0	0.2	-1.6	-1.6	-1.6	-2.5	-5.3
Primary (noninterest) revenue and grants	31.2	23.5	29.2	27.4	27.7	27.0	26.6	26.1	26.1	160.9	
Primary (noninterest) expenditure	35.6	36.6	27.1	28.4	28.7	27.2	25.1	24.5	24.5	158.4	
Automatic debt dynamics <sup>5/</sup>	-3.5	13.5	-7.3	-5.9	-5.9	-5.4	-5.5	-5.4	-5.3	-33.4	
Interest rate/growth differential <sup>6/</sup>	-5.3	1.8	-5.8	-5.9	-5.9	-5.4	-5.5	-5.4	-5.3	-33.4	
Of which: real interest rate	-2.7	2.6	-2.4	-2.3	-1.7	-2.1	-2.2	-2.4	-2.1	-12.8	
Of which: real GDP growth	-2.6	-0.8	-3.4	-3.7	-4.3	-3.3	-3.2	-3.1	-3.2	-20.7	
Exchange rate depreciation <sup>7/</sup>	1.8	11.7	-1.6	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
0 (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes <sup>8/</sup>	1.4	-1.0	5.3	1.3	1.5	1.1	1.2	0.9	0.8	6.8	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

5/ Derived as  $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+grt)]$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $a$  = share of foreign-currency denominated debt; and  $e$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

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

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

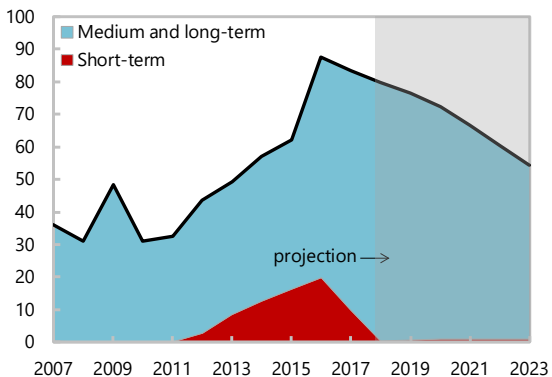
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

## Mongolia Public DSA - Composition of Public Debt and Alternative Scenarios

### Composition of Public Debt

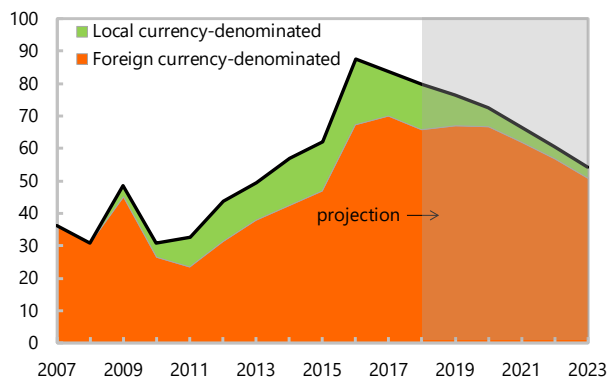
#### By Maturity

(in percent of GDP)



#### By Currency

(in percent of GDP)

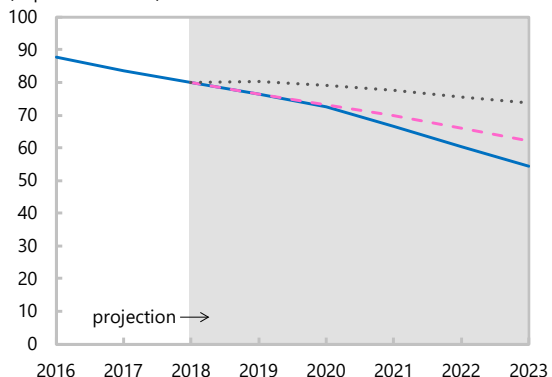


### Alternative Scenarios

— Baseline      ..... Historical      - - - Constant Primary Balance

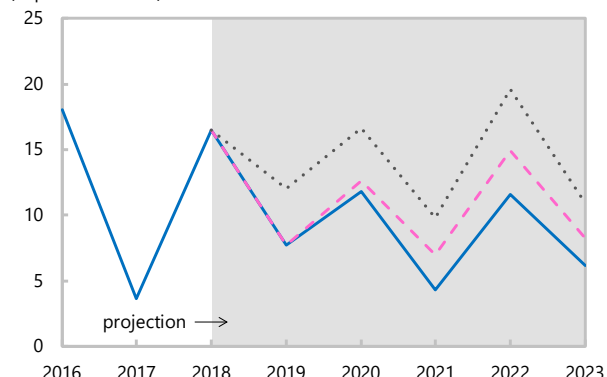
#### Gross Nominal Public Debt

(in percent of GDP)



#### Public Gross Financing Needs

(in percent of GDP)



### Underlying Assumptions

(in percent)

#### Baseline Scenario

	2018	2019	2020	2021	2022	2023
Real GDP growth	5.0	6.0	4.8	5.0	5.2	5.9
Inflation	8.1	6.9	6.9	6.4	6.8	6.6
Primary Balance	-1.0	-1.0	-0.2	1.6	1.6	1.6
Effective interest rate	5.4	4.9	4.2	3.3	3.2	3.0

#### Constant Primary Balance Scenario

Real GDP growth	5.0	6.0	4.8	5.0	5.2	5.9
Inflation	8.1	6.9	6.9	6.4	6.8	6.6
Primary Balance	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Effective interest rate	5.4	4.9	4.2	3.3	3.2	3.1

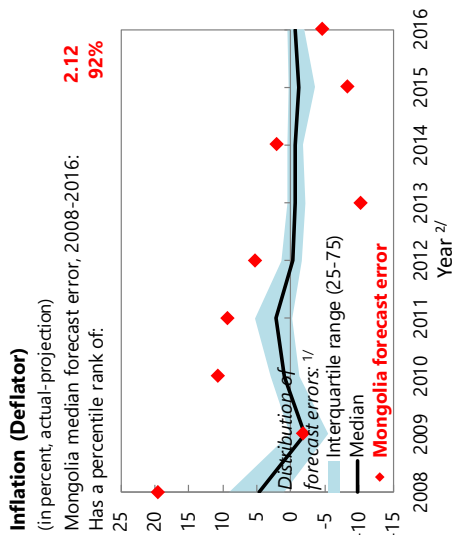
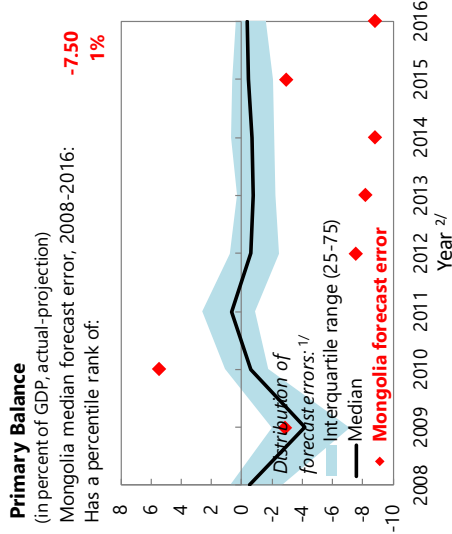
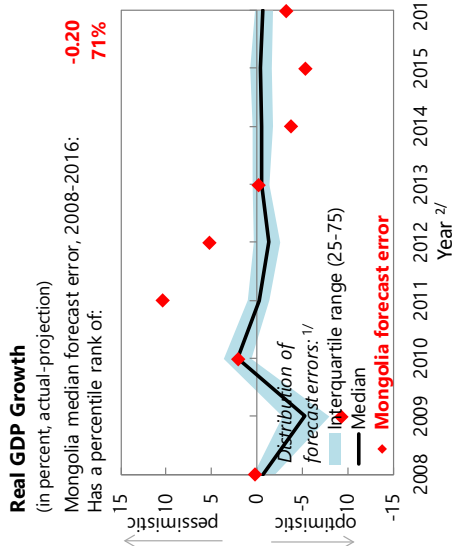
#### Historical Scenario

	2018	2019	2020	2021	2022	2023
Real GDP growth	5.0	7.1	7.1	7.1	7.1	7.1
Inflation	8.1	6.9	6.9	6.4	6.8	6.6
Primary Balance	-1.0	-5.3	-5.3	-5.3	-5.3	-5.3
Effective interest rate	5.4	4.9	3.5	2.4	2.1	1.8

Source: IMF staff.

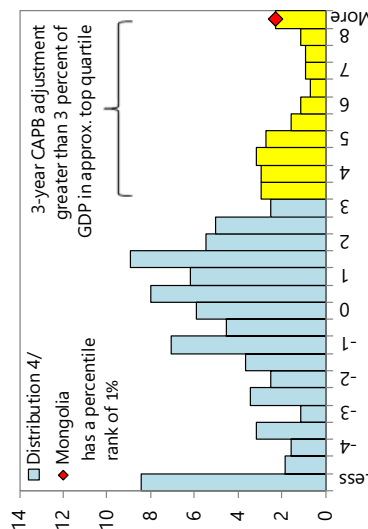
## Mongolia Public DSA - Realism of Baseline Assumptions

### Forecast Track Record, versus all countries

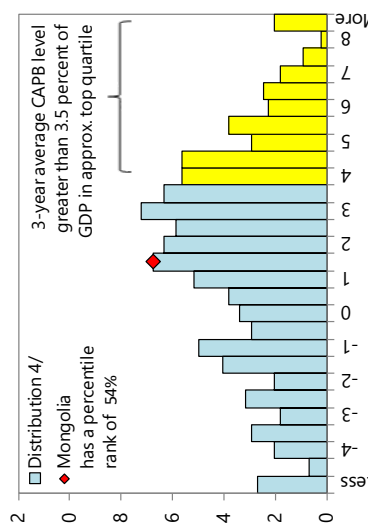


### Assessing the Realism of Projected Fiscal Adjustment

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

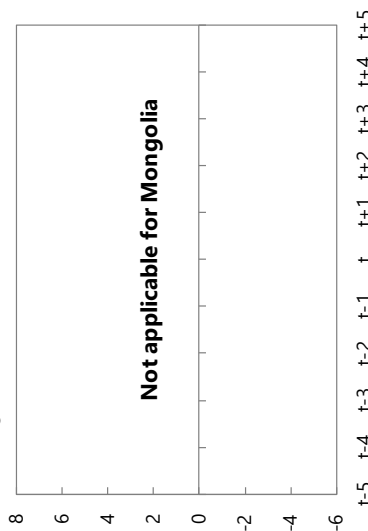


**3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPPB)**  
(Percent of GDP)



### Boom-Bust Analysis

**Real GDP growth**  
(in percent)



Source : IMF Staff.

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

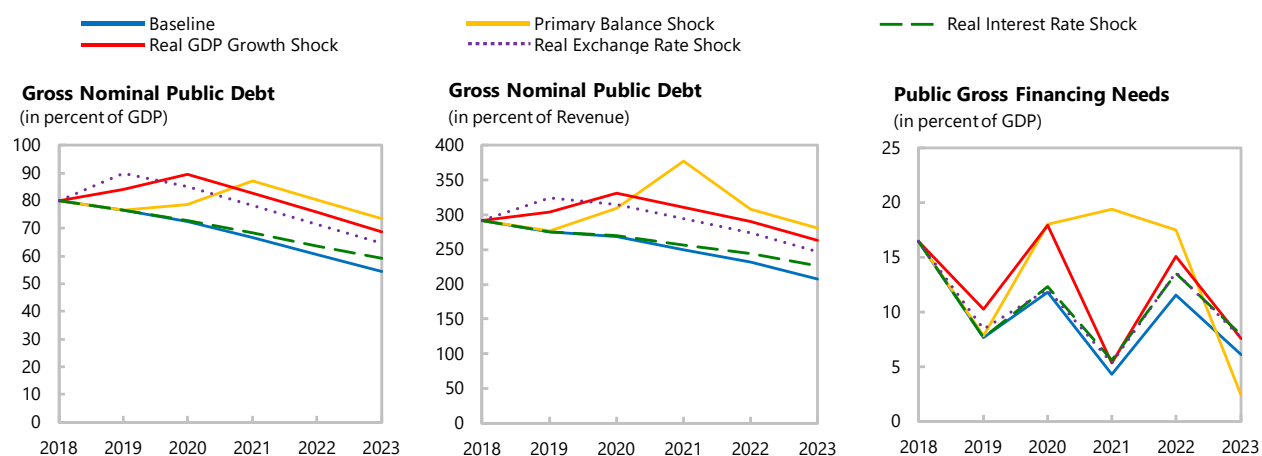
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Mongolia, as it meets neither the positive output gap criterion nor the private credit growth criterion.

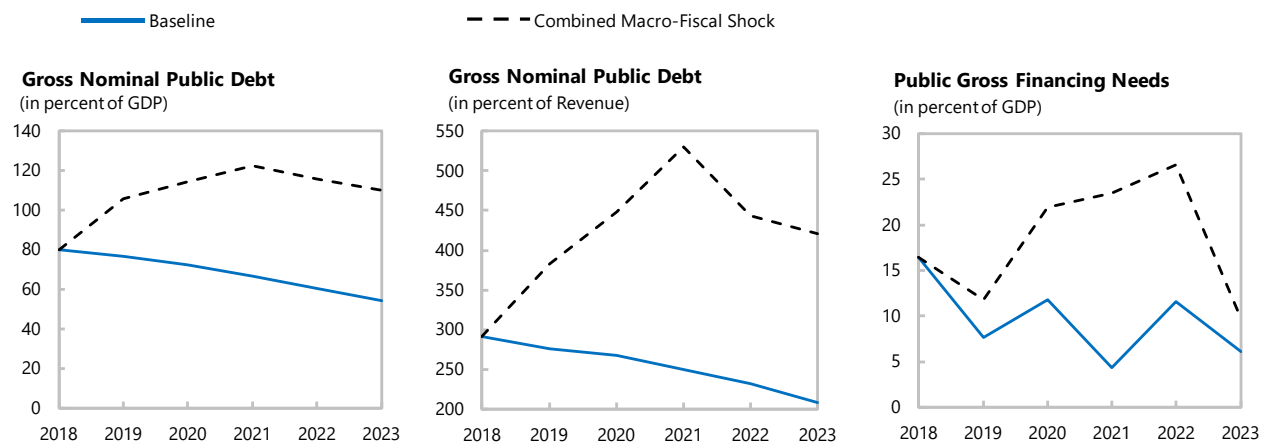
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis. □

### Mongolia Public DSA - Stress Tests

#### Macro-Fiscal Stress Tests



#### Additional Stress Tests



#### Underlying Assumptions (in percent)

	2018	2019	2020	2021	2022	2023
<b>Primary Balance Shock</b>						
Real GDP growth	5.0	6.0	4.8	5.0	5.2	5.9
Inflation	8.1	6.9	6.9	6.4	6.8	6.6
Primary balance	-1.0	-1.1	-6.4	-12.6	1.6	1.5
Effective interest rate	5.4	4.9	4.2	3.7	4.1	3.7
<b>Real Interest Rate Shock</b>						
Real GDP growth	5.0	6.0	4.8	5.0	5.2	5.9
Inflation	8.1	6.9	6.9	6.4	6.8	6.6
Primary balance	-1.0	-1.0	-0.2	1.6	1.6	1.6
Effective interest rate	5.4	4.9	4.9	5.1	5.7	6.5
<b>Combined Shock</b>						
Real GDP growth	5.0	0.2	-1.0	5.0	5.2	5.9
Inflation	8.1	5.4	5.5	6.4	6.8	6.6
Primary balance	-1.0	-3.1	-6.4	-12.6	1.6	1.5
Effective interest rate	5.4	5.9	4.6	5.3	6.2	7.1
<b>Real GDP Growth Shock</b>						
Real GDP growth	5.0	0.2	-1.0	5.0	5.2	5.9
Inflation	8.1	5.4	5.5	6.4	6.8	6.6
Primary balance	-1.0	-3.1	-4.3	1.6	1.6	1.6
Effective interest rate	5.4	4.9	4.1	3.5	3.5	3.2
<b>Real Exchange Rate Shock</b>						
Real GDP growth	5.0	6.0	4.8	5.0	5.2	5.9
Inflation	8.1	15.1	6.9	6.4	6.8	6.6
Primary balance	-1.0	-1.0	-0.2	1.6	1.6	1.6
Effective interest rate	5.4	5.9	3.9	3.2	3.1	3.0

Source: IMF staff.

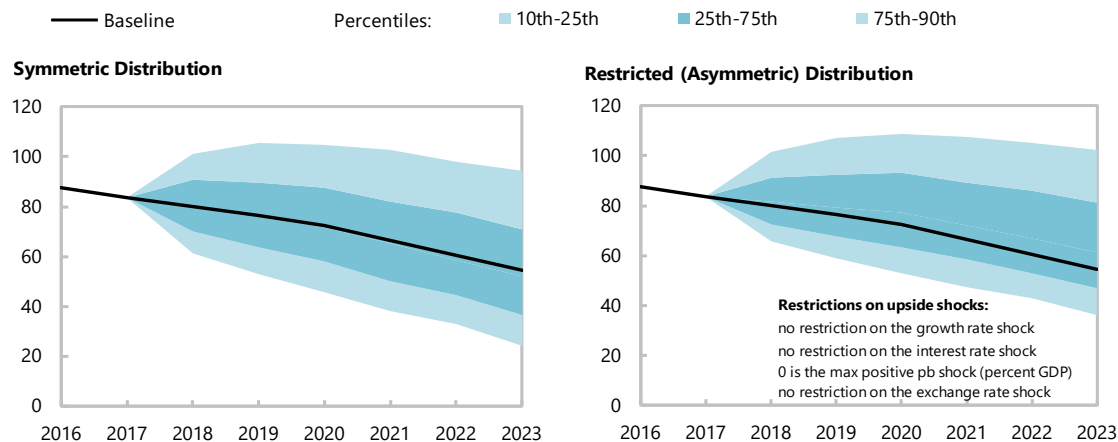
### Mongolia Public DSA Risk Assessment

#### Heat Map

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

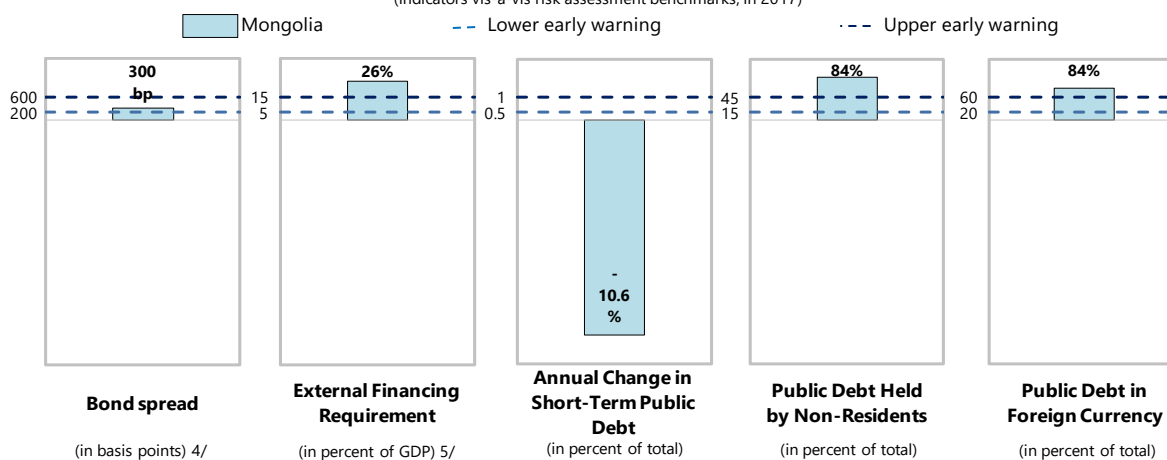
#### Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



#### Debt Profile Vulnerabilities

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



Source: IMF staff.

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

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

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

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

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

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



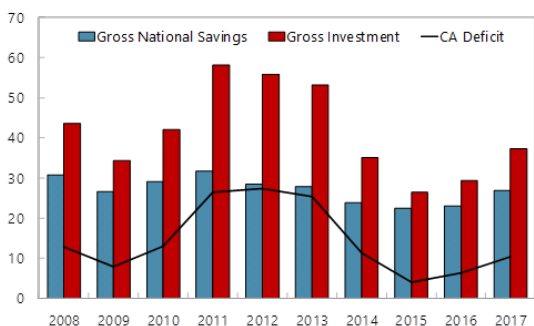
## Annex II. External Debt Sustainability Analysis

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

### 1. In the last 10 years, Mongolia’s external debt has risen from 40 to 240 percent of GDP.

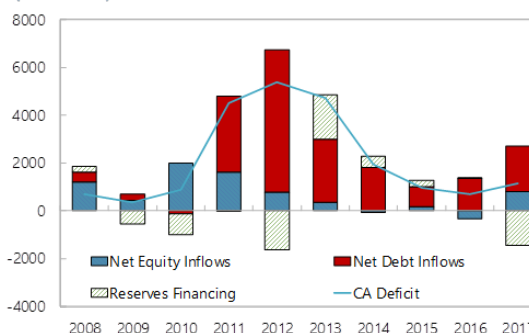
This primarily reflects high investment rates (rather than low savings rate) driving large current account deficits (average of 14 percent of GDP) that were largely financed by debt rather than equity. The high investment ratios are a function of large mining related capital needs, public capital spending, and real estate related building booms.

**Savings-Investment Balance**  
(Percent of GDP)



Sources: NSO, Fund staff calculations

**CA Deficit and Financing**  
(USD Millions)



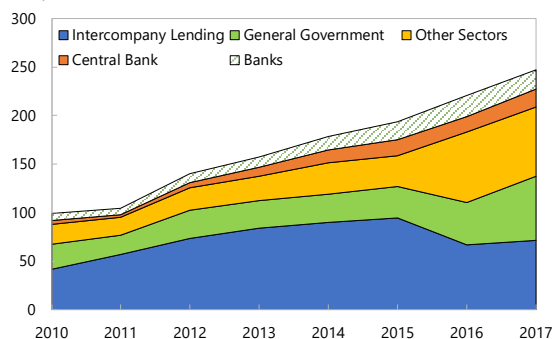
Sources: BOM, Fund staff calculations

**2. In the last two years, the increase in the external debt has reflected a few specific factors.** In 2016, there was a dramatic widening in the fiscal stance due to large public investment outlays and there was a 25 percent depreciation in the exchange rate. In 2017, investment in the second phase of the Oyu Tolgoi mining project resumed and this is financed by debt. In addition, as part of the program signed in early 2017, the authorities have borrowed just less than 10 percent of GDP from the multilateral and bilateral official sector to replace high cost domestic financing and improve debt sustainability.

### 3. One can break down the main borrowers in three categories.

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

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



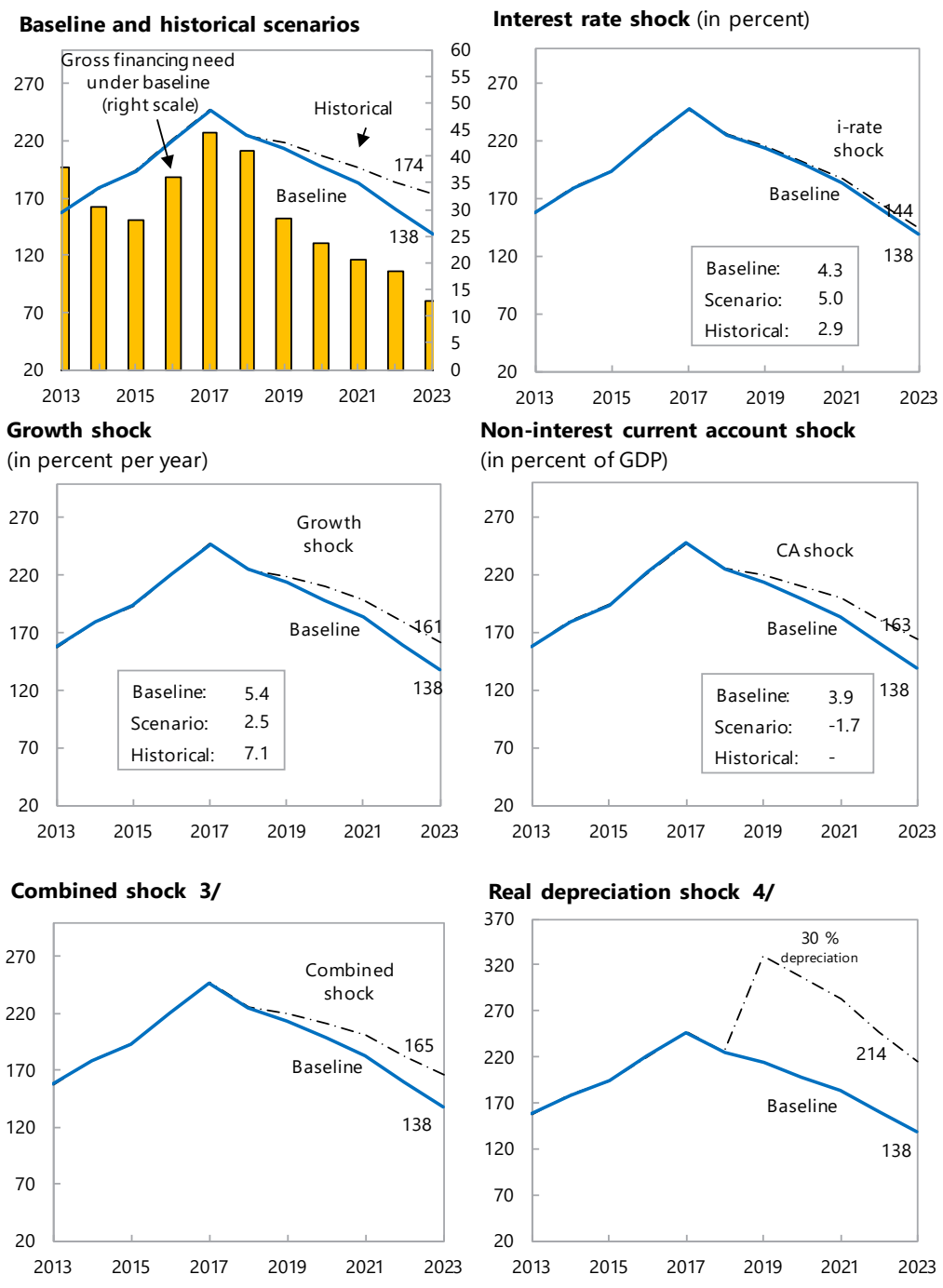
Sources: BOM

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

**5. Short-term external debt appears low but further analysis is needed.** Short-term external debt on an original maturity basis is 12 percent of GDP and only 40 percent of gross reserves. More analysis is needed to calculate short-term debt on a residual maturity basis. Public-sector amortizations of medium and long term external debt are low in both 2018 and 2019. Moreover, one would not expect any risks from short-term inter-company loans. However, it is critical to look at the phasing of maturities of medium and long term external debt of the private sector more broadly.

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

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



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

**Table 1. Mongolia: External Debt Sustainability Framework, 2013-23**  
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					Debt-stabilizing non-interest current account 6/ -13.9	
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022		2023
<b>Baseline: External debt</b>	157.6	178.7	193.3	220.7	246.9	224.8	213.2	198.2	183.1	159.5	138.2	
Change in external debt	17.4	21.1	14.6	27.4	26.2	-22.1	-11.6	-15.0	-15.1	-23.6	-21.3	
Identified external debt-creating flows (4+8+9)	5.4	13.3	10.0	53.6	6.5	-7.0	-11.2	-9.3	-11.6	-15.6	-16.7	
Current account deficit, excluding interest payments	21.6	5.0	-3.7	-3.0	-1.1	-2.5	-1	-1	-3	-6	-9	
Deficit in balance of goods and services	-100.1	-108.4	-87.6	-100.5	-119.7	-1.9	-0.2	0.4	-1.9	-4.5	-7.8	
Exports	39.6	51.9	45.2	50.2	61.1	59.4	55.9	51.2	50.2	48.9	49.9	
Imports	-60.5	-56.5	-42.4	-50.2	-58.6	57.5	55.8	51.6	48.3	44.3	42.2	
Net non-debt creating capital inflows (negative)	-16.7	-2.3	-0.9	37.4	-6.1	-4.0	-7.3	-7.7	-7.1	-8.2	-5.2	
Automatic debt dynamics 1/	0.5	10.6	14.7	19.2	13.7	-0.4	-3.0	-1.0	-1.3	-1.6	-2.6	
Contribution from nominal interest rate	3.8	6.3	7.7	9.2	11.6	10.5	9.3	8.4	7.7	7.0	5.9	
Contribution from real GDP growth	-15.8	-13.1	-4.7	-2.8	-9.7	-10.9	-12.2	-9.4	-9.0	-8.6	-8.5	
Contribution from price and exchange rate changes 2/	12.5	17.4	11.7	12.8	11.8	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	12.0	7.8	4.6	-26.3	19.7	-15.1	-0.4	-5.7	-3.5	-8.0	-4.6	
External debt-to-exports ratio (in percent)	398.3	344.1	428.1	439.3	404.3	378.6	381.2	387.0	364.9	326.4	276.8	
<b>Gross external financing need (in billions of US dollars) 4/</b>	4.7	3.7	3.3	4.0	5.0	5.2	3.9	3.6	3.4	3.4	2.6	
in percent of GDP	37.7	30.4	28.1	36.0	44.5	41.0	28.2	23.6	20.5	18.5	12.8	
<b>Scenario with key variables at their historical averages 5/</b>						<b>224.8</b>	<b>218.4</b>	<b>207.0</b>	<b>197.4</b>	<b>184.1</b>	<b>173.9</b>	<b>-22.6</b>
<b>Key Macroeconomic Assumptions Underlying Baseline</b>												
Real GDP growth (in percent)	11.6	8.1	2.5	1.4	4.3	5.0	6.0	4.8	5.0	5.2	5.9	
GDP deflator in US dollars (change in percent)	-8.2	-9.9	-6.1	-6.2	-5.1	7.6	4.5	4.7	4.4	5.0	4.9	
Nominal external interest rate (in percent)	2.8	3.9	4.1	4.5	5.2	4.8	4.6	4.3	4.3	4.2	4.1	
Growth of exports (US dollar terms, in percent)	-6.9	27.5	-16.4	5.6	21.3	9.8	4.4	0.5	7.4	7.5	13.6	
Growth of imports (US dollar terms, in percent)	-4.8	-9.3	-27.8	12.4	16.4	10.8	7.5	1.4	2.7	1.4	5.7	
Current account balance, excluding interest payments	-21.6	-5.0	3.7	3.0	1.1	2.5	0.9	0.7	3.2	5.9	8.9	
Net non-debt creating capital inflows	16.7	2.3	0.9	-37.4	6.1	4.0	7.3	7.7	7.1	8.2	5.2	

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

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

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

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

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

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

## Appendix I. Letter of Intent

June 8, 2018  
Ulaanbaatar

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

Dear Ms. Lagarde,

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

### **Context**

2. We are pleased to report that the Mongolian economy continues to re-bound, despite some recent temporary slowdown in coal exports. This recovery partly reflects strong external demand and benign global financial conditions. We have used the strong growth performance to over-perform on key macro targets and refinance outstanding debt at lower interest rates. Confidence is returning to the economy and the positive contribution of the mining sector has started to spread to other sectors. With the continuing support of our partners in the donor community, we envision significant further progress ahead.

### **Program Performance**

3. We have met all end-March 2018 quantitative performance criterion (QPCs) under the program. A 23-percent increase in revenues helped us reach a primary surplus in 1Q-18 of 2.1 percent of GDP, easily meeting the target. Even though gross reserves fell by \$40 million since end-2017, net international reserves rose by about \$200 million in 1Q-18, exceeding the target by \$487 million, as the Central Bank reduced outstanding liabilities. Over the same period, we increased our stock of central bank bills by over \$500 million to ensure that liquidity pressures remain under control, allowing us to meet the QPC on net domestic assets.

4. With respect to structural reforms, we continue to make progress on key benchmarks in the program, albeit with some delays:

- In the fiscal sector, we have submitted the tax law drafts to the Parliament to improve tax administration that were structural benchmarks due end-February—a revised General Tax law and a simplified regime for small and medium enterprises. In social protection, we have decided to adjust a previous program commitment in light of further evidence of a significant increase in poverty in recent years. After substantial consultation with donors, we increased the coverage of the Child Money program from 60 to 80 percent. We are maintaining the commitment to increase spending on targeted social programs.
  - In the financial sector, we approved amendments to the BOM law in January 2018, ahead of the end-March due date under the program. For systemic and viable banks, we will pass a recapitalization law in June (a prior action) which, in line with the principles established under the program, outlines eligibility for public support, governance of the process, burden sharing principles, supervision of the supported banks, management of public equity holdings in banks, and the need for privatization in due time. The Financial Stability Council has not yet finalized and published an NPL resolution strategy (originally planned for end-April) but we plan to do so soon.
5. We have also taken a number of steps regarding broader commitments in the program:
- During the last 12 months, we have made substantial efforts to improve tax collection with technical assistance from the Fiscal Affairs Department. Specialized strategies have been designed and are being implemented to improve the tax compliance of large, medium, small, and micro businesses. The compliance strategies have been underpinned by various reforms, including to the Mongolian Tax Authority's information systems, taxpayer services and communication programs, and auditing and risk management processes for larger businesses. As these reforms take root, they are expected to achieve sustained increases in taxpayers' compliance and tax revenue over the medium-term.
  - As agreed in the third review, the Parliament approved an increase in the tax credit to 240,000 MNT to support lower income groups in the 2019 budget.
  - We have also taken several steps as part of our follow-up to the Asset Quality Review (AQR) which was completed in January. Most importantly, on May 8, the BOM sent an official letter to banks, formally outlining the respective banks' capital shortfall and underscored that the deadline for meeting this capital requirement is end-December 2018. This capital shortfall was informed by both the results of the AQR itself and the business prospects of each bank. In addition, we have shared with each bank the quantitative results of the AQR and the qualitative information on how to improve their internal systems in line with such results.
  - With respect to our Anti-Money Laundering framework, we have taken a key step toward addressing some of the deficiencies identified in July 2017 by the APG, a regional body of the Financial Action Task Force. In April, Parliament passed amendments to the law on Combatting Money Laundering and Terrorism Financing. In addition, the Law on

Infringements, the Criminal Law, the Anti-Terrorism Law and other relevant laws were amended to bring them in line with the amended law on Combatting Money Laundering and Terrorism Financing.

## Fiscal Policy

6. For 2018, our fiscal program continues to overperform in cash terms (excluding commitments under investment projects with concessional donor financing discussed below). Strong consumption and machinery imports are supporting VAT revenues, and ongoing mining sector strength has led to a further recovery in royalties and corporate income taxes. Meanwhile, expenditures in cash terms remain consistent with the annual target.
  
7. Greater concessional donor financing for capital investment, of about 661 billion MNT or 2.2 percent of GDP, is available to us this year than was allowed for in the 2018 budget. The available financing is related to important infrastructure projects that can improve economic growth. Some of these expenditures have already been committed. In the coming months, we will explore ways to allow some of these projects to proceed. At the same time, we are prepared to take action if needed to keep our deficit in line with program goals, including by rationalizing other spending (for example, on other capital spending or non-essential current spending). In any case, we will make sure that the year ends without the accumulation of arrears and in line with agreed primary deficit targets. In addition, to ensure that budgets are consistent with available foreign financing going forward, we will work on specific steps to strengthen our public financial management in time to inform the next budget submission. Further details will be agreed at the next quarterly review.
  
8. We will also continue our progress with fiscal structural reforms.
  - As indicated during the third review, we are committed to gradually increasing the market determination of retail fuel prices to avoid putting an undue burden on the private sector. Moreover, we intend to gradually re-instate an excise tax on retail fuel prices to both increase revenue and discourage excessive fuel consumption. Informed by technical advice from the IMF, we will submit to Fund staff a strategy for doing this by end-September with implementation to take effect as of January 1, 2019 (**end-December structural benchmark**).
  
  - On social spending, our assessment is that the current 80 percent coverage of the Child Money program is appropriate. At the same time, we will maintain the recent scaling up of the targeted food stamps program as identified in the 2018 budget. The Ministry of Labor and Social Protection has established a working group to increase the efficiency of our social spending while keeping total social spending unchanged. We will incorporate the conclusions of the working group in the 2019 budget submission.
  
  - In light of potential fiscal risks, we plan to complete an audit of all outstanding concessions contracts, develop a repayment plan based on the recommendations of that audit, and

incorporate this repayment plan in our Medium Term Financial Framework (**structural benchmark end-August 2018**). MOF will also approve and publish a guideline on appraisal and selection of public investment projects, including specific methodology and evaluation criteria (**structural benchmark end-December 2018**).

- The Board of the Development Bank of Mongolia has formally agreed to have a comprehensive review of its 2012-2017 operations conducted by a third party and published on its website by end-November. As agreed at the time of program approval, DBM net lending should remain within the fiscal targets of the program until it is confirmed to be operating on a commercial basis.
- To continue to strengthen tax collection, we intend to take the following actions during the next twelve months: (i) by mid-July 2018, a joint MoF/GDT taskforce will be appointed to develop an action plan and timetable for implementing the new tax legislation that is expected to enter into effect on January 1, 2019; (ii) by mid-September 2018, the GDT will complete a comprehensive review of the first half-year implementation of the 2018 compliance improvement strategies; and, (iii) by mid-October 2018, the GDT will complete the design of its 2019 Operational Plan (which will include a new set of tax compliance improvement strategies) (**end-October structural benchmark**). We will also ensure that sufficient budgetary resources are allocated during the balance of 2018 and 2019 to support the implementation of the above activities.
- We will continue to make progress on eliminating BOM's exposure to quasi-fiscal activities, including the mortgage program, as agreed in the Memorandum of Understanding signed in late 2017.

### Monetary and Exchange Rate Policy

9. Inflation is currently in line with our target of 8 percent in 2018 and the balance of payments remains stable. Our inflation projections remain anchored around the target despite the strong outlook for economic growth. As a result, we recently cut the policy rate by 100 bps—bringing cumulative cuts to 500 bps and completing the reversal of the 2016 emergency hike. Going forward, preserving the real wages of the Mongolian people and the stability of the economy more broadly are key goals. To this end, further monetary policy moves will be a function of new data and we stand ready to adjust our policy stance if inflation threatens to rise durably above our target or the balance of payments do not strengthen. In addition, to improve the effectiveness of our monetary framework, we will continue to improve the explanation of our inflation forecasts.

10. While we have made considerable progress with respect to reserve accumulation, our foreign exchange buffers are not yet at desired levels given the volatility of our economy and the still large stock of foreign liabilities. In addition, in recent months, the pace of reserve accumulation has slowed. To resume progress, we will insure that our policy mix is sufficient to guard against excessive import growth, attract capital inflows, and continue the substantial donor support under



the program. Inflows that result from this policy mix will be used to build reserves. To preserve monetary stability while accumulating reserves, it is particularly important to manage the growth in domestic liquidity using a range of instruments, including keeping the policy rate at an appropriate level to create sufficiently high demand for Central Bank bills. If conditions in the balance of payments deteriorate, the sale of foreign exchange reserves will be limited to smoothing excessive volatility and preventing disorderly market conditions.

## Financial Sector Policy

### *Follow-Up to the AQR*

11. With banks informed of their capital shortfall and the recapitalization law passed, we will move ahead with remaining actions to follow up our recently completed AQR.

- We will ensure that banks book by end-June the provisioning gap identified by the AQR and reclassify their assets to non-performing category in line with the AQR (**structural benchmark**).
- Banks will have until end December 2018 to raise capital in amounts no less than those requested by BoM in the May 8 letter. BoM will intervene promptly on those banks that do not abide by the required capital increase with all the powers conferred upon it by the law. (**structural benchmark end-January**). Systemic and viable banks that are unable raise adequate capital from private sources will be eligible for public capital support under strict conditions, as outlined in the new recapitalization law. Non-systemic and non-viable banks unable to raise adequate capital will be resolved.
- In order to ensure that banks remain well capitalized, BoM will order banks not to pay dividends, coupon or principal of Tier 2 instruments, and bonuses to management until banks have reached a Tier 1 capital ratio of 11%. BoM will ensure that all newly issued Tier 2 instruments have early intervention triggers, so that they are loss-absorbing by full or partial write-down and/or conversion to equity upon request of the competent authority.
- As a general matter, it is important that the Financial Stability Council (BOM, MOF, FRC) is constantly ready to protect financial stability under all possible scenarios. To this end, we will strengthen contingency planning, crisis preparedness, and readiness for bank resolutions. Moreover, BOM will continue to provide liquidity only to banks that are solvent and viable on a forward-looking basis.
- We will adopt new prudential regulation with select elements from Basel II/III (such as the definition of capital, more sensitive credit risk weights, capital buffers, and the Pillar 2) (**end-December structural benchmark**).

### *Addressing Non-Performing Loans*

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

- By end-September, the MoJ, in cooperation with BoM and in consultation with IMF staff, will present draft amendments to legislations - including the civil code - to strengthen the enforcement of creditor rights (e.g. simplifying appeals and notifications, improving auctions, and allowing effective out-of-court enforcement of collateral). These legislative amendments shall be adopted by end November 2018 (**structural benchmark**).
- By end September 2018, the MoJ, in cooperation with BoM and in consultation with IMF staff, will present draft amendments to a reformed corporate bankruptcy law (including an improved access to procedures, protection of secured creditors, and an efficient reorganization process). The reformed law shall be adopted by end March 2019 (**structural benchmark**).
- By end April 2019, in consultation with IMF staff, we will adopt amendments to laws related to the real estate registry that will allow for full public access to the ownership of real estates and establish a price and transaction registry for real estates (**structural benchmark**) and will adopt a law on private bailiffs and introduce commercial courts (**structural benchmark**).
- We have decided not to proceed with a public Asset Management Company (AMC). In the event we do proceed with an AMC structure, we will take several steps to protect the public-sector balance sheet. In particular, the implementing legislation will not allow a Mongolian public stake greater than 20 percent nor will the government, BOM, or any other public-sector entity lend to or issue any guarantees to the AMC.

### *Other Financial Sector Issues*

13. We see scope for macro-prudential policies to be an increasingly important part of our toolkit. Based on the provisions of the banking law, BoM will define the institutional setup, internal BoM organization, and analytical framework for macroprudential policy in Mongolia. In the near-term, we see scope for adjusting our policies in one important respect. Given the strong growth in non-mortgage consumer lending, we will expand our toolkit by implementing a debt service-to-income ratio limit for all new lending by banks by end-September to address potential financial stability risks (**structural benchmark**). We will gradually tighten the limit further if risks from excessive consumer lending persist.

14. We are committed to continuing to rectify concerns raised by the Asia Pacific Group (APG) on Money Laundering. As part of this effort, we will increase resources available to the Financial Intelligence Unit (FIU) and Financial Regulatory Commission (FRC).

### **Conclusions**

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

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

/s/

Ch. Khurelbaatar  
Minister of Finance

/s/

N. Bayartsaikhan  
Governor, Bank of Mongolia

Table 1. Mongolia: Quantitative Performance Criteria and Indicative Targets

	Dec-17		Mar-18		Jun-18		Sep-18		Dec-18		Mar-19
	Actual	Target	Revised Target	Actual	Target	Revised Target	Target	Revised Target	Target	Revised Target	Indicative Target
<b>Performance Criteria 1/ 2/ 3/ 4/</b>											
Change in net international reserves (NIR) of the Bank of Mongolia (BOM) (floor, cumulative, change in eop stock, in million US\$ at program exchange rate)	1,893	1,700	1,600	2,087	1,700	1,900	2,000	2,000	2,500	2,200	2,500
Net domestic assets (NDA) of the BOM (ceiling, eop stock, in billion togrog at program exchange rate)	2,011	2,400		1,351	2,800	2,700	2,300	2,300	1,800	1,950	1,800
Primary balance of the general government (floor, cumulative since the beginning of the fiscal year, in billion togrog)	572	-377		637	-473	240	-594	-20	-476	-306	-102
Net nonconcessional external debt maturing in one year or more, contracted and/or guaranteed by the government or the BOM (ceiling, cumulative flow from November 15, 2017, in million US\$). /5	0	NA	NA	NA	20	20	NA	NA	20	20	20
Stock of guarantees on external debt extended by the government or BOM (ceiling, eop stock, in million US\$)	685	750		648	750	750	750	750	750	750	750
<b>Indicative Targets (IT)</b>											
Reserve money (ceiling, in billion togrog)	3,980	4,000		2,941	4,300	4,400	4,600	4,600	4,900	4,750	4,900
Social protection spending (floor, cumulative since the beginning of the fiscal year, in billion togrog)		1,387			2,841	2,841	4,287	4,287	5,816	5,816	1,498
<b>Continuous Performance Criteria</b>											
New nonconcessional external debt maturing in less than one year, contracted and/or guaranteed by the government or the BOM (ceiling, eop stock, in million US\$).	0	0	0	0	0	0	0	0	0	0	0
Accumulation of new external payment arrears (ceiling, eop, in million US\$).	0	0	0	0	0	0	0	0	0	0	0
<b>Memorandum items</b>											
Budget support from bilateral and multilateral donors excluding Fund under the program baseline (eop stock, cumulative, in million US\$)	603	703	603	603	753	703	753	753	1,195	753	1,096
Net nonconcessional borrowing received and repatriated by the general government (including the DBM) under the program baseline (eop stock, cumulative, in million US\$)	433	306	306	306	160	160	160	160	160	160	160
Program exchange rate (togrog/U.S. dollar)	2,489	2,489	2,489	2,489	2,489	2,489	2,489	2,489	2,489	2,489	2,489
U.S. dollar per SDR	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35
Monetary gold price (U.S. dollar/ounce)	1,142	1,142	1,142	1,142	1,142	1,142	1,142	1,142	1,142	1,142	1,142

1/ Evaluated at program exchange rates.

2/ Cumulative targets are all defined relative to 12/31/2016 except for the primary balance figures.

3/ Targets and actual from December 2017 on reflect the revised treatment of government forex deposits in the TMU.

4/ Additional new nonconcessional external debt inflows with the purpose of debt management do not affect the level of NDA as defined in the TMU.

5/ The net ceiling applies starting from the date of the completion of the second review. Prior to this date, the ceiling remains as specified in Table 10 of the May 31, 2017 ID Staff report and TMU.

Table 2. Mongolia: Structural Conditionality

Table 2. Mongolia: Structural Conditionality		
Prior Actions Due before Board Meeting		Status
Enact a law/amend existing law on use of public funds (recapitalization law) which ensures, among other points, that a) only systemic and viable banks can receive capital support from public sources, b) prior to injection of public funds, existing shareholders shall bear the first loss, c) the government remains at arm's length with no influence on day-to-day management and d) the government shall exit its shareholding in a timely fashion.		Expected to be met
BOM will inform banks that they must formally book the provisioning gap identified by the AQR results by end-June 2018.		Met
Structural Benchmark	Target Date	Status
<b>Fiscal</b>		
Submission to Parliament of a revised general taxation law that consolidates the common administrative provisions that apply to all tax types, promotes consistent administration of the tax system, and achieves an appropriate balance between taxpayers' interest and the powers of the tax authorities.	end-February 2018	Implemented with delay in May 2018
Submission to Parliament of legislation to create a simplified tax regime for micro and small businesses within the scope of IMF technical assistance recommendations.	end-February 2018	Implemented with delay in May 2018
Complete an audit of all existing concessions contracts, develop a repayment plan based on audit recommendations, contractual obligations and fiscal path, and incorporate in the medium-term fiscal framework (MTFF) repayment plan to be paid by the budget i) for each year of the MTFF and ii) the nominal sum for future years not covered by the MTFF.	end-August 2018	
Enact legislation to reform structure of retail fuel prices and increased excise tax rates.	End-December 2018	
The MoF to approve a Guideline on appraisal and selection of public investment projects, including specific methodology and evaluation criteria.	end-December 2018	
Implementation of 2019 Operational Plan that sets out the tax compliance improvement strategies for SMEs.	End-October 2018	
<b>Monetary</b>		
Adoption of the new BOM Law.	End-March 2018	Met

Table 2. Mongolia: Structural Conditionality (Concluded)

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

**Statement by the IMF Staff Representative on Mongolia**  
**June 27, 2018**

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

1. On June 15, the Bank of Mongolia Monetary Policy Committee (MPC) decided to leave the policy rate unchanged at 10 percent, noting higher oil prices and risks to the balance of payments. In addition, in response to a sharp rise in household debt, the MPC introduced a new macro-prudential requirement for consumer loans which puts a ceiling on the debt service-to-income ratio for new loans at 70 percent. This was the first meeting of the MPC since the amended Central Bank Law took effect on April 1 of this year. Under this revised law, 4 of the 7 members of the MPC are appointed by Parliament rather than by the Governor and MPC decisions are made by majority vote rather than by the Governor alone.
2. The primary balance through May of this year reached 3.4 percent of GDP in cash terms, up from 2.1 percent of GDP in the first quarter. The main driver was a 26 percent increase in revenue. While total primary spending as a percent of the annual budgeted amount was in line with historical trends, social spending (education, health, social protection, and insurance) in the first quarter of 2018 was below the level established as an Indicative Target under the program (actual spending of MNT 1200 billion, vs. the target floor of MNT1387 billion). The authorities acknowledged the backlog in social spending in the early part of the year and reaffirmed their commitment to allocating the full budget envelope by year-end.
3. On Friday, June 22, Parliament passed the Recapitalization Law, completing the final prior action for this review. This law outlines when and how public-sector funds can be used to support systemic banks in the event of a capital shortfall.

**Statement by Grant Johnston, Alternate Executive Director for Mongolia  
and Gantsogt Khurelbaatar, Advisor to Executive Director  
June 27, 2018**

Our Mongolian authorities appreciate the continuing engagement they have with the Fund and the candid and constructive discussions they had with staff during the fourth review of the Extended Fund Facility arrangement. This arrangement has enabled Mongolia to refinance its public debt, supported its economic revival, and provided a strong basis for ongoing macroeconomic reforms. However, the country remains vulnerable to external and domestic shocks and further building of economic buffers is required. The authorities are fully committed to the program and agree with staff's assessment and conclusions. The authorities also thank their development partners, the Asian Development Bank, China, Japan, Korea and the World Bank, for supporting Mongolia's program of macroeconomic adjustment.

**Program performance**

The EFF program remains firmly on track. All quantitative performance criteria for end-March 2018 were met, with some by big margins. Structural benchmarks have been achieved, albeit with some short delays, including the enactment of the Bank of Mongolia law and the submission of a general taxation bill to Parliament. Recently, the law governing the recapitalization of systemic and viable banks—a prior action for the fourth review—was passed, and an NPL resolution strategy was published by the Financial Stability Council.

**Fiscal policy**

Strong demand for coal and copper, and good prices for these commodities, has boosted growth and brought in significantly more revenue than previously expected. FDI in the mining sector has also increased and tax administration has been strengthened. Yet it is notable that, while revenue gains have been sizable, two-thirds of the improvement in the fiscal balance last year came from expenditure contraction.

The positive progress in 2017 has continued into 2018. The primary surplus for the first quarter of this year was 2.1 percent of GDP and annual growth (year-on-year) was 6.1 percent. Foreign debt obligations have been successfully rolled over until 2021 and the authorities are focused on reducing domestic debt, which has nearly halved since the end of 2016. The only risk to the fiscal balance target this year—which is being tightened—comes from higher-than-planned spending on capital projects funded by concessional debt from donors. Projections are that revenue may overperform by to 2 to 3 percent of GDP this year which will help offset these over-commitments. The authorities are committed to keeping the fiscal deficit in line with program goals and, if additional measures are needed, will take steps to meet the program target, for example by tighter control over domestically-financed projects and rationalizing non-essential current spending.

One emerging issue that concerns the authorities is a rising level of discontent around public servants' wages. Recently there have been street protests, and the lack of any salary increase over the past few years is becoming a major challenge to the public's ongoing acceptance of



the program, especially when they see continued revenue overperformance and strong fiscal balances. This issue is being discussed with staff. A successful resolution—within the program parameters—would help maintain public support and allow the authorities to continue with necessary economic reforms.

### **Monetary and financial sector policies**

Inflation is well-contained. The annual inflation rate at the end of May was 6.6 percent, which is below the target of 8 percent. Net international reserves continue to be accumulated, although the pace has slowed in recent months. With strengthening domestic demand, there is increased pressure on the balance of payments and on reserves. The exchange rate is currently stable and the Bank of Mongolia will not intervene in the market unless there is excessive volatility.

An asset quality review was concluded earlier this year. In May, the Bank of Mongolia notified commercial banks about the capital they are required to raise by the end of this year. Under-capitalized banks also need to book capital shortfalls on their balance sheets by the end of June. This exercise will promote more confidence in Mongolia's banking sector. The authorities are working to address AML/CFT deficiencies identified by the Asia Pacific Group. Earlier this year, both the Law on Combating Money Laundering and Terrorism and the Law on Infringements were strengthened in response to the mutual evaluation. Further work remains to be done, including increasing the supervision of non-bank financial institutions and high risk-entities.