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Mongolia: Letter of Intent and Memorandum of Economic and
Financial Policies

August 12, 2010

The following item is a Letter of Intent of the government of Mongolia, which describes the policies that Mongolia intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Mongolia, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

MONGOLIA: LETTER OF INTENT

August 12, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

Our macroeconomic policies, supported by the Stand-By Arrangement with the International Monetary Fund, have helped Mongolia through a difficult but necessary period of economic adjustment. Our efforts have been successful and the economy is rebounding strongly, aided by investments in the mining sector and a recovery in global copper prices.

Our economy stands to benefit greatly over the medium-term from its vast mineral deposits and we are committed to using this mineral wealth to secure strong, sustainable, and equitable growth with low inflation. In the near-term, this means pressing ahead with key structural reforms and avoiding a repeat of the boom-bust policies of the past. The attached Memorandum of Economic Policies (MEP) provides an update of our macroeconomic policies for the remainder of 2010, supplementing the policies described in our last MEP.

Given the success to date of the program, and our observance of all end-June 2010 performance criteria, we request completion of the fifth and sixth reviews and that the arrangement be rephased to allow us to make the remaining purchases under the arrangement on September 8, 2010.

During the period of the arrangement, the Mongolian government will maintain the usual close policy dialogue with the Fund and consult with the IMF before modifying measures contained in this letter or adopting new measures. We will continue to provide the IMF with the necessary information for program monitoring and we authorize the IMF to publish this letter and the attached MEP.

Sincerely yours,

/s/
S. Bayartsogt
Minister of Finance

/s/
L. Purevdorj
Governor of Bank of Mongolia

Attachment
Memorandum of Economic Policies

MONGOLIA: MEMORANDUM OF ECONOMIC POLICIES

1. **Outlook.** The economy is recovering briskly and growth, boosted by investments in the mineral sector, is expected to be at least 7½ percent this year. Inflation accelerated this year, due to rising meat prices as a result of the severe winter and a recovery in demand. We will continue to adjust policies as necessary to contain the increase in inflation and achieve inflation in the single digits by end-2011.
2. **Monetary and exchange rate policies.** Our primary objective for monetary policy continues to be oriented toward achieving and maintaining low inflation and macroeconomic stability. The central bank raised the policy interest rate by 100 basis points in May. Nevertheless, we remain concerned that inflation is already high and upward price pressures will be increased by the planned increase in spending. Therefore, the central bank will maintain its tightening bias and is prepared to act forcefully if inflation rises further. We also remain fully committed to allowing the exchange rate to move in line with market conditions while smoothing excess volatility due to temporary imbalances.
3. **Fiscal stance.** We remain committed to restoring health to public finances. Revenue is set to exceed initial expectations by a wide margin this year, due in large part to the recovery in copper prices. Given the social needs in our economy, we amended our budget to allow for 3 percent of GDP in higher spending, including an increase in pensions and civil service wages which have been frozen for more than two years. We are, however, committed to avoiding a repeat of the boom-bust policymaking of the past and will restrain spending to a level that is consistent with macroeconomic stability. This year, therefore, we will ensure that actual spending is no more than 2 percent of GDP above the original budget approved in December. Parliament has also adopted a prudent medium-term fiscal framework, and in line with this, the 2011 budget will limit spending to togrog 3250 billion.
4. **Structural fiscal reforms.** We recently passed a fiscal responsibility law. The fiscal responsibility law will help secure a lasting fiscal discipline and, as an organic law, has higher legal standing than the budget and requires a two-thirds majority of parliament to be amended. The law provides for comprehensive coverage of all fiscal spending and numerical rules to enforce fiscal discipline. The social transfer reform law, which strengthens the social safety net through introduction of a targeted poverty benefit, has been submitted to parliament. The law is expected to be approved by November 2010 and the related budget impact has been reflected in the medium-term fiscal framework.
5. **Bank restructuring.** The Empowering the Banking Sector and Capital Support Program was submitted to parliament in August. This program outlines a comprehensive strategy to strengthen our banking system and we intend to ensure its prompt approval. To complement this effort, the central bank will continue to improve supervision and tighten enforcement of prudential regulations. We amended the supervision regulations in August to strengthen loan classification rules for restructured loans and specify tougher penalties for non-compliance with prudential regulations.

Table 1. Mongolia: Quantitative Performance Criteria (PC) and Indicative Targets (IT)

	12/31/2008	12/31/2009			3/31/2010		6/30/2010		
	Actual	Prog.	Adjusted	Outcome	Prog.	Outcome	Prog.	Adjusted	Outcome
Performance criteria 1/									
Net international reserves (NIR) of the Bank of Mongolia (BOM) (floor, eop stock, in million US\$) 2/	495	798	766	923	809	957	776	736	983
Net domestic asset (NDA) of the BOM (ceiling, eop stock, in billion togrog) 3/	-171	-542	-492	-728	-645	-793	-477	-419	-796
Net credit to government (NCG) (ceiling, cumulative from the beginning of the fiscal year, in billion togrog) 3/	130	58	108	-17	220	16	270	328	130
New nonconcessional external debt maturing in one year or more, contracted or guaranteed by the government or the BOM (ceiling, eop stock since April 2009, in million US\$).	0	200	200	100	200	100	200	200	100
New nonconcessional external debt maturing in less than one year, contracted or guaranteed by the government or the BOM (ceiling, eop stock, in million US\$).	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
Accumulation of domestic payment arrears (ceiling, eop, in billion togrog).	0	0	0	0	0	0	0	0	0
Indicative targets									
General government fiscal deficit (ceiling, cumulative since the beginning of fiscal year, in billion togrog).	296	416	416	329	220	9	270	270	68
Memorandum items:									
Support from bilateral and multilateral donors excluding IMF (cumulative since April 2009, in million US\$), program level.	0	174	142	142	152	152	192	192	152
Disbursed new nonconcessional external debt (eop stock, in million US\$), program level.	...	75	75	75	75	75	0	0	0
Disbursed Oyu Tolgoi tax prepayment loans (eop stock, in million US\$), program level.	...	100	100	100	100	100	150	150	150

1/ Evaluated at the program exchange rate.

2/ NIR does not include commercial bank foreign currency deposits and foreign currency current accounts held at the Bank of Mongolia. The adjusters are specified in the Technical Memorandum of Understanding (TMU) which remains unchanged from the last review, and include: the floor on NIR will be adjusted upward (downward) by the amount of support from bilateral and multilateral donors (excluding IMF) in excess (short) of the program level cumulative since April 2009; the floor will be adjusted upward by the amount of nonconcessional borrowing disbursed in excess of the program level; the floor on NIR will be adjusted upward by the amount of the cumulative additional SDR allocations up to the test date.

3/ The adjusters are specified in the TMU, and include: the ceilings on NDA and NCG, respectively, will be adjusted downward (upward) by the amount of support from bilateral and multilateral donors (excluding IMF) in excess (short) of the program level; the ceilings will be adjusted downward by the amount of nonconcessional debt disbursed in excess of the program level.

Table 2. Mongolia: Structural Benchmarks

Actions	Date	Status
Revising relevant laws to require Erdenet to pay taxes in togrog.	6/30/2009	Completed on July 9.
Announcement of a resolution plan for Anod bank based on the diagnostic assessment of the external auditor.	6/30/2009	Completed. Anod bank was put into receivership on November 30, 2009.
A comprehensive review of transfer programs resulting in a revision of the relevant laws to streamline transfer programs and safeguard the social safety.	6/30/2009	Completed late June, reform plan approved by Cabinet-level Working Group.
Submission to the parliament of a revised banking law and other pertinent laws and legislations that include: (i) strengthened prompt corrective action clauses including an increase in penalties for noncompliance; (ii) requiring consolidated supervision; (iii) an improved bank resolution framework that more clearly defines the roles of the conservator and liquidator; (iv) legal protection for bank and nonbank supervisors; (v) a more clear definition of "group of connected parties;" and (vi) reinforced prudential supervision requirements.	6/30/2009	Completed on July 24.
Pass a 2010 budget consistent with the IMF supported Stand-By Arrangement.	12/1/2009	Completed November 27.
The submission to parliament of Fiscal Responsibility Law consistent with recommendations of Fund technical assistance.	12/31/2009	Completed, submitted to parliament on January 12.
Pass a comprehensive social transfer reform that saves money and protects the poor through better targeting.	12/1/2009	Delayed. Reset below.
Passage of a comprehensive social transfer reform.	6/15/2010	Delayed to November.
Parliamentary passage of Fiscal Responsibility Law consistent with recommendations of Fund technical assistance.	6/15/2010	Completed June 24.