



MONGOLIA

Highlights

- **The economy is firmly on the road to recovery following a major recession in 2020.** Driven by the mining sector, the economy grew by 6.3 per cent year-on-year in the first half of 2021 thanks to strong demand from China and elevated commodity prices.
- **A comprehensive stimulus plan to protect health and revive the economy was approved in February 2021.** Largely financed by the central bank, the package (around 27 per cent of gross domestic product (GDP)) will be implemented in 2021-23. It includes measures to improve access to credit, save jobs, provide housing and promote manufacturing, agriculture and non-mining exports.
- **The Bank of Mongolia has progressed on banking sector reforms.** Amendments to the banking law will require the five systemically important banks to conduct initial public offerings (IPOs) in the stock market and become public companies by June 2022, with a cap on bank shareholder rights at 20 per cent.

Key priorities for 2022

- **The social and economic effects of the Covid-19 pandemic need to be mitigated while strengthening fiscal buffers and avoiding the risk of overheating.** The government should continue to protect those most affected by the Covid-19 crisis through job creation and expanded social protection. At the same time, government priorities should focus on gradually withdrawing excess liquidity and increasing savings held in sovereign wealth funds.
- **It is critical to reach an agreement with Rio Tinto on the Oyu Tolgoi (OT) copper and gold mine.** Resolving outstanding issues with OT will be vital to increasing the country's benefits from investment in the mining sector, attracting more foreign direct investment (FDI) to Mongolia and helping to sustain high growth rates.
- **Banking sector reforms should advance further but take into account the absorption capacity of domestic capital markets.** Ambitious IPO targets for the five systemic banks should be balanced against the currently small liquidity of the Mongolian Stock Exchange, which makes it challenging to absorb upcoming large equity offerings.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	5.3	7.2	5.1	-6.5	6.1
Inflation (average)	4.3	6.8	7.3	3.7	6.5
Government balance/GDP	-3.8	3.0	0.9	-9.8	-6.0
Current account balance/GDP	-10.1	-16.8	-15.6	-5.1	-8.0
Net FDI/GDP [neg. sign = inflows]	-13.1	-14.9	-17.6	-13	-14.0
External debt/GDP	245.4	235.3	221.0	246.0	n.a.
Gross reserves/GDP	26.4	27.1	31.4	35.0	n.a.
Credit to private sector/GDP	53.1	55.7	49.6	46.4	n.a.

Covid-19: macroeconomic implications

Mongolia recorded real GDP growth of 6.3 per cent year-on-year in the first half of 2021. Growth was driven by the mining sector thanks to higher demand from China and elevated commodity prices. Exports rose by 25 per cent year-on-year in the first seven months of 2021 thanks to strong performances in iron ores and concentrates, copper concentrates and coal. Overall, mining output increased 34 per cent year-on-year in the first seven months of 2021. Services grew by a much more modest 3.0 per cent year-on-year. Agriculture was down by 4.6 per cent year-on-year due to large losses in livestock. Mongolia has one of the highest vaccination rates in the world: by late June 2021 more than 60 per cent of its population had been fully vaccinated.

The Bank of Mongolia loosened monetary policy and banking regulations. During 2020-21, the central bank reduced the reserve requirement by 2 percentage points, suspended the debt-service-to-income ceiling on consumer loans, provided longer-term financing to the banking sector and introduced temporary forbearance measures (softening asset classification requirements, extending maturities on consumer and mortgage loans, and restructuring business loans in the banking sector). The policy rate has been kept unchanged at 6.0 per cent since November 2020, supporting credit expansion (up 12 per cent year-on-year in July 2021). With the economy recovering, inflation accelerated to 9.0 per cent in August 2021 from a low of 2.3 per cent in December 2020. This is still within the central bank target corridor of between 4 and 8 per cent.

Reserve coverage has improved significantly. Since January 2020 the local currency (MNT) has lost 5 per cent against the US dollar, but it has been flat since September 2020. Gross international reserves are now at US\$ 4.7 billion, having dipped as low as US\$ 2.3 billion in spring 2020 due partly to a Eurobond repayment of US\$ 500 million by a commercial bank. Reserves have since recovered, providing nine-month import cover, thanks to strong import compression, robust growth in gold exports, the recovery of coal and copper exports to China, as well as borrowing from international financial institutions and Eurobond issues. However, international reserves include a large borrowed component (swaps with domestic banks and China).

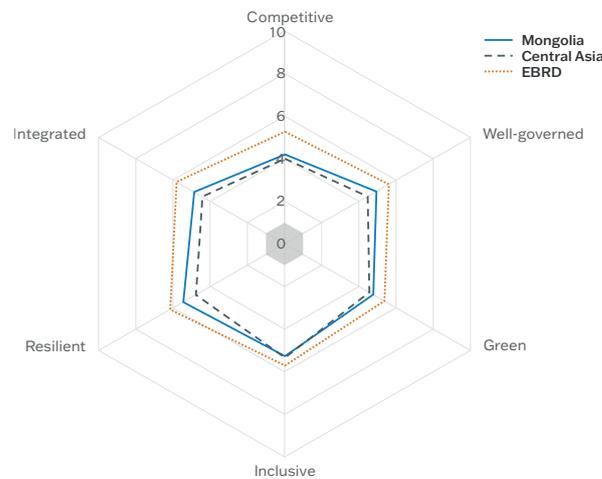
GDP is expected to grow strongly in the short term. Real GDP is forecast to expand by 6.1 per cent in 2021 and 6.5 per cent in 2022, supported by China's demand for Mongolia's key exports, higher private and public consumption and the recovery of FDI, which is contingent on the successful conclusion of negotiations over OT, Mongolia's largest FDI-financed project. Fiscal policy will support growth in 2021, with the budget deficit planned at 5.1 per cent of GDP.

Policy response to Covid-19

A comprehensive stimulus plan to protect health and revive the economy was approved. Largely financed by the central bank, the new package, approved in February 2021 and amounting to around 27 per cent of GDP, will be implemented in 2021-23. It includes measures to increase access to credit, promote manufacturers and business industries, save jobs, provide housing, support agricultural production and develop non-mining export products. The Bank of Mongolia will increase: repurchase agreement (repo) funding by MNT 2 trillion (US\$ 700 million) per year; funding available to small and medium-sized enterprises (SMEs) by MNT 500 million (US\$ 175,000); and funding for non-mining exporters by MNT 3 billion (US\$ 1 million). In April 2021 the government launched a one-time cash handout equivalent to MNT 1 trillion (US\$ 350 million or about 3 per cent of GDP) to support households.

A three-year joint project, Mongolia Covid-19 Crisis Response, was launched in October 2020. The European Union is providing support of €1 million and the World Health Organization is providing €62,000 and technical guidance to Mongolia's health sector. The project will focus on strengthening the capacity of the national health system, as well as laboratory capacity at the national and sub-national levels. It will also ensure continuity and quality of essential healthcare services during widespread community transmission and lockdown. In addition, the Asian Development Bank approved a US\$ 100 million loan in March 2021 to strengthen Mongolia's health sector and its response to the coronavirus pandemic.

Assessment of transition qualities (1-10)



Structural reform developments

Long-term reform planning has advanced. With both the presidency and parliament controlled by the Mongolian People's Party since June 2021, the government has been able to push ahead with its long-term development programme, Vision 2050, launched in 2020. This aims to diversify the economy away from raw material exports, mainly through large state projects, but also by stimulating growth in new sectors and attracting foreign investment.

The Bank of Mongolia has progressed on banking sector reforms. In January 2021 parliament approved amendments to the banking law, which requires five systemically important banks to become public companies through IPOs by June 2022, with a cap on bank shareholder rights at 20 per cent. This is expected to reduce shareholder concentration in the banking sector and provide for timely and fully transparent disclosure of the banks' financials and operations.

Progress has been made in resolving a dispute over Mongolia's largest copper and gold mine. The cost of expanding the OT mine has surged to US\$ 6.75 billion from its original budget of US\$ 5.3 billion in 2016, which became a bone of contention between the operator, Rio Tinto, and the government. An independent review dismissed Rio Tinto's explanation for the delays as being caused by geological difficulties. Subsequently, Rio Tinto expressed its willingness to reduce the interest rate on the loans it provided to the government of Mongolia to finance its share of the construction costs. In exchange, a long-term power agreement is sought by Rio Tinto.

The country needs to step up efforts for green energy transition to be able to fulfil its nationally determined contribution (NDC) target within the agreed timeframe.

Mongolia has an NDC target of generation capacity from renewable energy sources of 20 per cent by 2023 and 30 per cent by 2030. The country's ability to deliver on its NDC commitment will be stretched by the government's July 2021 decision to construct a new coal-fired power plant. The Baganuur plant will operate under a 21-year power purchase agreement; its two 200 MW blocks are expected to be completed in July 2026 and October 2026. The plant will not be a combined heat and power plant, so will not help the country meet heat demand.

