



## Mongolia

### Highlights

- **Growth is being affected by external shocks.** Real gross domestic product (GDP) grew by 1.9 per cent year on year in the first six months of 2022, despite intermittent border closures due to China's zero-Covid policy. Growth was supported by high commodity prices (total exports gained 29.8 per cent in the first half of the year) and the robust expansion of agriculture and service sectors.
- **The longstanding dispute with Rio Tinto over development costs for the Oyu Tolgoi copper mine has been resolved.** This helps allay concerns about Mongolia's investment climate while at the same time increasing the country's share of any benefits from future foreign direct investment (FDI) in the mining sector.
- **Mongolia is promoting its digitalisation agenda.** The newly established Ministry of Digital Development and Communications signed a memorandum of understanding with Estonia's e-Governance Academy to digitalise a wide range of government services, in a significant step towards Mongolia's digital transformation.

### Key priorities for 2023

- **Better targeting of support measures and fiscal consolidation are required to ensure macroeconomic stability and debt sustainability.** Large stimulus spending in 2020-21 led to persistent imbalances, constraining the government's fiscal space and pushing public debt close to 100 per cent of GDP. Monetary policy remains accommodative (the policy rate is below the inflation rate), encouraging growth at the expense of price stability, adding to the inflationary pressures stemming from more complicated import logistics and higher commodity prices.
- **The authorities should step up efforts to improve the management of critical border crossing points and invest in connectivity.** Greater efficiency of and additional physical capacity in freight transport will allow the country to benefit fully from elevated commodity prices and reduce bottlenecks on existing trade routes.
- **Plans to improve regional inclusion should be stepped up.** Current efforts to bring essential services and modern infrastructure to Ulaanbaatar's ger districts and build new modern districts outside the capital should be accelerated. Improved municipal services would boost living conditions for the poor and enhance their access to the labour market.

TABLE Main macroeconomic indicators %

|                                   | 2018  | 2019  | 2020  | 2021  | 2022 proj. |
|-----------------------------------|-------|-------|-------|-------|------------|
| GDP growth                        | 7.7   | 5.6   | -4.6  | 1.6   | 3.5        |
| Inflation (average)               | 6.8   | 7.3   | 3.7   | 7.1   | 14.8       |
| Government balance/GDP            | 2.9   | 1.0   | -9.2  | -3.1  | -0.4       |
| Current account balance/GDP       | -16.7 | -15.2 | -5.1  | -12.8 | -20.3      |
| Net FDI/GDP [neg. sign = inflows] | -14.8 | -17.2 | -12.9 | -13.3 | -14.5      |
| External debt/GDP                 | 249.4 | 250.5 | 275.8 | 219.8 | n.a.       |
| Gross reserves/GDP                | 27.0  | 30.7  | 34.2  | 28.9  | n.a.       |
| Credit to private sector/GDP      | 55.4  | 48.9  | 45.8  | 46.3  | n.a.       |

## Macroeconomic developments and policy response

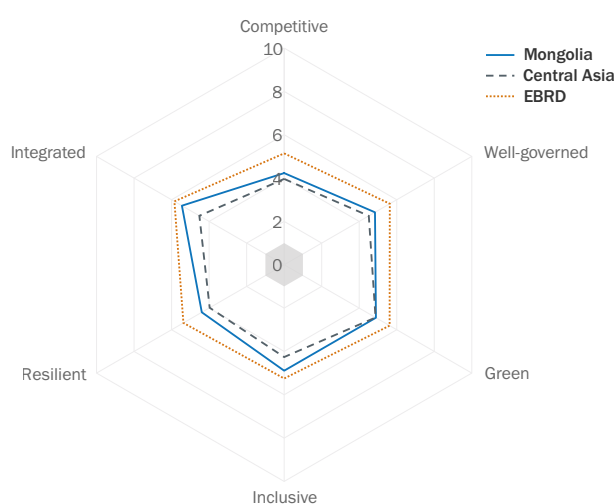
**Growth has been modest so far in 2022.** The economy shrank by 3.8 per cent year on year in the first quarter of 2022, but rebounded in the second quarter on the back of agriculture (up 11.3 per cent year on year) and services (up 4.9 per cent year on year), giving an overall growth rate of 1.9 per cent year on year in the first half. The country’s lack of diversification means that economic performance remains closely linked to China’s demand for its key export products (coal, copper and iron ore), though gold provides a significant hedge (increasing from 7.3 to 20 per cent of total exports in 2020). The recent Covid-19 outbreaks in China and Russia’s war on Ukraine put further pressure on the Mongolian economy, with volatile demand from China resulting in a contraction in the Mongolian mining and quarrying sector (down 28.8 per cent year on year in the first half).

**Inflation has become a key concern, necessitating a policy response.** Inflation peaked at 16.9 per cent year on year in June 2022, driven by supply-chain disruptions, higher transport costs and the rising prices of imported goods. Excessive stimulus spending and the accommodative monetary policy stance of the Bank of Mongolia (BoM) have also been important drivers. Having kept its benchmark interest rate unchanged at 6 per cent from November 2020 till March 2022, the BoM raised it stepwise to 12 per cent by September 2022. Consequently, inflation slowed down to 13.8 per cent year on year in September. To counter the impact of rising food prices, the Ministry of Food, Agriculture and Light Industry (MoFALI) has signed agreements with 17 businesses with regard to customs tax exemptions on wholesale imports of rice, sugar and vegetable oil in exchange for ensuring price stability.

**External resilience remains a challenge.** The currency has come under pressure and lost about 14.6 per cent of its value (as of 23 September 2022) against the US dollar since late February 2022. The BoM’s current international reserves (about US\$ 3.1 billion) cover six months of imports and 53 per cent of upcoming debt payments. In May 2022 Fitch affirmed Mongolia’s B rating with a stable outlook. However, a more recent rating by IHS Markit led to the outlook being downgraded from stable to negative, reflecting negative export dynamics due to frequent border closures with China.

**Short-term growth is likely to rise, but downside risks remain significant.** We expect real GDP to grow 3.5 per cent in 2022 and 7.0 per cent in 2023. Major downside risks relate mostly to the geopolitical situation and the possibility of negative spill-over effects on Mongolia’s main industries. Significant upside potential to 2023 growth lies in the tourism sector, provided it can finally rebound to its pre-pandemic level.

**CHART** Assessment of transition qualities (1-10)



## Structural reform developments

**Major reforms are under way in the banking sector.** Amended in January 2021, the Banking Law requires systemically important banks (SIBs) to conduct initial public offerings (IPOs) on the Mongolian Stock Exchange by June 2022 and to reduce maximum ownership by a single shareholder to no more than 20 per cent by 31 December 2023. Complying with the new limit is likely to require SIBs to sell their shares through multiple initial and secondary public offerings (IPOs and SPOs). On the International Monetary Fund's (IMF) recommendation, the deadline for IPOs has been postponed to allow all SIBs to undergo an asset quality review, which was completed by October 2022.

**The government launched a new economic reform programme.** Introduced in December 2021, the New Recovery Policy envisages a doubling of Mongolia's GDP by 2030 through investment and structural reforms focusing on: (i) border capacity and connectivity; (ii) industrial technology; (iii) regional integration; (iv) energy transmission and distribution networks; (v) climate change mitigation measures; and (vi) governmental and state-owned enterprise (SOE) efficiency. The programme's investment costs are estimated at around MNT 120-150 trillion (US\$ 36-45 billion), requiring active cooperation with private-sector companies, foreign investors and international financial institutions.

**A major dispute over FDI in the mining sector has been resolved.** An important breakthrough occurred in December 2021, when Mongolia's largest foreign investor, Rio Tinto, agreed to write off US\$ 2.3 billion of Mongolia's debt related to the Oyu Tolgoi mine. Putting this longstanding dispute to rest will help allay concerns over Mongolia's investment climate, while increasing the country's share of any benefits from future FDI in the mining sector. Meanwhile, in February 2022 the government decided to re-establish the country's Foreign Investment Agency. The agency will be responsible for resolving potential obstacles to FDI, including regulatory barriers and planning issues, as well as for landing high-value investment opportunities in Mongolia. It will also protect investors' interests and provide investor planning support and services.

**Mongolia is advancing its digitalisation agenda.** In January 2022 the authorities established the Ministry of Digital Development and Communications. In April 2022 the ministry and the Estonian e-Governance academy signed a memorandum of understanding to facilitate Mongolia's digital transformation. The scope of work includes introducing digital identity and electronic signatures, advising civil servants on digital skills and developing digital strategies.

**The country is encouraging sustainable finance and mobilising private-sector companies and citizens to reverse deforestation and desertification trends.** A national roadmap for sustainable finance, adopted in March 2022, envisages increasing green loans as a share of the total loan portfolios of banks and non-banking financial institutions to 10 and 5 per cent, respectively. Meanwhile, the One Billion Trees national movement, launched in late 2021, envisages the planting of 1 billion trees by 2030, with more than 600 million of those to be planted by large corporations.