

**IMMEDIATE
ATTENTION**

EBS/11/156

October 26, 2011

To: Members of the Executive Board

From: The Secretary

Subject: **Mongolia—Second Post-Program Monitoring**

Attached for consideration by the Executive Directors is a paper on the second post-program monitoring discussions with Mongolia. It is not proposed to bring this matter to the agenda of the Executive Board for discussion unless an Executive Director so requests by **noon on Wednesday, November 9, 2011**. If there is no request for a Board discussion, the Executive Board Assessment section of the Public Information Notice will be based on the staff appraisal. At the time of circulation of this paper to the Board, the authorities of Mongolia have indicated that they need more time to consider whether they will consent to the Fund's publication of this paper. Publication will only proceed upon the receipt by the Fund of the member's explicit consent. Any requests for modifications for publication are expected to be received two days before the Board concludes its consideration.

Questions may be referred to Mr. Barnett, OAP (ext. 34439) and Mr. Ojima, APD (ext. 35944).

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Thursday, November 3, 2011; and to the Asian Development Bank, the European Investment Bank, and the Organisation for Economic Cooperation and Development, following its consideration by the Executive Board.

This document, together with a supplement providing an informational annex, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. The supplement, which is not being distributed in hard copy, will also be available in the Institutional Repository; a link can be found in the daily list (<http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm>) for the issuance date shown above.

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INTERNATIONAL MONETARY FUND

MONGOLIA

Second Post-Program Monitoring

Prepared by the Staff Representatives for the Second Post-Program Monitoring

Approved by Nigel Chalk and Claire Waysand

October 25, 2011

Context. An 18-month Stand-By Arrangement was successfully completed in October 2010. The Mongolian economy is undergoing a rapid expansion underpinned by strong commodity prices. Macroeconomic policies, however, have been too expansionary and the economy is now overheating. A steady erosion of fiscal discipline, set against a backdrop of heightened global economic risks, has raised the risk of macroeconomic instability. There is an urgent need to reorient policies to contain overheating and strengthen the economy's ability to endure deterioration in the global environment. This will mean restraining fiscal spending and tightening monetary conditions.

Summary. Discussions focused on the following:

- ***Fiscal spending.*** Expenditure restraint is critical for containing overheating pressures. This year's budget, therefore, should not be amended to increase expenditure. Nominal spending next year should adhere to the targets already agreed by parliament in the medium-term budget framework.
- ***Monetary policy.*** Monetary policy needs to play a more active role in countering inflationary pressures. Policy rates should be increased and macro-prudential measures introduced to contain the risks from the recent surge in credit growth.
- ***Exchange rate policy.*** There was agreement that the flexible exchange rate regime is working well and provides an important shock absorber in the event of an external shock.
- ***Risks.*** The economy remains vulnerable to a commodity price downturn which has become a rising risk in the current global environment. Overheating threatens to push inflation up further, which will exact a heavy toll on the poor. Finally, the surge in credit growth is increasing banking system risks and reinforces the importance of strictly enforcing prudential regulations.

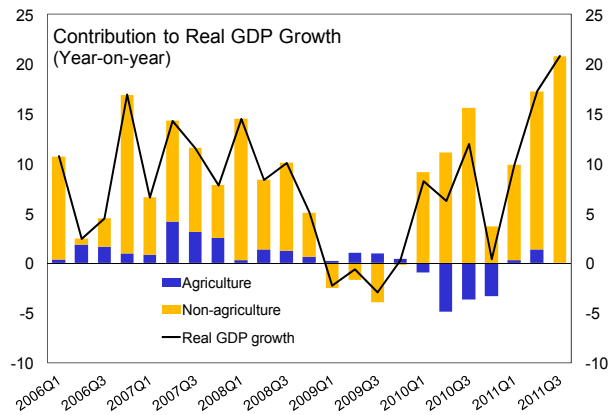
Discussions. A staff team visited Ulaanbaatar, September 14–20, 2011, consisting of Mr. Barnett (Head), Mr. Ojima (APD), Mr. Park (FAD) and Mr. Ramlogan (Resident Representative). Mr. Ishii (Director of the Regional Office for Asia and the Pacific (OAP)) joined the mission for the senior policy discussions.

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I. BACKGROUND

1. **Context.** Mongolia completed successfully its Fund-supported Stand-by Arrangement last October. The government's commitment to implement sound policies was a critical ingredient to the success of the program. Since the end of the program, however, macroeconomic discipline has eroded, placing in jeopardy the gains achieved during the course of the program. Parliamentary elections are scheduled for June 2012 and electoral politics are already starting to exert a stronger influence on policies.

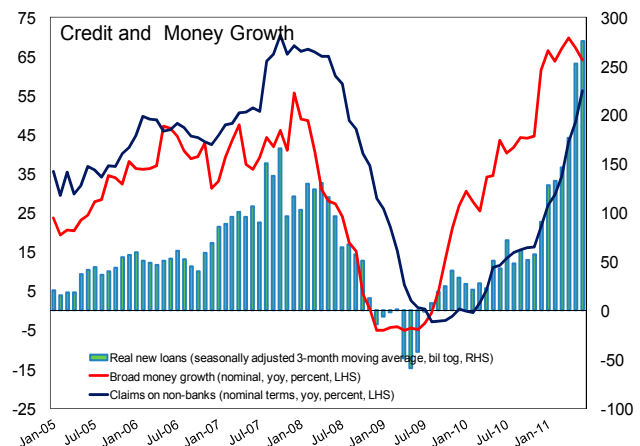
2. **Macroeconomy.** The economy is undergoing a vigorous recovery, fueled by strong global commodity prices and excessively loose macroeconomic policies. Mining output, moreover, is set to increase substantially as two huge mineral projects start production (Box 1). Growth accelerated sharply this year, reflecting booming mineral exports driven by global prices and rising coal production, ongoing development of large mining projects, surging credit growth, improved agricultural output (primarily a base effect from last year's severe winter), and expansionary macroeconomic policies (Figures 1 and 2). The economy is now overheating and inflation has accelerated sharply in the past few months.



II. POLICY DISCUSSIONS

A. The Economy is Overheating

3. **Growth.** Real GDP growth in the third quarter reached 20 percent, making Mongolia one of the fastest growing economies in the world. At the same time, private sector credit has increased by nearly 50 percent in real terms and imports of consumer goods have increased by over 80 percent. Such rapid growth is not sustainable and is driving inflation upwards. Momentum in underlying inflation—which excludes food and administered prices—has remained high throughout this year and is running well-ahead of the authorities' policy targets. The mission's projections assume that monetary policy is tightened in line with our recommendations, the 2011 budget is amended to increase spending 8 percent of GDP, and fiscal expenditure in 2012 is as specified in the draft budget submitted to parliament. With these assumptions, real GDP growth would surpass 10 percent both this year and next. End-year



Box 1. Mongolia: Large Mining Projects

The economy is expected to grow rapidly in the next few years as two large mining projects start production. As a result, U.S. dollar GDP per capita could triple from 2010 to 2016.

- **Oyu Tolgoi.** Oyu Tolgoi, located in the south near the border with China, will be one of the largest copper and gold mines in the world. Sizeable deposits of silver were also recently discovered during drilling. The government owns 34 percent of the mine, and the rest is owned by Ivanhoe Mines (Canada), in which Rio Tinto has a 46.5 percent stake. Mine construction is ahead of schedule, and production is expected to start in mid-2012.
- **Tavan Tolgoi.** Tavan Tolgoi, also located in southern Mongolia, is one of the world's largest untapped coal deposits with estimated reserves of about 6.4 billion tonnes. Erdenes Tavan Tolgoi LLC, a subsidiary of a 100 percent state-owned enterprise, has the mining license for what is called the eastern bloc. It is currently negotiating an operating contract with foreign companies. An initial public offering of 30 percent of Erdenes Tavan Tolgoi shares is expected to take place in the first quarter of 2012, another 10 percent of the shares will be sold to national companies at a nominal price, and 10 percent will be distributed at no cost to all Mongolian citizens. For the western block, the government is negotiating with international and domestic mining consortiums for the mining rights, and hopes to finalize the selection of companies and conclude investment agreements later this year.

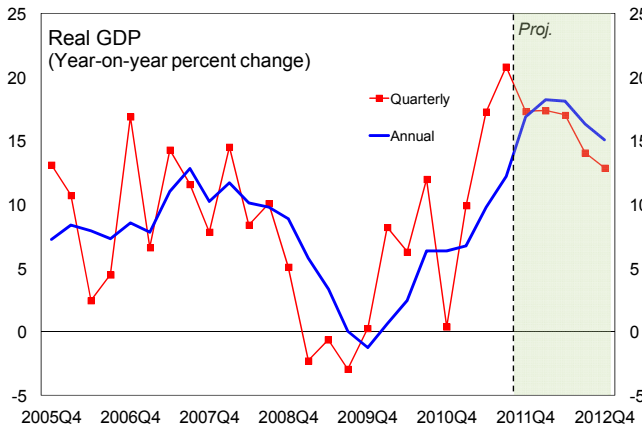
The government is receiving prepayments of taxes and sales revenue from these two projects. The advance payments are used for general budget financing, and in particular to help pay for the universal (monthly) cash transfers that were put in place to fulfill a promise from the last election. In June, the final US\$100 million (out of a total of US\$250 million) in Oyu Tolgoi related prepayments were received. In July, Erdenes Tavan Tolgoi signed an agreement with a Chinese firm to supply coal in exchange for advance payments that would total US\$250 million, money that will be transferred to the budget.

When operational, the mines will lead to massive increases in export earnings and fiscal revenue. Staff project that export proceeds from these mines will total US\$2.4 billion in 2013, rising to US\$10 billion by 2020. The 2020 export earnings are, for comparison, equal to about 140 percent of 2010 GDP. Fiscal revenue is projected to grow in tandem, though with some delay, as much of the initial government proceeds from Oyu Tolgoi must be used to repay the advance payments and a loan used to finance the government's equity stake. By 2016, however, fiscal mineral revenue is projected to amount to 28 percent of non-mineral GDP, compared with 18 percent of non-mineral GDP in 2010.

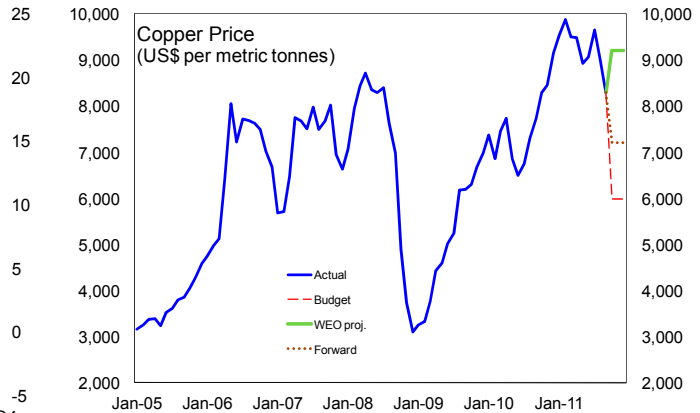
Figure 1. Mongolia—Macroeconomic Developments

Main Message: The economy has undergone a vigorous recovery, boosted by mineral exports, and overheating is now a key concern.

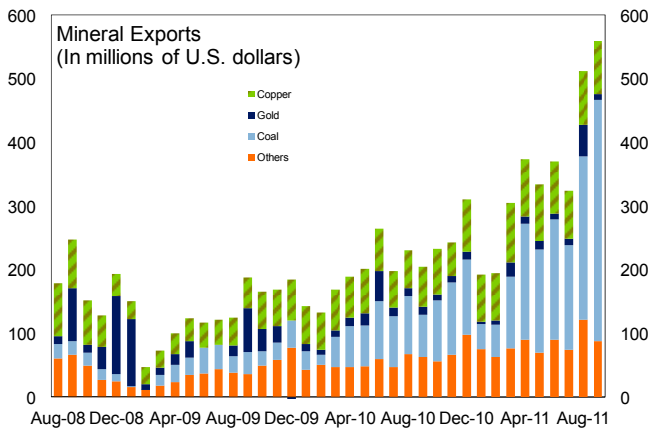
The economy bottomed out late 2009 and has bounced back strongly...



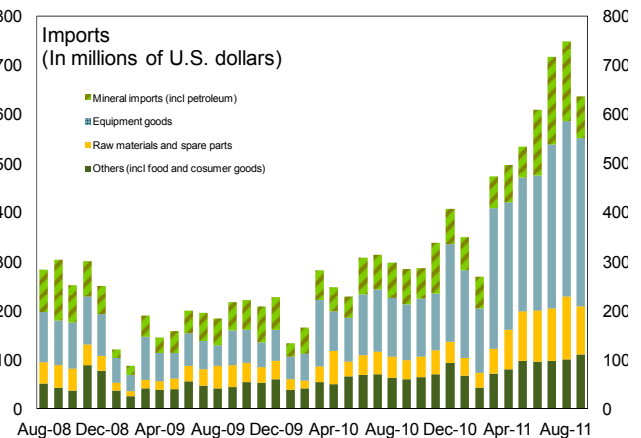
...in part due to the sharp rebound in copper prices...



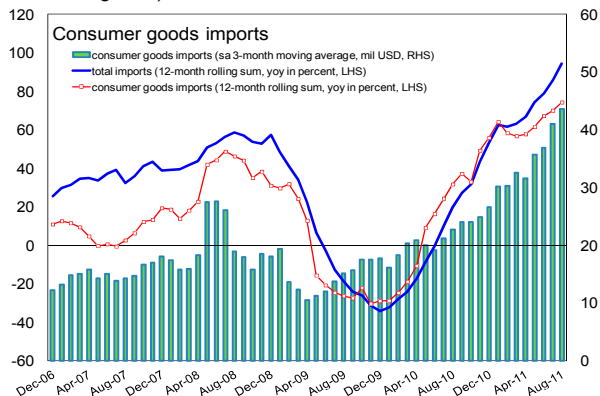
...that is driving export earnings along with a sharp increase in coal exports as production capacity increases.



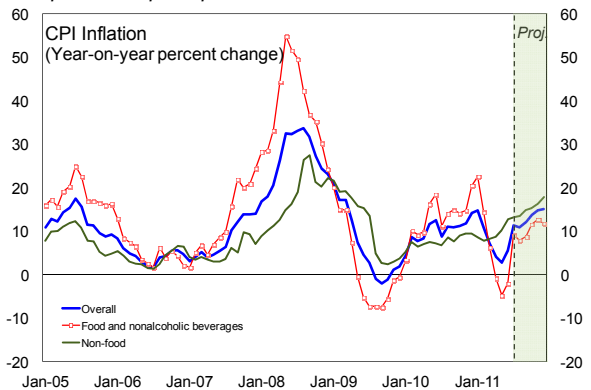
The ongoing development of the mineral sector is boosting imports, especially of equipment...



...as is strong domestic demand (indicated by surging imports of consumer goods).



Inflation has re-emerged, while volatility in food prices disguises more persistent price pressures in non-food inflation.

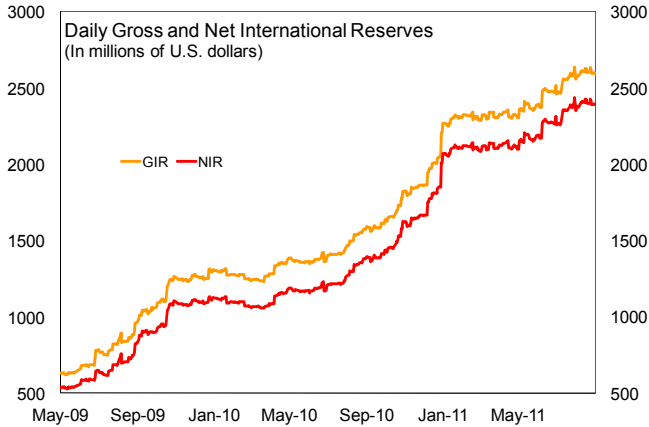


Sources: Mongolian authorities; and IMF staff estimates.

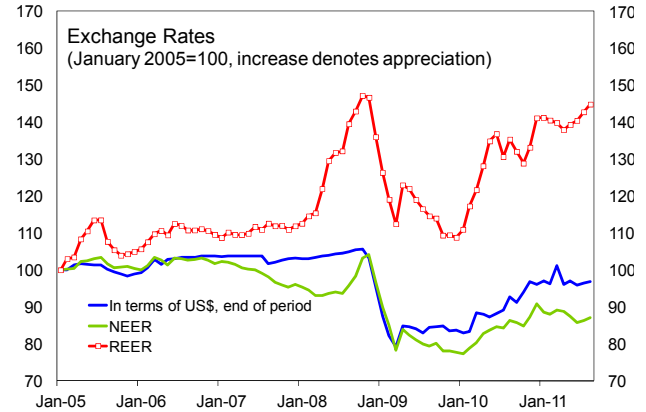
Figure 2. Mongolia—Monetary and Exchange Rate Developments

Main Message: Monetary policy has not been proactive enough to reign in credit growth, which is also being fueled by rapid growth in monetary aggregates.

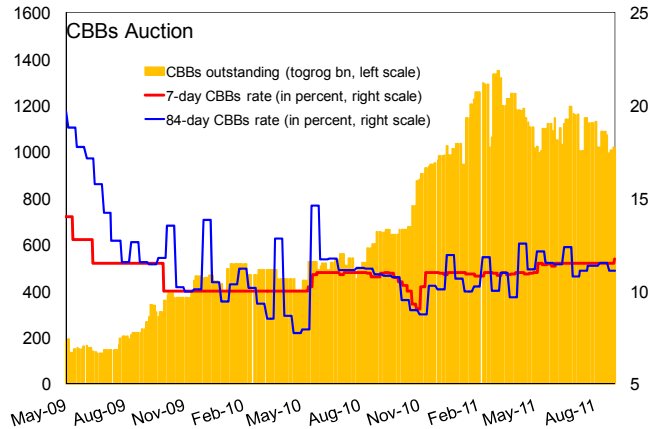
International reserve accumulation has slowed as the central bank has largely refrained from intervening in the market...



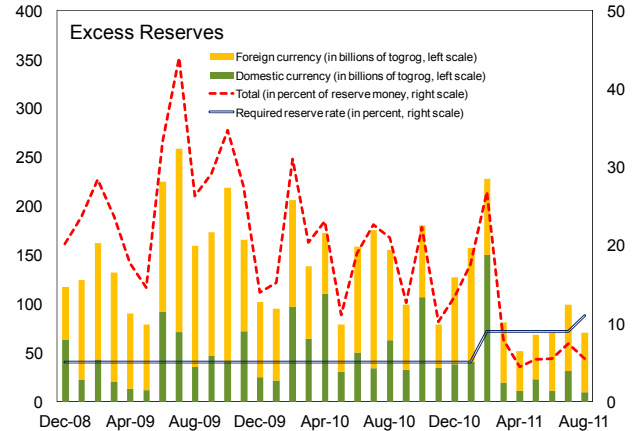
...and, despite the lack of intervention, the exchange rate has remained fairly stable in real effective terms.



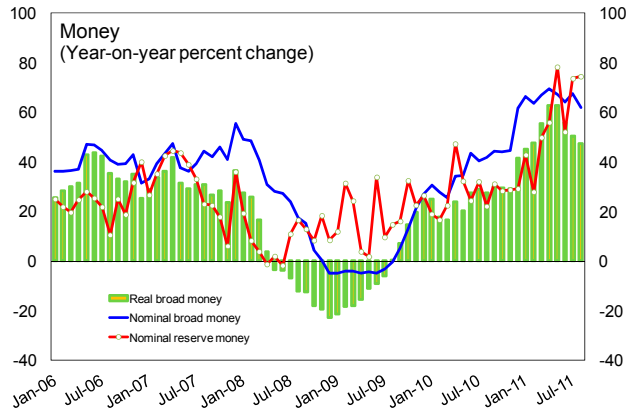
Central bank bill issuance has slowed and the policy interest rate has only been hiked twice this year...



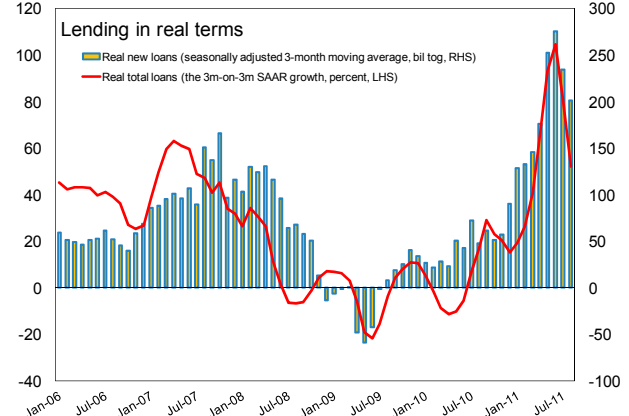
...and the two reserve requirement increases have been partly absorbed by a decline in banks' holding of excess reserves.



Monetary aggregates, meanwhile, continue to grow briskly.



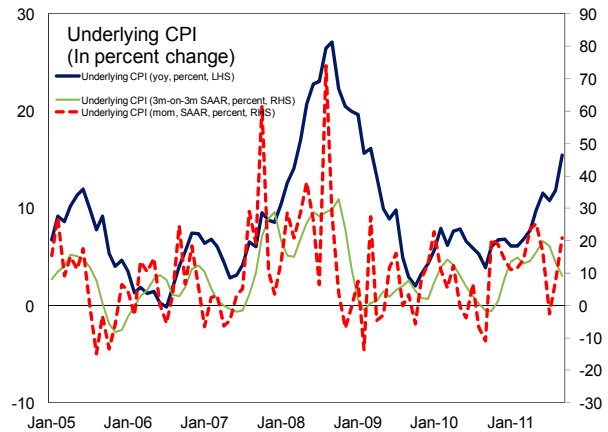
And, therefore, not surprisingly credit growth is surging.



Sources: Mongolian authorities; and IMF staff estimates.

inflation would exceed the authorities' target this year by a considerable margin and remain firmly in the double-digits in 2012.

4. **Inflation.** Inflation in Mongolia is volatile, making it difficult to discern underlying inflation pressures crucial for guiding macroeconomic policy. Changes in headline inflation have been heavily influenced by supply shocks to food, with the sharp decline in inflation earlier this year largely reflecting a drop in meat prices as the government sold stocks from its strategic meat reserves. Looking past this food price volatility, the momentum in underlying inflation has remained strong and well above the government's target of single-digit inflation. Staff emphasized the need for fiscal policy to stop adding to inflationary pressures and for monetary policy to be more proactive.



5. **Risks.** Mongolia is susceptible to a global downturn, and would be especially hard hit by a collapse in commodity prices. This is all the more worrying since copper prices have fallen sharply in recent weeks. Global financial volatility could also lead to delays in the two large mining project investments that are underway. This would hurt growth in the short run, reduce the value of contracts under negotiation, and delay the eventual fiscal revenue and export inflows. The economy, however, is more resilient to external shocks than before, largely thanks to the reforms put in place as part of the Stand-by Arrangement. International reserves are at their all time high, the flexible exchange rate will act as a critical shock absorber, and the recently signed renminbi swap line with the People's Bank of China provides a further buffer. At the same time, there are similarities between the current episode and the macro-policies in the run-up to the last crisis (Figure 3). The downside risks to the global outlook, moreover, add urgency to the need for tighter macroeconomic policies and avoiding a repeat of the missteps that fueled the 2009 crisis.

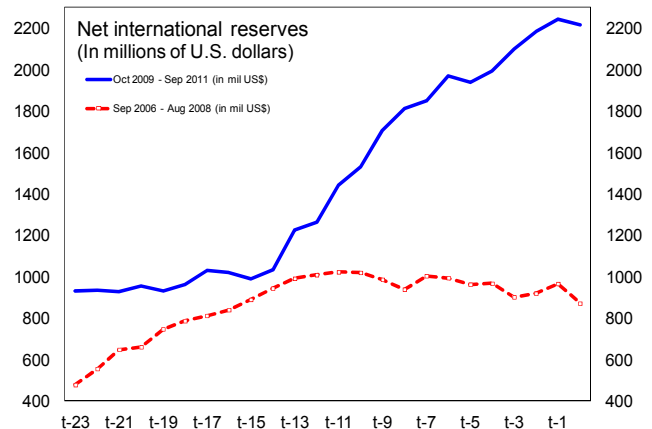
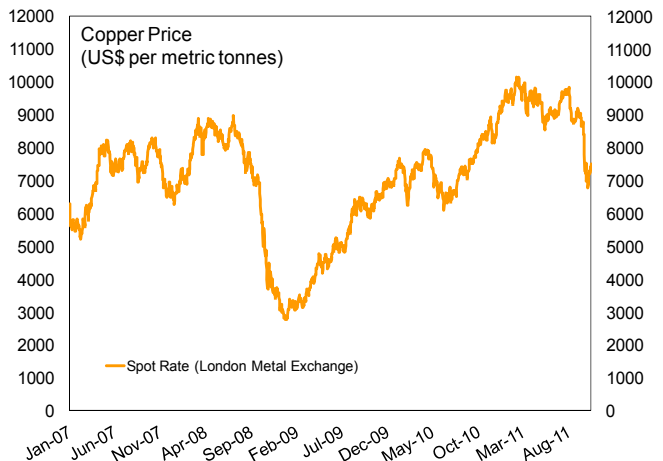
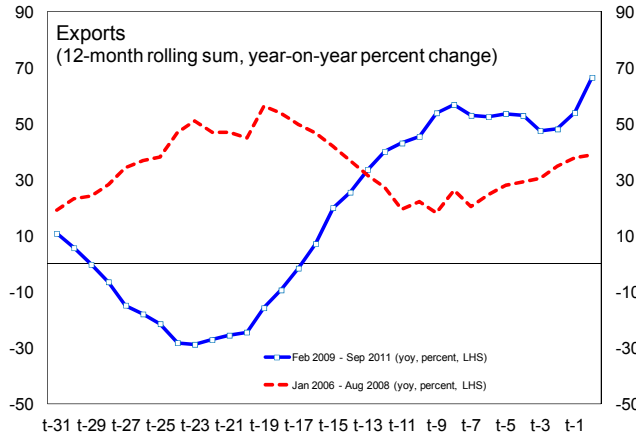


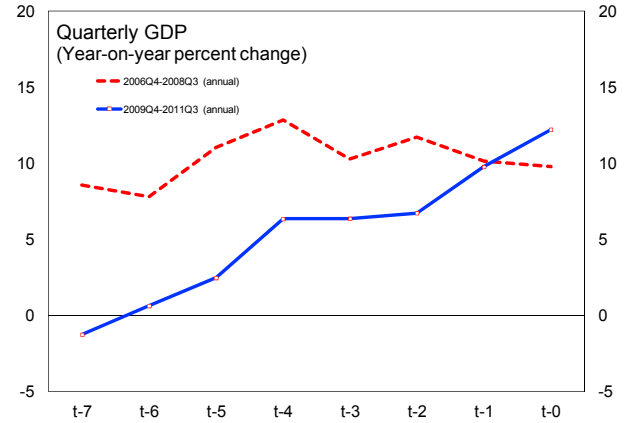
Figure 3. Mongolia—Comparing Now and Then

Main Message: An export boom is mixing with excessively loose macroeconomic policies to drive up growth and overheat the economy, showing striking similarities to the run-up to the last crisis.

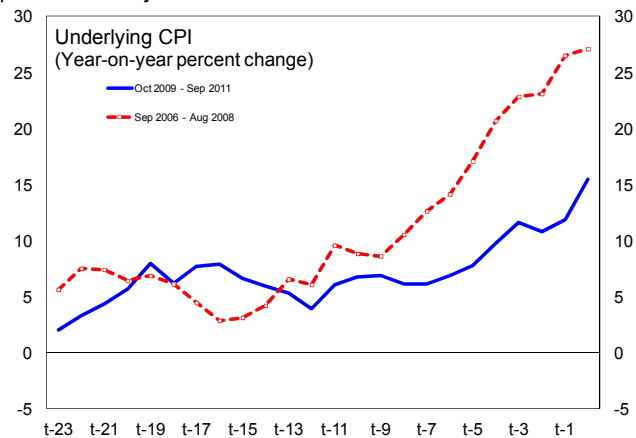
Exports are booming due to strong global commodity prices



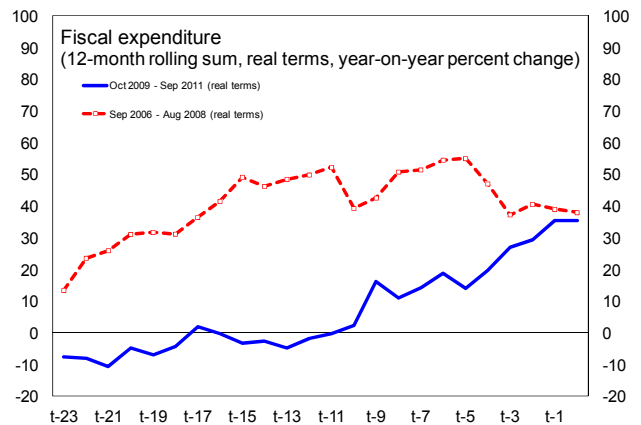
...helping push GDP growth to the pre-crisis rate...



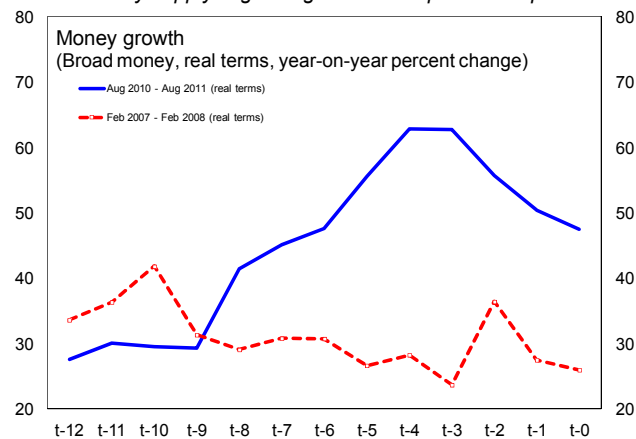
...and driving up inflation, which nonetheless remains well below the peaks reached just before the crisis.



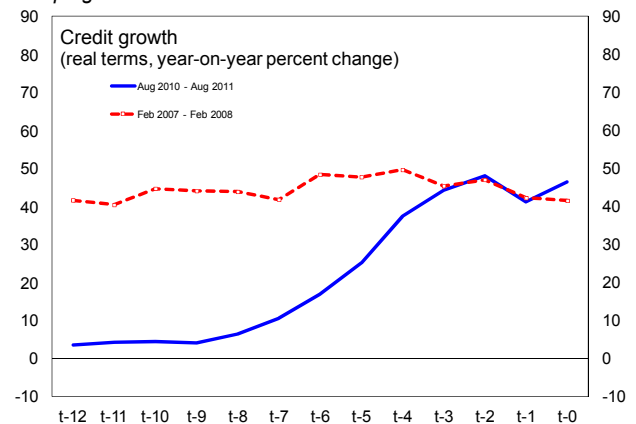
Fiscal expenditure is again growing strongly...



...and money supply is growing faster than pre-crisis speeds...



...helping fuel another credit boom.



Sources: Mongolian authorities; and IMF staff estimates.

6. **Authorities' views.** The authorities expect rapid growth to continue and the draft 2012 budget assumes real GDP growth of some 20 percent for this year and next. However, they did not believe the economy was overheating and thought that inflation could be contained to single-digits in 2012 (and below 8 percent in 2013–14) in line with their policy objective. Nevertheless, the budget assumes an increase in the GDP deflator of around 20 percent. More broadly, they cited under-developed infrastructure as the key impediment to sustaining high growth with moderate inflation and underlined the importance of their plans to increase infrastructure spending through both the budget and the Development Bank. They understood the risks to the global outlook, and the implications for Mongolia, but were confident that the economy was now much more resilient than in the past and that they would be able to adjust policies, if needed, in the event of a sharp drop in global commodity prices.

Mongolia: Authorities' Forecast, 2011-12						
	2011			2012		
	Baseline	Authorities 1/	Staff's recommendations	Baseline	Authorities 1/	Staff's recommendations
(In billions of togrogs)						
Total revenue and grants	4,262	4,139	4,248	5,287	6,733	4,999
Total expenditure and net lending	4,945	4,912	4,016	7,093	7,093	4,880
Overall balance	-683	-773	232	-1,806	-360	118
Nominal GDP	11,535	11,852	11,464	15,274	18,003	14,517
(In percent of GDP)						
Total revenue and grants	36.9	34.9	37.1	34.6	37.4	34.4
Total expenditure and net lending	42.9	41.4	35.0	46.4	39.4	33.6
Overall balance	-5.9	-6.5	2.0	-11.8	-2.0	0.8
Memorandum items: (In percent)						
Real GDP growth	16.9	20.0	16.2	15.1	25.6	11.1
Real Expenditure Growth	50.8	---	22.5	20.9	---	2.4
GDP deflator inflation	17.3	17.4	17.3	15.0	20.9	13.9
CPI inflation (eop) 2/	15.1	12.5	14.5	17.9	9.9	9.9
1/ Based on NDIC projection for 2012 budget proposal, except for CPI inflation.						
2/ The authorities' forecast is based on the draft 2012 Monetary Policy Guideline.						

B. Fiscal Policy has Returned to the Boom-Bust Ways of the Past

7. **Fiscal pressures.** Strong revenue collection means that the overall balance would almost certainly register a small surplus this year if spending is not increased. However, rather than saving this additional revenues, the government has decided to increase spending by some 8 percent of annual GDP in the last two months of this year. This includes nearly 4 percent of GDP in government loans—to small enterprises and processors of cashmere and wool—and 3 percent of GDP in new capital spending. Staff emphasized the negative impact on the poor of the current macroeconomic trajectory and the risks such a large jump in spending posed for inflation.

8. **Development Bank.** A development bank was recently established and will soon start operations. The Development Bank is supervised by the Ministry of Finance and is not subject to the standard commercial bank regulations nor supervised by the bank regulator, which is the

central bank. Staff expressed concern that this government-owned bank would be used primarily as an off-budget vehicle for additional spending. Planned lending by the bank is expected to be concentrated in non-commercial projects such as roads which will generate little to no cash flow and it is expected that the budget would repay these loans over time. Such quasi-fiscal activity would undermine the very goals of the recently-passed fiscal responsibility law.

9. **2012 budget.** The medium-term budget framework approved by parliament was consistent with the fiscal responsibility law's numerical targets. These include the high profile commitment to achieve a 2 percent of GDP structural deficit by 2013.¹ However, the spending path already skewed the adjustment burden to 2013, to the point that nominal spending was actually set to decline in that year. Staff argued, therefore, that nominal spending in the 2012 budget should be kept at or below the level in the medium-term budget framework that had already been approved by parliament, especially in light of rising inflation and the solid near-term growth prospects. Instead, the budget that was recently submitted to parliament includes sharply higher nominal spending that is 13 percent of GDP above that in the medium-term budget framework. In addition, the budget assumes extraordinary forecasts for both nominal growth and revenues. It also includes a wage increase of roughly 50 percent during the first half of the year, which would add substantially to inflation and further hurt Mongolia's competitiveness (since private sector wages are likely to follow the government's lead). Parliament is expected to pass the budget by the end of November. Based on the draft 2012 budget, fiscal spending in 2013 would have to be cut by some 25 percent in real terms in order to comply with the fiscal responsibility's law structural balance rule in 2013. Staff proposed a much lower path of fiscal spending in 2011–12, which would create room for a modest real increase in spending in 2013 (3 percent in real terms) rather than a precipitous decline. Further, such a path for spending would substantially reduce the overheating pressures in 2012 and beyond (see staff's recommendations presented in the previous text table). Staff did, however, welcome the inclusion in the 2012 budget of the long-delayed targeted poverty benefit. This social assistance would provide a higher level of support to the most needy and protect the poor from the planned cut in universal transfers in the second half of 2012.

¹ The structural balance is calculated by using smoothed mineral prices—derived as the average price during a 16-year period (12 years of historical data and projections for the current year and subsequent three years)—to estimate revenue. It does not adjust for the business cycle and thus differs conceptually from what is usually referred to as a structural balance. The other prominent numerical rules require (i) spending, starting in 2013, to grow less than the greater of non-mineral GDP growth in the budget year or the average of the previous 12 years, which allows for counter-cyclical spending; and (ii) a ceiling on the net present value of public debt, broadly defined to include state-owned enterprises and government guaranteed debt, that falls from 60 percent of GDP in 2012, to 50 percent of GDP in 2013, and 40 percent of GDP in 2014.

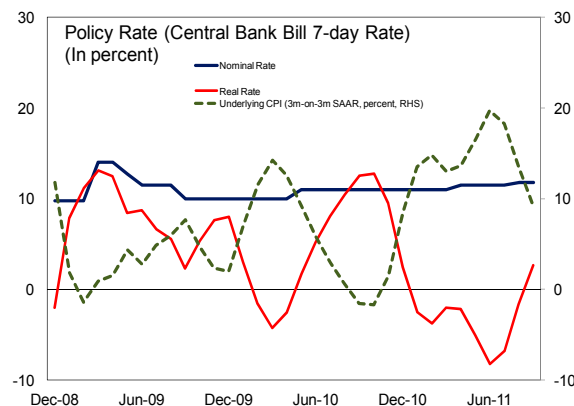
Mongolia: Fiscal Indicators, 2006-13 1/ (In percent of non-mineral GDP)								
	2006	2007	2008	2009	2010	Projected		
						2011	2012	2013
Overall balance (In percent of GDP)	7.6	2.6	-4.5	-5.0	1.2	-5.9	-11.8	-1.0
Structural balance (In percent of GDP)	0.2	-7.5	-10.1	-6.8	-2.7	-7.9	-13.1	-2.0
Non-mineral balance	-3.3	-16.1	-21.2	-17.9	-17.4	-24.3	-28.7	-13.1
Non-mineral revenue	38.0	41.9	36.3	35.5	41.9	47.2	43.1	40.7
Total expenditure	41.3	58.0	57.6	53.5	59.3	71.6	71.8	53.7
Fiscal effort (change in cyclically adjusted) 2/	-0.9	-13.4	-8.6	7.4	4.1	-12.7	-3.5	18.9
Real expenditure growth	32.2	53.3	11.2	-11.4	16.3	50.8	20.9	-24.9
Memorandum items:								
Real non-mineral GDP (growth in percent)	10.1	11.6	10.3	-1.8	6.0	17.5	12.5	2.0
Sources: Mongolian authorities; and IMF staff calculations.								
1/ Staff forecasts based on application of the numerical rules in the fiscal responsibility law.								
2/ In percent of potential non-mineral GDP. The elasticity assumptions are 1 for revenue and 0 for spending.								

10. **Authorities' views.** The authorities understood the risks from an increase in spending. They emphasized, however, the political importance of delivering on the campaign promises from the last election to distribute resources from the Oyu Tolgoi project to the population, invest in essential infrastructure, and significantly increase government wages. They noted that, despite the additional spending in the 2011 budget amendment, buoyant revenue collection would mean that the fiscal deficit would end the year well below the 9.9 percent of GDP target in the original budget. At the same time, much of the spending in the amendment was either in the form of loans that had been approved by parliament earlier in the year or would be used to finance investment projects which were underfinanced in the original budget. They were confident, moreover, that spending pressures would ease following the election and that the announced cut in universal transfers would take place allowing them to reach the fiscal responsibility law targets in 2013. To safeguard the poor from these cuts, they highlighted their intention to introduce a targeted social safety net in 2012. The higher spending in 2012, relative to the medium-term budget framework, reflects changes in macroeconomic assumptions and the authorities' highlighted that they consider the key variable to be the structural balance as a share of GDP. By this metric, the 2012 budget was actually more prudent than the medium-term fiscal framework. Finally, regarding the Development Bank, they highlighted that it had a modern governance structure and was under prudent foreign management (a management contract was agreed with the Korean Development Bank, which includes supplying the CEO and half of the management team).

C. Monetary Policy has been Tightened, but More Needs to be Done

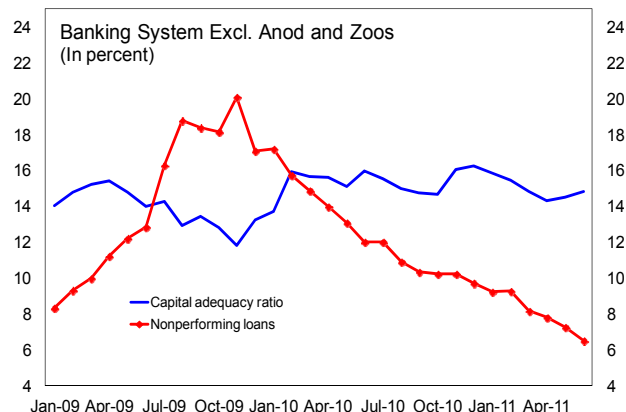
11. **Monetary policy.** Credit growth in real terms has surged to around 50 percent year-on-year with much of the credit concentrated in the larger banks. In August, the central bank announced increases of 25 basis points in the policy rate and 200 basis points in reserve requirements. These were welcome steps but certainly not enough given the pace at which inflation is rising. Staff advocated a further tightening of monetary conditions and suggested that the central bank use a variety of tools. First, the central bank should further raise the policy rate to send a strong signal to the market. In particular, the real policy rate has been consistently

negative for most of this year. In addition, a range of macro-prudential measures should be implemented to contain credit risks, including a further hike in reserve requirements, caps on the loan-to-value and debt-to-income ratios for real estate lending, tightening the liquidity ratio, tougher capital adequacy requirements, and additional provisioning. These would complement an interest rate hike and, in any event, be warranted on prudential grounds to stem the excessive growth in bank lending. MCM has been discussing these measures with the authorities and plans to soon field a technical assistance mission.



12. **Exchange rate policy.** The flexible exchange rate regime continues to work well and the central bank has intervened only sparingly over the past year. Staff advised, therefore, continuing with the current regime. In line with MCM technical assistance, the central bank has decided to use foreign currency swaps only as a liquidity management tool and has not been intervening using forward transactions.

13. **Banking.** Banking sector indicators have held up so far. However, these indicators are backward looking and the rapid acceleration in bank lending is increasing the banks' vulnerability and putting stress on the system (Figure 4). Moreover, even these indicators may not be representative of the true health of the system. For example, the decline in NPL numbers is distorted by the surge in credit and some banks have needed more time to implement the stricter rules put in place earlier this year on the treatment of restructured loans and lending to related parties. Staff underscored that the supervisor must be willing, as needed, to take tough action against banks that are not in compliance with regulations. In particular, for such banks, a bank-by-bank restructuring plan should be put in place with time bound action plans that are closely monitored. The supervisor should also move towards risk-based and forward-looking supervision. At this stage in the business cycle, it is especially important to strictly enforce prudential regulations and proactively manage risks to prevent the buildup of future problems.

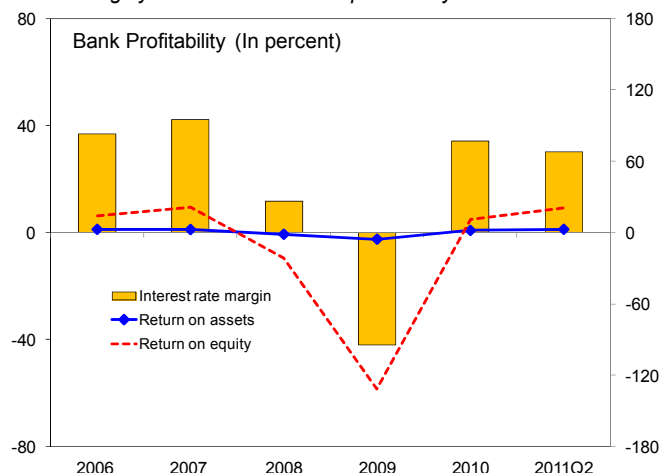


14. **Authorities' views.** The central bank emphasized that their policy response has been more proactive than in 2008, that the tightening measures put in place are showing signs of working (especially the hike in reserve requirements). They felt that the fundamental source of inflationary pressure was fiscal spending and monetary policy could only do so much to offset the large increases in spending that Mongolia was now absorbing. Nevertheless, they continued to watch incoming data and stood ready to implement further tightening measures if needed.

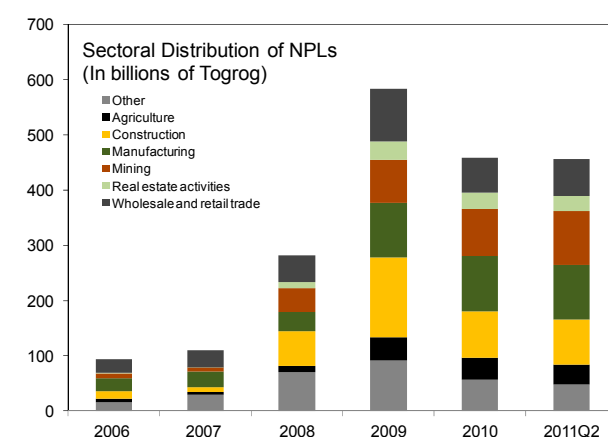
Figure 4. Mongolia—Banking System

Main Message: The banking system is recovering from the crisis and credit is now growing rapidly, which is raising concerns about credit quality.

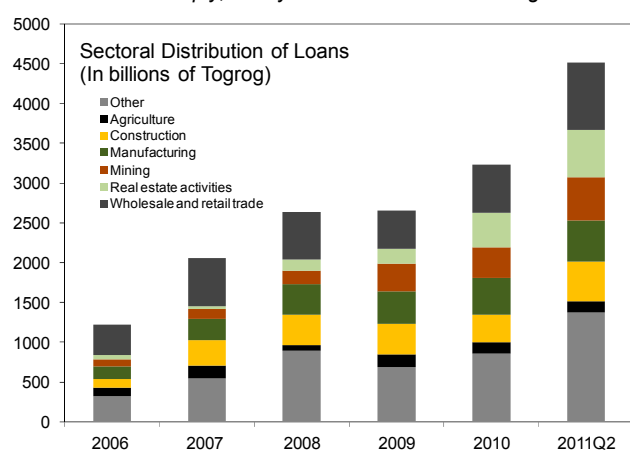
The banking system has returned to profitability...



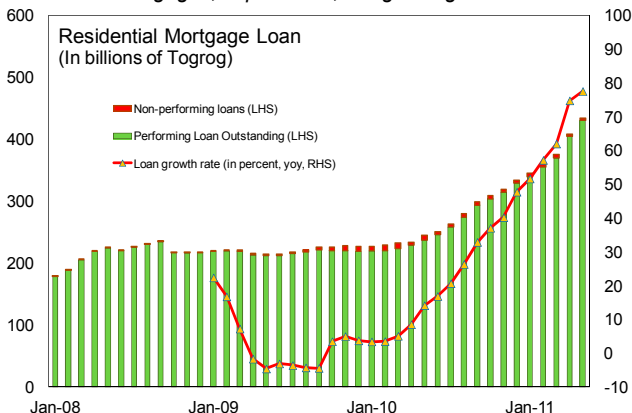
...and the stock of NPLs has fallen.



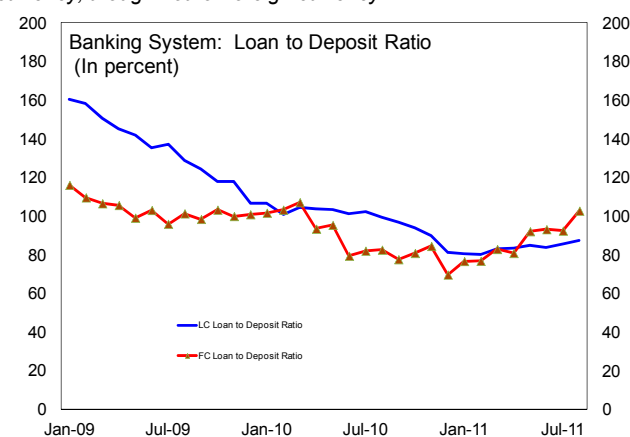
Credit has risen sharply, led by the real estate and mining sectors.



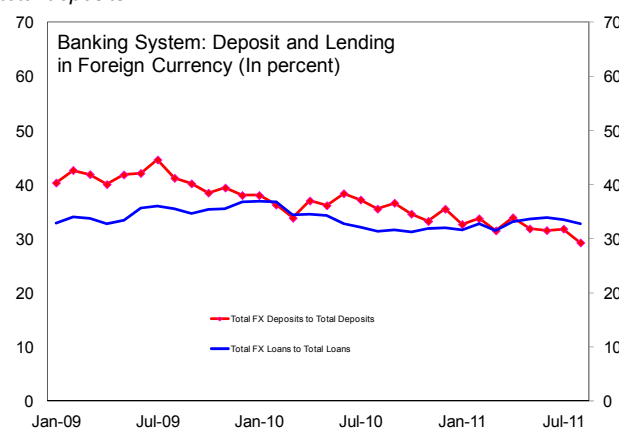
Residential mortgages, in particular, are growing fast.



Deposit growth, moreover, has kept pace with lending growth in local currency, though not for foreign currency...



...as foreign currency deposits, while growing, fell as a share of total deposits.



Sources: Mongolian authorities; and IMF staff estimates.

They agreed that interest rate hikes alone would not be sufficient, and were considering macro-prudential measures as a complementary tool. They shared staff's views that the flexible exchange rate continues to be well suited for Mongolia and that it, along with the substantially higher international reserves, would provide a critical buffer to a global shock. Regarding banks, they emphasized that supervision has made great strides since the crisis—supported by IMF technical assistance—and they agreed on the importance of strict enforcement. Parliament does not plan to take up the broader bank restructuring program, so the supervisor and a few banks, not in full compliance with the regulations, have agreed on bank-specific business plans, which include time bound action plans.

III. STAFF APPRAISAL

15. **Context.** Mongolia has a bright economic future. Its vast mineral deposits offer the potential to create strong and sustained growth, lasting economic prosperity, and a substantial reduction in poverty. Success, however, will depend on a shift in approach in managing the economy. At present, macroeconomic policies are too expansionary. This has created inflationary pressures and made the economy vulnerable to external shocks. This is especially dangerous at this juncture given the heightened downside risks to the global economy. The large mining projects under development, moreover, are still some time away from full production. If global mineral prices drop precipitously, exports and fiscal revenue would fall sharply and pressure would come on international reserves. This would necessitate a potentially painful and disorderly reduction in fiscal spending that would exact a heavy toll on the economy, particularly on the poor. Top priority, therefore, should be to restrain fiscal spending and tighten monetary conditions to cool the overheated economy and provide insurance in the event of future commodity price shocks.

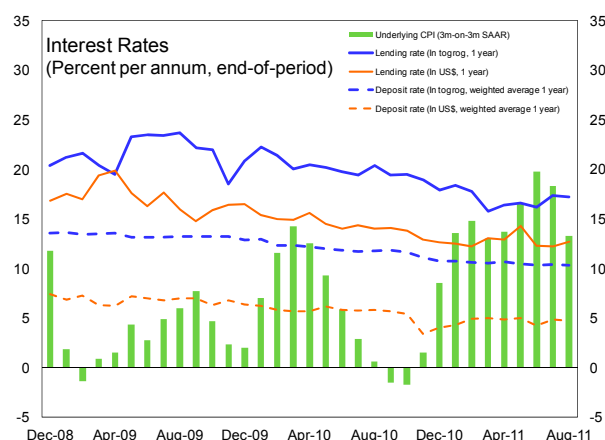
16. **Expenditure restraint.** The 2011 budget is too expansionary and a major source of the persistent inflationary pressures. Government spending, which was slated to grow by some 30 percent in the original budget, accounts for some two-thirds of the non-mineral economy and is thus a key determinant of aggregate demand. Any further increase in spending this year, therefore, is clearly not warranted, yet alone an increase of 8 percent of annual GDP, in just one quarter, as has been proposed. Additional spending this year would further overheat the economy, hurt the poor by driving up inflation, increase the vulnerability to a global commodity shock, and undermine credibility in fiscal policy and the fiscal responsibility law. Monetary policy, moreover, would not be able to offset a fiscal stimulus of this magnitude but in trying would inevitably lead to a crowding out of private sector activity.

17. **2012 budget.** Given the pressures facing the economy, nominal spending in 2012 should be kept at or below the level parliament has already approved in the medium-term budget framework. To better orient fiscal policy toward protecting the poor, a targeted poverty benefit should be introduced, starting in 2012. This would provide a welcome offset to the loss of income from the planned reduction in universal cash transfers, and make it much easier to protect the poor from budget cuts in the event of a global shock. In addition, the medium-term budget

framework includes a sharp reduction in spending in 2013 in order to adhere to the fiscal responsibility law. It would be much better to plan for a smoother path of spending.

18. **Development Bank.** The Development Bank poses significant fiscal risks. It is critical that the bank is not used as a vehicle for off-budget spending which would circumvent the very purpose of the fiscal responsibility law. To guard against this, the bank should be operated on commercial terms, with a high degree of transparency, and a board that is accountable for overseeing the bank's operations, risk management, and internal controls. The bank should also be subject to prudential requirements and independent prudential review, including external audit.

19. **Monetary policy.** The recent tightening of monetary policy is welcome but is still not enough given the coming inflationary pressures. Volatility in food prices has disguised the fact that underlying inflationary momentum has remained firmly in the double-digits. Despite this, the policy rate has been raised by less than 1 percentage point this year. Further rate hikes are necessary. In addition, and as a complement to rate hikes, the central bank should implement a range of macro-prudential measures to ensure that inflation pressures are contained and credit growth is brought under control. These measures include further hikes in reserve requirements, tightening of the liquidity ratio, requirement to provision against all new lending, limits on the loan-to-value and debt-to-income ratios, and an increase in capital adequacy requirements.



20. **Exchange rate policy.** The flexible exchange rate regime has been working well and continues to be well suited for the Mongolian economy. It will help control inflation, provide a shock absorber against external shocks, and facilitate the real exchange rate changes that are likely to take place over the medium term with the rapid growth in the mineral sector. The flexible exchange rate and the fact that international reserves are now at record highs will make the economy more resilient to a global commodity shock.

21. **Banking system.** The rapid acceleration in bank lending is increasing the banks' vulnerability and putting stress on the financial system. It is especially important to strictly adhere to the existing prudential regulations and proactively manage risks to prevent the buildup of future problems. Recent international experience has made painfully clear that a key to avoiding a banking crisis is to prevent the buildup of risks during economic booms. The macro-prudential measures described above are a key line of defense in this regard. Moreover, the banking supervisor must be willing, as needed, to take tough action against banks that do not comply with regulations. The supervisor should also move towards much more risk-based and forward-looking supervision.

Table 1. Mongolia: Selected Economic and Financial Indicators, 2009–12

Nominal GDP (2010): US\$6,244 million 1/
 Population, end-year (2010): 2.78 million
 Per capita GDP (2010): US\$2,233 2/
 Poverty incidence (2007/08): 35.2 percent 3/
 Quota: SDR 51.1 million

	2009	2010	Proj.		Article IV	
			2011	2012	2011	2012
(Percent change)						
Real sector						
Real GDP growth	-1.3	6.4	16.9	15.1	10.3	7.6
Mineral	0.2	7.4	15.3	22.0	13.4	12.6
Non-mineral	-1.8	6.0	17.5	12.5	9.0	5.5
Consumer prices (period average)	6.3	10.2	10.2	18.7	16.4	16.0
Consumer prices (end-period)	1.9	14.3	15.1	17.9	20.0	12.0
GDP deflator	1.8	20.0	17.3	15.0	14.1	8.9
(In percent of GDP)						
General government budget						
Revenue and grants	30.2	36.5	36.9	34.6	35.1	35.0
Expenditure and net lending	35.2	35.3	42.9	46.4	38.5	38.9
Current balance	2.6	9.2	8.1	4.3	4.4	6.8
Primary balance	-4.5	1.7	-5.5	-10.6	-3.1	-3.7
Overall balance (including grants)	-5.0	1.2	-5.9	-11.8	-3.5	-3.9
Non-mineral overall balance	-11.8	-10.4	-14.6	-18.6	-13.3	-11.8
Structural balance 4/	-6.8	-2.7	-7.9	-13.1	-6.3	-6.5
(Percent change)						
Money and credit						
Broad money	26.9	61.6	68.6	44.2	45.0	23.5
Broad money velocity (GDP/BM)	2.3	1.8	1.5	1.4	1.5	1.5
Interest rate on 7-day central bank bills, end-period (percent)	10.0	11.0	...	...	...	...
(In millions of US\$)						
Balance of payments						
Current account balance (including official transfers)	-410	-931	-1,821	-2,031	-1,302	-1,438
(In percent of GDP)	-9.0	-14.9	-19.5	-16.3	-15.1	-13.6
(In percent of GDP, excluding mining related imports)	-5.8	-5.7	0.2	-2.4	2.5	0.1
Trade balance	-194	-278	-1,285	-1,349	-1,049	-1,107
Exports	1,876	2,899	4,296	4,922	3,825	4,083
Imports	-2,070	-3,177	-5,581	-6,271	-4,874	-5,190
Foreign direct investment	496	1,574	2,412	894	1,130	548
Gross official international reserves (end-period)	1,328	2,288	2,984	3,302	3,586	4,127
(In months of next year's imports of goods and services)	4.0	4.2	4.9	5.8	7.1	8.8
Trade prices						
Export prices (US\$, percent change)	-13.2	33.1	18.9	-0.5	9.8	-1.4
Import prices (US\$, percent change)	-16.0	11.6	14.6	-0.6	7.4	0.5
Terms of trade (percent change)	3.3	19.3	3.8	0.1	2.3	-1.9
(In percent of GDP)						
Public and publicly guaranteed debt						
Total public debt	46.6	42.2	47.1	47.6	38.6	37.1
Domestic debt 5/	3.4	12.0	25.4	30.6	15.8	17.3
External debt	43.3	30.2	21.7	17.0	22.8	19.8
(In millions of US\$)	1,977	2,023	2,064	2,097	2,064	2,097
Exchange rate						
Togrogs per US\$ (end-period)	1,443	1,257	...	...	...	...
Togrogs per US\$ (period average)	1,441	1,348	...	...	...	...
Nominal effective exchange rate (end-period; percent change)	-15.8	3.4	...	...	...	...
Real effective exchange rate (end-period; percent change)	-11.1	11.3	...	...	...	...
Nominal GDP (In billions of togrogs)	6,591	8,415	11,535	15,274	10,382	12,166

Sources: Mongolian authorities; and IMF staff projections.

1/ Based on period average exchange rate and NSO revisions.

2/ Estimate, based on period average exchange rate and NSO revisions.

3/ Based on The Household Socio-Economic Survey 2007-08.

4/ As defined in the fiscal responsibility law, which uses smoothed instead of actual commodity prices to calculate revenue.

5/ Domestic debt in 2009 includes the Oyu Tolgoi tax-prepayment while the estimates for 2010 and the projections for 2011 additionally include the estimated fiscalization cost of bank restructuring and the financing of the government's equity share in Oyu Tolgoi.

Table 2. Mongolia: Summary Operations of the General Government, 2009–12

	2009	2010	Proj.		Article IV	
			2011	2012	2011	2012
(In billions of togrogs)						
Total revenue and grants	1,993	3,073	4,262	5,287	3,639	4,259
Total expenditure and net lending	2,322	2,974	4,945	7,093	3,999	4,738
Overall balance (incl. grants)	-329	99	-683	-1,806	-360	-478
Non-mineral overall balance	-778	-873	-1,681	-2,836	-1,380	-1,440
Structural balance	-445	-231	-907	-2,006	-652.2	-795.9
Financing	329	-99	683	1,806	360	478
Foreign (net)	300	-107	50	41	48	39
Domestic (net)	29	8	633	1,765	311	440
Privatization receipts (valuation adj.)	26	1	0	0	1	1
Domestic bank financing (net)	76	-29	396	1,965	-50	439
Domestic non-bank financing (net)	-73	36	462	0	361	0
Stabilization fund accumulation	0	0	-224	-200	0	0
(In percent of GDP)						
Total revenue and grants	30.2	36.5	36.9	34.6	35.1	35.0
Current revenue	29.8	36.0	36.7	34.6	34.7	34.6
Tax revenue and social security contributions	24.5	31.8	32.1	29.3	30.4	29.5
Income taxes	7.9	11.6	7.3	6.6	8.1	7.5
Social security contributions	3.9	3.8	4.0	4.3	4.0	4.3
Sales tax and VAT	4.9	6.9	8.8	7.9	7.4	7.7
Excise taxes	2.5	3.2	3.0	2.7	3.1	3.0
Customs duties and export taxes	1.8	2.3	2.8	2.4	2.5	2.3
Other taxes	3.5	4.0	6.2	5.3	5.3	4.7
Non-tax revenue	5.3	4.2	4.6	5.3	4.3	5.1
Capital revenue and grants	0.4	0.5	0.2	0.2	0.4	0.4
Total expenditure and net lending	35.2	35.3	42.9	46.4	38.5	38.9
Current expenditure	27.2	26.8	28.6	30.4	30.3	27.9
Wages and salaries	8.8	7.7	7.0	8.1	7.6	8.2
Purchase of goods and services	5.9	6.2	6.0	5.7	6.1	6.1
Subsidies to public enterprises	0.6	1.0	1.1	0.7	0.9	0.9
Transfers 1/	11.5	11.4	14.2	14.6	15.3	12.4
Interest payments	0.4	0.5	0.4	1.3	0.4	0.3
Capital expenditure and net lending	8.0	8.6	14.3	16.1	8.2	11.1
Capital expenditure	6.9	6.7	9.7	15.7	7.3	10.0
Net lending	1.1	1.8	4.6	0.4	0.9	1.0
Overall balance (incl. grants)	-5.0	1.2	-5.9	-11.8	-3.5	-3.9
Non-mineral overall balance (incl. grants)	-11.8	-10.4	-14.6	-18.6	-13.3	-11.8
Structural balance	-6.8	-2.7	-7.9	-13.1	-6.3	-6.5
Financing	5.0	-1.2	5.9	11.8	3.5	3.9
Foreign (net)	4.5	-1.3	0.4	0.3	0.5	0.3
Disbursements	5.9	0.2	1.1	1.1	1.2	1.2
Project loans	1.4	0.9	1.1	1.1	1.2	1.2
Program loans	3.0	0.4	0.0	0.0	0.0	0.0
Gold financing loan	1.4	-1.1	0.0	0.0	0.0	0.0
Amortization	1.3	-0.7	0.6	0.8	0.7	0.9
Domestic (net)	0.4	0.1	5.5	11.6	3.0	3.6
Banking system (net)	1.2	-0.3	3.4	12.9	-0.5	3.6
Non-bank	-0.7	0.4	4.0	0.0	3.5	0.0
Of which : Oyu Tolgoi tax-prepayment	2.2	0.8	1.1	0.0	1.2	0.0
Stabilization fund accumulation	0.0	0.0	-1.9	-1.3	0.0	0.0
Memorandum items:						
Overall balance incl. banking sector restructuring costs (percent of GDP) 2/	-5.0	-0.3	-6.9	-11.8	-4.6	-3.9
Mineral revenue (percent of GDP)	6.8	11.6	8.7	6.7	9.8	7.9
Non-mineral revenue (percent of GDP)	23.0	24.5	28.3	27.9	24.9	26.7
Nominal GDP (in billions of togrogs)	6,591	8,415	11,535	15,274	10,382	12,166
Copper price (US\$ per ton)	5,165	7,538	9,204	8,880	9,000	8,500

Sources: Ministry of Finance; and IMF staff projections.

1/ Includes reclassifications between goods and services and transfers starting in 2009, which accounts for about two-thirds of the increase in transfers relative to GDP in 2009.

2/ Includes the estimated fiscalization cost of bank restructuring.

Table 3. Mongolia: Statement of Operations and Stock Positions of the General Government, 2009–12

	2009	2010	Proj.		Article IV	
			2011	2012	2011	2012
(In billions of togrogs)						
Revenue	1,990	3,065	4,248	5,266	3,629	4,246
Expenditure	2,247	2,813	4,404	7,007	3,898	4,598
Expense	1,792	2,254	3,300	4,637	3,147	3,389
Net acquisition of nonfinancial assets	455	559	1,104	2,370	751	1,209
Operating balance	198	811	948	629	482	857
Net lending/borrowing (Overall balance)	-257	252	-157	-1,741	-269	-352
Net acquisition of financial assets	205	175	751	265	89	125
Net incurrence of liabilities	462	-77	907	2,006	359	477
Domestic	162	30	857	1,965	310	439
Foreign	300	-107	50	41	48	39
(In percent of GDP)						
Revenue	30.2	36.4	36.8	34.5	35.0	34.9
Income tax	7.9	11.6	7.3	6.6	8.1	7.5
VAT	4.9	6.9	8.8	7.9	7.4	7.7
Excise tax	2.5	3.2	3.0	2.7	3.1	3.0
Customs and import duty	1.7	2.3	2.8	2.4	2.5	2.3
Royalty	2.2	2.4	4.6	3.6	3.6	2.9
Social contributions	3.9	3.8	4.0	4.3	4.0	4.3
Others	7.0	6.2	6.3	7.0	6.2	7.2
Expense	27.2	26.8	28.6	30.4	30.3	27.9
Compensation of employees	8.8	7.7	7.0	8.1	7.6	8.2
Use of goods and services	5.9	6.2	6.0	5.7	6.1	6.1
Interest	0.4	0.5	0.4	1.3	0.4	0.3
Subsidies	0.6	1.0	1.1	0.7	0.9	0.9
Social benefit	11.5	11.4	14.2	14.6	15.3	12.4
Net acquisition of nonfinancial assets	6.9	6.6	9.6	15.5	7.2	9.9
Operating balance	3.0	9.6	8.2	4.1	4.6	7.0
Net lending/borrowing (Overall balance)	-3.9	3.0	-1.4	-11.4	-2.6	-2.9
Net acquisition of financial assets	3.1	2.1	6.5	1.7	0.9	1.0
Policy lending	1.1	1.8	4.6	0.4	0.9	1.0
Stabilization fund	0.0	0.0	1.9	1.3	0.0	0.0
Net incurrence of liabilities	7.0	-0.9	7.9	13.1	3.5	3.9
Domestic	2.5	0.4	7.4	12.9	3.0	3.6
Foreign	4.5	-1.3	0.4	0.3	0.5	0.3
Stock positions:						
Net financial worth	-0.3	2.8	0.7	-10.9		
Financial assets	59.4	48.6	42.0	33.4	-	-
Currency and deposits	20.4	16.3	13.8	11.7	-	-
Securities other than shares	0.1	0.1	0.1	0.0	-	-
Loans	28.4	24.1	22.1	17.1	-	-
Shares and other equity	0.0	0.0	0.0	0.0	-	-
Other accounts receivable	10.4	8.2	6.0	4.5	-	-
Liabilities	59.7	45.8	41.3	44.3	-	-
Securities other than shares	11.3	8.5	6.2	4.7	-	-
Loans	45.0	34.7	33.2	38.2	-	-
Other accounts payable	3.4	2.6	1.9	1.5	-	-

Sources: Ministry of Finance; and IMF staff projections.

Table 4. Mongolia: Monetary Aggregates, 2009–12 1/

	2009	2010	Proj.		Article IV	
			2011	2012	2011	2012
(In billions of togrog; end of period)						
Monetary survey						
Broad money	2,880	4,655	7,847	11,314	6,750	8,333
Currency	285	390	785	1,131	675	833
Deposits	2,595	4,266	7,062	10,182	6,075	7,500
Net foreign assets	1,533	2,740	3,495	3,998	4,013	4,668
Net domestic assets	1,347	1,915	4,352	7,316	2,737	3,665
Domestic credit	1,987	2,448	5,030	7,836	3,553	4,244
Net credit to government 2/	-717	-836	-319	1,646	-765	-326
Claims on non-banks	2,704	3,284	5,349	6,190	4,318	4,571
Other items, net	-640	-533	-678	-520	-816	-579
Monetary authorities						
Reserve money	733	947	1,534	2,071	1,231	1,477
Net foreign assets	1,539	2,530	3,285	3,788	3,803	4,458
BOM defined reserves 3/	1,652	2,628	3,498	3,945	4,269	4,993
Net international reserves (NIR) 4/	1,335	2,140	3,281	3,728	3,781	4,505
Other BOM defined reserves	318	488	217	217	488	488
Other assets, net	-114	-98	-213	-157	-466	-536
Net domestic assets	-806	-1,583	-1,751	-1,717	-2,572	-2,981
Net credit to government	-265	-493	-497	-432	-663	-324
Claims on deposit money banks	198	131	4	20	15	16
Minus: Central bank bills (net)	393	1,101	1,299	1,377	1,777	2,628
Other items, net	-346	-120	41	72	-147	-45
Memorandum items:						
(In percent; unless otherwise indicated)						
Annual broad money growth	26.9	61.6	68.6	44.2	45.0	23.5
Annual reserve money growth	26.4	29.2	62.0	35.0	30.0	20.0
Velocity	2.3	1.8	1.5	1.4	1.5	1.5
Broad money/reserve money	3.9	4.9	5.1	5.5	5.5	5.6
Claims on non-banks growth	0.4	21.5	62.9	15.7	---	---
Claims on non-banks (in percent of GDP)	41.0	39.0	46.4	40.5	---	---
Total loans/deposits	104.2	77.0	75.7	60.8	71.1	60.9
BOM defined reserves (in millions of US\$) 3/	1,145	2,092	2,783	3,138	3,392	3,967
Net international reserves (NIR, in millions of US\$) 4/	925	1,704	2,610	2,965	3,004	3,580

Sources: Mongolian authorities; and IMF staff projections.

1/ Previously based on program exchange rate (1,560 tog/USD).

2/ Including bank restructuring cost

3/ Evaluated at end-2010 exchange rate for 2011 and 2012.

4/ Previously referred to as net international reserves under program definition. The definition of NIR has been revised in line with the recommendation of the IMF Safeguard Assessment, and does not include commercial bank foreign currency deposits and foreign currency current accounts held at the Bank of Mongolia. Evaluated at end-2010 exchange rate for 2011 and 2012.

Table 5. Mongolia: Balance of Payments, 2009–12

(In millions of US\$, unless indicated otherwise)

	2009	2010	Proj.		Article IV	
			2011	2012	2011	2012
Current account balance (including official grants)	-410	-931	-1,821	-2,031	-1,302	-1,438
Trade balance	-194	-278	-1,285	-1,349	-1,049	-1,107
Exports	1,876	2,899	4,296	4,922	3,825	4,083
Mineral Export 1/	1,560	2,521	3,742	4,392	3,382	3,655
Non-mineral Export	316	378	554	530	443	428
Imports	-2,070	-3,177	-5,581	-6,271	-4,874	-5,190
Oil imports	-528	-676	-1,099	-1,211	-903	-1,005
Food imports	-311	-336	-586	-666	-534	-555
For investment in mining 2/	-143	-576	-1,839	-1,738	-1,517	-1,445
Other	-1,088	-1,589	-2,056	-2,657	-1,920	-2,186
Services, net	-164	-279	-430	-447	-268	-291
Income, net	-190	-561	-253	-393	-133	-197
Current transfers	138	186	147	158	147	158
General government 3/	-1	49	24	34	24	34
Other sectors	140	137	123	124	123	124
Of which: workers remittances	120	102	103	103	103	103
Capital and financial account	737	2,180	2,520	2,385	2,602	2,013
Capital account	208	175	96	96	96	96
Financial account	529	2,005	2,424	2,289	2,506	1,917
Direct investment	496	1,574	2,412	894	1,130	548
Portfolio investment	-93	879	387	391	457	343
Trade credits, net	13	53	35	43	35	38
Currency and deposits, net	-45	-624	-624	-935	-506	-574
Loans, net	274	94	361	2,490	1,108	2,045
Other, net	-116	31	-148	-594	282	-483
Errors and omissions	187	-311	0	0	0	0
Overall balance	514	938	699	354	1,301	575
Financing	-514	-938	-699	-354	-1,301	-575
Gross official reserves (- increase)	-670	-960	-695	-318	-1,297	-540
Use of IMF credit (+)	156	23	-4	-36	-4	-35
Memoranda items:						
Current account balance (in percent of GDP)						
Including official grants	-9.0	-14.9	-19.5	-16.3	-15.1	-13.6
Excluding mining related imports	-5.8	-5.7	0.2	-2.4	2.5	0.1
Excluding official grants	-8.9	-15.7	-19.8	-16.6	-15.4	-13.9
Gross official reserves (end-period)	1,328	2,288	2,984	3,302	3,586	4,127
(In months of imports of goods and services)	4.0	4.2	4.9	5.8	7.1	8.8
Copper price (in US\$ per ton)	5,165	7,538	9,204	8,880	9,000	8,500
Oil price (in US\$ per barrel)	62	79	103	100	90	90
Gold price (in US\$ per troy oz.)	973	1,225	1,582	1,758	1,362	1,405

Sources: Mongolian authorities; and IMF staff projections.

1/ Including copper, coal, gold and others.

2/ This covers Oyu Tolgoi copper project and Tavan Tolgoi coal project.

3/ Starting in 2009, investment-related grants have been reclassified in the capital account per BPM5.

Table 6. Mongolia: Selected Economic and Financial Indicators, 2008-16 1/

	2008	2009	2010	Proj.					
				2011	2012	2013	2014	2015	2016
(In percent of GDP; unless indicated otherwise)									
Real sector									
Nominal GDP (in billions of togrogs)	6,556	6,591	8,415	11,535	15,274	18,641	22,145	24,129	29,064
Per capita GDP (in US\$) 2/	2,108	1,688	2,233	3,288	4,321	5,226	6,156	6,516	7,684
Real GDP growth (percent change)	8.9	-1.3	6.4	16.9	15.1	12.2	12.3	4.5	14.1
Mineral real GDP growth	5.2	0.2	7.4	15.3	22.0	37.1	25.7	0.6	25.6
Non-mineral real GDP growth	10.3	-1.8	6.0	17.5	12.5	2.0	5.0	7.0	7.0
GDP deflator (percent change)	21.4	1.8	20.0	17.3	15.0	8.8	5.8	4.3	5.6
Mineral GDP deflator	7.9	-0.4	40.7	18.1	-4.5	0.1	-1.7	3.3	1.8
Non-mineral GDP deflator	25.9	4.5	9.0	17.2	27.2	11.5	10.2	5.1	8.1
Consumer prices (end-period; percent change)	23.2	1.9	14.3	15.1	17.9	9.0	8.5	7.9	7.3
Copper prices (US\$ per ton)	6,963	5,165	7,538	9,204	8,880	8,800	8,640	8,450	8,210
General government accounts									
Total revenue and grants	33.1	30.2	36.5	36.9	34.6	31.4	29.9	31.7	32.9
Mineral revenue	9.4	6.8	11.6	8.7	6.7	6.9	6.8	8.4	10.8
Non-mineral revenue	23.4	23.0	24.5	28.3	27.9	24.5	23.1	23.3	22.1
Total expenditure and net lending	37.6	35.2	35.3	42.9	46.4	32.4	31.2	33.1	33.5
Primary balance	-4.2	-4.5	1.7	-5.5	-10.6	0.6	0.2	0.1	0.8
Overall balance	-4.5	-5.0	1.2	-5.9	-11.8	-1.0	-1.3	-1.4	-0.6
Non-mineral overall balance	-13.9	-11.8	-10.4	-14.6	-18.6	-7.9	-8.0	-9.8	-11.4
Structural balance	-10.1	-6.8	-2.7	-7.9	-13.1	-2.0	-2.0	-2.0	-1.1
(In percent of non-mineral GDP)									
Non-mineral revenue and grants	36.2	35.5	41.7	47.4	43.2	40.7	39.5	38.4	37.9
Total expenditure and net lending	57.6	53.5	59.3	71.6	71.8	53.7	53.1	54.5	57.5
Non-mineral overall balance	-21.2	-17.9	-17.4	-24.3	-28.7	-13.1	-13.7	-16.1	-19.6
(In percent of GDP; unless indicated otherwise)									
Monetary sector									
Broad money (percent change)	-5.1	26.9	61.6	68.6	44.2	26.7	23.6	13.5	25.7
Velocity (GDP/M2)	2.9	2.3	1.8	1.5	1.4	1.3	1.3	1.2	1.2
Balance of payments									
Current account balance	-12.9	-9.0	-14.9	-19.5	-16.3	-2.2	3.0	4.4	6.8
Excluding mining related imports	-9.5	-5.8	-5.7	0.2	-2.4	7.7	12.0	11.6	14.2
Gross official reserves (in millions of US\$)	658	1,328	2,288	2,984	3,302	3,679	3,976	4,850	5,722
(In months of next year's imports of goods and services)	3.0	4.0	4.2	4.9	5.8	6.2	6.7	7.5	8.0
Debt indicators									
Total public debt	31.0	46.6	42.2	47.1	47.6	39.8	33.0	28.0	24.1
Domestic public debt 3/	0.0	3.4	12.0	25.4	30.6	25.9	20.5	15.4	12.7
External public debt	31.0	43.3	30.2	21.7	17.0	13.9	12.5	12.6	11.3
(In millions of US\$)	1,602	1,977	2,023	2,064	2,097	2,149	2,271	2,469	2,654

Sources: Mongolian authorities; and IMF staff projections.

1/ The medium-term projections are based on the assumption that the fiscal responsibility law will be adhered to.

2/ Based on period average exchange rate.

3/ Includes the expected fiscalization cost of bank restructuring, the financing of the government's equity share in Oyu Tolgoi and the Oyu Tolgoi tax-prepayment.



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APPENDIX I. IMF Executive Board Concludes the Second Post-Program Monitoring with Mongolia

On November XX, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Post Program Monitoring with Mongolia.¹

Background

Mongolia completed successfully its Fund supported Stand-by Arrangement last October. The government's commitment to implement sound policies was a critical ingredient to the success of the program. Since the end of the program, however, macroeconomic discipline has been steadily eroded, placing in jeopardy the gains achieved during the course of the program. Parliamentary elections are scheduled for June 2012 and electoral politics could, therefore, start to exert a stronger influence on policies.

The economy is undergoing a vigorous recovery, fueled by strong global commodity prices and excessively loose macroeconomic policies. Mining output, moreover, is set to increase substantially as two huge projects underway will soon start production. Growth has accelerated sharply this year, reflecting booming mineral exports driven by global prices and rising coal production, ongoing development of large mining projects, surging credit growth, improved agricultural output (primarily a base effect from last year's severe winter), and expansionary macroeconomic policies. The economy is now overheating and inflation has accelerated sharply in the past few months.

¹ Post-Program Monitoring provides for more frequent consultations between the Fund and members whose arrangement has expired but that continue to have Fund credit outstanding, with a particular focus on policies that have a bearing on external viability. There is a presumption that members whose credit outstanding exceeds 200 percent of quota would engage in Post-Program Monitoring.

Executive Board Assessment

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Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Mongolia: Selected Economic and Financial Indicators, 2009–12

	2009	2010	Proj.	
			2011	2012
	(Percent change)			
Real sector				
Real GDP growth	-1.3	6.4	16.9	15.1
Mineral	0.2	7.4	15.3	22.0
Non-mineral	-1.8	6.0	17.5	12.5
Consumer prices (period average)	6.3	10.2	10.2	18.7
Consumer prices (end-period)	1.9	14.3	15.1	17.9
GDP deflator	1.8	20.0	17.3	15.0
	(In percent of GDP)			
General government budget				
Revenue and grants	30.2	36.5	36.9	34.6
Expenditure and net lending	35.2	35.3	42.9	46.4
Current balance	2.6	9.2	8.1	4.3
Primary balance	-4.5	1.7	-5.5	-10.6
Overall balance (including grants)	-5.0	1.2	-5.9	-11.8
Non-mineral overall balance	-11.8	-10.4	-14.6	-18.6
Structural balance 1/	-6.8	-2.7	-7.9	-13.1
	(Percent change)			
Money and credit				
Broad money	26.9	61.6	68.6	44.2
Broad money velocity (GDP/BM)	2.3	1.8	1.5	1.4
Interest rate on 7-day central bank bills, end-period (percent)	10.0	11.0	...	...
	(In millions of US\$)			
Balance of payments				
Current account balance (including official transfers)	-410	-931	-1,821	-2,031
(In percent of GDP)	-9.0	-14.9	-19.5	-16.3
(In percent of GDP, excluding mining related imports)	-5.8	-5.7	0.2	-2.4
Trade balance	-194	-278	-1,285	-1,349
Exports	1,876	2,899	4,296	4,922
Imports	-2,070	-3,177	-5,581	-6,271
Foreign direct investment	496	1574	2,412	894
Gross official international reserves (end-period)	1,328	2,288	2,984	3,302
(In months of next year's imports of goods and services)	4.0	4.2	4.9	5.8
Trade prices				
Export prices (US\$, percent change)	-13.2	33.1	18.9	-0.5
Import prices (US\$, percent change)	-16.0	11.6	14.6	-0.6
Terms of trade (percent change)	3.3	19.3	3.8	0.1
	(In percent of GDP)			
Public and publicly guaranteed debt				
Total public debt	46.6	42.2	47.1	47.6
Domestic debt 2/	3.4	12.0	25.4	30.6
External debt	43.3	30.2	21.7	17.0
(In millions of US\$)	1,977	2,023	2,064	2,097
Exchange rate				
Togrogs per US\$ (end-period)	1,443	1,257	...	...
Togrogs per US\$ (period average)	1,441	1,348	...	...
Nominal effective exchange rate (end-period; percent change)	-15.8	3.4	...	...
Real effective exchange rate (end-period; percent change)	-11.1	11.3	...	...
Nominal GDP (In billions of togrogs)	6,591	8,415	11,535	15,274

Sources: Mongolian authorities; and IMF staff projections.

1/ As defined in the fiscal responsibility law, which uses smoothed instead of actual commodity prices to calculate revenue.

2/ Domestic debt in 2009 includes the Oyu Tolgoi tax-prepayment while the estimates for 2010 and the projections for 2011 additionally include the estimated fiscalization cost of bank restructuring and the financing of the government's equity share in Oyu Tolgoi.