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GRAY/20/2259

June 2, 2020

**Statement by Mr. Merk and Mr. Braeuer on Mongolia
(Preliminary)
Executive Board Meeting 20/66
June 3, 2020**

We thank staff for their report and Mr. Ray, Ms. Johnson, and Mr. Khurelbaatar for their buff statement. **We can support the authorities' request for a purchase under the RFI in the amount of SDR 72.3 million**, as staff does not deem it feasible to design or implement an UCT-quality Fund-supported program at the current juncture and given the urgent BoP need. That being said, we have some concerns about the sustainability of the authorities' policy response. We urge the authorities to cooperate with the Fund and make appropriate efforts to solve the balance of payments difficulties, as is required under the RFI policy.

While we broadly concur with staff's appraisal, we would like to offer the following comments, mainly for emphasis:

We note the insufficient progress (including on the recapitalization of banks) under the recent EFF arrangement, which also prevented the completion of the final six of the envisaged 11 program reviews. *Could staff comment on the state of play of the outstanding issues regarding banking sector capitalization, which prevented the successful completion of the EFF-supported program?*

We regret to take note of the quasi-fiscal role of the BOM during the current crisis. Like staff, we have several concerns with the parliament's decision to expand the quasi-fiscal role of the central bank, potentially leading to reduced transparency in shifting fiscal costs, damage to the BOM's balance sheet and risks to monetary policy effectiveness. This is all the more worrying, because staff has already recommended to end quasi-fiscal activities through its safeguards assessment in the past. Furthermore, this does not only lead to monetary expansion as reserves are falling sharply (staff notes that net international reserves are near zero) in the short term but also undermines the BOM's independence and thus adversely affects the Central Bank's credibility going forward. We therefore join staff in strongly encouraging the authorities to stop all quasi-fiscal spending by the BOM as soon as possible.

We take note that public debt is sustainable, however with a high risk of debt distress. It is encouraging that public debt decreased markedly before the crisis, albeit remaining at an elevated level. Mongolia's high share of foreign exchange-denominated debt and the large gross financing needs due to a difficult near-term amortization schedule pose a risk to the debt trajectory, especially taking into account the high refinancing costs. Therefore, staff's advice to improve the currency composition of public and private debt through greater local debt issuance is well taken. This could be facilitated by increasing the independence and the credibility of the BOM through limiting monetary financing.

We agree with staff that further fiscal loosening could put excessive pressure on public debt and on the BoP. We note that parliamentary elections are upcoming in June and caution against increased fiscal stimulus and quasi-fiscal spending in this context.

As outlined by staff, Mongolia runs a tightly managed exchange rate regime. This weighs heavily on reserve accumulation, increases depreciation expectations and has resulted in an overvalued real exchange rate. Staff further states that buffers remain inadequate. We therefore join staff in calling for greater exchange rate flexibility.

Pursuing vigorous structural reforms in the banking sector is key to building resilience. We note that some of the financial measures announced by the BOM present risks with regard to moral hazard and therefore echo staff's call for adhering to internationally accepted practices for loan classification and provisioning. Given the weak capital buffers in the banking system, it is essential to manage carefully risks arising from the temporary regulatory loosening in the financial sector.

We take note that Mongolia was placed on the FATF's grey list last year. In a broader context, and given the importance of having adequate safeguards in place to ensure that emergency financing is used for its intended purpose of macroeconomic stabilization and the protection of the most vulnerable, *could staff provide a more thorough elaboration on the governance and transparency situation in Mongolia, including possible follow-up on the 2019 OECD-Anti Corruption Network Monitoring Report?*

Could staff explain the definition of and rationale for using "gross usable reserves" in Table 6 (Indicators of Fund Credit)?