INTERNATIONAL MONETARY FUND

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MONGOLIA

December 2017

FIRST AND SECOND REVIEWS UNDER THE EXTENDED FUND FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MONGOLIA

In the context of the First and Second Reviews Under the Extended Fund Facility, 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 December 15, 2017, following discussions that ended on October 30, 2017, 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 November 30, 2017.
- 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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COMMUNICATIONS DEPARTMENT

Press Release No. 17/502
FOR IMMEDIATE RELEASE
December 15, 2017

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First and Second Reviews under the Extended Arrangement for Mongolia and Approves US$ 79.1 Million Disbursement

On December 15, 2017, the Executive Board of the International Monetary Fund (IMF) completed the first and second reviews 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 55.912 million (about US$ 79.1 million), bringing total disbursements under the arrangement to SDR 83.868 million (about US$ 118.6 million).

Performance under the program thus far has been strong. Growth in 2017 is projected to reach 3.3 percent, considerably better than forecasted at the time of program approval. The combination of strong policy implementation and a supportive external environment has helped the authorities over-perform on all of the quantitative targets under the program. Performance on structural reforms has also been strong, notwithstanding the delays due to the change in government in September.

Mongolia's three-year extended arrangement was approved on May 24, 2017, in an amount equivalent to SDR 314.5054 million, or about US$425 million 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. Mitsuhiro Furusawa, Acting Chair and Deputy Managing Director, said:

"Mongolia's performance under the Fund-supported program has been positive, despite delays related to political developments. Growth has recovered more strongly than anticipated and confidence is returning, allowing the exchange rate to stabilize, external financing costs to fall, and foreign exchange reserves to recover. The authorities have cut the fiscal deficit and have started structural reforms that would improve the quality of growth going forward.

“All quantitative targets under the program have been met. Fiscal results have been better than expected, supported by stronger revenues and tight expenditure control, and the fiscal deficit this year, at 7.6 percent of GDP, is less than half of what it was in 2016. The recently approved 2017 Supplementary Budget and the 2018 Budget are in line with the program. About half of the revenue overperformance will be saved, thus helping to reduce borrowing and control debt, while the remainder will be used to fund productive spending in line with the government action plan and for a one-off bonus to civil servants. Net international reserves have improved, reflecting strong coal export performance, capital inflows into the bond and money markets, and donor disbursements.

“Despite an unsettled political environment, the authorities are moving ahead with ambitious structural reforms that will help sustain growth over the medium term, promote competitiveness and diversification, and mitigate the boom-bust cycle. The rehabilitation and strengthening of the banking system is underway: the results of the comprehensive Asset Quality Review are expected imminently and the Bank of Mongolia is taking steps to improve the regulatory and supervisory framework. Important legal reforms regarding the governance and operations of the Bank of Mongolia, the Deposit Insurance Corporation, and the banks are expected to be passed soon. On the fiscal side, progress is being made in strengthening tax administration, tax policy, and budgetary controls, including through the establishment of a high-level working group on tax policy. To strengthen the social safety net and target pro-poor expenditures toward the most vulnerable, the government is focusing the Child Money Program on less affluent families and using the savings to increase food stamps for the poor.

“With debt still high and the economy still exposed to global commodity developments, it is critical to maintain strong commitment to the program. Sustained implementation of the reform agenda, will help cement solid growth, improve confidence, strengthen fiscal revenues and foreign reserves, and mobilize donor support.”

MONGOLIA

November 30, 2017

FIRST AND SECOND REVIEWS UNDER THE EXTENDED FUND FACILITY ARRANGEMENT

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 approximately $425 million). The arrangement forms part of a $5.5 billion multi-donor financing package that supports the authorities' program of policy adjustment and structural reforms to stabilize the economy and lay the basis for sustainable, inclusive growth. The extended arrangement is subject to quarterly reviews though, because of delays, this is a combined first and second review.*

Recent Developments and Outlook. *The economy is performing better than expected at the time of program approval, supported by strong performance in the coal sector which has had material spillovers to the rest of the economy, particularly services. Growth is expected to reach slightly over 3 percent this year and over 4 percent in 2018. The combination of the strong backdrop and the authorities' cautious policy mix has resulted in better than expected fiscal deficits and reserve accumulation. Nonetheless, Mongolia continues to have high debt and remains highly exposed to changes in global commodity demand.*

Program Performance. *All end-September performance criteria were met. Performance on structural benchmarks was more mixed with some reforms met on time while others are expected to be met with some delay largely because the fall of the government in September interrupted implementation of the ambitious agenda.*

Policy Discussions. *The authorities committed to tighten the 2018 fiscal targets relative to the path set at program approval and save at least half of any revenue overperformance. They intend to take a cautious approach toward future monetary policy moves and to continue to try and build foreign exchange reserves to a more comfortable level. The authorities are committed to pushing ahead with structural reforms in the fiscal and financial sectors.*

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

Discussions were held in Ulaanbaatar during October 18–30, 2017. The team included Geoff Gottlieb (head), Neil Saker (resident representative), Manuk Ghazanchyan (all APD), Wendell Daal (FAD), Pierpaolo Grippa, Laszlo Butt (both MCM), and Pragyan Deb (SPR). The team was supported by Mmes. Selenge Sandagsuren, Ardak Bazarbai and Khulan Buyankhishig (all economists in the res. rep. office), Mr. Paroutzoglou and Ms. Tolentino (both APD). Mr. Choi and Mr. Kh. Gantsogt (OED) participated in some of the discussions. The mission met Prime Minister U. Khurelsukh, Finance Minister Ch. Khurelbaatar, Bank of Mongolia Governor N. Bayartsaikhan, and other senior officials as well as private sector representatives.

CONTENTS

CONTEXT 4

RECENT DEVELOPMENTS 5

DISCUSSIONS 8
A. Outlook and Risks 8
B. Economic Policies 9

PROGRAM MODALITIES 13

STAFF APPRAISAL 14

BOXES
1. New CPI Weights and Basket 16
2. How Does the Program Support Women? 17

FIGURES
1. Real Sector Developments 19
2. Fiscal and Monetary Sector Developments 20
3. External Sector Developments 21

TABLES
1. Selected Economic and Financial Indicators, 2013–22 22
2a. Summary Operations of the General Government, 2016–22 (In billions of togrogs) 23
2b. Summary Operations of the General Government, 2016–22 (In percent of GDP) 24
3. Balance of Payments, 2013–22 25
4. Monetary Aggregates, 2013–22 26
5. Summary of Financial Stability Indicators 27
6. External Financial Requirements and Sources, 2015–22 28

7. Capacity to Repay Indicators, 2017–22 ____ 29
8. Indicators of Fund Credit, 2017–22 ____ 30
9. Proposed Access and Phasing Under the Extended Fund Facility (EFF) ____ 31

ANNEXES

I. Public Debt Sustainability Analysis ____ 32
II. External Debt Sustainability Analysis ____ 37

APPENDIX

I. Letter of Intent ____ 40
Attachment I. Technical Memorandum of Understanding ____ 53

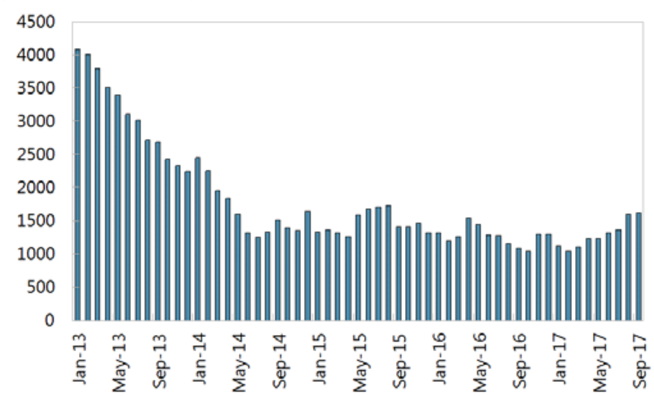
CONTEXT

1. After years of rising vulnerabilities, Mongolia nearly experienced a financial crisis in 2016. For several years, Mongolia had maintained low foreign exchange reserves, on the order of 2–3 months of imports. During this period, prices of key commodity exports had continued to fall, contributing to a sharp slowdown in growth. Then, in 2016, the fragile stability began to unravel: in April, the authorities borrowed externally at double digit interest rates and, in June, the newly elected government announced that the fiscal deficit was going to reach 17 percent of GDP. Over the following 6 months, the exchange rate depreciated by 20 percent.

2. The government responded by launching its Economic Recovery Plan later that year, eventually supported by considerable official sector financing. To address macroeconomic imbalances and avoid default, the authorities committed to policy action that would reduce the fiscal deficit, strengthen the banking system, stabilize the exchange rate, and build foreign exchange reserves. Then, in early 2017, the authorities sought and received a combination of $5.5 billion in official sector resources, including $420 million from the IMF in the form of an Extended Fund Facility (EFF), to help catalyze additional private sector financing, reduce borrowing costs and smooth the overall pace of adjustment. At the time of approval of the EFF, it was recognized that the program faced large domestic and external risks.

Gross International Reserves

(In millions of US dollars)

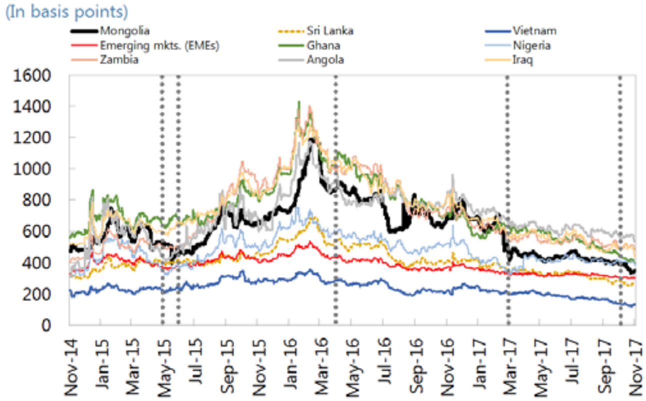


Source: Mongolian authorities.

3. Since program approval, a better external environment and strong policies have stabilized the economy, although domestic political developments have resulted in program delays. Growth has exceeded expectations due to a combination of strong terms of trade and an unexpected surge in coal exports. The authorities have used the stronger economic activity to reduce the fiscal deficit and build up reserves faster than initially anticipated, both of which have helped cut the cost of borrowing by roughly 600 bps (to less than 6 percent externally and roughly 12 percent domestically). Due to the stronger growth and better fiscal performance, public debt is now projected to reach 73 percent of GDP in the medium-term versus 84 percent of GDP at the time of program request. Despite this strong performance, the first review of the program and

EMBI Global Sovereign Spreads

(In basis points)



Source: Bloomberg L.P.

Note: Vertical dotted lines depict sovereign bond issuances.

significant associated donor flows needed to be delayed when the Prime Minister was removed after a surprise loss in the July Presidential election led a majority of the ruling Mongolian People's Party (MPP) and the opposition parties to pass a vote of no confidence against the government. However, in October, the MPP elevated the previous Deputy Prime Minister U. Khurelsukh to be Prime Minister and he promptly renewed the authorities' commitment to the IMF program, allowing for a combined first and second review to proceed.

Key Program Indicators

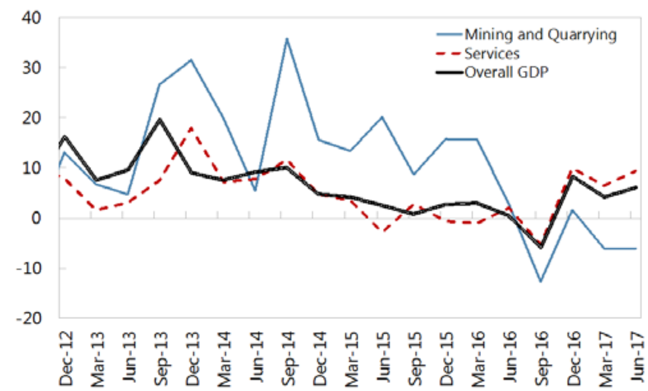
	2016	2017		2018	
		Program	Revised	Program	Revised
Real GDP (percent)	1.2	-0.2	3.3	1.8	4.2
Primary fiscal deficit (percent of GDP)	-13.1	-5.5	-3.4	-3.1	-2.6
Current account deficit (percent of GDP)	-6.3	-4.4	-7.0	-9.5	-8.6
Gross international reserves (USD Million)	1,297	1,692	1,919	2,515	2,534

Source: Mongolian authorities; and Fund staff estimates and projections.

RECENT DEVELOPMENTS

4. The economy is performing better than envisaged at the time of program approval. Growth was 5.3 percent in 1H2017, up from 1.2 percent in 2016 and well above the zero-growth projected for 2017 in April. The primary driver was the coal sector in which prices doubled and export volumes rose by 90 percent in the Jan-July period over the year before (the latter primarily reflects reductions in China's domestic coal production). The service sector has also boomed, both due to direct links to coal (higher use of transportation services) as well as a broader improvement in household credit, employment, and confidence. Nonetheless, the high GDP growth figures were achieved despite a contraction in the mining sector as a whole.[1] Growth in construction also remained negative, as it has for most of the last four years, due to a still large inventory overhang in real estate.

Real GDP Growth
(In Y-o-Y percent change)



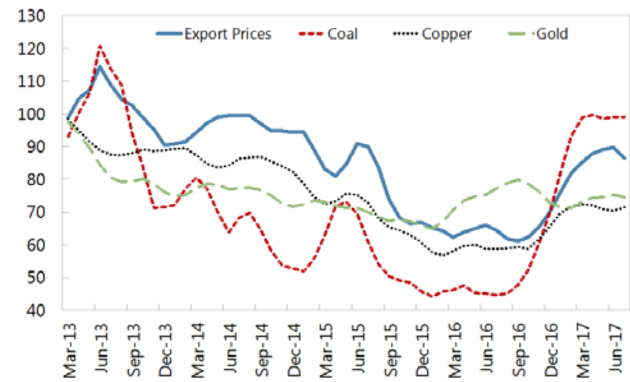
Sources: Haver Analytics Inc.;and IMF staff calculations.

[1] The higher coal production was offset by lower gold and copper output as the key mine—Oyu Tolgoi—is in the process of excavating a mineral-poor section of the ore body

5. The strong commodity sector and weaker exchange rate translated into a considerably stronger-than-expected fiscal outturn. In cash terms, the general government recorded a primary budget surplus of about 1 percent of GDP in the year through September, on track to substantially outperform the -5.5 percent deficit originally targeted for the year. Revenues have been particularly strong as coal and copper prices have substantially exceeded those assumed in the budget and the weaker exchange rate increases the local currency value of mining royalty payments. The over-performance in the fiscal deficit is expected to moderate in the fourth quarter due to an expected slowdown in coal exports, a seasonal uptick in capital spending, and a recent supplementary budget that allocates half of the projected MNT 700 million (about 2.5 percent of GDP) in over-performance to additional one-off spending, including capital investment projects (0.8 percent of GDP), the Child Money Program (0.4 percent of GDP), a wage bonus to civil servants (0.2 percent of GDP) and assorted expenditure cuts (-0.3 percent of GDP). This most recent budget implies a primary deficit of 3.4% of GDP for the year, well below the 13 percent of GDP recorded in 2016.

Export Prices

(Index, Jan-13=100, 3-Month Moving Average)

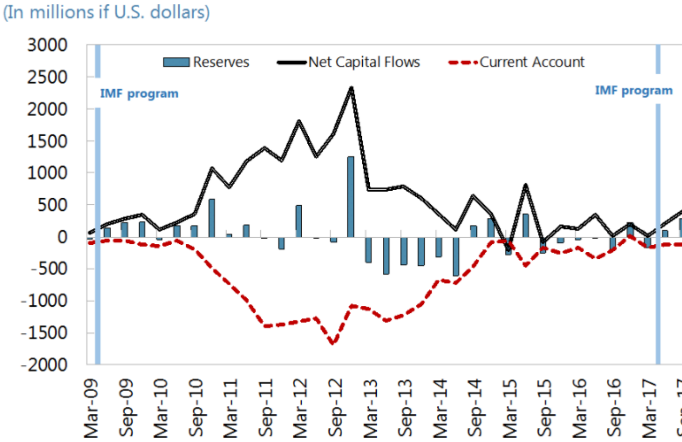


Sources: IMF, *Commodity Price System (CPS)*; and IMF staff calculations.

6. A recovery in investor confidence has supported the balance of payments and reserves. The strong commodity performance has narrowed the current account deficit to roughly 4 percent of GDP in 3Q-17 (rolling four quarters) from more than 8 percent a year earlier, but it is expected to widen again before year end to wider levels than initial projected due to high dividend payments in the mining sector and a slowdown in coal exports. Net capital flows also improved, as the official sector financing package, economic recovery, and still-high domestic interest rates helped support a significant improvement in investor confidence. This is reflected in the authorities' issuance in October of a 5-year $800 million bond at 5.625 percent (versus a peak of 11 percent in 2016) fully covering the government's $660 million in external bond maturities for the next year. Much of the remaining amount will be used to repay high cost domestic debt. This issuance covers all external financial needs through end-2020.

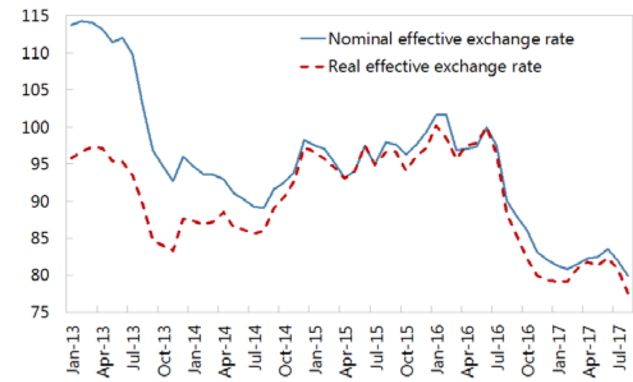
Balance of Payments

(In millions if U.S. dollars)



Source: Haver Analytics Inc.

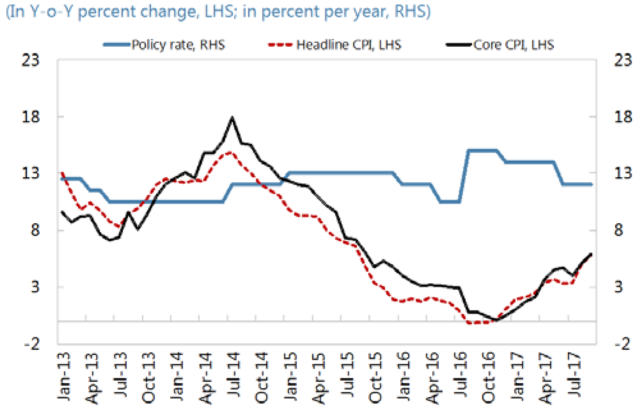
Exchange Rates
(Index, Jun-16=100)



Sources: IMF, *Information Notice System (INS)*.

7. Thus far, the authorities have taken advantage of the favorable balance of payments to build reserves rather than allow currency appreciation. Gross reserves reached $1.6 billion in 2017Q3, above the $1.5 billion originally projected. This reserve level reflects stronger than expected private capital inflows; indeed, external donor funding was $500 million behind schedule due to the program interruption following the fall in the government in September. Meanwhile, the nominal and real effective exchange rates have weakened marginally since program approval and remain roughly 20 percent below levels seen in mid-2016. While not critical to export competitiveness in the short-term given the limited non-mining sector, a competitive real exchange rate remains important to preventing excessive import growth and external debt accumulation.

CPI Inflation and Policy Rate
(In Y-o-Y percent change, LHS; in percent per year, RHS)



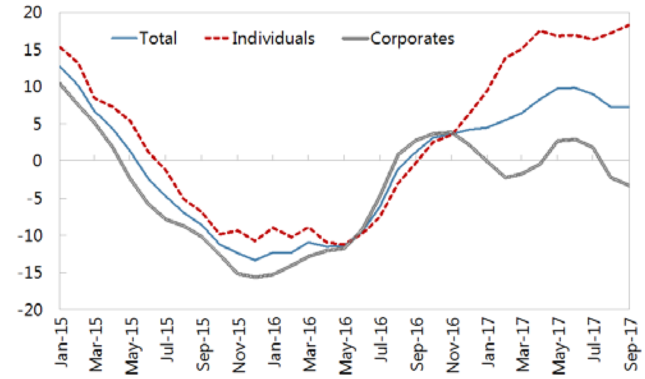
Source: Haver Analytics Inc.

8. Inflation is rising amid a recovery in economic activity and one-off factors. In June, not long after program approval, the authorities cut interest rates by 200 basis points to 12 percent. In its statement following the cut, the Bank of Mongolia argued that inflation remained contained while the recent agreement with international donors had started to stabilize the balance of payments. This move continued the process of unwinding the 450-basis point hike that took place in 2016 as a response to the sharp rise in exchange rate pressure. However, inflation has now risen from near zero in 2016 to over 8 percent as of October. This appears to reflect a combination of stronger demand, delayed FX pass through, one-off factors (e.g. change in CPI basket, fiscal measures), and supply shocks **(See Box 1)**. As a result, the authorities have kept policy rates on hold to await more evidence regarding inflation developments and monitor the lagged impact of the previous cut.

9. Key financial sector indicators remain relatively healthy but concerns about underlying asset quality remain. Since the large correction in 2015-16, credit growth has recovered strongly, largely due to the nearly 20 percent credit growth to households. The banking sector is currently benefitting from decent profitability (ROE of 10 percent) and substantial liquidity (one quarter of total assets are liquid) which in part reflects banks' large exposure to the public sector (one quarter of bank assets are in public sector securities which currently pay double-digit interest rates). Banks are exposed to foreign currency movements - FX deposits are 31 percent of total and 17 percent of GDP while FX loans are 21 percent of total and 10 percent of GDP - but the open position has declined considerably. Finally, reported capital adequacy ratios remain high at 17.5 percent (Tier 1 at 13.4 percent), NPLs are broadly stable at 7.7 percent, and provision coverage of NPLs is substantial at 73 percent. However, significant concerns persist that the strength of asset quality ratios is overstated due to regulatory forbearance and that there is wide disparity within the aggregate indictors. More generally, the operational environment continues to be unfavorable to loan origination (lack of reliable data on borrowers) and resolving NPLs. These concerns underscore the importance of the ongoing Asset Quality Review (results expected in mid-December), forthcoming stress test, and requirements for updated bank business plans.

Credit Growth

(In Y-o-Y percent change of 3-Month Moving Average)



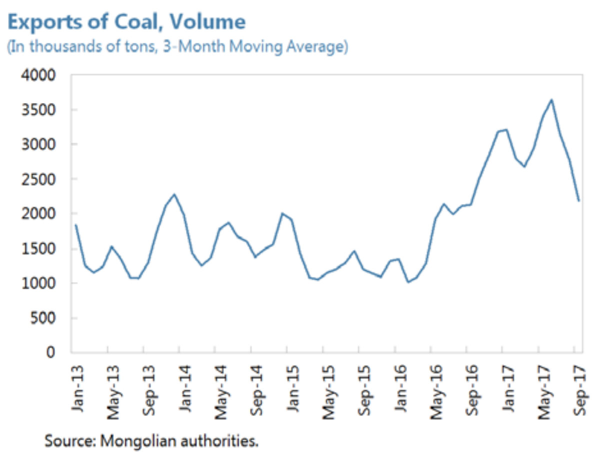
Sources: Haver Analytics Inc.; and IMF staff calculations.

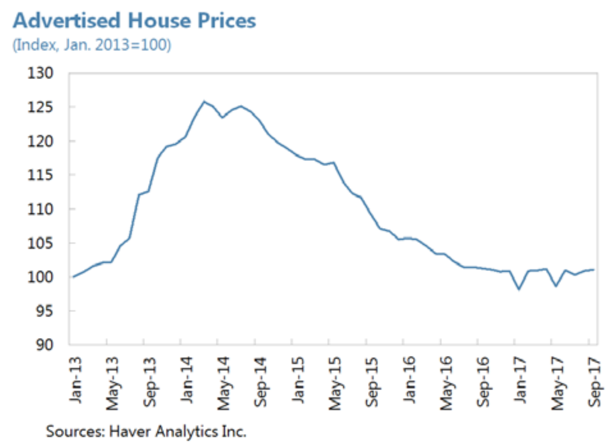
DISCUSSIONS

A. Outlook and Risks

10. Mongolia faces a near-term slowdown in economic growth but the recovery is expected to resume in 2018. Growth in 2017 is projected to reach 3.3 percent, below the 5.3 percent recorded in 1H-17. The slowdown reflects both a base effect and the recent emergence of major bottlenecks at the border where coal exports cross into China. The recovery will resume in 2018 with growth projected to accelerate to 4.2. The key driver is construction, which will be the first positive outturn for the sector since 2013 because of a scheduled pick up in mining-related projects. In addition, advertised housing prices have stabilized after a roughly 25 percent fall suggesting there has been some tightening in the real estate market which could support non-mining construction. The growth in real mining output will also turn positive as the resumption in strong coal volumes will be bolstered by a better production phase for the key gold mine.

11. The baseline forecast for the medium-term assumes continuing strong policy implementation and supportive global conditions. In addition to broadly stable commodity prices, the baseline assumes that the two major construction projects—the OT underground pit (copper) and the TT project (coal as well as related railway and power plant)—are finalized during the projection period. This implies an increase in near-term FDI and imports in coming years before yielding much higher growth starting in 2022 when the projects are completed.





12. The outlook continues to face both domestic and external risks.

- On the domestic front, the main near-term risk relates to the banking sector. It will be critical that, if the AQR finds a capital short-fall at any bank, it is met with swift action. An additional risk stems from the political fragility seen in recent months. It could compromise the authorities' ability to implement the structural reform agenda and resist spending pressures. There is also lingering uncertainty regarding the completion of the mega-construction projects assumed in the baseline, particularly the TT project. Finally, in the near-term, Mongolia is exposed to climate risks which can undermine agricultural output and disinflation efforts.

- On the external side, the key risks stem from the impact of global demand on commodity prices and the scope for further difficulties at the border with China. On the positive side, the authorities have reduced their vulnerability to changes in global liquidity conditions as they have covered all of their 2018-21 refinancing needs.

B. Economic Policies

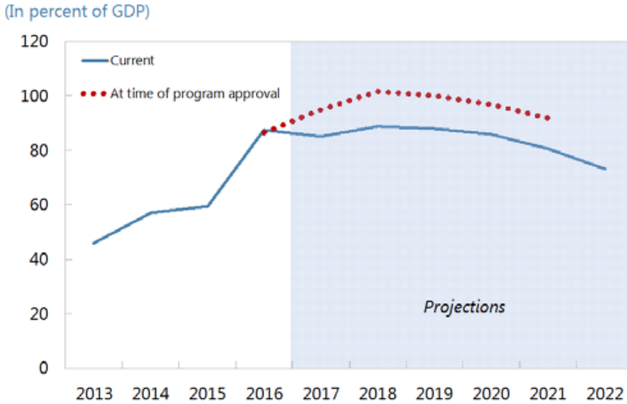
13. Now that the acute balance of payments pressures from 2016 have subsided, the focus of the program can turn toward preparing for the medium term. The strategy has three pillars. First, it is critical that the authorities take advantage of better growth and investor confidence to build buffers, particularly fiscal and external. Doing so will help move Mongolia away from boom and bust cycles of the past. The second pillar is to complete a thorough diagnosis of the financial sector and address key identified weakness. A more robust financial sector will allow for stronger and safer credit flows to the private sector. And finally, cautious monetary policy and reserve accumulation will help preserve recent competitiveness gains from the 2016 correction in the real exchange rate and promote economic diversification away from just mining to tourism and agriculture. Such diversification will support more sustainable and inclusive growth over the long-term.

Fiscal Policy

14. Amid expectation of continued strong growth, the authorities have committed to continued fiscal consolidation in 2018. The government has submitted a budget that is consistent with a primary deficit of slightly more than 2½ percent of GDP, below the 3.1 percent of GDP targeted at the time of program approval. The key measures in the budget include introduction of a progressive income tax, raising the social contribution rate, increasing excise on alcohol and tobacco, an increase in the retirement age, and an additional year of the wage and hiring freeze. As was the case in 2017, the authorities have committed to again save at least half of any revenue overperformance. The budget also includes a targeting of the Child Money program to the poorest 60 percent of children **(structural benchmark end-December 2017)**. The savings from this targeting, on the order of MNT100 billion (0.4 percent of GDP) will be reallocated to other pro-poor initiatives including a targeted cash benefit program and hot meals program for the homeless. While Mongolia generally performs well on gender metrics, the program seeks to promote this equality further **(see Box 2)**.

15. At present, the authorities are on track to outperform the debt projections at the time of the program approval. The fiscal path for 2019-2022 is broadly unchanged. The plan remains to reach a primary deficit of 1 percent of GDP in 2019 and a surplus of 1.5 percent of GDP in the medium term, which would be in line with the Fiscal Stability Law. The ongoing consolidation can be achieved via a mixture of expenditure restraint and revenue mobilization while protecting pro-poor spending. Meanwhile, maintaining a policy mix in line with program commitments combined with ongoing donor support will allow the interest bill to steadily fall from about 4 percent of GDP to 2½ percent of GDP in the medium term. With this combination of better growth, interest rates, and fiscal deficits, public debt is projected to fall from 87 percent of GDP in 2016 to 73 percent of GDP in 2022 (compared with 84 percent of GDP at program approval). In present value terms, public debt is marginally lower than headline in 2017 but falls more rapidly through the end of the program as the share of debt that is concessional rises.

General Government Debt
(In percent of GDP)

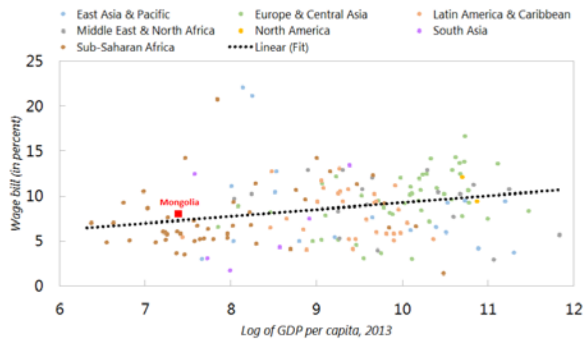


Sources: IMF staff estimates.

16. Going forward, greater attention will be needed to the composition of the wage bill. In recent months, a series of protests—mainly by doctors and teachers—have broken out regarding the authorities' decision to freeze the pay of civil servants in nominal terms in order to help reduce the deficit. Available data suggests that public sector wages are relatively low but the wage bill as a whole is in line with peers. This reflects the fact that the total size of the civil service is very large. In this regard, any wage increase that has a material impact on individual civil servants would risk jeopardizing much of the recent gains in fiscal sustainability unless it is accompanied by a civil service reform. The authorities have appropriately responded cautiously thus far but finding ways of addressing wage concerns while recognizing the required tradeoffs will be a key priority in the months ahead.

Wage Bill

(In percent of GDP)

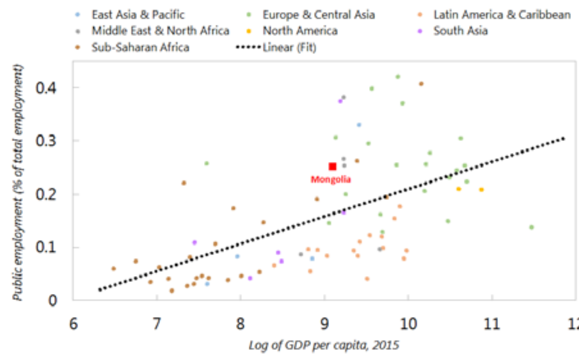


Source: The World Bank.

Note: Wage bill data for Mongolia as of 2015; all other countries as of 2013.

Public Employment

(In percent of total employment)



Source: The World Bank.

17. The authorities are also investing substantial resources in improving the processes and institutions that govern fiscal policy-making. Parliament has recently passed a so-called PAYGO provision which restricts Parliament from being able to increase the aggregate expenditure envelope relative to what is in the budget presented by the Finance Ministry. The authorities have established a working group to provide advice on tax policies to stimulate sustainable growth and it will submit its interim report to the Ministry of Finance **(structural benchmark end-December 2017)**. They are working on establishing a Fiscal Council that would provide a second opinion on the implications of budget proposals for fiscal sustainability **(structural benchmark end-December 2017)**. And the authorities have committed to three new **structural benchmarks** which aim, respectively, to improve revenue administration **(end-January 2018)**, complete an audit of concession contracts and develop a corresponding payment plan **(end-June 2018)**, and approve a guideline on the appraisal and selection of public investment projects **(end-September 2018)**.

Monetary, Exchange Rate and Reserves

18. Given inflation pressures, there is no scope for a sustained easing cycle at this time. The authorities have an inflation guideline of 8 percent for 2017 and 2018. As of now, it appears that inflation will remain broadly in line with that target. That is, despite the sharp rise in inflation this year from near zero percent in 2016 to 7 percent in recent data, staff does not expect significant further increases, especially because one-off factors are expected to fall out of the index over the coming quarters. Nonetheless, the speed of the rise in inflation and the ongoing firming of the economy argues for caution. While the 20-percent depreciation in the exchange rate in 2016 did not lead to consumer price inflation at that time, it may have reflected the weak pricing power at the retail level. With a stronger economy in 2018, firms may seek to recover the lost margins. Amid this broader uncertainty, the authorities remain committed to keeping inflation and exchange rate pressures contained so future interest rate moves will be a function of data developments.

19. Going forward, it will be critical that the authorities continue to manage any exchange rate pressure carefully. The external sector is broadly in line with fundamentals. Going forward, with the first and second review of the IMF program completed, donor funding resumed, and ongoing strong commodity prices, there could be further appreciation pressure in the period ahead. If this materializes, it will be important to use this tailwind to accumulate additional foreign exchange reserves both to ensure an adequate external buffer, prevent excessive imports and help preserve recent competitiveness gains from the change in relative prices. Of course, purchases of reserves could lead to excessive reserve money growth, credit growth and inflation pressures if not sterilized, underscoring the importance of ongoing active use of Central Bank bills. By contrast, if there is pressure for the exchange rate to depreciate, the authorities should generally refrain from intervening given still limited buffers: the sale of reserves should be limited to cases of disorderly market conditions and should not prevent a needed correction.

20. The authorities are also taking steps to improve the legal frameworks in which monetary policy is conducted. The new Central Bank law, expected to pass shortly, will clarify the mandate of the BOM, improve governance arrangements, and enhance its independence. Meanwhile, there are ongoing efforts to clarify the legal and financial issues surrounding the management of the mortgage program originally initiated by the BOM. The BOM and Ministry of Finance signed a Memorandum of Understanding on the mortgage program, as per the recommendations of the recent safeguards assessment mission, and are also following up on the other recommendations of the safeguards team.

Financial Sector

21. The immediate priority is completing the ongoing assessment of capital adequacy in the banking system and preparing for a robust response if needed. An international firm (Price Waterhouse Coopers) has conducted an Asset Quality Review (AQR) on all Mongolian banks. The results are expected by mid-December **(structural benchmark end-December 2017)**, two months later than originally intended mainly to give enough time for the analytical work to proceed appropriately. The authorities have devised a communications strategy for the post-AQR period to ensure transparency and avoid misunderstandings with respect to next steps. Based on the AQR results, banks' own business plans, and additional inputs including a stress test, the BOM will inform banks if they have a capital shortfall and give them until November 2018 to restore their capital adequacy. If there are systemically important and viable banks that do not manage to raise the necessary capital from private sources (or via other means such as reducing their risk-weighted assets), some public funds may be needed. To help in this regard, the authorities are finalizing a

Recapitalization Law **(structural benchmark end-January 2018)** that will set out the detailed conditions in which public funds can be used. To help promote stability in the financial sector, the authorities will pass a law that should ensure that the deposit insurance agency is in line with international best practice and is sufficiently funded **(structural benchmark end-February 2018)**.

22. The authorities are also taking a series of measures to strengthen the underlying regulatory and supervisory infrastructure more broadly. An updated banking law, expected to be approved shortly, will modernize the financial safety net (e.g. early intervention and bank resolution framework) while providing stronger requirements for governance within banks (e.g. suitability for bank board members and exposures to related parties). Meanwhile, an interagency working group has been set up to develop a strategy for improving the operating environment for resolving existing NPLs and preventing the emergence of excessive levels of problem loans going forward. The strategy will be finalized shortly **(structural benchmark end-March 2018)** and the agreed reforms will be implemented by end-2019. After being upgraded in June 2017 to reflect best international standards, especially regarding NPL classification and forbearance, the regulation on asset classification and provisioning will be further improved **(structural benchmark end-September 2018)**, based on the AQR findings and advice provided by external experts. And finally, the BOM will carry out a review of related-party exposures in the banking system **(structural benchmark end-December 2018)**. These policies and frameworks are being designed in close collaboration with the ADB and the IMF.

23. The authorities are making progress in improving their AML/CFT framework but further efforts are needed. At the recent meeting of the Asia Pacific Group (APG), Mongolia was given until October 2018 to strengthen its AML/CFT framework, including in relation to targeted financial sanctions, scope of coverage of the legal AML/CFT framework and effective risk-based supervision. Strengthening implementation and improving the effectiveness of the AML/CFT regime will be key going forward, particularly to prevent an adverse impact on correspondent banking relationships which could make cross-border flows more arduous and costly. The authorities are committed to amending their AML/CFT and anti-corruption frameworks to bring them in compliance with international standards by end-April 2018.

PROGRAM MODALITIES

24. While all quantitative performance criteria were met, performance on structural benchmarks was more mixed. The authorities met the primary balance and NIR targets by sizeable margins. Meanwhile, even though all structural benchmarks due by end-June were implemented as planned, several structural benchmarks due in the September to November period are in progress but are not yet complete due in part to the dismissal of the government in September.

- On fiscal matters, the authorities have passed a 2018 budget in line with program targets and revised the integrated budget law to restrict Parliament's ability to expand the budget envelope. However, the authorities opted not to submit a revised general taxation law or a simplified regime for SMEs in piecemeal fashion and preferred to group these bills with a more comprehensive tax reform envisioned in February 2018 (a new structural benchmark).

- On monetary and financial issues, the authorities have submitted a revised Bank of Mongolia law but the passage of a new deposit insurance (DICOM) law and new Banking law are likely to be missed and will be re-phased.

25. The attached Letter of Intent describes the authorities' commitments going forward (see Appendix). The end-December quantitative performance criteria (QPCs) and indicative targets (ITs) are proposed to be modified and new QPCs and ITs for end-March and end-June are proposed to be set at this review. New end-September ITs are also proposed (Table 1 attached to the LOI and the TMU). They have been adjusted to reflect the better outlook. Specifically, the revised NIR QPC locks in most of the overperformance to-date while maintaining the future incremental improvement in this quarterly performance criterion; and the revised fiscal deficit QPC has been tightened by half of the increase in projected revenues, consistent with approach agreed with the authorities. A new ceiling on net debt issuance is proposed to replace the ceiling on gross issuance to give the authorities more flexibility to conduct debt liability management, while retaining an appropriate limit on the stock of external debt. Finally, the completion dates for some structural benchmarks were adjusted to reflect time constraints while the list of structural benchmarks was expanded to cover policy priorities for 2018 (see Table 2 attached to the LOI).

26. The program remains fully financed. Firm financing assurances from the World Bank, Asian Development Bank and key bilateral donors are in place for the next 12 months with reasonable prospects for the outer years of the program. Capacity to repay the Fund is adequate under the baseline scenario (Table 7) with higher reserves and lower public debt compared to the original program scenario. While external developments have surprised positively, program financing remains critically important both to bolster the external position, catalyze donor financing and help restore debt sustainability. Key risks to the program are still present, particularly with respect to domestic political risks and exposure to volatile commodity markets.

27. An update of the 2009 safeguards assessment of the BOM has been completed. The assessment found limited progress in strengthening the safeguards and governance frameworks at the central bank. While financial accountability and transparency practices were found to be robust, other areas, such as operational and financial autonomy, collegial decision making, oversight of central bank operations and audit mechanisms, and internal audit need to be strengthened. Many of these weaknesses will be reduced by the forthcoming BOM law which is a structural benchmark under the program.

STAFF APPRAISAL

28. The economy is recovering and the authorities deserve credit for progress under their program. The external environment – particularly strong commodity demand from China - has been considerably more supportive than envisioned at the outset of the program. The authorities have appropriately used this positive backdrop to over-perform on fiscal policy and accumulate more reserves than expected. Public debt is now projected to peak at - and fall to - considerably lower levels than envisioned at the time of program approval. And the external sector remains broadly in line with fundamentals.

29. Policymaking cannot afford to become complacent as key challenges remain. As growth is not broad-based, public debt remains high and reserve buffers are still low, Mongolia remains highly vulnerable to a change in the external environment or policy slippages that would prematurely draw down its limited buffers further. It is critical that Mongolia stay the course and not allow the positive backdrop to slow the pace of reform.

30. A sound macro-economic policy mix is critical. On the fiscal front, the authorities strong 2018 budget and commitment to save half of any revenue overperformance will help avoid the over-borrowing that initially triggered the crisis. It is important monetary policy remains cautious in light of the sharply rising inflation. And given still low reserves, further improvements in the balance of payments should continue to translate into reserve accumulation.

31. The most important immediate challenge is to ensure that any weakness in the banking sector is addressed swiftly and firmly. A well-capitalized and well-regulated financial sector can be a crucial engine of growth. However, there are likely important weaknesses in the banking sector related especially to assessments of asset quality. The financial sector reform agenda over the coming quarters is ambitious and posits a robust response to the AQR. For macroeconomic stability going forward, it is particularly critical that any capital shortfalls are addressed in a way that does not unduly favor shareholders and over-expose the public-sector balance sheet.

32. Improvements to the framework governing the fiscal policymaking remain equally important. The recent crisis in Mongolia stemmed largely from an unsustainable rise in budgetary expenditures. The recent changes to the budget law to limit the scope for Parliament to increase expenditures without budgetary offsets is welcome. Looking ahead, progress on the Fiscal Council will help further insulate Mongolia from the risk of pro-cyclical spending that has been so destabilizing in the past.

33. In light of the progress so far and the authorities' policy commitments going forward, staff support completion of the first and second reviews of the extended arrangement. Staff also support the modification of existing performance criteria, setting of new performance criteria for end-March 2018 and end-June 2018 and new ITs for end-September 2018; and the making of two purchases following the completion of the review.

Box 1. New CPI Weights and Basket

The National Statistics Office of Mongolia published a newly rebased CPI in May 2017. The updated index uses expenditure weights derived from the 2015 Household Socio-Economic Survey, moving the base year from 2010 to 2015. This makes the index more representative of current expenditure patterns and is consistent with the international standard of updating the base year at least every five years. With the most recent revision, the authorities removed 25 obsolete goods and services items from the consumption basket and added 40 new items to the new basket, bringing the total number of goods and services in Ulaanbaatar City index to 344. After these changes, the share of food and beverages declined by 3.0 percentage points in the new basket. In addition, more detailed data are now available, with 3-digit level 143 personal consumption good and services sub-indices published rather than the previous 2-digit sub-indices.

Mongolia: Household Consumption Weights and Changes, 2000 and 2015

(in units)

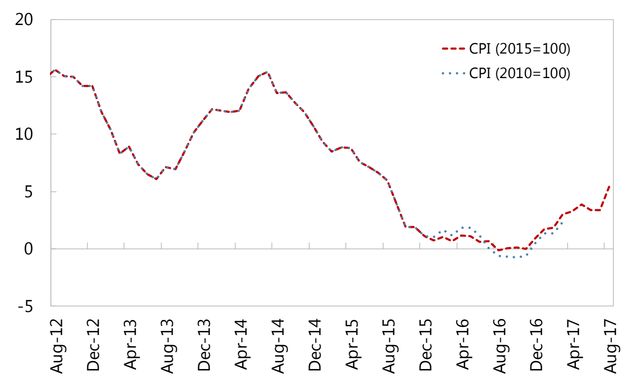
	2010	2015	Change
Total weights	100	100	
Food and beverage	30.0	27.1	-3.0
Alcoholic drinks and tobacco	3.7	5.7	2.0
Clothing and shoes	12.2	12.7	0.5
Utilities and fuel	14.1	10.2	-3.9
Furniture	3.5	3.6	0.1
Medical goods and services	3.0	3.5	0.5
Transportation	12.6	15.1	2.5
Communications and postal services	4.4	4.5	0.1
Leisure and recreation	3.1	3.3	0.2
Education	6.1	4.7	-1.4
Hotels and dining	3.5	4.4	0.9
Other	3.8	5.3	1.5

Source: Mongolian authorities.

The new basket and weights increased the measured rate of inflation by about 1 percentage point in 2017. This partly reflects increased expenditure by households on cars and tires in the new CPI due to soaring demand for cars ahead of announced excise tax increases in July. Price increases for cars and tires were close to 22 percent in May accounting for 0.9 percentage point of the overall increase in inflation. The inclusion of newer models of cars in the basket will further increase the measured rate of inflation. The authorities indicated that the divergences between the overlapping old and new series particularly after June 2016 were due to changes in the data collection points for some goods and services in the clothing, housing, transportation, and communications categories as well as the change in service quality.

Comparison of Reported Inflation (2010 vs 2015)

(In Y-o-Y percent change)



Sources: Mongolian authorities; and IMF staff calculations.

Box 2. How Does the Program Support Women?

While Mongolia performs relatively well on some measures of gender equity and has much legislation supportive of that goal, there are still gaps and weaknesses in implementation that put women at a disadvantage in the economy. Successful implementation of the EFF-supported program will help tackle gender imbalances, including by creating conditions for more inclusive job-creating growth, financing female entrepreneurs, and supporting better social outcomes. In particular, the move to progressive income taxation will reduce wage gaps, and a better capitalized banking sector and diversification beyond mining will support higher female participation in the economy.

Mongolia does reasonably well on gender equity in some global rankings, coming 58 out of 144 countries in the World Economic Forum's 2016 Gender Gap Index with a score of 0.705. It also performs well in terms of life expectancy (women live almost 10 years more than males), sex ratio at birth, literacy, and enrollment in secondary and tertiary education.

Women, however, remain at a disadvantage in the economy too. Labor force participation for women is 55.4 percent compared to 68.1 percent for men. Despite higher educational attainment, the relatively low participation of women in the labor market is due to their domestic caregiving responsibilities, lower retirement age, and weak enforcement of laws and government policies. Women are also more likely to be employed in the informal sector, with the majority (65.5 percent) engaged in wholesale trade and services, and other similar low-return business activities. In 2015, the national average wage for men was 12.5 percent higher than that for women, down from 18.9 percent in 2013. Gender inequality in asset ownership is also a constraint on women's economic empowerment, with only 19.2 percent of married women in rural areas owning land individually or jointly with their husbands.

While Mongolia has in place comparatively good legislation on gender equality, implementation is inadequate. The reasons include limited accountability for the mainstreaming of gender considerations, insufficient institutional capacity to take gender into account in the policymaking process, and a lack of sex-disaggregated data and/or use of data for gender-specific analysis, policy planning, and budgeting.

The program will support women's economic empowerment in a number of important ways, including:

- **Macroeconomic stability and growth potential**. Stabilizing the economy, reducing the risk of extreme exchange rate volatility and keeping inflation in check will help stop a further deterioration in living standards. This will especially affect women who account for some of the most vulnerable people in the population. In the medium term, the focus on diversifying the economy and supporting job creating growth will create more opportunities for women to enter the workforce and to gain from a growing economy.
- **Tax and pension changes.** The move to a progressive income tax system should help address the gender wage gap. Steps to narrow the gap between male and female retirement ages (65 for men by 2027 and 65 for women by 2037—up from 60 for men and 55 for women (50 for those with four or more children) currently) will provide women with more opportunities to participate in the economy in line with their high life expectancy.
- **Protecting the social safety net.** Under the program, spending on the social safety net is safeguarded. The Child Money Program will be better targeted—to the poorest 60 percent of children (slightly less ambitious than the original program intention to target to the poorest 40 percent of households and 50 percent of children). All the savings from this reform will be allocated to food stamps for the poorest—which are disproportionately women-headed single households.

Box 2. How Does the Program Support Women? (Concluded)

- **Creating the conditions for inclusive job creating growth.** Strengthening the banking system and reducing the interest rate structure will allow banks to lend to new sectors including SMEs that have a large proportion of female entrepreneurs. Economic diversification will create more opportunities for female participation.

- **Unlocking the contribution of development partners.** The EFF will allow other IFIs, including the Asian Development Bank (ADB) and World Bank, to lend more to Mongolia. In particular, the ADB has processed a $150 million policy-based loan in 2017 to support welfare programs in Mongolia—with women the largest beneficiaries. The Fund is also working closely with the United Nations Development Program in Mongolia in its work to pursue the Sustainable Development Goals, which include gender equality issues. In addition, the program has helped facilitate the World Bank's Export Development project, which focuses on diversification toward non-mineral exports and which includes special efforts to reach out to women entrepreneurs.

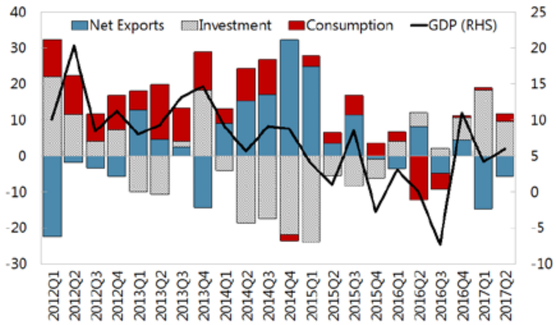
Mongolia: Selected Data
(In percent, unless otherwise indicated)

	2012	2015
Share of females in total population	...	50.8
Share of single mothers in total households	10.6	9.1
Share of female graduates at all levels of education	54.0	52.8
Total unemployment rate	8.2	7.5
Female unemployment rate	8.1	6.7
Female MPs (in persons, out of a total of 76)	11	13 (in 2016)
Females in public sector		
Political appointees	...	23.6
Public administration positions	...	58.0
Special services	...	25.9
Support services	...	69.8
Life expectancy		
Total	68.32	69.89
Female	71.79	75.84
Male	64.68	66.02

Sources: World Development Indicators, World Bank; Mongolian authorities; and IMF.

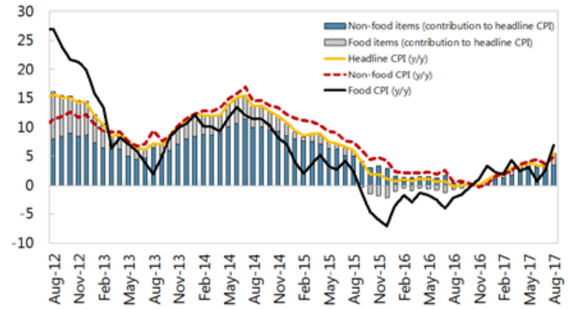
Figure 1. Real Sector Developments

Real GDP Growth
(Contribution; Year-on-year percentage change, RHS)



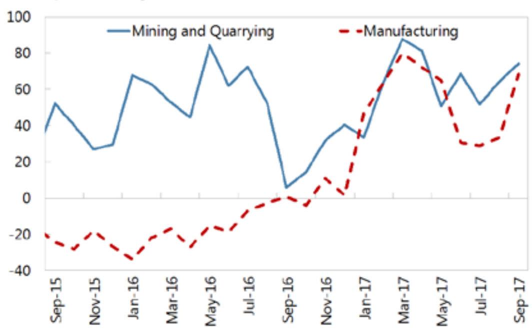
Source: Mongolian authorities.

Consumer Price Inflation
(In percent)



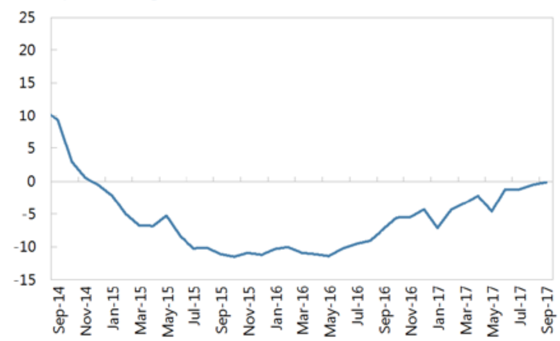
Sources: Mongolian authorities; and IMF staff calculations.

Industrial Production
(In Y-o-Y percent change)



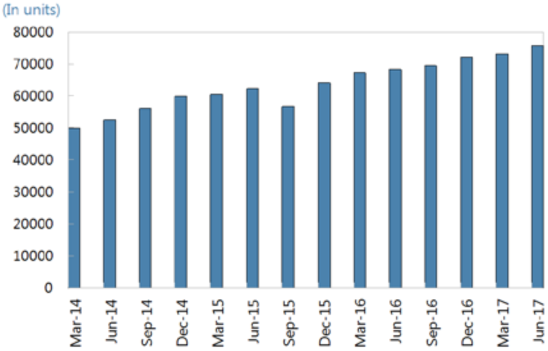
Sources: Haver Analytics; and IMF staff calculations.

Housing Prices
(In Y-o-Y percent change)



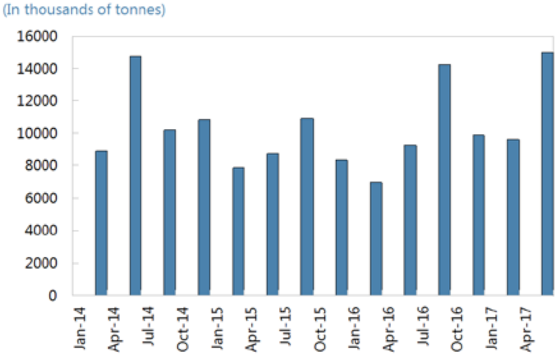
Sources: Haver Analytics; and IMF staff calculations.

Registered Enterprises: Active
(In units)



Sources: National Statistics Office of Mongolia; and IMF staff calculations.

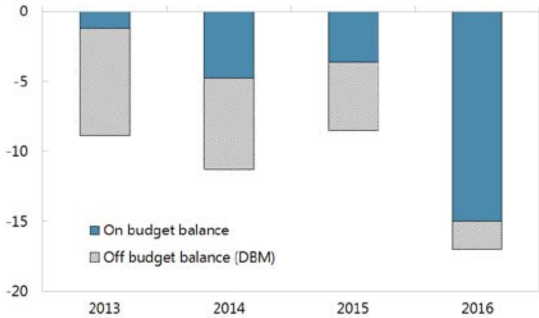
Transport: Carried Freight
(In thousands of tonnes)



Sources: National Statistics Office of Mongolia; and IMF staff calculations.

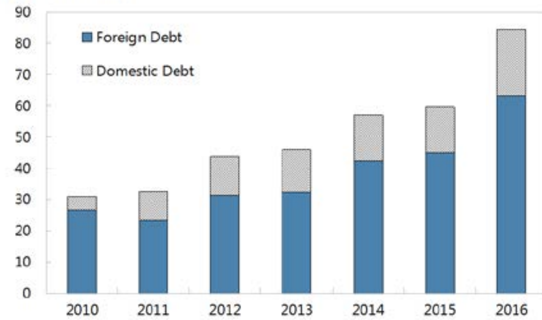
Figure 2. Fiscal and Monetary Sector Developments

Fiscal Balance
(In percent of GDP)



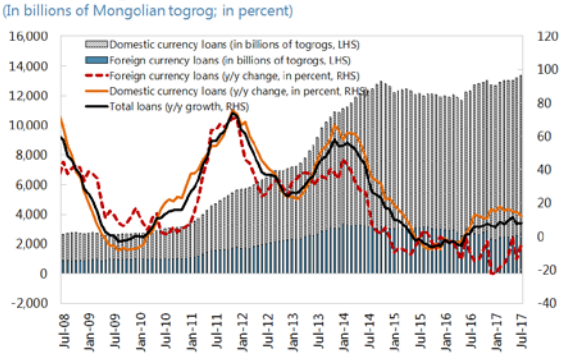
Sources: Mongolian authorities; and IMF staff calculations.

External and Domestic Debt
(In percent of GDP)



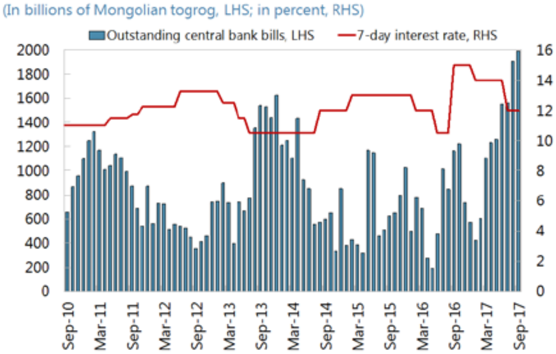
Sources: Mongolian authorities; and IMF staff estimates.

Bank Lending
(In billions of Mongolian togrog; in percent)



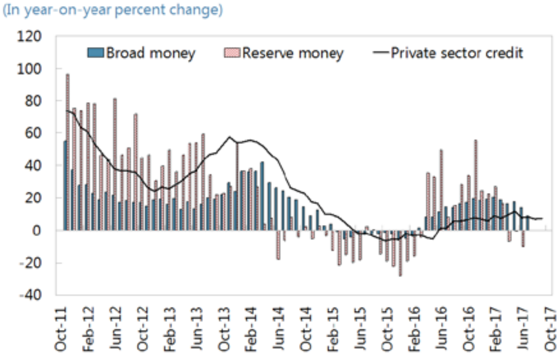
Sources: Mongolian authorities; and IMF staff calculations.

Stock of Central Bank Bills and Policy Rate
(In billions of Mongolian togrog, LHS; in percent, RHS)



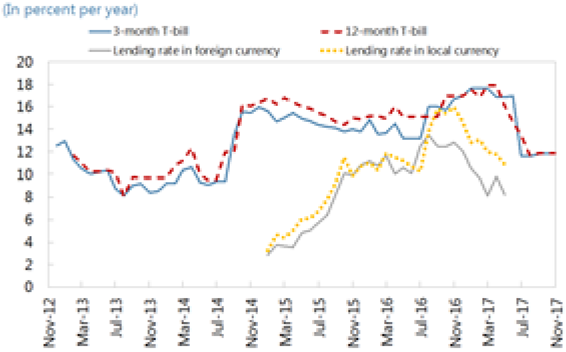
Sources: Mongolian authorities; and IMF staff calculations.

Monetary Aggregates
(In year-on-year percent change)



Sources: Mongolian authorities and IMF staff calculations.

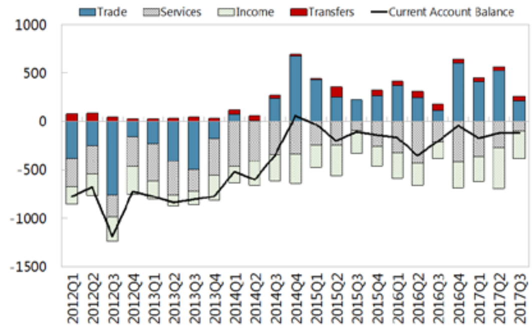
Interest Rates
(In percent per year)



Source: Mongolian authorities.

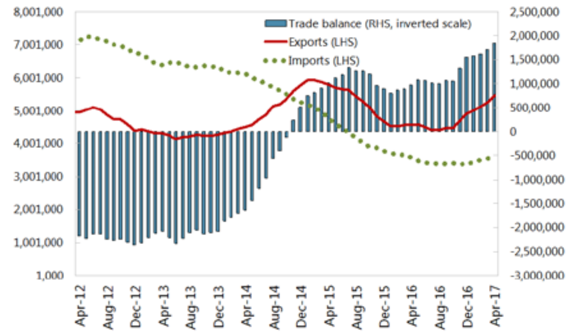
Figure 3. External Sector Developments

Current Account Balance
(In millions of US dollars)



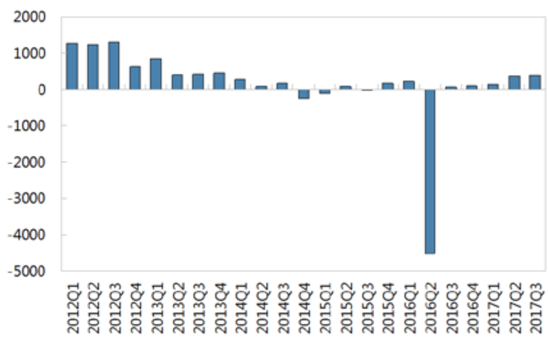
Source: Mongolian authorities.

Trade Balance
(12-month rolling sums, in US dollars)



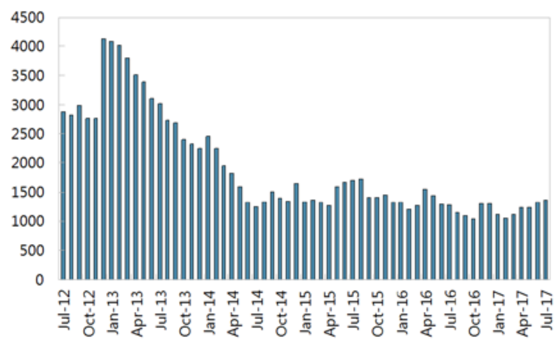
Sources: Mongolian authorities; and IMF staff calculations.

Foreign Direct Investment
(In millions of US dollars)



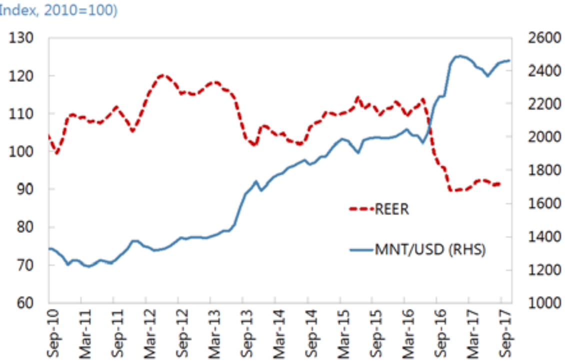
Source: Mongolian authorities.

Gross International Reserves
(In millions of US dollars)



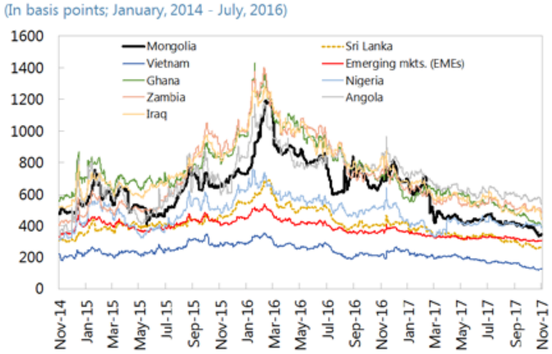
Source: Mongolian authorities.

Exchange Rates of the Togrog
(Index, 2010=100)



Sources: IMF, *Information Notice System*; and IMF staff calculations.

JP Morgan EMBI Global Sovereign Spreads
(In basis points; January, 2014 - July, 2016)



Source: Bloomberg LP.

Table 1. Mongolia: Selected Economic and Financial Indicators, 2013-22

	2013	2014	2015	2016	2017	2017	2018	2018	2019	2020	2021	2022
				Est.	EFF	Proj.	EFF			Projections		
	(In percent of GDP, unless otherwise indicated)											
Real sector												
Nominal GDP (in billions of togrogs)	19,174	22,227	23,150	23,936	26,048	27,438	27,688	30,378	34,429	38,233	42,707	48,845
Real GDP growth (percent change)	11.6	7.9	2.4	1.2	-0.2	3.3	1.8	4.2	6.7	5.0	5.8	8.2
GDP deflator (percent change)	2.9	7.4	1.7	2.1	9.3	11.0	4.4	6.2	6.2	5.8	5.6	5.7
Consumer prices (End-period; percent change)	11.2	10.7	1.1	0.5	6.1	8.0	6.1	8.0	6.9	6.5	6.5	6.5
Gross national saving	26.3	23.4	20.7	26.0	30.3	27.1	30.1	29.5	31.2	34.7	36.3	40.6
Public	7.4	3.7	0.4	-4.2	-3.4	0.1	-1.5	1.0	2.4	3.8	5.3	5.6
Private	18.9	19.7	20.3	30.3	33.8	26.9	31.6	28.5	28.8	30.8	31.0	34.9
Gross capital formation	53.3	35.2	26.4	29.4	34.8	34.0	39.6	38.1	43.8	44.4	43.6	44.5
Public	16.4	15.0	9.2	13.1	7.7	8.1	7.5	7.8	7.9	7.1	7.1	7.1
Private	36.9	20.2	17.2	16.3	27.1	26.0	32.2	30.4	35.9	37.3	36.5	37.5
General government accounts												
Total revenue and grants	31.2	27.8	25.1	23.5	24.7	25.9	26.3	25.9	26.6	26.6	26.6	26.6
Total expenditure and net lending 1/	40.1	39.1	33.6	40.5	35.3	33.6	34.8	32.3	31.8	29.6	28.0	27.7
Overall balance (IMF definition) 2/	-8.9	-11.3	-8.5	-17.0	-10.6	-7.6	-8.5	-6.4	-5.2	-2.9	-1.4	-1.1
Primary balance (IMF definition)	-7.5	-8.8	-5.6	-13.0	-5.5	-3.4	-3.1	-2.6	-1.0	0.8	1.5	1.5
	(In percent of GDP, unless indicated otherwise)											
Monetary sector												
Credit growth (percent change)	57.3	20.2	2.9	6.1	9.0	10.5	10.3	12.7	13.4	12.4	11.7	11.5
Reserve money growth (percent change)	54.0	2.7	-28.2	24.6	21.8	13.2	19.3	19.1	15.4	13.3	13.4	14.3
Balance of payments												
Current account balance	-25.4	-11.5	-4.0	-6.3	-4.4	-7.0	-9.5	-8.6	-12.6	-9.8	-7.3	-3.9
Gross official reserves (in millions of US$) 3/	2,242	1,648	1,324	1,297	1,692	1,919	2,515	2,534	3,725	4,380	4,968	5,384
(In months of imports)	3.9	4.0	2.8	2.4	3.4	3.5	4.4	4.1	6.1	6.8	7.6	8.4
Debt indicators 4/												
General government debt	49.4	57.1	62.1	87.6	94.9	85.5	101.3	89.2	88.4	86.4	80.9	73.5
Domestic	11.6	14.7	15.2	20.2	21.4	12.7	19.4	14.1	12.2	9.7	11.9	10.8
External	37.8	42.3	46.9	67.5	73.4	72.9	81.9	75.1	76.2	76.6	69.0	62.7
General government debt in NPV terms	...	...	55.0	69.6	86.3	82.9	89.6	81.8	80.0	77.1	72.7	66.6
GFN	9.8	13.3	10.7	18.0	22.4	19.4	21.5	14.2	14.0	11.2	11.8	15.7
Memorandum items:												
Copper prices (US$ per ton)	7331	6,863	5,510	4,868	5,722	6,030	5,733	6,430	6,462	6,471	6,469	6,469
Gold prices (US$ per ounce)	1411	1,266	1,160	1,248	1,212	1,254	1,225	1,291	1,313	1,341	1,367	1,393

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 swap line.

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

Table 2a. Mongolia: Summary Operations of the General Government, 2016–22
(In billions of togrogs)

	2016	2017	2017	2018	2018	2019	2020	2021	2022
	Prelim	EFF	Proj.	EFF	2nd Rev. Proj.		Projections		
Total revenue and grants	5,635	6,431	7,113	7,279	7,862	9,163	10,181	11,365	13,002
Current revenue	5,556	6,285	7,037	7,169	7,752	9,038	10,042	11,210	12,824
Tax revenue and social security contributions	4,875	5,523	6,237	6,346	6,900	8,087	9,001	10,061	11,525
Income taxes	1,043	1,120	1,332	1,292	1,408	1,646	1,830	2,071	2,483
CIT	520	520	729	556	691	783	903	1,040	1,259
PIT	523	600	602	735	716	863	927	1,032	1,224
Social security contributions	1,034	1,199	1,249	1,410	1,431	1,731	2,094	2,369	2,812
VAT	1,141	1,279	1,449	1,434	1,517	1,853	1,963	2,151	2,295
Excise taxes	630	487	512	659	684	836	883	975	1,096
Customs duties and export taxes	328	417	490	476	537	610	635	690	711
Other taxes	698	1,020	1,205	1,076	1,323	1,412	1,596	1,804	2,127
Non-tax revenue	682	762	800	823	852	951	1,041	1,149	1,300
Capital revenue and grants	78	146	76	110	110	125	139	155	178
Total expenditure and net lending	9,699	9,183	9,211	9,640	9,813	10,954	11,304	11,970	13,516
Current expenditure	6,571	7,178	7,000	7,574	7,452	8,219	8,574	8,948	10,071
Wages and salaries	1,747	1,764	1,766	1,796	1,797	1,939	2,154	2,406	2,751
Purchase of goods and services	1,386	1,426	1,322	1,497	1,455	1,639	1,747	1,870	2,139
Subsidies	229	233	199	245	236	269	287	306	351
Transfers	2,265	2,431	2,556	2,522	2,814	2,936	2,974	3,100	3,571
Interest payments	943	1,324	1,156	1,514	1,150	1,437	1,412	1,266	1,260
Capital expenditure and net lending 1/	3,128	2,005	2,211	2,066	2,361	2,735	2,730	3,022	3,445
Capital expenditure	2,360	1,607	1,802	1,623	1,989	2,300	2,259	2,520	2,881
Domestically-financed	2,360	949	1,144	816	1,182	1,340	1,488	1,662	1,929
o/w DBM noncommercial spending	240	173	0	0	0	0	0	0	0
Foreign-financed	0	658	658	807	807	960	771	858	952
Net lending	768	398	409	443	371	435	471	501	564
o/w DBM commercial spending 2/	247	150	70	159	161	182	203	226	259
o/w Mortgage program net lending	0	111	111	120	120	130	140	151	163
Overall balance (Authorities' definition)	-3,660	-2,330	…	-2,126	…	…	…	…	…
Structural overall balance (Authorities' definition)	-3,660	-2,321	…	-2,126	…	…	…	…	…
DBM spending	487	323	70	159	161	182	203	226	259
Overall balance (IMF definition)	-4,065	-2,753	-2,098	-2,361	-1,950	-1,791	-1,123	-604	-514
Primary balance (IMF definition)	-3,121	-1,428	-942	-846	-800	-354	288	662	746
Financing	4,065	2,753	2,098	2,361	1,950	1,791	1,123	604	514
External	1,214	2,024	2,787	2,560	1,563	2,467	2,283	-603	417
Disbursement	1,350	2,646	3,393	3,268	3,503	3,307	2,968	1,459	4,132
Amortization	-136	-622	-606	-708	-1,940	-840	-685	-2,062	-3,716
Domestic (net)	2,850	729	-689	-199	387	-677	-1,159	1,207	97
Government bonds	2,454	1,069	-220	-274	286	-677	-1,159	1,207	97
Privatization	1	100	100	75	101	0	0	0	0
Other	396	-440	-569	0	0	0	0	0	0
Memorandum items:									
Mineral revenue (in percent of GDP)	2.5	3.74	4.5	3.7	4.3	4.0	4.2	4.4	4.6
Non-mineral revenue (in percent of GDP)	21.1	20.95	21.4	22.6	21.6	22.6	22.4	22.3	22.0
Total expenditure (in percent of non-mineral GDP)	50.7	46.42	43.1	45.9	40.9	40.3	38.1	36.7	37.3
Non-mineral overall balance (in percent of non-mineral GDP)	-24.4	-25.47	-15.6	-23.4	-13.6	-11.7	-9.2	-7.6	-7.7
Primary spending (change in percent)	23.1	-10.48	-8.0	3.4	7.5	9.9	3.9	8.2	14.5

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, 2016–22

(In percent of GDP)

	2016	2017	2017	2018	2018	2019	2020	2021	2022
		EFF	Proj.	EFF	2nd Rev. Proj.		Projections		
Total revenue and grants	23.5	24.7	25.9	26.3	25.9	26.6	26.6	26.6	26.6
Current revenue 1/	23.2	24.1	25.6	25.9	25.5	26.3	26.3	26.3	26.3
Tax revenue and social security contributions	20.4	21.2	22.7	22.9	22.7	23.5	23.5	23.6	23.6
Income taxes	4.4	4.3	4.9	4.7	4.6	4.8	4.8	4.9	5.1
CIT	2.2	2.0	2.7	2.0	2.3	2.3	2.4	2.4	2.6
PIT	2.2	2.3	2.2	2.7	2.4	2.5	2.4	2.4	2.5
Social security contributions	4.3	4.6	4.6	5.1	4.7	5.0	5.5	5.5	5.8
VAT	4.8	4.9	5.3	5.2	5.0	5.4	5.1	5.0	4.7
Excise taxes	2.6	1.9	1.9	2.4	2.3	2.4	2.3	2.3	2.2
Customs duties and export taxes	1.4	1.6	1.8	1.7	1.8	1.8	1.7	1.6	1.5
Other taxes	2.9	3.9	4.4	3.9	4.4	4.1	4.2	4.2	4.4
Non-tax revenue	2.8	2.9	2.9	3.0	2.8	2.8	2.7	2.7	2.7
Capital revenue and grants	0.3	0.6	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Total expenditure and net lending	40.5	35.3	33.6	34.8	32.3	31.8	29.6	28.0	27.7
Current expenditure	27.5	27.6	25.5	27.4	24.5	23.9	22.4	21.0	20.6
Wages and salaries	7.3	6.8	6.4	6.5	5.9	5.6	5.6	5.6	5.6
Purchase of goods and services	5.8	5.5	4.8	5.4	4.8	4.8	4.6	4.4	4.4
Subsidies	1.0	0.9	0.7	0.9	0.8	0.8	0.8	0.7	0.7
Transfers	9.5	9.3	9.3	9.1	9.3	8.5	7.8	7.3	7.3
Interest payments 2/	3.9	5.1	4.2	5.5	3.8	4.2	3.7	3.0	2.6
Capital expenditure and net lending 3/	13.1	7.7	8.1	7.5	7.8	7.9	7.1	7.1	7.1
Capital expenditure	9.9	6.2	6.6	5.9	6.5	6.7	5.9	5.9	5.9
Domestically-financed	9.9	3.6	4.2	2.9	3.9	3.9	3.9	3.9	3.9
o/w DBM noncommercial spending	1.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign-financed	0.0	2.5	2.4	2.9	2.7	2.8	2.0	2.0	1.9
Net lending	3.2	1.5	1.5	1.6	1.2	1.3	1.2	1.2	1.2
o/w DBM commercial spending 4/	1.0	0.6	0.3	0.6	0.5	0.5	0.5	0.5	0.5
o/w Mortgage program net lending	0.0	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3
Overall balance (Authorities' definition)	-15.3	-8.9	…	-7.7	…	…	…	…	…
Structural overall balance (Authorities' definition)	-15.3	-8.9	…	-7.7	…	…	…	…	…
DBM spending	2.0	1.2	0.3	0.6	0.5	0.5	0.5	0.5	0.5
Overall balance (IMF definition)	-17.0	-10.6	-7.6	-8.5	-6.4	-5.2	-2.9	-1.4	-1.1
Primary balance (IMF definition)	-13.0	-5.5	-3.4	-3.1	-2.6	-1.0	0.8	1.5	1.5
Financing	17.0	10.6	7.6	8.5	6.4	5.2	2.9	1.4	1.1
External	5.1	7.8	10.2	9.2	5.1	7.2	6.0	-1.4	0.9
Disbursement	5.6	10.2	12.4	11.8	11.5	9.6	7.8	3.4	8.5
Amortization	-0.6	-2.4	-2.2	-2.6	-6.4	-2.4	-1.8	-4.8	-7.6
Domestic (net)	11.9	2.8	-2.5	-0.7	1.3	-2.0	-3.0	2.8	0.2
Government bonds	10.3	4.1	-0.8	-1.0	0.9	-2.0	-3.0	2.8	0.2
Privatization	0.0	0.4	0.4	0.3	0.3	0.0	0.0	0.0	0.0
Other	1.7	-1.7	-2.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Mineral revenue (in percent of GDP)	2.5	3.7	4.5	3.7	4.3	4.0	4.2	4.4	4.6
Non-mineral revenue (in percent of GDP)	21.1	20.9	21.4	22.6	21.6	22.6	22.4	22.3	22.0
Total expenditure (in percent of non-mineral GDP)	50.7	0.2	43.1	0.2	40.9	40.3	38.1	36.7	37.3
Non-mineral overall balance (in percent of non-mineral GDP)	-24.4	20.8	-15.6	22.4	-13.6	-11.7	-9.2	-7.6	-7.7
Primary spending (change in percent)	23.1	-17.9	-8.0	-2.7	7.5	9.9	3.9	8.2	14.5
Nominal GDP (in billions of togrogs)	23,936		27,438		30,377	34,428	38,232	42,705	48,843

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, nor are interest payments from DBM.
3/ Includes DBM spending.
4/ Not on the budget, using instead Fund projections.

Table 3. Mongolia: Balance of Payments, 2013–22

	2013	2014	2015	2016	2017	2017	2018	2018	2019	2020	2021	2022
					EFF	Proj.	EFF	Projections				
	(In millions of U.S. dollars, unless otherwise indicated) 1/											
Current account balance (including official grants)	-3,192	-1,405	-469	-700	-456	-772	-1,004	-1,034	-1,641	-1,356	-1,094	-660
Trade balance	-1,321	994	1,178	1,337	1,266	1,428	968	1,082	674	872	1,079	1,445
Exports	4,269	5,776	4,616	4,809	4,898	5,677	4,943	5,389	5,735	5,934	6,418	6,829
Mineral export	4,050	4,762	4,099	4,027	4,314	5,007	4,351	4,760	5,090	5,279	5,742	6,135
Non-mineral export	219	1,014	517	782	584	670	592	629	646	654	676	694
Imports	-5,590	-4,783	-3,438	-3,473	-3,632	-4,249	-3,975	-4,308	-5,062	-5,062	-5,339	-5,384
Services, net	-1,314	-1,553	-857	-1,337	-1,017	-1,082	-1,174	-1,211	-1,321	-1,264	-1,281	-1,299
Income, net	-699	-989	-966	-911	-937	-1,294	-1,033	-1,110	-1,214	-1,196	-1,140	-1,051
Current transfers	145	169	205	173	231	176	234	206	220	232	249	244
General government	27	28	56	18	31	18	32	40	43	46	49	25
Other sectors	118	142	148	156	200	159	202	166	177	187	200	219
Of which: Workers remittances	26	55	76	117	88	119	88	125	135	144	156	175
Capital and financial account	1,438	1,112	382	903	91	910	785	664	1,785	1,252	1,532	1,025
Capital account	126	100	114	91	114	64	117	144	156	166	180	186
Financial account	1,312	1,012	268	812	-23	846	667	519	1,628	1,086	1,352	840
Direct investment	2,098	276	110	-4,171	995	1,056	1,547	1,424	2,279	1,971	1,954	1,546
Portfolio investment	-156	277	274	487	-94	351	0	-145	0	-500	-294	-206
Trade credits, net	9	-136	-302	-101	-45	-80	-45	-85	-89	-85	-86	-86
Currency and deposits, net	-1,376	-210	-233	-204	-886	-219	-663	-368	-543	-414	-422	-411
Loans, net	737	758	347	4,920	7	-261	-171	-307	-19	114	200	-2
Other, net	0	48	72	-120	0	0	0	0	0	0	0	0
Errors and omissions	-113	-128	-181	-221	0	0	0	0	0	0	0	0
Overall balance	-1,867	-421	-268	-18	-365	138	-220	-371	144	-103	438	365
Financing Gap	0	0	0	0	760	483	1,043	986	1,047	759	150	50
Fund credit	-93	-61	-3	0	113	113.5	134.7	134.7	141.8	35.5	0.0	0.0
Donor support					647	370	908	852	905	723	150	50
Memorandum items:												
Current account balance (in percent of GDP)	-25.4	-11.5	-4.0	-6.3	-4.4	-7.0	-9.5	-8.6	-12.6	-9.8	-7.3	-3.9
Gross official reserves (end-period) 2/	2,242	1,648	1,324	1,297	1,692	1,919	2,515	2,534	3,725	4,380	4,968	5,384
(In months of next year's imports of goods and services)	3.9	4.0	2.8	2.4	3.4	3.5	4.4	4.1	6.1	6.8	7.6	8.4
Change in reserves 3/	-1,885	-594	-324	-27	395	622	823	615	1,191	655	588	415
Copper price (in U.S. dollars per ton)	7,331	6,863	5,510	4,868	5,722	6,030	5,733	6,430	6,462	6,471	6,469	6,469
Oil price (in U.S. dollars per barrel)	104	96	51	43	55	50	56	50	51	51	52	53
Gold price (in U.S. dollars per troy oz.)	1,411	1,266	1,160	1,248	1,212	1,254	1,225	1,291	1,313	1,341	1,367	1,393

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/ Gross official reserves includes drawings from swap line.

3/ Changes in reserves reflect valuation adjustments.

Table 4. Mongolia: Monetary Aggregates, 2013–22

	2013	2014	2015	2016	2017	2017	2018	2018	2019	2020	2021	2022
					EFF	Proj.	EFF			Proj.		
	(In billions of togrog, end of period)											
Monetary survey												
Broad money	9,449	10,635	10,008	12,113	13,967	14,930	15,822	17,127	19,582	22,138	25,170	29,040
Currency	582	499	461	565	656	696	743	799	913	1,033	1,174	1,354
Deposits	8,867	10,135	9,547	11,548	13,311	14,234	15,079	16,328	18,669	21,105	23,996	27,686
Net foreign assets	777	-2,005	-4,151	-5,010	-4,176	-3,346	-2,037	-1,818	1,136	3,073	5,882	7,139
Net domestic assets	8,673	12,639	14,158	17,123	18,143	18,276	17,859	18,945	18,446	19,065	19,289	21,901
Domestic credit	9,978	13,379	14,344	16,358	18,252	16,702	19,640	18,291	19,931	21,202	24,985	28,603
Net credit to government	-1,061	106	683	1,868	2,044	688	1,770	248	-522	-1,784	-700	-37
Credit to the private sector 1/	11,039	13,272	13,660	14,490	16,208	16,014	17,870	18,043	20,452	22,986	25,685	28,639
Other items, net	-1,305	-739	-185	764	-109	1,574	-1,780	654	-1,485	-2,137	-5,696	-6,701
Monetary authorities												
Reserve money	3,335	3,427	2,462	3,067	3,734	3,472	4,457	4,137	4,776	5,413	6,139	7,014
Net foreign assets	1,957	136	-1,270	-1,690	-731	-460	1,072	813	3,722	5,652	8,609	10,015
Net domestic assets	1,378	3,291	3,732	4,757	4,466	3,932	3,385	3,324	1,054	-239	-2,469	-3,001
Net credit to government	-1,685	-570	-474	-332	-332	-13	-332	-13	-13	-13	-13	-13
Claims on deposit money banks	4,297	2,608	1,686	1,471	1,097	1,794	837	1,997	2,184	2,305	1,193	1,173
Minus: Central bank bills (net)	1,627	854	1,025	573	979	3,595	2,535	4,861	7,756	9,214	10,211	10,594
Other items, net	393	2,107	3,544	4,191	4,680	5,745	5,415	6,200	6,639	6,683	6,562	6,433
Memorandum items:	(In percent, unless otherwise indicated)											
Annual broad money growth	24.1	12.5	-5.9	21.0	16.1	23.3	13.3	14.7	14.3	13.1	13.7	15.4
Annual reserve money growth	54.0	2.7	-28.2	24.6	21.8	13.2	19.3	19.1	15.4	13.3	13.4	14.3
Velocity	2.0	2.1	2.3	2.0	1.9	1.9	1.8	1.8	1.8	1.8	1.7	1.7
Credit growth (percent)	57.3	20.2	2.9	6.1	9.0	10.5	10.3	12.7	13.4	12.4	11.7	11.5

1/Includes mortgage-backed securities.

Sources: Mongolian authorities; and Fund staff projections.

Table 5. Mongolia: Summary of Financial Stability Indicators

	2010	2011	2012	2013	2014	2015	2016	2017	2017	2017	2017
				Dec	Dec	Dec	Dec	Jun	Jul	Aug	Sep
Capital (in percent)											
Risk Weighted CAR	16.2	15.9	15.5	16.0	17.7	17.9	18.6	18.0	17.8	17.6	17.5
Asset quality											
Asset Growth (percent change from start of year)	43.0	46.5	50.5	68.2	11.7	-3.6	21.3	1.7	5.4	8.5	10.8
Loan Growth (Net) (percent change from start of year)	26.4	34.0	37.8	52.4	17.5	-8.6	4.7	3.6	4.6	6.4	7.7
Loan share in total assets (in percent)	47.9	49.6	49.6	53.1	55.9	53.0	46.0	46.8	45.7	45.1	44.7
Non Performing Loan (in percent)											
NPL to gross loans	6.7	6.0	5.8	2.5	3.1	7.3	7.2	7.3	7.3	7.4	7.5
Past-due to gross loans	3.0	3.3	3.5	0.0	2.2	5.6	7.1	6.2	6.9	7.1	6.3
NPL + Past due to gross loans	9.7	9.2	9.3	3.6	5.3	12.9	14.2	13.5	14.2	14.5	13.8
Provision/NPLs	62.4	65.2	65.4	71.6	70.2	61.6	72.2	74.3	75.2	74.7	73.3
Provision/NPL+Past due	43.2	42.2	40.9	49.7	41.5	34.8	36.4	40.1	38.8	38.0	39.9
NPLs net of provision /Capital	12.5	10.6	10.5	4.3	5.0	12.7	7.9	7.4	7.2	7.6	8.0
NPLs+Past due net of provision /Capital	27.2	27.3	28.6	11.1	16.5	38.2	35.7	32.0	34.4	36.4	33.3
FX lending to total lending	33.7	33.2	34.4	27.5	23.5	24.5	20.2	21.4	21.9	21.6	21.4
Interest Rate (in percent)											
Average lending rate	17.4	17.4	17.0	14.0	14.3	15.2	16.7	18.7	19.7	20.7	21.7
Earnings and Profitability (in percent)											
Return on assets	1.8	2.7	1.8	2.7	1.8	1.2	0.8	1.0	0.9	1.0	1.0
Return on equity	11.2	24.2	14.6	20.4	13.5	9.1	6.9	9.0	8.3	9.0	9.6
Interest income to gross income	34.2	30.5	34.6	49.3	54.6	64.5	60.9	85.2	85.8	86.0	86.0
Interest expenses to gross income	21.3	19.2	22.5	30.2	34.7	41.1	42.2	59.9	59.9	60.2	59.8
Non-interest expenses to gross income	72.7	72.7	71.2	57.9	55.4	51.4	53.3	32.2	32.7	31.6	31.3
Personnel expenses to Non-interest expenses	7.2	6.5	7.7	10.2	11.2	13.9	11.8	24.4	24.7	25.2	25.1
Liquidity (in percent)											
Liquid assets to Total assets	44.1	43.3	43.4	30.9	25.2	22.0	24.0	23.7	24.5	26.0	26.8
Liquid assets to Short-term liabilities	53.3	52.1	52.1	32.0	29.7	30.6	35.8	34.6	35.4	37.2	38.0
FX deposit to total Deposits	32.4	29.9	30.9	21.6	26.8	26.1	31.7	24.9	27.0	25.9	27.6

Source: Mongolian authorities.

Table 6. Mongolia: External Financing Requirements and Sources, 2015–22

(In millions of U.S. dollars)

	2015	2016	Projections 2017	2018	2019	2020	2021	2022
Gross financing requirements	935	2057	2976	3295	4233	3615	3164	3602
External current account deficit (excl. official transfers)	497	756	790	1074	1684	1401	1143	685
Amortization	427	689	1291	1266	851	1193	1071	2155
Public sector	64	62	257	446	329	259	734	1174
o/w bonds	0	0	0	145	0	0	500	1000
o/w loans	58	62	257	301	329	259	234	174
Private sector	363	627	1034	820	523	933	338	981
Repayment of arrears	0	0	0	0	0	0	0	0
Gross reserves accumulation (increase = +)	-324	-27	622	615	1191	655	588	415
IMF repurchases and repayments	3	0	0	0	0	0	0	0
Other net capital outflows 1/	332	638	274	340	508	365	361	346
Available financing	935	2057	2492	2309	3187	2856	3014	3552
Grants	28	56	18	40	43	46	49	25
Disbursements to public sector	255	1133	672	335	344	308	263	1223
o/w bonds		500	295	0	0	0	0	1000
o/w loans		467	377	335	344	308	263	223
Disbursements to private sector	543	5039	747	510	520	530	747	758
Foreign direct investment	110	-4171	1056	1424	2279	1971	1954	1546
Financing need	0	0	483	986	1047	759	150	50
Financing	0	0	483	986	1047	759	150	50
IMF 2/	0	0	113.5	134.7	141.8	35.5	0	0
Other IFI	0	0	320	418	472	290	0	0
Identified bilateral support	0	0	50	433	433	433	150	50
PBOC swap (additional drawing)	0	0	0	0	0	0	0	0
PBOC swap rollover (net zero)			1805			1805		

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 7. Mongolia: Capacity to Repay Indicators, 2017–22
(In millions of SDR, unless otherwise indicated)

	Projections					
	2017	2018	2019	2020	2021	2022
Exposure and Repayments from Existing and Prospective Fund Arrangements						
GRA credit to Mongolia	83.87	183.45	288.29	314.51	312.18	294.27
In percent of quota	116.00	253.74	398.75	435.00	431.78	407.01
Debt service on GRA credit	0.28	2.29	5.49	8.41	11.07	26.47
Principal (repayments/repurchases)					2.33	17.91
Charges and interest	0.28	2.29	5.49	8.41	8.74	8.56
Debt and debt service ratios (In percent of GDP)						
Public and publicly-guaranteed debt	85.34	89.05	88.27	86.24	80.79	73.38
Excluding proposed IMF	84.33	87.00	85.29	83.19	78.00	71.03
GRA credit to Mongolia	1.01	2.05	2.98	3.04	2.79	2.35
Public and publicly-guaranteed debt service	16.67	12.21	13.55	12.48	13.79	17.23
Excluding proposed IMF	16.67	12.18	13.49	12.39	13.69	17.01
GRA debt service	0.00	0.03	0.06	0.08	0.10	0.21
Debt and debt service ratios (In percent of exports of goods and services)						
Public and publicly-guaranteed debt	140.71	168.51	169.98	171.16	161.46	154.46
Excluding proposed IMF	139.04	164.63	164.25	165.12	155.89	149.52
GRA credit to Mongolia	1.67	3.87	5.73	6.04	5.58	4.94
Public and publicly-guaranteed debt service	27.49	23.10	26.09	24.76	27.56	36.26
Excluding proposed IMF	27.48	23.05	25.98	24.60	27.36	35.82
GRA debt service	0.01	0.05	0.11	0.16	0.20	0.44

Sources: IMF Finance Department; and Fund staff estimates and projections.

Table 8. Mongolia: Indicators of Fund Credit, 2017-22
(In millions of SDR, unless otherwise indicated)

		Projections				
	2017	2018	2019	2020	2021	2022
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
Obligations 2/	0.28	2.29	5.49	8.41	11.07	26.47
Principal (repayments/repurchases)					2.33	17.91
Charges and interest 3/	0.28	2.29	5.49	8.41	8.74	8.56
Stock of existing and prospective Fund credit 1/	83.87	183.45	288.29	314.51	312.18	294.27
In percent of quota	116.00	253.74	398.75	435.00	431.78	407.01
In percent of GDP	1.01	2.05	2.98	3.04	2.79	2.35
In percent of exports of goods and services	1.67	3.87	5.73	6.04	5.58	4.94
In percent of gross usable reserves	4.37	7.24	7.74	7.18	6.28	5.47
Obligations to the Fund from existing and prospective Fund arrangements	0.28	2.29	5.49	8.41	11.07	26.47
In percent of quota	0.39	3.17	7.59	11.63	15.31	36.61
In percent of GDP	0.00	0.03	0.06	0.08	0.10	0.21
In percent of exports of goods and services	0.01	0.05	0.11	0.16	0.20	0.44
In percent of gross usable reserves	0.01	0.09	0.15	0.19	0.22	0.49
Memorandum Items						

Sources: IMF Finance Department; and Fund staff estimates and projections.
1/ End of period.
2/ Repayment schedule based on scheduled debt service obligations.
3/ As of November 2, 2017, data for current year shows remaining payments in the year.

Table 9. Mongolia: Proposed 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	27.9560	37.82	38.67
December 15, 2017	Observance of end-September 2017 performance criteria, completion of second review	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 eight 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 twelfth review	26.2106	35.46	36.25
		314.5054	**425.44**	**435.00**

Annex I. Public Debt Sustainability Analysis

Mongolia Public DSA–Baseline Scenario

(percent of GDP, unless otherwise indicated)

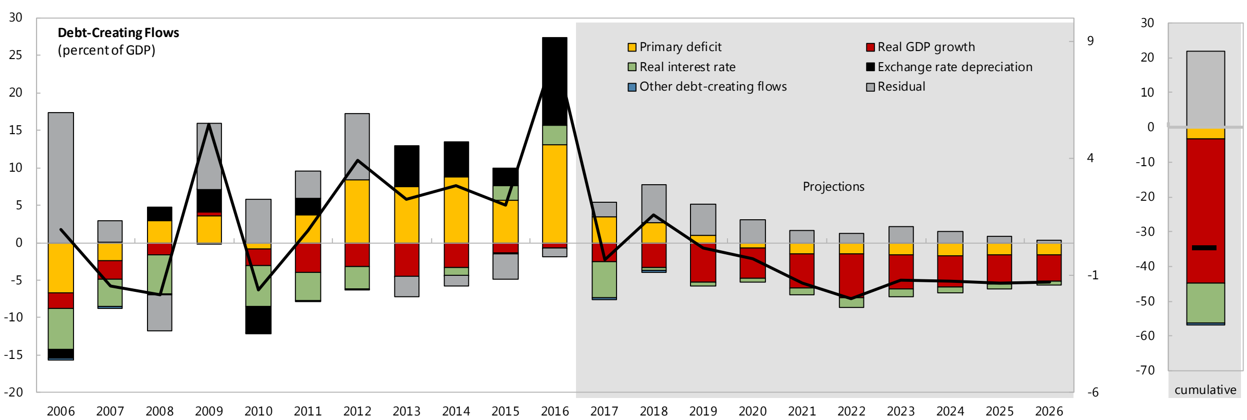
Debt, Economic and Market Indicators 1/

	Actual			Projections									
	2006–2014 2/	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	37.3	62.1	87.6	85.3	89.0	88.3	86.2	80.8	73.4	68.4	63.3	58.0	52.7
PV of public debt		55.0	69.6	82.9	81.8	80.0	77.1	72.7	66.6	62.1	58.1	53.8	49.3
Public gross financing needs	3.8	10.7	18.0	19.4	14.2	14.0	11.2	11.8	15.7	11.1	17.6	14.6	13.7
Real GDP growth (percent)	8.8	2.4	1.2	3.3	4.2	6.7	5.0	5.8	8.2	7.0	7.0	6.9	6.8
Inflation (GDP deflator, percent)	13.1	1.7	2.1	11.0	6.2	6.2	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Nominal GDP growth (percent)	23.8	4.2	3.4	14.6	10.7	13.3	11.1	11.7	14.4	13.0	12.8	12.6	12.6
Effective interest rate (percent) 4/	2.3	5.3	6.6	5.1	6.0	6.0	5.5	4.7	4.2	4.4	4.7	4.7	4.8

As of April 05, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		455
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	Caa1	Caa1
S&Ps	B-	B-
Fitch	B-	B-

Contribution to Changes in Public Debt

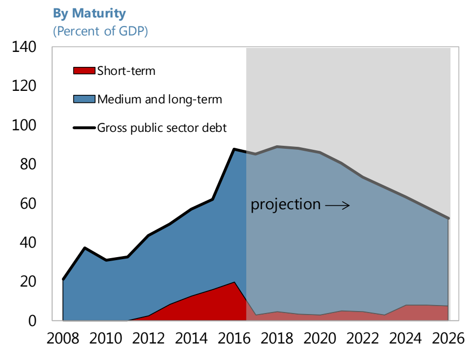
	Actual			Projections											
	2006–2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	Cumulative	Debt-stabilizing primary balance 9/
Change in gross public sector debt	2.7	5.0	25.5	-2.3	3.7	-0.7	-2.1	-5.4	-7.4	-5.0	-5.1	-5.3	-5.3	-34.9	-4.0
Identified debt-creating flows	-1.6	8.4	26.7	-4.2	-1.4	-4.8	-5.2	-7.0	-8.7	-7.2	-6.6	-6.1	-5.7	-56.9	
Primary deficit	2.8	5.6	13.0	3.4	2.6	1.0	-0.8	-1.5	-1.5	-1.7	-1.7	-1.7	-1.7	-3.5	
Primary (noninterest) revenue and grants	28.8	25.1	23.5	25.9	25.9	26.6	26.6	26.6	26.6	26.5	26.5	26.5	26.6	264.4	
Primary (noninterest) expenditure	31.6	30.7	36.6	29.4	28.5	27.6	25.9	25.1	25.1	24.8	24.8	24.9	24.9	261.0	
Automatic debt dynamics 5/	-4.2	3.0	13.6	-7.3	-3.7	-5.8	-4.5	-5.4	-7.2	-5.5	-4.9	-4.5	-4.0	-52.7	
Interest rate/growth differential 6/	-5.6	0.6	1.9	-7.3	-3.7	-5.8	-4.5	-5.4	-7.2	-5.5	-4.9	-4.5	-4.0	-52.7	
Of which: real interest rate	-3.1	1.9	2.7	-4.8	-0.4	-0.5	-0.5	-1.0	-1.3	-1.0	-0.7	-0.6	-0.5	-11.3	
Of which: real GDP growth	-2.5	-1.3	-0.7	-2.5	-3.3	-5.3	-4.0	-4.4	-5.8	-4.6	-4.2	-3.9	-3.5	-41.4	
Exchange rate depreciation 7/	1.4	2.3	11.7	... ...	...	...	...	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.1	-0.2	0.0	-0.4	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.7	
Net privatization proceeds	-0.1	-0.2	0.0	-0.4	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.7	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other liabilities (bank recap. and PSI sweetner)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 8/	4.3	-3.3	-1.2	1.9	5.1	4.1	3.1	1.6	1.3	2.2	1.5	0.8	0.4	21.9	

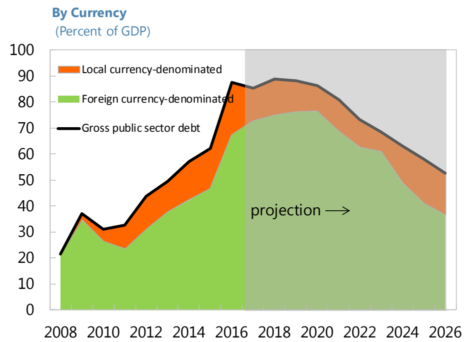


Source: IMF staff
1/ Public sector is defined as general government
2/ Based on available data
3/ Bond Spread over U.S. Bonds.
4/ Defined as interest payments divided by debt stock at the end of previous year
5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation
6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g
7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
8/ Includes changes in the stock of guarantees, 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

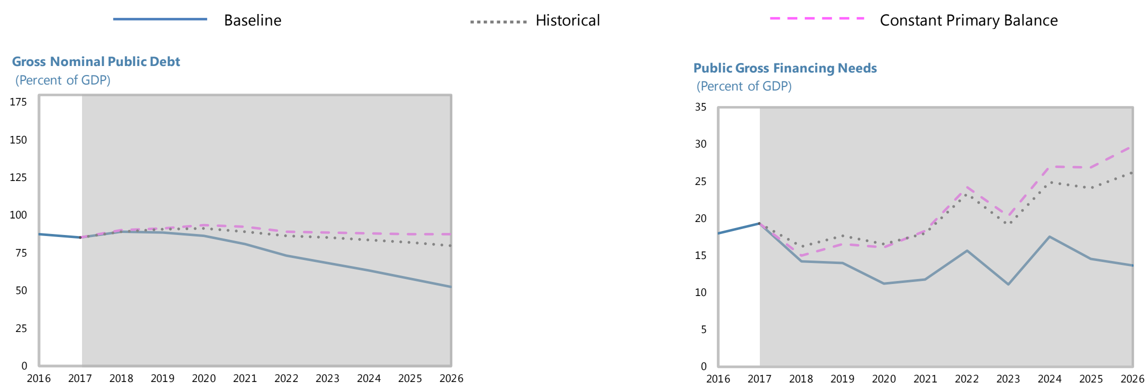
Mongolia Public DSA–Composition of Public Debt and Alternative Scenarios

Composition of Public Debt





Alternative Scenarios



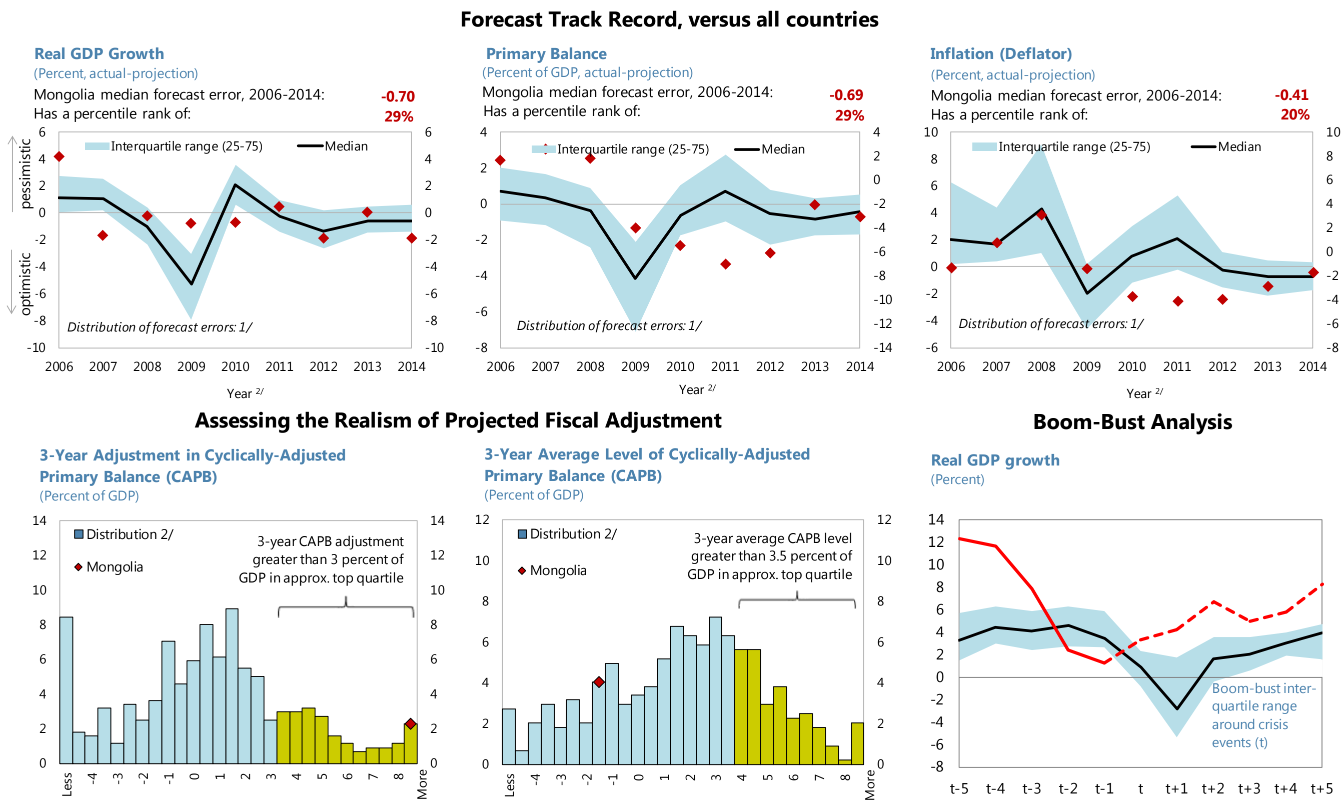
Underlying Assumptions
(Percent)

Baseline scenario	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Real GDP growth	3.3	4.2	6.7	5.0	5.8	8.2	7.0	7.0	6.9	6.8
Inflation	11.0	6.2	6.2	5.8	5.6	5.7	5.6	5.4	5.4	5.5
Primary balance	-3.4	-2.6	-1.0	0.8	1.5	1.5	1.7	1.7	1.7	1.7
Effective interest rate	5.1	6.0	6.0	5.5	4.7	4.2	4.4	4.7	4.7	4.8
Constant primary balance scenario										
Real GDP growth	3.3	4.2	6.7	5.0	5.8	8.2	7.0	7.0	6.9	6.8
Inflation	11.0	6.2	6.2	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-3.4	-3.4	-3.4	-3.4	-3.4	-3.4	-3.4	-3.4	-3.4
Effective interest rate	5.1	6.0	5.9	5.3	4.6	4.3	4.4	4.3	4.9	5.0

Historical scenario	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Real GDP growth	3.3	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
Inflation	11.0	6.2	6.2	5.8	5.6	5.7	5.6	5.4	5.4	5.5
Primary balance	-3.4	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0
Effective interest rate	5.1	6.0	5.0	3.9	2.8	2.0	1.6	1.2	1.2	1.1

Source: IMF staff

Mongolia Public DSA–Realism of Baseline Assumptions



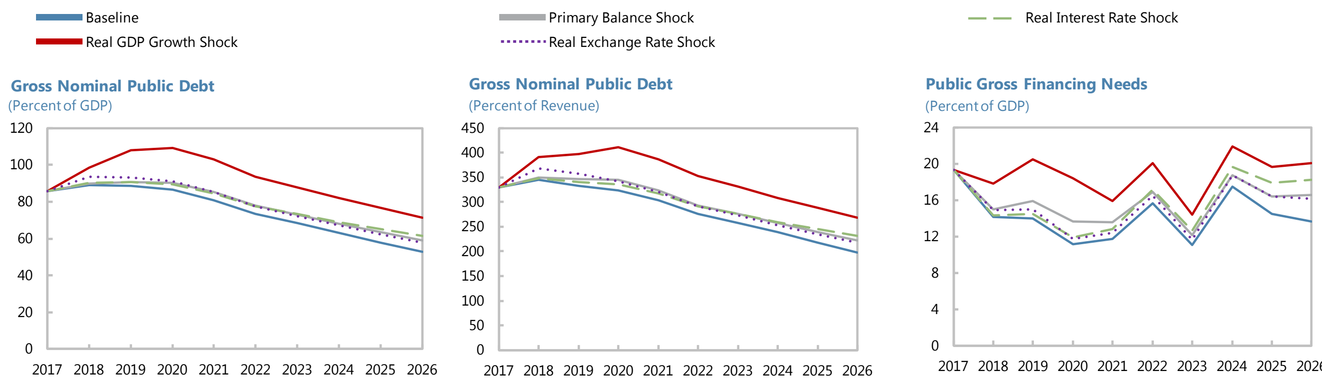
Source : IMF staff

1/ Plotted distribution includes all countries, percentile rank refers to all countries. Projections made in the spring WEO vintage of the preceding year

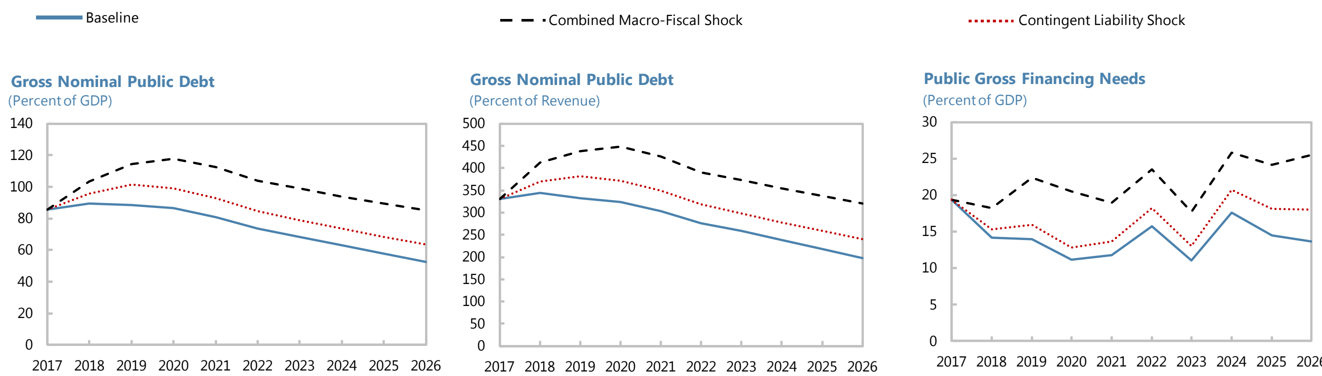
2/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis

Mongolia Public DSA–Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(Percent)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Primary Balance Shock										
Real GDP growth	3.3	4.3	6.9	5.2	5.9	8.2	7.0	7.0	6.9	6.8
Inflation	11.0	6.2	6.2	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-3.4	-2.6	-1.0	0.8	1.5	1.5	1.7	1.7	1.7
Effective interest rate	5.1	6.0	6.0	5.6	4.9	4.4	4.6	4.8	4.8	5.0
Real Interest Rate Shock										
Real GDP growth	3.3	3.0	5.7	4.4	5.4	8.0	6.8	6.8	6.7	6.6
Inflation	11.0	6.2	6.2	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-2.6	-1.0	0.8	1.5	1.5	1.7	1.7	1.7	1.7
Effective interest rate	5.1	6.0	6.2	5.9	5.3	5.0	5.4	5.3	6.3	6.4
Combined Shock										
Real GDP growth	3.3	-1.5	1.0	4.4	5.4	8.0	6.8	6.8	6.7	6.6
Inflation	11.0	4.8	4.7	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-5.5	-5.6	-3.5	0.8	1.5	1.5	1.7	1.7	1.7
Effective interest rate	5.1	6.3	6.3	5.9	5.4	5.1	5.4	5.4	6.3	6.4

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Real GDP Growth Shock										
Real GDP growth	3.3	-1.5	1.0	5.0	5.8	8.2	7.0	7.0	6.9	6.8
Inflation	11.0	4.8	4.7	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-5.5	-4.6	-3.1	1.5	1.5	1.7	1.7	1.7	1.7
Effective interest rate	5.1	6.0	6.0	5.4	4.7	4.2	4.3	4.1	4.6	4.7
Real Exchange Rate Shock										
Real GDP growth	3.3	3.7	6.5	5.0	5.8	8.2	7.0	7.0	6.9	6.8
Inflation	11.0	7.9	6.2	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-3.1	-1.5	0.8	1.5	1.5	1.7	1.7	1.7	1.7
Effective interest rate	5.1	6.3	5.9	5.3	4.6	4.2	4.3	4.1	4.7	4.7
Contingent Liability Shock										
Real GDP growth	3.3	-1.5	1.0	5.0	5.8	8.2	7.0	7.0	6.9	6.8
Inflation	11.0	4.8	4.7	5.8	5.6	5.7	5.6	5.4	5.4	5.4
Primary balance	-3.4	-2.6	-1.0	0.8	1.5	1.5	1.7	1.7	1.7	1.7
Effective interest rate	5.1	6.3	5.9	5.3	4.6	4.2	4.3	4.1	4.7	4.7

Source: IMF staff

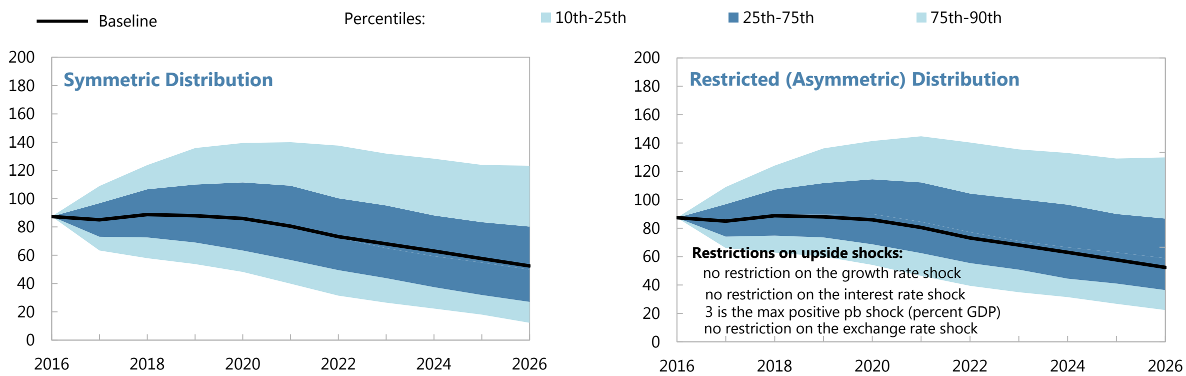
Mongolia Public DSA–Risk Assessment

Heat Map

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

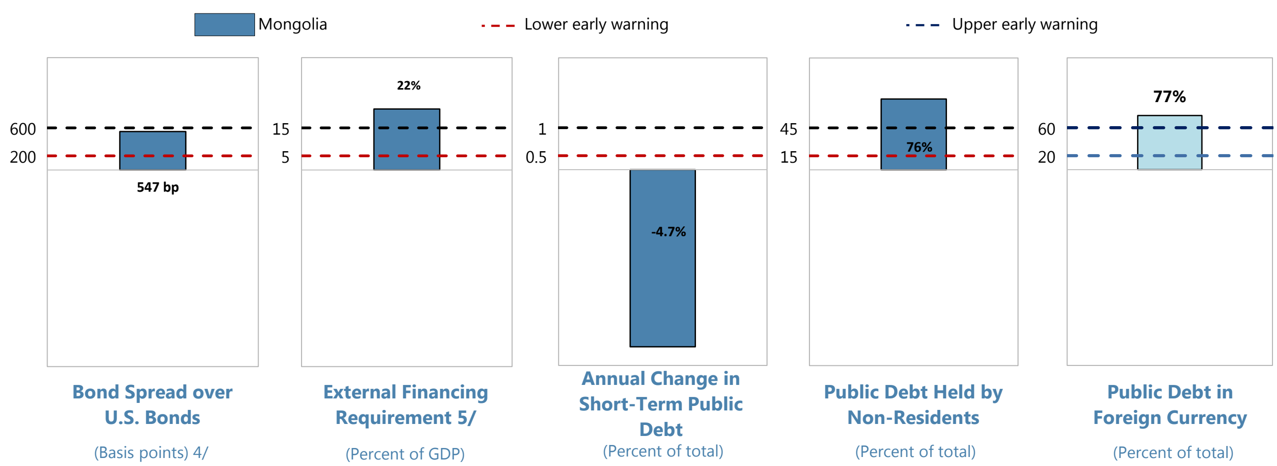
Evolution of Predictive Densities of Gross Nominal Public Debt

(Percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



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/ Bond Spread over U.S. Bonds, an average over the last 3 months, 05-Jan-17 through 05-Apr-17.

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.

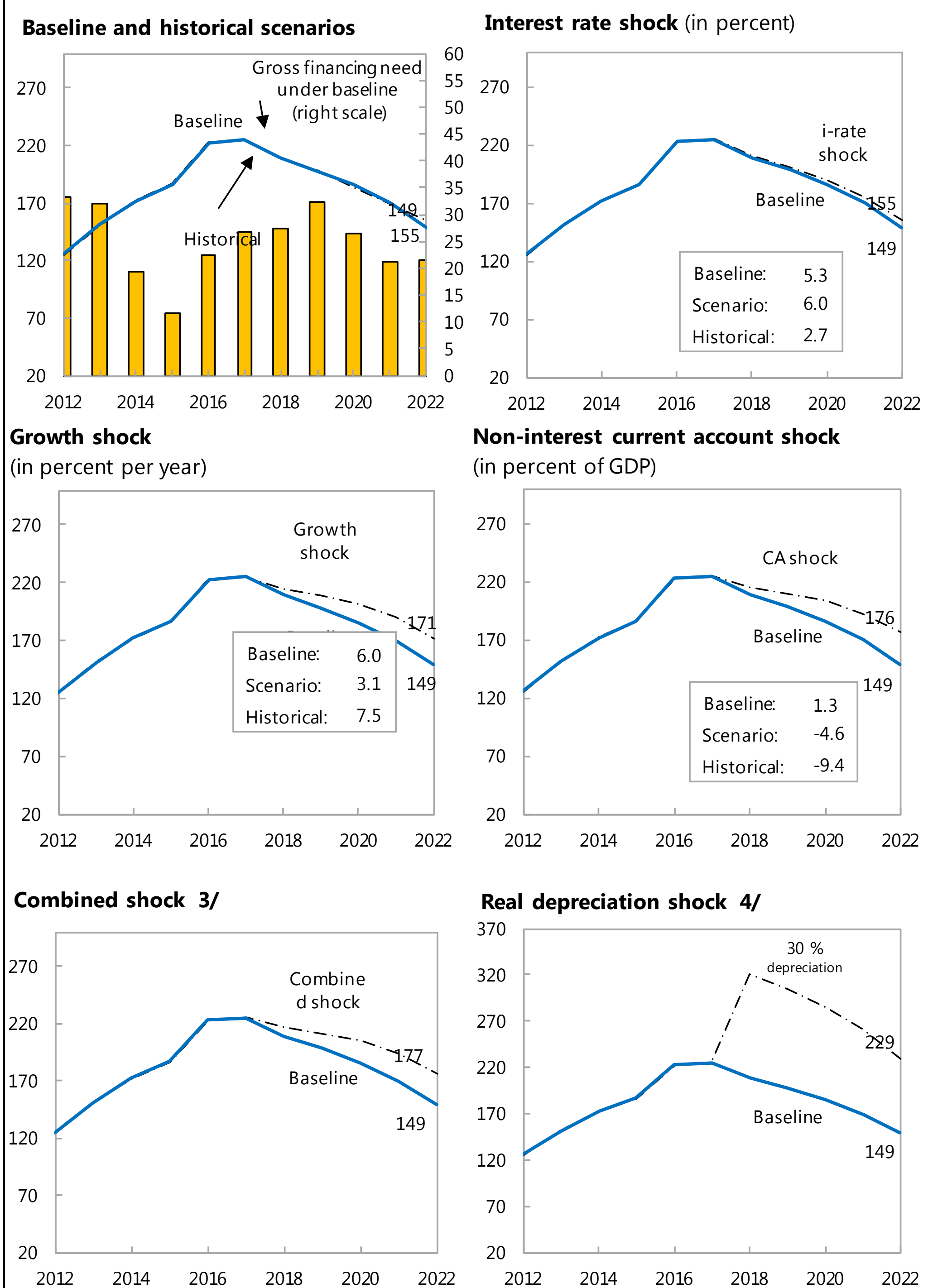
Annex II. External Debt Sustainability Analysis

External debt has risen sharply and is now high at 220 percent of GDP. It rose by over 30 percentage points of GDP from end-2015 to end-2016. About two-thirds of this increase is due to the impact of the nearly 25 percent depreciation in the exchange rate. The remainder of the increase in 2016 stemmed largely from a government loan of $240mn from Credit Suisse in March and a $500mn bond issuance in April.

The largest single category of external debt is intercompany loans. Such obligations account for 30 percent of the total stock or 65 percent of GDP and largely relate to the mining sector. The figure was close to 50 percent at end-2015 but Oyu Tolgoi converted a 4.1bn intercompany loan into a long term external loan (which is no longer classified as intra-company lending). Risks associated with such obligations are generally less than with other types of external debt because repayment capacity is less directly tied to economic conditions in Mongolia and there is less rollover risk since a parent company is not quick to pull funding from its subsidiary.

Looking ahead, external debt is projected to start declining rapidly but the path remains highly sensitive to shocks. Public sector debt composition will increasingly favor external borrowing because of the large committed donor funding in the program but the low interest cost will be supportive of fiscal sustainability in the medium term. On the private side, ongoing mining developments are expected to deliver significant FDI inflows (non-debt financing of the current account) as well as favorable export and growth dynamics, especially toward the end of the forecast horizon. Debt dynamics are sensitive to external shocks, particularly a steep depreciation. However, given that it appears to be largely the tradable sector that is borrowing from abroad, changes in the exchange rate should not undermine repayment capacity.

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. Country: External Debt Sustainability Framework, 2012-2022

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2012	2013	2014	2015	2016	10-Year Historical Average	10-Year Standard Deviation	2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
Baseline: External debt	125.2	151.2	171.7	186.2	222.8			**224.9**	**209.3**	**197.9**	**185.8**	**169.8**	**148.8**	**-19.3**
Change in external debt	32.7	26.0	20.5	14.4	36.6			2.1	-15.6	-11.4	-12.1	-16.1	-20.9	
Identified external debt-creating flows (4+8+9)	-22.7	5.8	14.0	9.9	55.4			-9.9	-12.0	-18.0	-13.7	-15.6	-17.8	
Current account deficit, excluding interest payments	25.5	21.6	5.2	-3.7	-3.0			-3.2	-3.6	1.6	-0.1	-1.6	-2.6	
Deficit in balance of goods and services	-108.6	-100.1	-108.7	-87.8	-101.4			-3.1	1.1	5.0	2.8	1.3	-0.9	
Exports	43.5	39.6	52.1	45.3	50.7			60.7	52.8	51.9	50.4	50.0	47.5	
Imports	-65.1	-60.5	-56.7	-42.5	-50.7			57.5	53.9	56.9	53.2	51.4	46.6	
Net non-debt creating capital inflows (negative)	-35.9	-16.7	-2.3	-0.9	37.7			-9.5	-11.8	-17.5	-14.2	-13.0	-9.2	
Automatic debt dynamics 1/	-12.3	0.9	11.1	14.6	20.7			2.8	3.4	-2.0	0.7	-1.0	-5.9	
Contribution from nominal interest rate	1.9	3.8	6.3	7.7	9.3			10.1	12.1	11.0	9.9	8.8	6.6	
Contribution from real GDP growth	-9.6	-14.2	-12.3	-4.3	-2.5			-7.3	-8.8	-13.0	-9.2	-9.9	-12.5	
Contribution from price and exchange rate changes 2/	-4.5	11.4	17.1	11.1	13.8			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	55.3	20.2	6.5	4.5	-18.8			12.0	-3.6	6.6	1.6	-0.5	-3.2	
External debt-to-exports ratio (in percent)	287.8	382.0	329.8	411.3	439.3			370.8	396.1	381.3	369.0	339.4	313.4	
Gross external financing need (in billions of US dollars) 4/	4.1	4.0	2.4	1.3	2.5			3.0	3.3	4.2	3.6	3.2	3.6	
in percent of GDP	33.2	32.0	19.3	11.5	22.5			26.7	27.4	32.2	26.3	21.1	21.5	
Scenario with key variables at their historical averages 5/								**224.9**	**208.8**	**197.7**	**183.2**	**169.0**	**154.8**	**-24.5**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	12.3	11.6	7.9	2.4	1.2	7.5	5.7	3.3	4.2	6.7	5.0	5.8	8.2	
GDP deflator in US dollars (change in percent)	5.1	-8.3	-10.2	-6.1	-6.9	4.4	16.0	-2.8	4.0	1.2	1.6	2.4	3.4	
Nominal external interest rate (in percent)	2.4	3.1	4.1	4.3	4.7	2.7	1.4	4.6	5.9	5.7	5.3	5.2	4.3	
Growth of exports (US dollar terms, in percent)	-1.7	-6.9	27.5	-16.4	5.6	13.6	27.4	20.1	-5.5	6.2	3.5	7.6	6.3	
Growth of imports (US dollar terms, in percent)	5.4	-4.8	-9.3	-27.8	12.4	17.3	39.6	14.0	1.6	14.0	-0.3	4.6	1.6	
Current account balance, excluding interest payments	-25.5	-21.6	-5.2	3.7	3.0	-9.4	11.7	3.2	3.6	-1.6	0.1	1.6	2.6	
Net non-debt creating capital inflows	35.9	16.7	2.3	0.9	-37.7	11.4	22.2	9.5	11.8	17.5	14.2	13.0	9.2	

1/ Derived as [r - g - r(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

November 30, 2017
Ulaanbaatar

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

Dear Ms. Lagarde,

This letter serves as an update to our Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) of April 13, 2017, as well as our supplementary LOI of May 17, 2017. The policy commitments laid out in those earlier documents remain valid, except as modified here.

Context

We are pleased to report that our Economic Recovery Plan, supported by the IMF-led package, is now showing positive results, and the Mongolian economy is rebounding. Boosted by better market conditions for coal exports in China and the impact of investment inflows, growth is expected to reach 3.3 percent this year and increase further after that, and foreign-exchange reserves have grown. Strong performance in the coal sector has spilled over into other areas of the economy as well, and fiscal revenues are substantially above the projected level. Against this backdrop, confidence is returning and market interest rates have fallen sharply.

We have secured substantial financing from donors to support our adjustment program. We renewed the RMB15 billion Swap Line with the People's Bank of China for another three years in July 2017. We have agreed with the Japanese government the terms and conditions on $850 million in budget support which will be disbursed in three annual tranches. The ADB has disbursed $200 million in loans for the financial and social sectors, as part of its multi-year $900 million commitment. The World Bank is expected to approve the first phase of its funding in the coming months, and the Korean government is working with the Government of Mongolia to identify projects that could be supported by Korean concessional financing.

Continued involvement of our private-sector creditors is another key part of the financing of our program. We have tapped the international capital markets a second time this year, at yields consistent with debt sustainability, to roll over sovereign bonds falling due in 2018. The coupon rates have progressively tightened at each new issuance, reaffirming the international investors' confidence in the Mongolian authorities' policies and support for the IMF program. Consistent with our commitments, we have maintained engagement with foreign private sector creditors and have not used foreign-exchange reserves to settle these debts. As for our domestic borrowings, we have engaged closely with banks to obtain their commitment to maintain their holdings of treasury bills, and yields have dropped sharply over the past few months, also reflecting increased confidence in the economy, reduced borrowing needs (in turn a reflection of our fiscal consolidation and foreign inflows), and the June 2017 policy rate cut by the Bank of Mongolia.

Program Performance

Although the economy has clearly strengthened, we recognize that the recovery is still fragile, and we remain committed to the macroeconomic adjustment and structural reforms laid out in the extended arrangement with the IMF. In this context, we note that all end-September 2017 quantitative performance criteria were met—by large margins in some cases—and targets going forward have been adjusted to reflect the economy's turnaround.

With respect to the structural agenda, all structural benchmarks due by end-June have been met: (i) the General Department of Taxation finalized compliance improvement strategies for different taxpayer categories, by end-April; (ii) the Bank of Mongolia amended its regulation on asset classification and provisioning in June; and (iii) in August, we constituted a working group to undertake a comprehensive study of the overall tax structure.

For structural benchmarks due for end-October and end-November, most reforms have been implemented, although there have been a few delays due to unforeseen developments including the change in government. More specifically, we have taken the following steps in line with IMF advice:

- On fiscal benchmarks, the 2018 budget has been passed in line with the program's fiscal path and we have revised the integrated budget law and other relevant laws to restrict Parliament's ability to increase expenditure envelope. However, we faced several delays in other areas due to the change in government and complexity of the issues. As a result, we were not able to submit the revised general taxation law or the simplified tax regime for micro and small businesses despite most of the technical work being done. We have re-committed to submitting this legislation in February (see below).

- On monetary issues, we have submitted to Parliament a new Bank of Mongolia law to clarify BoM's mandate, strengthen autonomy and governance and improve operations.

- In the financial sector, we have submitted the amendments to the banking law and we plan to submit the DICOM law shortly but we will not have passed the laws within the timeframe originally envisaged under the program due to the impact of political developments on the legislative calendar. We expect them to be passed in coming months.

The Cabinet decision on July 4 to universalize benefits under the Child Money Program was the sole area in which our policies deviated from program understandings. Given widespread dissatisfaction with the ambitious and rapid move to targeting of benefits we had undertaken, we decided to use our substantial revenue over-performance to suspend the targeting and provide benefits to all children, regardless of income level. That said, we recognize the importance of targeting our assistance to poor families, and we have passed a 2018 budget, targeting poorest 60 percent of children through Child Money Program, starting from January 2018 **(structural benchmark end-December 2017)**. In addition, we have allocated the resulting savings from this targeting to higher spending on food stamps and other programs for the most vulnerable, to ensure a strong pro-poor orientation to our expenditure. Maximizing the effectiveness of social benefit programs is a key government priority, particularly given that, between 2014 and 2016, the poverty level increased from 21 percent to close to 30 percent. The government sought to increase coverage of the Child Money Program to 80 percent. We will continue to review our social assistance programs with development partners including ADB and JICA, while maintaining full consensus on how best to increase the coverage and maximize the effectiveness of those programs.

Fiscal Policy

Fiscal consolidation remains at the heart of the recovery program. We have kept tight control on our expenditure and have implemented all the tax increases in the program, despite the still recovering economic environment and political constraints.[1] As noted above, revenues have over-performed substantially, and the 2017 revenue target is likely to be exceeded by more than 2 percent of GDP. In line with our supplementary budget passed in October, we have used less than half of this over-performance to fund priority items in the government's action plan, including repairs to schools, hospitals, and local administrative offices, and purchases of medical equipment and settle outstanding contingent liabilities. Within this spending envelope, we have also provided a one-off wage bonus to civil servants which amounts to 0.2 percent of GDP in aggregate. Most of these expenditures will be one-off in nature, and will thus have no adverse consequences for future years. By not spending the other half of revenue over-performance, we can have a lower deficit which allows us to limit costly short-term borrowing. We expect that the primary and overall deficit this year will fall to 3.4 and 7.6 percent of GDP, respectively, on the IMF's basis, well below the program targets and about a quarter the level of 2016.

In light of the expectation of ongoing strong growth, the 2018 budget aims for a primary deficit of 2.6 percent of GDP vs 3.1 percent of GDP at program approval. Most of the consolidation in 2018 is achieved via measures agreed at the time of program approval. Should revenues exceed projected levels, we are again committed to saving at least half of the over-performance in percent of GDP, allowing us to reduce further the fiscal deficit, new borrowing and the interest bill.

Looking further ahead to the medium term, the government also remains committed to the medium-term consolidation strategy in the program. The goal is to secure long-term debt sustainability by reaching a primary surplus of roughly 1½ percent of GDP by 2022, which would be in line with the Fiscal Stability Law. This can be achieved via a mixture of expenditure restraint and revenue mobilization. Combined with preserving the current economic recovery and ongoing improvements in the wage bill, we project that this consolidation path will enable our public debt to reach about 73 percent of GDP in the medium term.

[1] Two caveats: the reversal of the first petroleum excise cut was delayed by a few weeks, while the reversal of the second cut was delayed by almost two months as compared to the original timetable.

We will continue to make progress on our ambitious structural fiscal reform agenda that is crucial to breaking the boom-bust cycle. We have established a tax working group and will submit its interim report to the Ministry of Finance shortly **(structural benchmark end-December 2017).** We are committed to improving the budgetary process and making sure that the fiscal position complies with our fiscal rules. We are working on establishing a Fiscal Council that will oversee the budget **(structural benchmark end-December 2017)**. To enhance revenue mobilization, we are improving the operations of the GDT with the support of IMF assistance. Looking further into 2018, on fiscal issues, we are committing to three new structural benchmarks and one benchmark that reflects reforms that were previously due at end-October and have been re-phased to end-February:

- Start the implementation of the 2018 compliance improvement strategies for large, medium, small, and micro businesses based on a review of the results of the 2017 compliance strategies and taking into account IMF recommendations **(structural benchmark end-January 2018).**

- We will submit to parliament both i) 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 and ii) legislation that creates a simplified tax regime for micro and small businesses within the scope of IMF technical assistance recommendations **(structural benchmark end-February 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 **(structural benchmark end-June 2018).**

- Cabinet to approve a Guideline on appraisal and selection of public investment projects, including specific methodology and evaluation criteria **(structural benchmark, end-September 2018).**

Monetary and Exchange Rate Policies

After raising the policy rate by 450 basis points in 2016 to stem major depreciation pressures, the balance of payments has improved considerably. This has allowed us to partially unwind the previous rate increase, most recently with a 200-basis point cut in June. However, inflation has risen this year from less than 1 percent at end-2016 to over 6 percent in September, reflecting revisions to the CPI basket, one-off fiscal measures, the lagged impact of the large 2016 depreciation, supply shocks, and the ongoing economic recovery. In this context, we remained on hold in September in order to allow more time to monitor the impact of the last cut. Inflation is expected to be around 8 percent at end-2017 and remain broadly unchanged in 2018, in line with the target in the Bank of

Mongolia's (BOM) monetary policy guideline. It will be important to confirm that inflation and exchange rate pressures remain contained so further easing will be a function of data developments.

Liquidity management will be a key issue, particularly given the large donor inflows expected under the program. We have increased our issuance of central bank bills and stand ready to take additional steps to ensure that excess liquidity is minimized. We are considering also incorporating macroprudential tools. Finally, we intend to explore steps to contain foreign currency balance sheet risks.

Given improved confidence and renewed capital inflows, the togrog may come under appreciation pressure. To build reserves and avoid undue real exchange rate appreciation that would hinder competitiveness and diversification strategies, we stand ready to intervene and thus offset the impact of a stronger balance of payments on the exchange rate. We are committed to building reserves at a faster pace than envisaged under the program targets if there is additional appreciation pressure and market conditions remain favorable. We will continue to allow the exchange rate to move flexibly, with FX sales limited to smoothing excessive volatility and preventing disorderly market conditions.

The mortgage program is now being operated by BOM solely as an agent of government, the financing of new mortgages from interest on existing assets is reflected transparently in the budget, and a World-Bank-funded expert is advising us on a time-bound plan for the BOM to fully exit the program. We will agree with the Fund no later than end-September 2018 on a plan to make this transfer. We have signed a revised Memorandum of Understanding between the BOM and Ministry of Finance on the mortgage program, as per the recommendations of the 2017 Safeguards Assessment mission. We are also following up on the other recommendations of the safeguards team.

Financial Sector Policy

We are making good progress in rehabilitating and strengthening the financial system and are undertaking several interconnected actions with the support of donors. A key step is undertaking the Asset Quality Review (AQR) of all Mongolian banks. After a competitive tender process, we have selected an international firm to conduct the AQR. The methodology is based on the ECB's AQR manual, with adjustments for Mongolian conditions. The results will be delivered by mid-December 2017 **(structural benchmark end-December 2017)**—later than originally intended, given the selected firm's recommendation that banks be given more time to adequately revalue a larger number of collaterals than anticipated. This in turn requires that other benchmarks related to the AQR process be put back accordingly.

We will independently determine the size of any capital buffer banks might need to ensure continuous compliance with prudential requirements through 2019. We will make this determination by means of, inter alia, a stress test exercise based on baseline and adverse scenarios. We will discuss the assumptions in the adverse scenario with IMF staff; the plan is to simulate a partial reversal of the recent signs of economic recovery. Based on the AQR and stress-test results, banks will, by mid-March 2018, prepare and submit plans demonstrating their financial strength and continuous compliance with prudential requirements through the end of 2019. By end-May 2018, we will review banks' plans, reconcile them with our results to ensure that their regulatory capital reaches and remains at a level that is both prudent and reasonable, and communicate to banks our assessment of their capital positions – either excesses or additional needs. We have defined a strategy for the communication of the AQR results. BOM will coordinate the communication strategy for the post-AQR phase with the other members of the Financial Stability Council.

Bank shareholders are responsible for ensuring that their banks are fully recapitalized, profitable, and well managed. If a capital shortfall exists, including prospectively, shareholders will be required to fully capitalize institutions by end-November 2018, either by themselves or by bringing in new fit-and-proper shareholders, including possibly foreign investors as minority or majority shareholders **(structural benchmark end-November 2018)**. We will ensure that adequate backup funds are available and that financial stability can be maintained through the bank recapitalization and restructuring process.

We discussed with IMF staff and reached common understanding on the general principles for setting up a recapitalization framework for systemically important and viable banks that do not manage to raise needed additional capital fully from private sources. Such principles include the scope of the banks eligible for support, the governance of the process, the burden sharing principles, the restructuring and increased supervision of the supported banks, and the need for privatization in due time (see Annex.) Based on these principles, a draft recapitalization law has been drafted with the technical assistance of the Fund. The law describes the process and sets out detailed conditions for using public funds to potentially recapitalize banks. The law also regulates the management of public equity holdings in banks such that it is temporary, at arm's length, and without political interference. The draft law on recapitalization will be submitted by the Ministry of Finance to Parliament and enacted no later than end-January 2018 **(structural benchmark end-January 2018).** The BoM and other members of the FSC will start now preparing an action plan for dealing with non-viable and non-systemic banks to be completed no-later than January-2018.

An operational plan to set up a specialized entity to manage potential government-participation in banks will be prepared by March 2018.The entity will start operating by end November 2018 if the public participation in the banks proves to be substantial as defined in due time in consultation with IMF staff. An exit strategy for divesting existing and potential public participation in banks, following the recapitalization process, will be prepared by end February 2019.

The financial safety net is being strengthened. Draft amendments to the Central Bank and Banking Laws have been finalized and submitted to Parliament for discussion. Parliament is expected to approve these laws shortly, and they will enter into force immediately thereafter. Once the banking law is approved, we will elaborate the regulations to be adopted by the BoM according to the law. In order to limit the risks in banks, the BOM will carry out a review of related party exposures based on the new banking law and related regulation by end-December 2018 **(structural benchmark end December 2018).**

We are also strengthening the regulatory and supervisory regime. After being upgraded in June 2017 to reflect best international standards, especially regarding NPL classification and forbearance, the regulation on asset classification and provisioning will be further improved by end-September 2018, based on the AQR findings and advice provided by external experts **(structural benchmark end September 2018)**.

With the help of the Fund, the MOF will finalize by the end of March 2018 draft amendments to the Law related to the Licensing of Appraisers, which will be adopted by no later than end-September 2018. The Bank of Mongolia will develop a new regulation for banks on Appraisal and Valuation, which will be completed no later than March 2018 and adopted by the following September.

At the recent meeting of the Asia Pacific Group (APG), Mongolia was given until October 2018 to strengthen its AML/CFT framework, and building on our recent progress we are redoubling our efforts in this area; we will amend our AML/CFT framework by end-June 2018.

Following an assessment and assistance provided by the World Bank and the Fund, draft amendments to the law on the deposit insurance have been finalized. The amendments aim to bring the law into compliance with international principles and ensure that DICOM can flexibly contribute to funding of potential bank resolutions. The draft law was originally supposed to be approved by end-November but has been re-phased with a new deadline (**structural benchmark end-February 2018)**. A solution will be found to ensure adequate back-up funding for DICOM that does not incur excessive fiscal costs. **(structural benchmark end-February 2018).**

A multi-agency working group (WG) has been set up with the task of developing an NPL resolution strategy to improve banks' operating environment of banks and banks practices. The WG includes members from the BOM, Ministry of Finance, Ministry of Justice, and the secretariat of the Financial Stability Council (FSC). With the technical assistance of the IMF and other IFIs, the WG has been analyzing impediments to NPL resolution and examining the credit underwriting and NPL management practices of banks, drawing also from AQR findings. Based on the analytical work, the draft NPL resolution strategy will be discussed with IMF staff by end-December and finalized and published by the FSC by end-March 2018 **(structural benchmark end March 2018)**. Given the wide-ranging issues, complexity, and need for cooperation between many state institutions, we have appointed a project manager to support the successful design and implementation of this strategy. We commit to implement agreed reforms contained in the NPL strategy by the end of 2019 using a timeline developed together with the Fund. As part of this work, the BOM will issue a regulation by end-February 2018 to require banks to develop their own NPL strategies, operational policies, report NPLs in more detail, and set targets on NPL resolution. We will also define a comprehensive strategy for the credit information framework in Mongolia. This strategy would include improvements to the Bank of Mongolia central credit registry and the establishment of a credit bureau industry that follows international best practices.

We see an asset management company (AMC) as one possible mechanism to assist in NPL resolution if it is designed in line with best international practices regarding governance and valuation. The AQR process will reveal a great deal of information about the size, type, and distribution of NPLs, and the WG on NPL strategy will analyze the legal environment and impediments. We will wait for these results and prepare a thorough feasibility and cost benefit assessment before taking a final decision on whether or not to establish an AMC. We will coordinate closely with staff of the IMF and other partners and consult and reach understandings with all of them before taking any legislative action related to NPL resolution (including the establishment of an AMC).

Many of our reforms in the financial sector, as well as other areas, will be supported by substantial technical assistance from the IMF and other donors. We have appointed a coordinator to manage these efforts, avoid duplications, and ensure that all the different work streams are well aligned to achieve our overall objectives.

Conclusion

Beyond these changes, our policy agenda remains as described in the April 2017 LOI and MEFP and the May 2017 supplementary LOI. We have revised the Technical Memorandum of Understanding, attached to this letter, to clarify how some program targets are to be measured. Table 1 sets out the program's quantitative targets through end-September 2018, while Table 2 sets out the target dates for structural benchmarks. The third and fourth reviews under this arrangement are expected to be completed on or after March 15, 2018, and June 15, 2018, respectively.

We believe that the policies set forth in this and previous Letter of Intent are adequate to achieve the objectives of our economic program, but the Government stands ready to take additional measures as appropriate to ensure achievement of its objectives. We will continue to consult in advance with Fund staff on adoptions of measures or revisions of the policies contained in the MEFP and in this letter, in accordance with the Fund's policies on such consultations. We will provide the Fund with the information it requests for monitoring program implementation.

Against the background of our performance to date and our strong commitment going forward, we request completion of the first and second reviews of the extended arrangement under the Extended Fund Facility, following which we intend to draw two tranches amounting to SDR 27.9560 million each (SDR 55.912 million total).

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

ANNEX. PUBLIC RECAPITALIZATION FRAMEWORK

It will be critical to introduce a legal framework with strict principles guiding the possible use of public funds to recapitalize banks. Such a framework could reflect the following international best practices:

- **Financial stability considerations.** Should private capital prove insufficient, systemic and viable banks would be eligible to receive capital from public sources in order to protect financial stability. Other banks would undergo resolution or be liquidated in line with financial stability considerations and with a view to minimize the need for public funds.
- **Governance of the public recapitalization process.** The Financial Stability Council coordinates the recapitalization and restructuring process with clarified roles, decision making powers and competence, and cooperation and exchange of information between various authorities. A strategy is defined to ensure timely and consistent information to markets and the public on the AQR and the recapitalization process. A dedicated, specialized entity may be set up to manage the state's interest in banks, depending on the final ownership structure of the state. The government remains at arm's length from the banks, with no influence on day-to-day business conduct.
- **Burden sharing.** Losses are identified in the independent AQR and the equity of the banks reduced accordingly, prior to any injection of public funds, so that existing shareholders (and other holders of capital instruments) bear the first loss. Losses will be allocated further up on the creditor hierarchy to funds provided to the bank by related parties, and possibly, by other creditors (including junior and senior debt holders) with due consideration for financial stability.
- **Restructuring**. Solvency support from public sources needs to be paired with the preparation of a comprehensive restructuring plan of the bank. The restructuring plan with key performance indicators should be agreed with relevant authorities. This seeks to address structural weaknesses and ensure viability of the bank's business model. The plan should provide for full repayment of the liquidity and solvency support and help the sale of the bank within a reasonable timeframe. For example, payment of dividends and interest on subordinated debt that qualifies as capital should be suspended until the support has been repaid, financial solidity restored, and operational efficiency of the bank improved. In addition, and as in liquidation cases, the BOM and relevant authorities will take appropriate actions against managers and board members.
- **Strict oversight**. Recipients of public support must be subject to strict supervision and enhanced reporting to prevent excessive risk-taking, foster robust governance and safe and sound practices, and ensure consistent implementation of the restructuring plan. Relevant authorities should have and use the power to monitor and approve/veto certain large transactions, and all transactions involving related parties.
- **Exit scenarios**. Incentives should be introduced for the timely recovery of the solvency and liquidity support. The government should develop a privatization strategy in which the exit should allow for recovery of the capital injection and other financial support within a reasonable period of time.

Table 1. Mongolia: Quantitative Performance Criteria and Indicative Targets

	Actual 12/31/2016	Actual 6/30/2017	Target 9/30/2017	Actual 9/30/2017	Target 12/31/2017	Revised Target 12/31/2017	Target 3/31/2018	Revised Target 3/31/2018	Target 6/30/2018	Indicative target 9/30/2018
Performance Criteria 1/ 2/ 3/ 4/										
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)		636	100	809	250	950	550	1,200	1,100	1,300
Net domestic assets (NDA) of the BOM (ceiling, eop stock, in billion togrog at program exchange rate)	4,774	4,540	4,900	4,146	4,600	4,400	4,000	3,850	3,900	3,700
Primary balance of the general government (floor, cumulative since the beginning of the fiscal year, in billion togrog)	-3,127	314	-1,050	585	-1,500	-950	-350	-425	-650	-850
New nonconcessional external debt maturing in one year or more, contracted and/or guaranteed by the government or the BOM (ceiling, eop stock, in million US$).		600	1,800	600	1,800	NA	1,800	NA	NA	NA
Net nonconcessional external debt maturing in one year or more, contracted and/or guaranteed by the government or the BOM (ceiling, cumulative flow from November 15, 2017, in million US$). /5		NA	NA	NA	NA	20	NA	NA	20	NA
Stock of guarantees on external debt extended by the government or BOM (ceiling, eop stock, in million US$)	1,385	757	850	688	750	750	750	750	750	750
Indicative Targets (IT)										
Reserve money (ceiling, in billion togrog)	3,067	3,234	3,900	3,280	4,000	3,650	4,200	3,600	3,800	4,000
Continuous Performance Criteria										
New nonconcessional external debt maturing in less than one year, contracted and/or guaranteed by the government or the BOM (ceiling, eop stock, in million US$).	0	0	0	0	0	0	0	0	0	0
Accumulation of new external payment arrears (ceiling, eop, in million US$).	0	0	0	0	0	0	0	0	0	0
Memorandum items										
Budget support from bilateral and multilateral donors excluding Fund under the program baseline (eop stock, cumulative, in million US$)		0	427	100	597	320	783	682	717	849
Net nonconcessional borrowing received and repatriated by the general government (including the DBM) under the program baseline (eop stock, cumulative, in million US$)		20	20	20	20	295	20	295	150	150
Program exchange rate (togrog/U.S. dollar)	2489.4	2489.4	2489.4	2489.4	2489.4	2489.4	2489.4	2489.4	2489.4	2489.4
U.S. dollar per SDR	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Monetary gold price (U.S. dollar/ounce)	1,142	1142.0	1,142	1,142	1142.0	1,142	1142.0	1,142	1,142	1142.0

1/ Evaluated at program exchange rates.
2/ Cumulative targets are all defined relative to 12/31/2016 except for the primary balance figures.
3/ Revised targets from December 2017 have been updated to reflect the revised treatment of government forex deposits in the TMU.
4/ Additional new nonconssessional 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 Staff report and TMU.

Table 2. Mongolia: Structural Benchmarks			
Structural Benchmark	**Target Completion Date**	**Status**	**Proposed Revised Date**
Fiscal			
Finalization and commencement of implementation by the General Department of Taxation (GDT) and tax offices of compliance improvement strategies for large, medium, small, and micro businesses that will include baseline performance measures and an automated monitoring and evaluation framework.	end-April 2017	Met	
Establishment of a working group to review the tax structure and make recommendations to improve efficiency and equity including review of the investment, VAT, personal income tax, and economic entity tax laws with a view to enhance revenue, reduce complexity, and introduce progressivity in personal income tax, in consultation with IMF staff.	end-August 2017	Met	
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-October 2017	Not Met	end-February 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-October 2017	Not Met	end-February 2018
Passage of a 2018 budget in line with the program's fiscal path.	end-November 2017	Met	
Revision of the Integrated Budget Law and other relevant laws to restrict, effective 2018 onward, Parliament from increasing the aggregate expenditure envelope reflected in the budget presented by the Minister of Finance (including through a PAYGO provision).	end-November 2017	Met	
Revision of the relevant budget laws and/or introduction of a new law to establish a fiscal council, in line with international best practice and in consultation with Fund staff.	end-December 2017		
Submission of the tax working group's report to the Ministry of Finance.	end-December 2017		
Start the implementation of the 2018 compliance improvement strategies for large, medium, small, and micro businesses based on a review of the results of the 2017 compliance strategies and taking into account IMF recommendations.		New structural benchmark	end-January 2018

Table 2. Mongolia: Structural Benchmarks (Continued)			
Structural Benchmark	**Target Completion Date**	**Status**	**Proposed Revised Date**
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		New structural benchmark	end-June 2018
Cabinet to approve a Guideline on appraisal and selection of public investment projects, including specific methodology and evaluation criteria.		New structural benchmark	end-September 2018
Social Protection			
In the 2018 budget, the Child Money Program will be targeted to the poorest 60 percent of children and the savings redirected gradually toward the better-targeted Food Stamps program.	end-December 2017		
Monetary			
Submission to Parliament of a new Bank of Mongolia Law, to clarify the BOM's mandate, strengthen autonomy and governance, and improve operations, in consultation with IMF staff.	end-November 2017	Met	
Adoption of the new Bank of Mongolia Law.	end-March 2018		
Banking			
BOM to adopt an amendment to its regulation on asset classification and provisioning in consultation with IMF staff.	end-June 2017	Met	
Amendment of DICOM law to bring it in line with IADI Core Principles for Effective Deposit Insurance Systems.	end-November 2017	Not Met	end-February 2018
Approval of Amendment of the Banking Law to • improve the early intervention framework • bring the bank resolution legislation, funding and cooperation framework up to best international standards in cooperation with MoF, DICOM • ensure that BOM has adequate powers to request from banks additional capital and provisioning to enhance financial strength or to absorb existing and estimated future credit losses, including based on the diagnostic studies and the analysis of the business plans. • introduce power for BOM to apply levies on banks to cover the cost of supervision incl. AQRs • strengthen shareholders', board members', and senior management's fit and proper requirements • upgrade rules on banks' related party exposure and final beneficial owners.	end-November 2017	Not Met – Expected by end-December	

Table 2. Mongolia: Structural Benchmarks (Concluded)

Structural Benchmark	Target Completion Date	Status	Proposed Revised Date
Setting up of a backup funding to DICOM.		New structural benchmark	End-Feb 2018
Completion of the Asset Quality Review of all Mongolian banks		New structural benchmark	end-December 2017
Enact a law or an amendment of existing laws on the use of public funds.	end-December 2017		End-January 2018
Financial Stability Council (FSC) finalization and publication of an NPL resolution strategy.	end-January 2018		end-March 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.		New structural benchmark	end-September 2018
Completion of the recapitalization process for viable banks and of resolution for nonviable ones.		New structural benchmark	end-November 2018
BOM to carry out a review of related party exposures based on improved legislation.	end-September 2018		end-December 2018

Attachment I. Technical Memorandum of Understanding

This Technical Memorandum of Understanding (TMU) sets out the understandings between the Mongolian authorities and IMF staff regarding the definition of quantitative performance criteria (QPC) for the extended arrangement under the Extended Fund Facility (EFF). It sets out the QPC adjusters and data reporting requirements for the duration of the extended arrangement, as described in the authorities' Letter of Intent (LOI) dated April 13, 2017, and the attached Memorandum of Economic and Financial Policies (MEFP). The TMU also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets.

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS: DEFINITION OF VARIABLES

Test Dates

1. Performance criteria for end-June 2017, end-September 2017, end-December 2017, end-March 2018, end-June 2018 and end-September 2018 have been established with respect to:

- Floors on the change in level of net international reserves of the Bank of Mongolia (BOM);
- Ceilings on the level of net domestic assets of the BOM;
- Floors on the level of primary balance of the general government;
- Ceilings on the contracting and/or guaranteeing by the general government or the BOM of
- new nonconcessional external debt maturing in one year or more; and

2. Performance criteria that are applicable on a continuous basis have been established with respect to:

- Ceilings on the contracting and/or guaranteeing by the general government or the BOM of new nonconcessional external debt maturing in less than one year,
- Ceilings on the accumulation of new external payment arrears;

3. Indicative targets have been established for, end-June 2017, end-September 2017, end-December 2017, end-March 2018, end-June 2018 and end-September 2018, with respect to:

- Ceilings on the level of reserve money.

Definitions

4. For the purposes of the program the following definitions will be used:

- The general government (GG) includes all units of budgetary central government, social security funds, extra-budgetary funds (including but not limited to the Stabilization Fund and the Future Development Heritage Fund), and local governments, and the Development Bank of Mongolia (DBM). Debts of other legally autonomous state-owned enterprises (SOEs) and BOM liabilities including the swap line with the People's Bank of China (PBOC) are excluded.

- The domestic banking system is defined as the BOM and licensed commercial banks incorporated in Mongolia.
- The fiscal year is the calendar year, starting on January 1 and ending on December 31.
- For program purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "program accounting exchange rates" as defined below, with the exception of items affecting government fiscal balances, which will be measured at current exchange rates. Unless otherwise indicated, U.S. dollar denominated components of the balance sheet of the Bank of Mongolia (BOM) will be valued at the reference exchange rate of the Mongolian togrog to the U.S. dollar of 2489.4 announced by the BOM as of December 31, 2016. Amounts denominated Chinese Renminbi (RMB), SDR and gold will be converted for program purposes into U.S. dollar amounts using the following cross-rates as of December 31, 2016: Chinese Renminbi (RMB) valued at 0.14389 U.S. dollars, Special Drawing Right (SDR) valued at 1.344330 U.S. dollars, and official gold holdings at 1142.54 U.S. dollars per troy ounce.
- For program purposes nonconcessional external borrowing excludes (i) the use of IMF resources; (ii) lending from the Asian Development Bank, European Bank for Reconstruction and Development, Asian Infrastructure Investment Bank, and the World Bank Group, and; (iii) lending from governments and government agencies such as the Japan International Cooperation Agency, the Export-Import Banks of India, Korea, and Turkey, and the Development Bank of Germany; (iv) concessional debts; (v) any togrog-denominated treasury bill and government bond holdings by nonresidents.
- For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. [1]
- For debts carrying a variable interest rate in the form of a benchmark interest rate plus a fixed spread, the PV of the debt would be calculated using a program reference rate plus the fixed spread (in basis points) specified in the debt contract. The program reference rate for the six-month USD LIBOR is 3.18 percent and will remain fixed for the duration of the program. The spread of six-month Euro LIBOR over six-month USD LIBOR is -308 basis points. The spread of six-month JPY LIBOR over six-month USD LIBOR is -306 basis points.

5. The spread of six-month GBP LIBOR over six-month USD LIBOR is -231 basis points. For interest rates on currencies other than Euro, JPY, and GDP, the spread over six-month USD LIBOR is 0 basis points. [2]

[1] For debts with a grant element equal or below zero, the PV will be set equal to the nominal value of the debt. The discount rate used for this purpose is the unified discount rate of 5 percent set forth in Executive Board Decision No. 15248-(13/97).

[2] Where the variable rate is linked to a benchmark interest rate other than the six-month USD LIBOR, a spread reflecting the difference between the benchmark rate and the six-month USD LIBOR (rounded to the nearest 50 bps) will be added.

A. Net International Reserves of the BOM

6. A floor applies to the change in level of net international reserves (NIR) of the BOM. The floor on the change in NIR will be adjusted upward (downward) by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in excess (short) of the programmed level as shown in Quantitative Performance Criteria table. The floor on the change in NIR will also be adjusted upward (downward) by the amount of net nonconcessional borrowing (excluding project financing) received and repatriated by the general government in excess (short) of the programmed level during the program period as shown in Quantitative Performance Criteria table.

7. NIR will be calculated as gross international reserves less international reserve liabilities. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the BOM shall be valued at program exchange rates and gold price as described in paragraph 5 above. Gross international reserves of the BOM are defined as the sum of:

- Monetary gold holdings of the BOM;
- Holdings of SDRs;
- Mongolia's reserve position in the IMF; and
- Foreign currency assets held abroad (plus such cash held in BOM's vault) that are under the direct and effective control of the BOM and readily available for intervention in the foreign exchange market, or the direct financing of balance of payments imbalances.

8. Excluded from the definition of gross reserves are any foreign currency claims on residents including MNT swaps with local banks, capital subscriptions in international institutions other than in the IMF, and gross reserves that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities. International reserve liabilities of the BOM are defined as the sum of:

- All outstanding liabilities of Mongolia to the IMF;
- Any foreign currency liabilities of the BOM to nonresidents with an original maturity of up to and including one year including any gold deposits by foreign banks;
- The liabilities to the People's Bank of China under the swap line; and
- Any foreign currency liabilities of any maturity of the BOM to residents including current accounts and deposits of the commercial banks. Government foreign currency deposits at the BOM will be treated as an international reserve liability; however, IMF liabilities already included under the first bullet above shall not be included again. Foreign currency owed to commercial banks with any maturity as part of the swap program will be treated as a reserve liability.

B. Reserve Money

9. An indicative ceiling applies to the level of reserve money. This consists of currency issued by the BOM (excluding BOM holdings of currency) and commercial banks' deposits held with the BOM (excluding foreign currency time deposits).

C. Net Domestic Assets of the BOM

10. A ceiling applies to the level of net domestic assets (NDA) of the BOM. The ceiling on NDA will be adjusted downward by the amount of external borrowing (both budget support from bilateral and multilateral donors and net nonconcessional borrowing excluding project financing except for debt management purposes) received by the general government in excess of the programmed level. The ceiling on NDA will be adjusted upward by 50 percent of the amount of external borrowing (both budget support from bilateral and multilateral donors and net nonconcessional borrowing excluding project financing except for debt management purposes) received by the general government in short of the programmed level.

- NDA will be calculated as the difference between reserve money and the sum of NIR and other net foreign assets (ONFA) of the BOM. For calculating the NDA, NIR will be adjusted for the swap program with commercial banks, foreign exchange demand deposits of commercial banks that are already part of the reserve money, and government foreign currency current accounts.
- ONFA is defined as other net foreign assets of the BOM, including the difference between accrued interest receivables on gross international reserves of the BOM and accrued interest payables on international reserve liabilities of the BOM and deposits of international financial institutions.

D. Primary Balance of the General Government

11. A floor applies to the primary balance of the general government excluding DBM plus net lending and net interest payments of DBM. This is measured on a cumulative basis over the course of the year. This definition includes three components:

- Overall balance of general government excluding DBM: This will be defined below the line as:
    - o net bank credit to the general government—this includes net borrowing from BOM (ways and means advances, loans, holdings of treasury bills and government bonds, minus deposits) and commercial banks (loans, advances, and holdings of treasury bills and government bonds, minus deposits).
    - o net nonbank financing—this would include tax prepayments and holdings of government by pension and insurance funds, as well as any changes to the net assets (negative financing flows) of Fiscal Stability Fund, Social Security Funds, and Future Heritage Fund.

  - o net external financing—this would include program loans, project loans, nonconcessional borrowing or long term external debts such as sovereign bonds or commercial loans.

  - o Privatization receipts

- Gross Interest payments of the general government on domestic and external debt excluding DBM. This will be measured above the line.

- DBM's net lending (loan disbursements less repayments) and net interest payments (DBM's interest payments less interest receipts excluding interest payments and receipts to other general government). This will be measured above the line.

E. Non Concessional Medium- and Long-Term External Debt

12. Prior to the completion of the second review, there was a ceiling on the issuance of gross debt. The ceiling applied to the contracting and/or guaranteeing by the general government or the BOM or other agencies on behalf of the general government of new debt with nonresidents with original maturities one year or more. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received.

13. Starting from the completion of the second review, there will be a ceiling on net debt issuance rather than gross debt issuance. Such a ceiling allows the authorities to conduct debt liability management. However, when conducting such operations, and for the purpose of netting, there should be no more than 6 months between the contracting of new debt and the retirement of existing debt. The ceiling applies to contracting and/or guaranteeing by the general government or the BOM or other agencies on behalf of the general government of debt with nonresidents with original maturities one year or more. The ceiling will apply end-June and end-December of every year, starting from end-December 2017. The two GOM bonds maturing in January 2018 and June 2018 will be excluded from the netting since they are already in the process of being refinanced through the issuance of the US$800 million Eurobond in October 2017. The definition of debt, for the purposes of the program, is set out in Executive Board Decision No. 15688, Point 8, adopted December 5, 2014 (see Annex 1).

14. For program purposes, the guarantee of a debt arises from any explicit legal obligation of the general government, the BOM, or other agencies on behalf of the general government to service a loan in the event of nonpayment by the recipient (involving payments in cash or in kind). The stock of guarantees on external debt stood at $1,385 million at the end of 2016.

F. Stock of Guarantees on External Debt

15. For program purposes, the guarantee of a debt arises from any explicit legal obligation of the general government, the BOM, or other agencies on behalf of the general government to service a loan in the event of nonpayment by the recipient (involving payments in cash or in kind), or indirectly through any other obligation of the general government, the BOM, or other agencies on

behalf of the general government to finance a shortfall incurred by the loan recipient. The stock of debt stood at $1,385 million at the end of 2016.

G. Short-Term External Debt

16. A ceiling applies to the contracting and guaranteeing by the general government, the BOM, or other agencies on behalf of the general government of new debt with nonresidents with original maturities of less than one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This is a continuous performance criterion. For program purposes, the definition of debt is set out in Executive Board Decision No. 15688, Point 8, adopted December 5, 2014 (see Annex I).

17. Excluded from the ceiling are (i) debts classified as international reserve liabilities of the BOM; (ii) debts to restructure, refinance, or prepay existing debts; (iii) togrog-denominated treasury bills, government bonds, and BOM bills held by nonresidents; and (iv) normal import financing. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

II. DATA PROVISION

18. Data required to monitor performance under the program, including those related to performance criteria and indicative target(s) will be provided electronically or in hard copy to the Fund's Resident Representative by the 20th day of each month, unless otherwise indicated. The data to be reported are listed below, and the reporting responsibilities are indicated in parentheses.

A. Monetary Data (BOM)

- The monetary survey, the balance sheet of the BOM, and the consolidated balance sheet of the commercial banks. Data will be provided on a monthly basis, with the exception of the balance sheet of the BOM, which will be provided on a weekly basis within five working days of the end of the respective week.

- Net international reserves and auctions of the BOM in the foreign exchange market on daily basis and full reporting of all interventions on a weekly basis.

- Interest rates and volume on standing facilities and market operations on a weekly basis within five working days of the end of the respective week.

- A detailed breakdown of net credit to government from the BOM (on a weekly basis) and the commercial banks. The latter will be reconciled with the MOF and sent monthly.

- Stock of monetary gold in both thousands of troy ounces and U.S. dollars on a weekly basis. If the BOM engages in monetary gold transactions or employs any other accounting rate, directly or implicitly, for valuing gold assets, this information will be reported to the Fund. Any increase in monetary gold through purchases from domestic sources and refining of nonmonetary gold held or purchased by the BOM will also be reported (both prices and volumes) on a monthly basis. Any liabilities that are guaranteed or otherwise backed by gold will be reported to the Fund.

- A detailed breakdown of "other items net" for both the BOM and the commercial banks, including, inter alia, all valuation changes in net international reserves and net other foreign assets arising from exchange rate changes and/or revaluation of gold on a monthly basis for BOM and the banks.
- A bank-by-bank list of required reserves and actual reserves on a biweekly basis.
- Results of each central bank bills auction within five working days of each auction, including amount of bills offered, amount demanded, amount sold to each bank, announced rates, and cut-off rates.
- Data on the stock of BOM swaps with resident and non-resident commercial banks on a quarterly basis;
- Data on the stock of BOM guarantees issued on behalf of the government or any other third party on a quarterly basis;
- Data on BOM's foreign convertible currency liabilities reflecting long- and short- term maturities of debt on a quarterly basis.

B. Fiscal Data (Ministry of Finance (MOF))

- Monthly consolidated accounts of the central, local, and general government, including detailed data on tax, nontax, and capital revenues, current and capital expenditures, net lending, and financing. Financing components should be separated into foreign sources (cash, project, and program loans) and domestic sources (bank and nonbank).
- Classified transactions of all social insurance funds.
- Results of each treasury bills auction within five working days of each auction, including amount of bills offered, amount demanded, amount sold to each bank and nonbanks, and the average yield in percent per month.
- Monthly accounts of the DBM detailing new lending and repayment as well as the stock of outstanding loans on a cash basis.
- Outstanding balances of all deposit accounts of the general government in commercial banks, including those of the extrabudgetary funds on a quarterly basis.
- Outstanding balances of any new deposit accounts of the general government opened in addition to the existing ones for grants and loans received from multilateral or bilateral donors, including associated counterpart funds.

- Monthly report on the stock of outstanding debt of the general government including DBM, including domestic and external debt, promissory notes, tax pre-payments and guaranteed debt netting out any cross holdings between DBM and the GoM.

C. External Sector Data (BOM and MOF)

- Complete list of new contracts above $10 million for the execution of public investment projects, which have been signed or are under negotiation with foreign or domestic entities, including details on the amounts, terms, and conditions of current or future debt or nondebt obligations arising from these contracts on a quarterly basis by MOF.

- Outstanding stock, disbursements, amortization, and interest payments of short-term external debt contracted and/or guaranteed by the government or the BOM by creditor in original currency and U.S. dollars on a quarterly basis by BOM.

- Outstanding, disbursements, amortization, and interest payments of medium- and long-term external debt contracted and/or guaranteed by the government or the BOM by creditor in original currency and U.S. dollars on a quarterly basis by BOM.

- Daily midpoint exchange rates of the togrog against the U.S. dollar, including the reference, interbank, and parallel market exchange rates (BOM).

- Arrears on the external debt contracted and/or guaranteed by the government or the BOM by creditor in original currency and U.S. dollars on a quarterly basis by BOM.

D. Other Data (National Statistical Office (NSO))

- The monthly consumer price index and a detailed breakdown by major categories of goods and services included in the consumer basket.

- The NSO's monthly statistical bulletin, including monthly export and import data.

ANNEX 1. GUIDELINES ON PERFORMANCE CRITERIA WITH RESPECT TO FOREIGN DEBT

Excerpt from Executive Board Decision No. *15688-(14/107), adopted December 5, 2014*

8.

(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

Statement by the IMF Staff Representative on Mongolia
December 15, 2017

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. Third quarter real GDP growth was 6.7 percent year-on-year, up from 6 percent in Q2 and slightly higher than estimated at the time of the mission. The strong result was driven by a turn-around in net exports on the expenditure side and a recovery in mining on the production side. Real GDP growth for the entire year 2017 may thus be slightly higher than projected in the staff report, although a significant slowdown is still projected in the fourth quarter, mainly due to developments in the coal sector. Coal exports in October (the latest month for which there is data) were 16 percent below the average level for the fourth quarter of 2016, and per the Ministry of Road and Transportation Development, the number of coal truck crossings to China averaged 650 per day in October and November, about half the number recorded earlier in the year.

2. In November, the authorities submitted and parliament passed a 2018 budget in line with program targets. On December 5, the President vetoed the expenditure part of this budget. Despite the ongoing consolidation, he argued that the budget was too loose and thus crowded out private sector borrowing. However, parliament overturned the President's veto on December 7, allowing the original version to proceed.

3. After several months of delay, donor funding resumed in November. The Asian Development Bank disbursed a $100 million loan after the authorities completed the final condition related to the targeting of the Child Money Program, and the World Bank proceeded with its $120 million Development Policy Credit. In early December, the Japan International Cooperation Agency (JICA) signed its loan agreement with the authorities for $280 million which is expected to be disbursed toward year's end.

Statement by Heenam Choi, Executive Director for Mongolia and Gantsogt Khurelbaatar, Senior Advisor to Executive Director
December 15, 2017

Our Mongolian authorities thank staff for their constructive engagement and request the completion of the first and second reviews under the Extended Fund Facility (EFF) arrangement.

The EFF arrangement, favorable external conditions and the launching of an economic recovery plan have resulted in better-than-anticipated outcomes. Economic growth has outperformed initial forecasts, in part due to high global prices and increased coal exports. Fiscal discipline and effective monetary policy have contributed to the stabilization of the economy, a reduced deficit, lower public debt and greater international reserves. However, the authorities are treating these initial results with caution, and are determined to continue structural reforms, build buffers and reduce economic vulnerabilities under the program. Challenges include maintaining fiscal discipline and policy stability, strengthening economic activity, continuing to increase reserves, improving resilience of the banking and financial sectors, and developing financial sector infrastructure.

All performance criteria and most structural benchmarks have been achieved. The change of government caused delays in achieving some benchmarks and in completing the first review. However, the new government swiftly announced its strong commitment to the EFF arrangement. Strong program performance has helped boost investor confidence, as shown by the successful issuance of a US$800 million Eurobond in October. All external financing needs to cover external bond maturities have been met for the remainder of the program period.

Fiscal policy

Greater-than-expected revenue and strong fiscal discipline has meant a significant reduction in the fiscal deficit. Half of the recent fiscal overperformance was used to reduce debt and this policy will be continued in the coming years. The authorities are aiming to halve the overall budget deficit from 17 percent of GDP in 2016 to 6.4 percent by 2018. The new government has also made it a priority to reduce expensive domestic borrowing to a minimum in 2018. Interest payments account for 5.5 percent of GDP and the Government is potentially crowding out private sector borrowing. Strict fiscal discipline and budget support funding will be important in achieving this objective.

There continues to be strong pressure on the public sector wage bill. From August to November, for example, school teachers and doctors held nationwide strikes and street demonstrations over salaries that have not increased since 2014 and that remain part of the public sector wage freeze until 2019. Recent studies show poverty increasing and many people struggling to maintain a minimum standard of living. The authorities recognize the seriousness of this situation and, in consultation with staff, provided a compensation payment to civil servants equal to half of one month's salary in 2017 and 2018. The authorities would like to continue a dialogue with staff on long-term civil service reform and wage issues.

The authorities would also like to discuss with staff and development partners the ongoing effectiveness of the Child Money program, which is being reduced in coverage to target 60 percent of children. Increasing poverty, and a 15 percent reduction in the average household income over two years, has put great pressure on families in Mongolia, and Child Money could provide a reliable source of income for families to ensure that basic needs can be met.

Monetary and financial sector

The Bank of Mongolia aims to maintain CPI inflation at a long-term equilibrium of 8 percent, and this is embedded in the Monetary Policy Guidelines. Inflation is picking up, and in November reached 6.5 percent in the country as a whole and 7.6 percent in Ulaanbaatar. Inflation is expected to rise slightly in the coming months in response to the recovery of the economy but the authorities are committed to keeping inflation pressures contained.

Under favorable conditions, the authorities increased net international reserves from 2.4 months of import coverage in 2016 to 4.4 months in November of this year. They will continue to take opportunities to increase reserves when conditions permit.

Financial sector stability is a cornerstone of future economic growth. The banking sector asset quality review was delayed due to a limited number of qualified reviewers, but is set to finish in December 2017. The authorities will use this report, and the advice of staff, to prepare and implement a banking sector strategy.

The mortgage program has been fully transferred from the Bank of Mongolia to the government and BOM now acts only as an agent of the government. The authorities continue to stress the importance of this program. Lack of quality housing and infrastructure, together with poverty, are the main drivers of the extreme pollution found in Ulaanbaatar, which is one of the most polluted cities in the world.