

COORDINATION OF FISCAL AND MONETARY POLICIES

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Content

- Legal Environment
- Large-scale Mining Projects and Government Actions
- Current Fiscal and Monetary Policies
- Coordination of Policies
- Conclusion



Legal Environment

- The Government
 - Fiscal Stability Law
 - Public Sector Financial Management Law
 - Law on Central Budget
 - Budget Law proposal
 - Proposal of Law on Development Policy and Planning
- Bank of Mongolia
 - Law on Central Bank
 - Law on Treasury Fund
 - Law on Currency Settlements



Large-scale mining projects and government actions

- Development Bank
- Fiscal Stabilization Fund
- Human Development Fund
- Government bond (MNT800 billion)



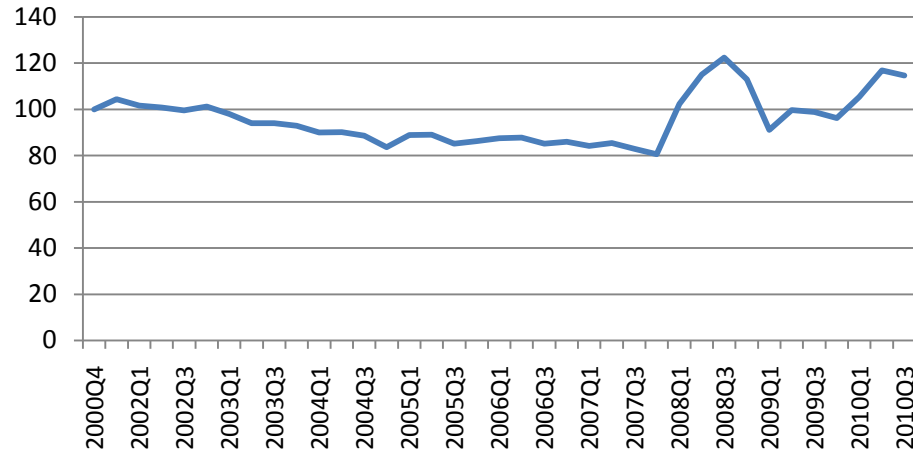
Capital Flow

- Capital inflow is increasing in recent years with regard to investment in large-scale mining projects and is expected to increase further.
- Capital account was positive in 2006-2009. Following facts show that capital inflow is increasing rapidly.
 - Net Foreign Direct Investment was positive and the amount of FDI into Mongolia increased 2.8 times between 2006 and 2009.
 - Net amount of other investment was -164.1 in 2006, but 211.4 in 2009.

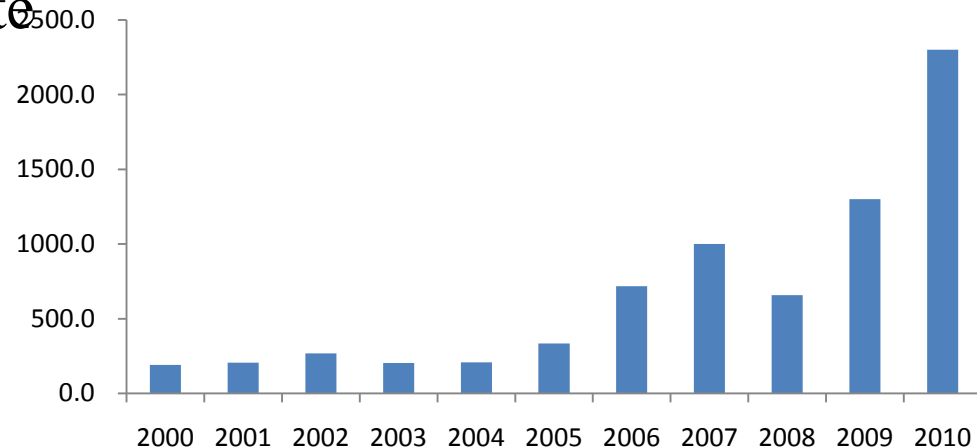
Exchange rate

- Massive capital inflow has had pressure on the exchange rate of togrog to appreciate.
 - Real exchange rate
 - Nominal exchange rate
 - Change in official reserves

REER, base year 2000

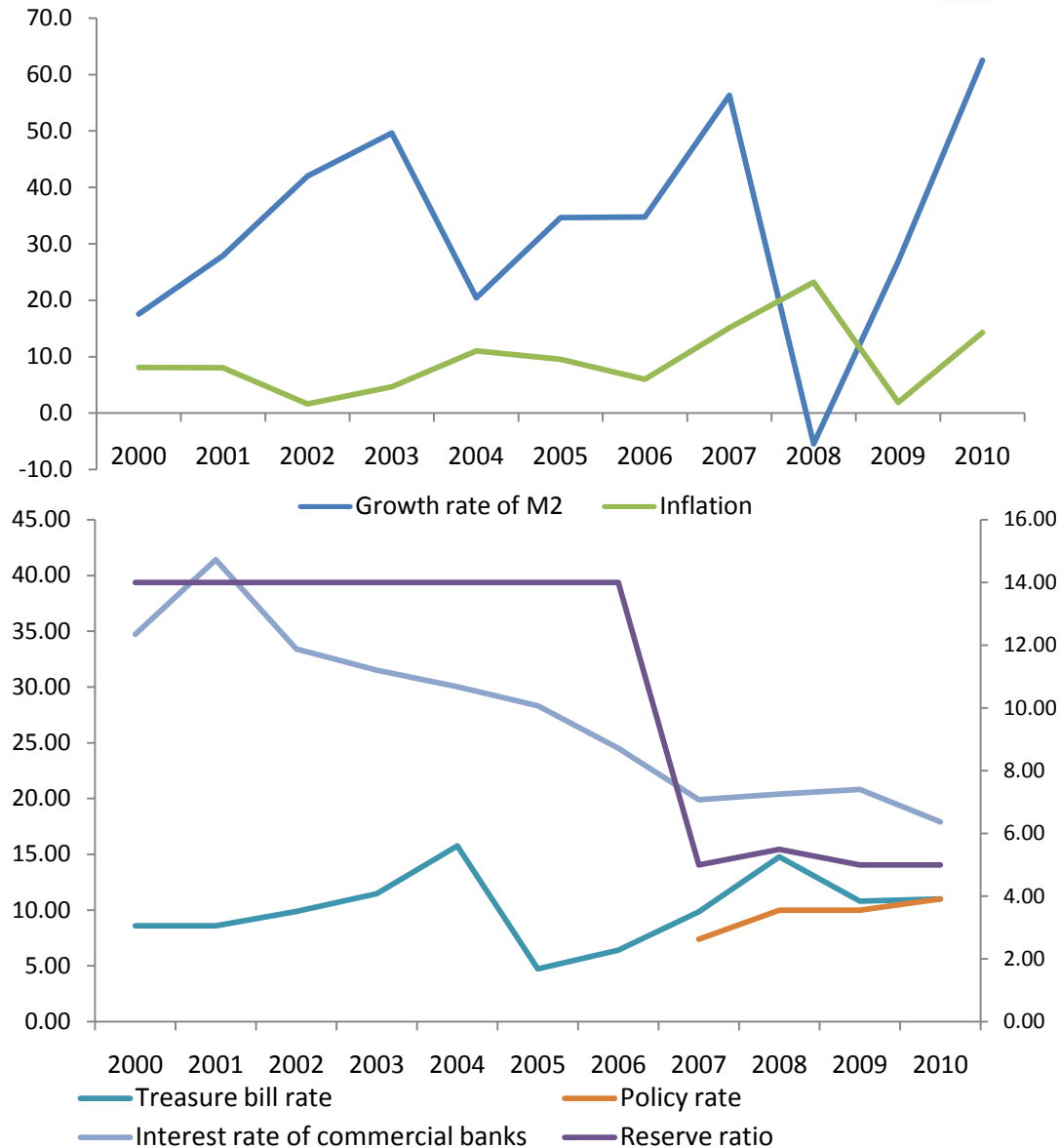


Official Reserves (mln. USD)



Monetary Policy

- Money supply
 - Policy rate
 - Interest rate
- Required reserve ratio
- Inflation





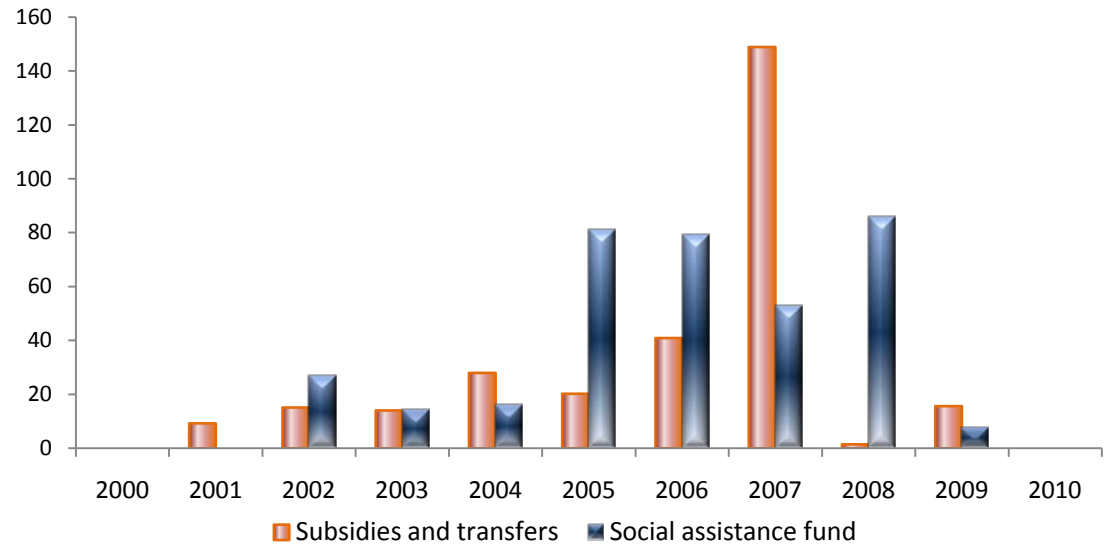
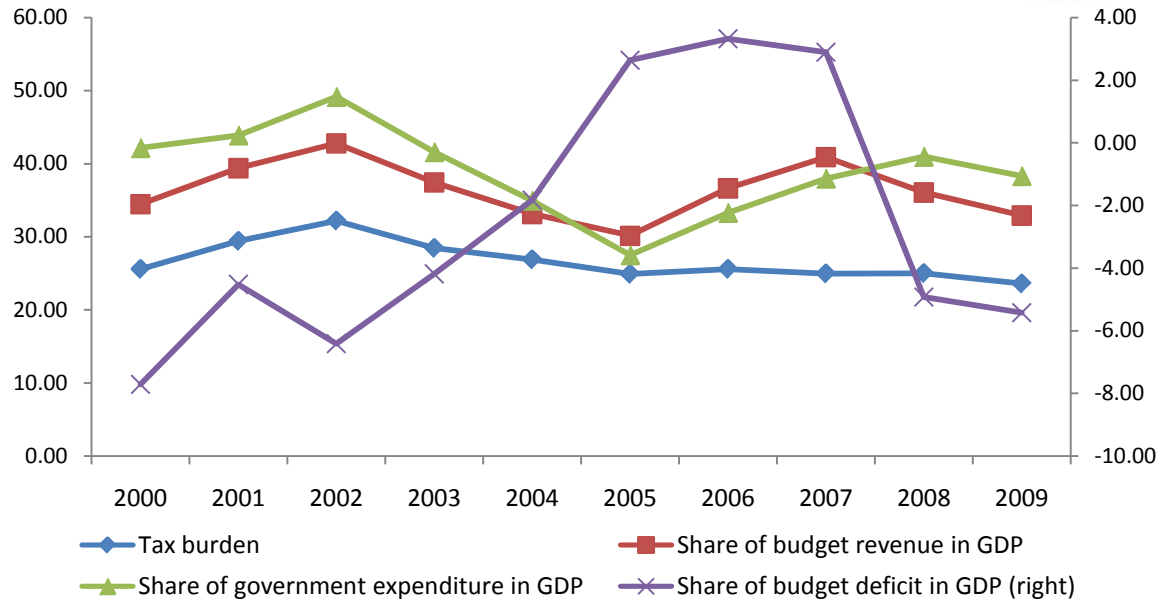
Monetary Policy

- Policy challenge for the Bank of Mongolia
 - Hard choice of policy objective
 - Exchange rate
 - Inflation
 - Capital control



Fiscal Policy

- Current fiscal policy
 - Budget expenditure: budget investment
 - Share of budget expenditure in GDP
 - Budget revenue: mining revenue
 - Share of budget deficit in GDP
 - Tax rate
 - Subsidies and transfer





Fiscal Policy

- Challenges for the government
 - Fluctuation in revenue from mining sector
 - Fiscal prudence



Recent fiscal and monetary policy mix

- In recent years, Mongolia has experienced **expansionary fiscal policy** followed by a **restrictive monetary policy**.



Coordination of policies

- Expected results of anticipated large-scale capital inflow:
 - Capital inflow with moderate pressure on exchange rate of togrog.
 - Appreciation of togrog
 - Reduce net exports and aggregate demand
 - Capital inflow with high pressure on exchange rate of togrog.
 - Increase aggregate demand.
 - Increase inflationary pressure.



Coordination of policies

- Better options for macroeconomic policies in anticipation of large-scale capital inflow
 - To stabilize aggregate demand
 - Managed floating exchange rate system with restrictive fiscal policy will prevent overheating.
 - Priority has to be given to inflation and flexible exchange rate system. Then, monetary policy can maintain price level stability.



Conclusion

- Coordination of fiscal and monetary policies is very difficult in anticipation of large-scale capital inflow.
- The current policy mix is undesirable as it destabilizes the economy.
- The Bank of Mongolia has to give its priority to inflation.
- Fiscal prudence and long-term planning are important challenges for the government.