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International Monetary Fund
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IMF Executive Board Approves US\$229.2 Million Stand-By Arrangement for Mongolia

The Executive Board of the International Monetary Fund (IMF) today approved a 18-month Stand-By Arrangement for Mongolia in an amount equivalent to SDR 153.3 million (about US\$229.2 million) to support the country's economic stabilization program.

Upon the Executive Board's approval, an amount equivalent to SDR 51.1 million (about US\$76.4 million) becomes immediately available to Mongolia. The remaining amount will be phased in, subject to quarterly reviews. The total amount of the IMF resources made available under the arrangement equals 300 percent of the country's quota.

Key objectives of the IMF-supported program are: to restore macroeconomic stability through fiscal, monetary and financial sector policies; and to protect the poor from the burden of the needed adjustment. The program also aims at outlining a solid macroeconomic framework to provide the basis for the authorities to approach the broader international community for financial support.

Following the Executive Board discussion on Mongolia, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chairman, stated:

“Mongolia has been severely affected by the global financial crisis through a sharp reduction in the prices of its main mineral exports, notably copper. The authorities' program aims to smooth Mongolia's adjustment to the large terms-of-trade shock, put the fiscal finances on a sustainable footing, allow for a more flexible exchange rate, address weaknesses in the banking system, and mitigate the impact of adjustment on the most vulnerable. The authorities are committed to restoring macroeconomic stability and putting in place the conditions for strong and equitable growth.

“The centerpiece of the authorities' economic program is a significant adjustment in the fiscal stance to strengthen Mongolia's finances and restore fiscal sustainability. The program also seeks a legislated framework for fiscal responsibility, which will help limit the procyclicality of fiscal policy.

“The program is supported by a shift in Mongolia’s monetary stance designed to safeguard international reserves, prevent an overshooting of the nominal exchange rate, and put inflation on a steady downward path. The central bank’s recent decisions to raise interest rates and contain liquidity are consistent with those objectives.

“The authorities have moved quickly to address vulnerabilities in the banking system, taking one bank into conservatorship, clarifying the blanket deposit guarantee scheme, and requiring other banks to raise their level of capital over time.

“The program aims to address the social consequences of the economic downturn, in particular on the more than one third of the population living below the poverty line. In the coming months, the authorities intend to improve the system of social transfers through better targeting, ensuring that the very poorest households are more fully protected, while conserving fiscal resources,” Mr. Kato said.

Recent Economic Developments

Mongolia has been hit hard by the global economic and financial crisis through a sudden and catastrophic drop in the price of its main export commodities, most notably copper. This shock, combined with the procyclical policies implemented during the more favorable times, has quickly exacerbated the country's macroeconomic situation in the past several months. Mineral revenues, which accounted for more than one-third of budget revenues at the peak of the commodity boom in 2007, have fallen sharply and expected to account for only 12½ percent of total revenues in 2009, putting significant pressures on the fiscal position. The economic growth is set to fall to around 3 percent this year from 9 percent in 2008, and the current account deficit is expected to remain substantial, at around 6½ percent of GDP this year, mainly due to a sharp fall in the terms of trade. The shock to the economy has also led to a retrenchment of credit; broad money has fallen by 14 percent since mid-2008, and the banking system came under stress.

Program Summary

Against this background, the Mongolian authorities have embarked on a program to restore macroeconomic stability while protecting the poor during the process of adjustment. To support this program, they have requested IMF financial assistance.

The program includes the following key elements:

- **Fiscal policy:** The large drop in the mineral revenues necessitates bold fiscal measures to bring government finances back to a sustainable level. The program seeks to constrain the general government deficit to 6 percent of GDP in 2009. The fiscal adjustment is centered primarily around expenditure restraint. The biggest savings will come from postponement of domestically financed capital expenditure plans. Additional savings will be generated from a wage and hiring freeze, cuts in some untargeted social allowances, and reductions in other purchases and good and services. To prevent the future boom-bust fiscal cycle, a stronger institutional framework will be placed to ensure a greater proportion of windfall copper revenues is saved.
- **Monetary and foreign exchange policy:** The program envisages strengthening the country's international reserve position and calibrating monetary policy to prevent any undue overshooting of the exchange rate and to keep inflation on a downward path. A new system of foreign currency auction has been introduced to have a nondiscriminatory and transparent mechanism to sell foreign exchange that allows for market determination of the exchange rate.

- **Financial sector:** To build confidence in the local banking system, the program includes measures to further strengthen the banking system by improving the current framework for deposit guarantees and enhancing bank supervision.
- **Social protection:** With one-third of the population living below the poverty line, improving the social safety net is a key element of the program to ensure that the poorest segment of the society are protected adequately. In collaboration with the Asian Development Bank and the World Bank, the authorities will design a comprehensive overhaul of the existing untargeted system of social transfer programs. The goal will be to better target these programs towards the very poor and increase the support that poor households receive.

Mongolia, which joined the Fund on February 14, 1991, has a quota of SDR 51.1 million (about US\$76.4 million).