MONGOLIA

Highlights

- **Strong growth rates are being sustained.** The economy expanded by 7.3 per cent year-on-year in the first half of 2019, accelerating from 6.9 per cent in 2018, mainly due to increases in gross capital formation related to the underground expansion of the Oyu Tolgoi copper mine.
- **The authorities are taking steps to strengthen the banking sector albeit with some delays in resolving bank undercapitalisation.** Following an Asset Quality Review, some banks were supposed to take action to boost capital by the end of 2018 but, as of September 2019, not all of them have met capital requirements in full.
- **Key tax laws have been revised by the parliament.** Amendments to the General Law on Taxation, the Corporate Income Tax Law, the Value Added Tax Law and the Personal Income Tax Law were passed in March 2019. One of the key changes includes a reduction in the licence transfer tax for land rights.

Key priorities for 2020

- **Financial-sector reforms should advance.** The central bank should strengthen the supervision of the sector and implement the non-performing loan (NPL) resolution strategy.
- **It is critical to maintain fiscal discipline to achieve a commitment to reducing debt.** The authorities need to avoid fiscal loosening in the run-up to parliamentary elections in 2020 and should adhere to the budget targets agreed under the International Monetary Fund (IMF) programme.
- **Governance issues need to be addressed.** Maintaining judicial independence and improving judiciary capabilities to effectively deal with commercial cases are essential for attracting investment, including in non-extractive sectors. The authorities should also take concrete measures to reduce corruption.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	2.4	1.2	5.3	6.9	6.8
Inflation (average)	5.9	0.5	4.6	7.6	8.1
Government balance/GDP	-8.5	-17	-1.9	-3.4	0.5
Current account balance/GDP	-4.0	-6.3	-10.1	-17.0	-15.0
Net FDI/GDP [neg. sign = inflows]	-0.8	37.2	-13.1	-15.0	-18.0
External debt/GDP	171.3	183.9	245.4	235.3	n.a.
Gross reserves/GDP	25.6	11.6	26.3	26.5	n.a
Credit to private sector/GDP	53.9	56.9	53.0	56.2	n.a

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Macroeconomic performance

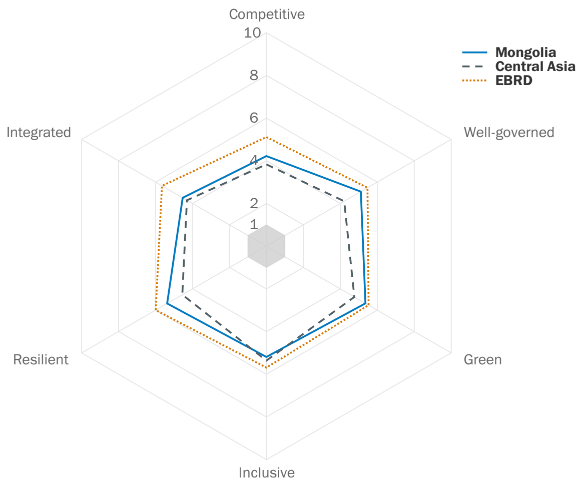
Real GDP growth remains strong. Economic growth accelerated to 6.9 per cent in 2018 and to 7.3 per cent year-on-year in the first half of 2019. Growth was primarily driven by fixed investment in the mining sector, related to the underground expansion of the Oyu Tolgoi copper mine. Gross capital formation increased by around 25.0 per cent year-on-year in the first half of 2019. Inflation accelerated from an average of 4.3 per cent in 2017 to 6.8 per cent in 2018. Credit growth expanded to 27.0 per cent in 2018 from 10.0 per cent in 2017. In response to these developments, the central bank tightened monetary policy by raising the policy rate from 10.0 per cent to 11.0 per cent in November 2018 and by restricting the growth of consumer lending through a ceiling on the household debt-to-income ratio. Inflation reached 9.0 per cent year-on-year in June 2019, exceeding the central bank's 8.0 per cent target.

External pressures intensified in 2018. Exports rose by 13.0 per cent year-on-year in US dollar terms in 2018 and imports surged by 35.0 per cent in the same period. High import growth was driven by major inflows of foreign direct investment, which financed purchases of machinery and equipment. This led to a further widening of the current account deficit to 15.0 per cent of GDP in 2018 from 10.0 per cent in 2017. In the second half of 2018, the tugrik came under pressure, depreciating overall by 8.0 per cent in 2018. However, in the first six months of 2019 the current account deficit narrowed slightly, as the growth of exports outpaced that of imports. Exchange rate pressures eased in the first half of 2019. This, coupled with central bank interventions, has stabilised the exchange rate. Gross international reserves continued rising and reached US$ 3.2 billion in June 2019, covering six and a half months of imports.

The fiscal position continued improving. The overall fiscal balance was in surplus in 2018 (versus a 3.8 per cent of GDP deficit in 2017). This is the first time this has happened since 2010. This was achieved by improved economic performance and fiscal adjustment policies. Revenues increased due to rising tax receipts from value added tax and social insurance. A moderation in capital expenditures also contributed to better fiscal performance. Public debt decreased to 73.3 per cent of GDP in 2018 from 84.6 per cent in 2017, according to the IMF.

High growth will continue, although at a slightly slower pace. The economy is projected to grow by 6.8 per cent in 2019, slowing down somewhat to 5.4 per cent in 2020, aided by further investment in the underground expansion of Oyu Tolgoi. Private consumption is also projected to support GDP growth as real incomes rise, thanks in part to an increase in public workers' salaries. Downside risks include a possible slowdown in growth in China and the stalling of reforms due to political uncertainty in the run-up to parliamentary elections, which are scheduled for 2020.

Assessment of transition qualities (1-10)



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Major structural reform developments

The authorities are taking steps to strengthen the banking sector, but delays are occurring. An Asset Quality Review in 2017 identified a capital shortfall in the sector of around 2.0 per cent of GDP. Banks were supposed to take action by the end of 2018 but, as of September 2019, not all of them have met capital requirements in full. The regulator – Bank of Mongolia (BoM) – is committed to ensuring all banks raise capital as required. In April 2019, the BoM dissolved Capital Bank, as the bank failed to fulfil requirements for reserve and capital adequacy and could no longer carry out normal operations. Weak asset quality remains a concern for the sector, with NPLs rising at the end of 2018 and reaching 10.5 per cent of total loans as of June 2019.

The sixth review of the IMF's three-year Extended Fund Facility has been suspended. Disbursements have been impeded since December 2018, partly due to the delays in financial-sector reform regarding banks' capitalisation. In addition, as requested by the IMF, the BoM launched a forensic review in July 2019 to ensure that the additional capital, contributed by shareholders of five banks in 2018, is from legitimate sources. For 2019, the programme goals are to continue reducing public debt, resume international reserve accumulation, ensure the banking system is well-capitalised and strengthen the investment climate to attract foreign capital.

Key tax laws, including the licence transfer tax, have been amended. Amendments to the General Law on Taxation, the Corporate Income Tax Law, the Value Added Tax Law and the Personal Income Tax Law were passed by the parliament in March 2019. The changes will be effective from January 2020. One of the key amendments includes a reduction in the licence transfer tax for land rights. In 2017 the authorities introduced a payment of a 30.0 per cent tax rate on gross assessed value of transfer of licence for land use, including exploration and extraction licences for mining, which further increases the costs of doing business for investors. The revised law lowers the rate to 10.0 per cent of the assessed net value of the transfer rights. Furthermore, there are reductions in the withholding tax on income provided to non-residents and tax on dividends for foreign investors. Other changes concern the simplification of reporting procedures and the provision of tax relief for companies that are struggling financially.

Judicial reform has experienced a major setback. In March 2019 the parliament adopted a new regulation regarding the dismissal of judges, prosecutors and the head of the Anti-Corruption Agency. Legal amendments were quickly passed by the parliament and were not subject to hearings and public consultations. They allow the National Security Council (consisting of the president, the chairman of the parliament and the prime minister) to remove judges and prosecutors, thus undermining judicial independence and investor confidence in the country. The president then dismissed 17 judges, as well as the head and deputy head of the Mongolian anti-corruption agency, supposedly on the grounds of corruption. Transparency International has issued several statements condemning these developments, while UN Special Rapporteurs from the United Nations have urged the government not to politically interfere in the judicial system.

Data transparency is improving, with Mongolia subscribing to the IMF's Special Data Dissemination Standard. Previously, Mongolia implemented the enhanced General Data Dissemination System, which includes maintaining a National Summary Data Page, where key macroeconomic and financial indicators are published online. In April 2019, Mongolia made the next step in enhancing data dissemination in line with the best international practices by committing to ensure timely availability of statistics in accordance with an advance release calendar. This measure is key to enhancing decision-making by the authorities and enabling access to important data for external stakeholders.