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**Statement by Mr. Rosen, Ms. Pollard, and Mr. Grohovsky on Mongolia
(Preliminary)
Executive Board Meeting 20/66
June 3, 2020**

Mongolia is in a vulnerable position, exacerbated by lockdowns related to the COVID-19 pandemic and the resulting economic shock. The authorities have taken many steps to respond and we welcome that they were able to act quickly to prevent any domestic spread of the virus. However, while the country's fiscal performance has been strong, a lack of foreign exchange reserve build-up and weak financial institutions have made the necessary policy response to the pandemic more challenging. Given that a new balance of payments gap has opened up, we support the authorities' request for an RFI of 100 percent of quota. Going forward, the authorities will likely need to prioritize a new upper credit tranche arrangement, with a focus on the following issues.

While fiscal performance was strong under the EFF, Mongolia is at high risk of debt distress and we agree with staff's concerns about the quasi-fiscal role of the Bank of Mongolia (BOM). In particular, financing debt relief for the elderly and subsidizing housing are issues that should be left to the government. As staff rightly note, forcing these issues on the BOM undermines its independence and balance sheet, while risking an unsustainable expansion of credit. We welcome that staff were able to reach agreement with the authorities on limits to these types of activities but this issue should remain an area of focus in any future arrangement. *In that regard, could staff comment on the potential timing of discussions and areas of conditionality with respect to monetary policy and banking sector reform for a successor program, particularly given limited space under normal access limits following the RFI disbursement?*

Further, vulnerabilities are increasing in the financial sector. While problems with bank recapitalization derailed the previous program, new financial measures to lessen the negative economic impact of containing the virus could further worsen bank solvency and credit management practices. We urge the BOM to adhere to international best practice for loan

classification and provision and provide appropriate guidance to banks to ensure their sustainability. Weaknesses in these institutions need to be addressed, including the major governance and corruption challenges associated with some of the ownership.

Additionally, the authorities' difficulty in building up foreign exchange reserves points to the need for greater exchange rate flexibility going forward. While we agree that the authorities should make any changes after the pandemic subsidies, they will need to be attentive to any foreign exchange drains in the near-term and shift policy as necessary to avoid a disruptive adjustment. Making progress in this area is critical to put the Mongolian economy on a more sustainable footing.

We recognize that the BOM's swap agreement with the People's Bank of China has been rolled over for one year, and would be interested in understanding possible scenarios for rollover beyond the one year period. However, given the significant balance of payments pressures facing Mongolia, particularly the large external amortizations coming due over the next three years, we were surprised to see no mention of the DSSI in staff's assessment and would welcome staff's analysis of the benefits to Mongolia. *Can staff comment on the assumption in the balance of payments tables that the PBOC swap will be renewed for an additional three years after 2021, and also on the authorities' potential participation in the DSSI?*

Finally, we note that the RFI resources will be used for budget support, given the acute government financing needs in the wake of the pandemic. However, with this disbursement so close to the upcoming parliamentary elections, we stress the need for strong safeguards, reporting, and transparency. We welcome the authorities' commitments to these safeguards, including quarterly reports on crisis-related spending, third-party audits, and publication of procurement contracts. Noting our point above about the quasi-fiscal role of the BOM, we think that an updated central bank safeguards assessment will also be particularly important.