



MONGOLIA

Highlights

- **The Covid-19 pandemic has exposed Mongolia's key economic vulnerabilities.** The economy's extreme dependence on China as its main export market and a narrow specialisation in a small number of mineral commodities have contributed to a 9.7 per cent year-on-year fall in GDP in the first half of 2020.
- **The authorities adopted two packages of anti-crisis fiscal measures to stimulate economic activity and save jobs.** Measures include tax exemptions, increases in child allowances and unemployment benefits, credit guarantees to small and medium-sized enterprises (SMEs) and soft loans for cashmere producers.
- **Mongolia received substantial assistance from international financial institutions.** Among other support, a US\$ 99 million emergency assistance package from the International Monetary Fund (IMF) is helping the country meet urgent budgetary and balance-of-payments needs and support the most affected sectors and vulnerable groups.

Key priorities for 2021

- **A key priority is to mitigate the social and economic impacts of the pandemic.** The government should continue protecting those most affected by the crisis through job creation and expanded social protection, while improved access to digital technologies and skills will increase inclusion, especially for those in remote areas and migrants living on the outskirts of large cities.
- **Macroeconomic stability and fiscal discipline should be maintained.** The authorities should stick to their commitment to unwind fiscal loosening in 2021 once the immediate impact of the pandemic subsides.
- **Investment climate and governance issues need to be addressed.** The Investment Protection Council can be used as an effective tool to protect the rights and interests of investors. Public investment in physical and human capital is also key for attracting foreign direct investment and achieving longer-term diversification of the economy.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	1.2	5.3	7.2	5.1	-6.5
Inflation (average)	0.7	4.3	6.8	7.3	5.0
Government balance/GDP	-15.3	-3.8	3.0	0.9	-12.0
Current account balance/GDP	-6.3	-10.1	-16.8	-15.6	-13.0
Net FDI/GDP [neg. sign = inflows]	37.2	-13.1	-14.9	-17.6	-8.0
External debt/GDP	183.9	245.4	235.3	221.0	n.a.
Gross reserves/GDP	11.7	26.4	27.1	31.4	n.a.
Credit to private sector/GDP	56.9	53.1	55.7	50.1	n.a.

Covid-19: macroeconomic implications

The pandemic has exposed the Mongolian economy's key vulnerabilities. These are, first: the extreme dependence on China as the main export market (accounting for 93 per cent of total exports in 2019), and second, the narrow specialisation in a very small number of mineral commodities (around 87 per cent of total exports). In the first eight months of 2020, as a result of the partial border closure in February 2020 for freight cargo and weaker demand, exports declined by around 17 per cent year-on-year, with coal exports contracting by 45 per cent and copper by 24 per cent. In contrast, gold exports rose by 233 per cent year-on-year in the same period. The drop in export revenues and the introduction of tax relief measures have resulted in a 19 per cent contraction year-on-year of fiscal revenues in January to August 2020, and the delay in the production schedule of Oyu Tolgoi's phase 2 may put further pressure on the budget. Public debt had already reached 69 per cent of GDP at the end of 2019, and Mongolia faces large bond maturities in 2021-24 equal to roughly half of international reserves.

Mongolia's economy is one of the most severely affected by Covid-19 in Central Asia.

Real GDP fell by 9.7 per cent year-on-year in the first half of 2020, as partial lockdown measures from mid-February 2020 until 30 April 2020 significantly constrained household demand. This period also included a temporary suspension of coal exports to China in February and March, tight restrictions on international flights and railways, and strict social-distancing measures. The transportation, trade and services sectors posted losses. Mining was down by 30 per cent year-on-year in the first half of the year, with production of most commodities shrinking, except for gold.

Credit to the economy is declining due to lower levels of economic activity and higher risks.

Total outstanding loans shrank by 4 per cent year-on-year in September 2020 compared with 11 per cent growth a year ago. Both retail and corporate loans dropped despite steps taken by the central bank to soften prudential regulations (and hence support bank lending to the private sector) and reduce the policy rate (stepwise from 11.0 per cent in February 2020 to 9.0 per cent in April 2020 and further to 8.0 per cent in September). Inflation decelerated significantly to 1.7 per cent year-on-year in September 2020, well below the target rate of 8 per cent, amid sluggish domestic demand. The exchange rate depreciated by a modest 5 per cent between the beginning of 2020 and 30 September 2020, as the central bank regularly intervened in the foreign exchange market. As a result, gross international reserves dropped from an historic high of US\$ 4.4 billion in February 2020 to US\$ 3.6 billion by 31 August 2020.

A strong recession in forecast in the short term, but with some recovery in 2021. With tourism activities not materialising in the third quarter of 2020 (severely affecting the hospitality sector and cashmere exports), Mongolia's GDP is expected to contract by 6.5 per cent in 2020. The economy is forecast to grow by 5.0 per cent in 2021 as tourism and China's demand for Mongolia's key exports gradually recover, but significant downside risks remain, to do mainly with a possible resurgence of the pandemic.

Policy response to Covid-19

The authorities adopted two packages of anti-crisis fiscal measures to stimulate economic activity and save jobs.

The first set of measures (amounting to 14 per cent of GDP), approved in April 2020, include tax exemptions on selected imported food and medical items, exemptions on income tax and social security contributions, an increase in child allowances and unemployment benefits, credit guarantees to SMEs and soft loans to cashmere producers. The second package (2 per cent of GDP), approved in May, provided additional support to households (increasing social welfare pensions and food stamp allowances for the elderly, disabled and orphans), as well as subsidies to the cashmere sector.

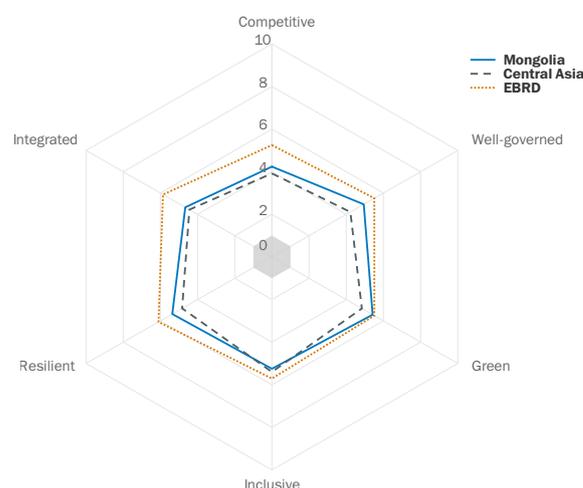
The central bank implemented prudential measures to support the banking sector and stimulate lending.

In March 2020, the central bank reduced reserve requirements in local currency and banks' liquidity ratios. In addition, the central bank has taken temporary financial forbearance measures to ease the financial pressure on distressed businesses and households. These involve easing loan classifications, restructuring standards allowing a deferred payment of consumption

loan principals and interests, and suspending corrective actions against breaches of the capital conservation buffer. Furthermore, the central bank temporarily resumed a subsidised mortgage loan programme for an estimated MNT 150 billion (US\$ 52 million) until the end of 2020.

Mongolia received US\$ 99 million emergency financial assistance from the IMF. This is to help the country meet urgent budgetary and balance-of-payments needs stemming from the outbreak of Covid-19, and to support the most affected sectors and vulnerable groups. The IMF's previous Extended Fund Facility (EFF) arrangement with the government of Mongolia went off track due to insufficient progress on the recapitalisation of banks and expired in May 2020. Only five out of 11 reviews were completed under the EFF programme. The authorities have reiterated their commitment to ensure a fully capitalised banking system after Covid-related pressures subside and to address the outstanding commitments under the EFF. In addition, in May 2020 the Asian Development Bank provided a US\$ 100 million loan to mitigate the severe health and economic impacts of the Covid-19 pandemic.

Assessment of transition qualities (1-10)



Structural reform developments

Mongolia is making progress with addressing deficiencies in anti-money laundering and combating the financing of terrorism (AML/CFT). Mongolia was added to the Financial Action Task Force's (FATF) grey list in October 2019 after the country failed to pass the necessary requirements related to AML/CFT. The FATF's June 2020 plenary meeting recognised that Mongolia has successfully addressed all six high priority actions and warrants an onsite assessment to verify that the implementation of Mongolia's AML/CFT reforms has begun and is being sustained, and that the necessary political commitment remains in place to sustain implementation in the future. Some key reforms conducted by the government include applying a risk-based approach to supervision and applying proportionate and dissuasive sanctions for breaches of AML/CFT obligations, along with demonstrating increased investigations and prosecutions of different types of money laundering activity in line with identified risks.

The government intends to take measures to amend the Oyu Tolgoi investment agreement.

In December 2019 the parliament issued a resolution that directed the cabinet to seek discussions with Rio Tinto to amend the investment agreement and the Oyu Tolgoi Underground Mine Development and Financing Plan, and develop an option to convert the 34 per cent government share ownership into a royalty or production-sharing arrangement. This is regarded as a negative signal for investors and underscores the longstanding strained relations over taxation, delays and other aspects of the large-scale copper mining project between the government and Rio Tinto, the operator of the copper and gold mine.