



Mongolia

Highlights

- **The Mongolian economy is booming on China's reopening.** Real gross domestic product (GDP) grew 6.4 per cent year on year in the first half of 2023. This was driven by a surge in commodity exports and a tourism boom following the reopening of the Chinese economy after the removal of Covid-related restrictions.
- **The financial system is undergoing a major transformation.** With XacBank conducting a successful initial public offering in May 2023, all five of Mongolia's systemically important banks have been transformed into publicly traded companies. As a result, Mongolian stock-market capitalisation exceeds US\$ 3 billion (€2.84 billion) and trading volumes in the first half of 2023 nearly doubled year on year.
- **The investment environment is improving.** A revised investment law, offering major improvements for foreign investors, entered the public discussion phase, and the government established the Private Partnership Centre and the Investment and Trade Agency. The latter is tasked with safeguarding investor interests and serving as a streamlined one-stop shop for foreign investors.

Key priorities for 2024

- **The government should use windfall revenues from commodity exports to inject capital into the newly created sovereign wealth fund, while ensuring its independence.** The government's decision to transform the state-owned mining company, Erdenes Mongol, into a sovereign wealth fund is conceived as a countercyclical move, but it is important to ring-fence the fund from political interference through proper corporate governance arrangements.
- **Measures to improve soft connectivity infrastructure would help diversify the economy.** Newly built railways are enabling Mongolia to significantly increase mineral exports by cutting transport and logistics costs. To boost non-commodity exports, Mongolia should digitalise border crossings and customs protocols, as well as address well-known e-trade challenges, such as legal and regulatory bottlenecks for cross-border payments.
- **Resolving legacy issues in the energy sector will help unlock investment in renewables.** Challenges related to the curtailment of electricity supply from existing variable renewable energy generators, issues of non-payment, and non-cost-reflective tariffs discourage new private-sector investment in renewables. Addressing these challenges is paramount given Mongolia's extreme reliance on coal and recently unveiled plans to construct new coal-fired power plants.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	5.6	-4.6	1.6	5.0	7.2
Inflation (average)	7.3	3.7	7.4	15.2	12.3
Government balance/GDP	1.0	-9.2	-3.0	0.7	-0.7
Current account balance/GDP	-15.2	-5.1	-13.8	-13.4	-10.9
Net FDI/GDP [neg. sign = inflows]	17.2	12.9	14.2	14.9	n.a.
External debt/GDP	222.7	243.1	222.0	n.a.	n.a.
Gross reserves/GDP	30.7	34.1	28.7	20.2	n.a.
Credit to private sector/GDP	48.9	45.8	47.5	n.a.	n.a.

Macroeconomic developments and policy response

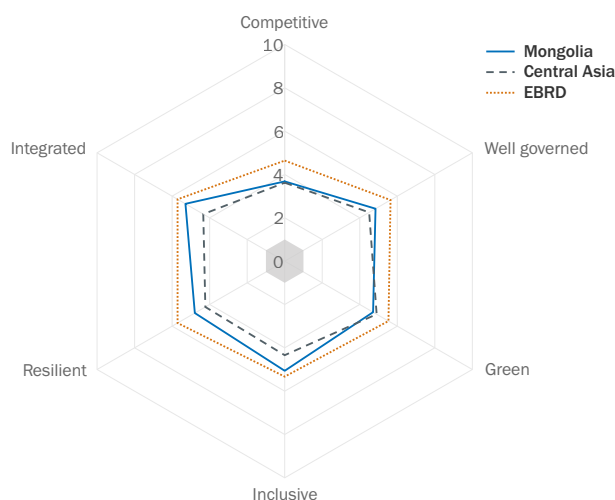
The economy is booming. China's removal of Covid-related restrictions in December 2022 enabled a rapid expansion of Mongolian mining and quarrying activities, as well as the full recovery of tourism. In the first half of 2023, the economy grew 6.4 per cent year on year. Foreign trade turnover increased dramatically in January-July 2023. Exports rose 34.5 per cent year on year, driven by a more than 60 per cent increase in coal exports, supported, in turn, by the launch of two new rail lines connecting Mongolia's main coal deposits in Tavan Tolgoi to China. Imports grew by 5.5 per cent year on year on very strong demand for machinery, equipment and electrical appliances (up 26.9 per cent year on year), reflecting foreign direct investment-related capital investment. With pandemic-related travel restrictions finally rescinded, the number of incoming travellers in the first half of 2023 saw a threefold increase from the previous year, boosting revenues in the hotels, restaurants and catering sector, as well as the cashmere trade (Mongolia's largest producer, Gobi, saw its domestic sales increase 89 per cent on the year).

Inflation is on a downward trajectory. Following a broader global trend, consumer price inflation decreased to 9.2 per cent in July 2023, having peaked at 16.9 per cent in June 2022. Even so, the Bank of Mongolia has maintained its policy rate at 13 per cent since December 2022. Since March 2023, the tugrik has appreciated by 1.5 per cent (as at 28 August) against the US dollar, reflecting a massive increase in exports and foreign-currency earnings. However, the currency remains below its value before the war on Ukraine, having lost about 20.8 per cent against the dollar in 2022.

The fiscal stance is improving. The government budget posted a surplus of 0.7 per cent of GDP in 2022, compared with a deficit of 3 per cent the previous year. This positive trend continued in the first seven months of 2023, with the budget seeing a surplus of MNT 1.36 trillion (€370.5 million, or 2.3 per cent of 2022 GDP), driven by a 41.4 per cent year-on-year increase in tax revenue, against a government spending increase of just 16.7 per cent. Public debt decreased as a share of GDP, to 82.4 per cent in 2022 from a peak of 97.4 per cent in 2020 (according to the International Monetary Fund), but remains elevated by regional standards. On the positive side, the country was able to partly refinance US\$ 1.1 billion (€1.04 billion) in debt maturing in 2023 and 2024 by issuing a new US\$ 650 million (€615.2 million) bond with a lower coupon rate. This reflects investors' confidence in Mongolia's continued growth and improved fiscal discipline, as manifested in the recently adopted budget law, which enhances fiscal transparency and accountability.

Strong growth is likely to continue in the short term. We forecast real GDP to grow by 7.2 per cent in 2023 and 7.5 per cent in 2024. There is significant upside potential to the 2023 growth outlook from the boom in tourism continuing in the second half of 2023 (and beyond), as well as from mining activities and commodity exports gathering further steam. Downside risks relate to unfavourable external developments, such as the war on Ukraine further disrupting transportation and transit through Russia, a continued tightening of global credit conditions and China's potential slowdown affecting commodity prices and demand for Mongolia's exports.

Assessment of transition qualities (1-10)



Structural reform developments

A comprehensive national anti-corruption strategy is being considered. In April 2023 the State Grand Khural, Mongolia's parliament, received a draft strategy from the Ministry for Justice and Home Affairs for consideration. The proposed strategy envisions enhancements to the governance of state-controlled assets, augmented protection for whistleblowers, anti-corruption education, the standardisation of operations for state-owned enterprises and heightened transparency in public appointments and procurement. The prime minister has emphasised the need to fortify anti-corruption measures in the extractive industries – a noteworthy development given massive protests in December 2022 due to corruption allegations in the coal mining sector. Mongolia launched the Opening Extractives programme in June 2022 following the implementation of a law mandating public disclosure of beneficial ownership in major companies, including those in the extractive sector. With 2023 declared the Year of Fighting Against Corruption, these efforts underscore the country's commitment to combating corruption and upholding the principles of good governance. The measures taken so far have received a positive response from international partners, but they need to be implemented consistently.

Government proposals to enhance the investment climate have entered a critical public debate stage. The proposed amendments to the existing Investment Law seek to make Mongolia more attractive to foreign investors. The main improvements include: cancelling the mandatory requirements to obtain a special residency permit, to meet a minimum investment threshold (of US\$ 100,000 [€94,648]) and to have at least one-third of company shares owned by a Mongolian national; limiting the number of inspections of foreign-owned firms; equalising permit fees for local and foreign enterprises; reducing the withholding tax on repatriating profits; and granting foreign investors limited land tenure rights. Following public criticism of the land tenure-related provisions, in August 2023 the Ministry of National Economic Development put forward a revised proposal for public discussion. In parallel, the government announced the establishment of two entities, the Private Partnership Centre and the Investment and Trade Agency. The latter is tasked with safeguarding investor interests and serving as a one-stop shop for foreign investors.

Mongolia's rapid digital transformation is gaining momentum. Consistent with its Vision 2050 strategy, the Mongolian government has progressed significantly in the digital realm by broadening internet access, introducing e-government services and investing in information and communications technology (ICT) infrastructure. Supported by the European Bank for Reconstruction and Development (EBRD) and the Republic of Korea, the United Nations Conference on Trade and Development conducted an eTrade Readiness Assessment, helping to formulate a roadmap for Mongolia's e-commerce progression. Key challenges identified by the assessment include logistics bottlenecks, limited cross-border payment options, an inadequate legal framework and an extensive digital divide between urban and rural areas. The government intends to tackle the latter issue by granting two licences to SpaceX to provide low-orbit satellite internet via Starlink to augment connectivity in remote regions.

Green finance initiatives are receiving international support. In March 2023 the International Finance Corporation (IFC) invested in Khan Bank's inaugural green bond issuance. As Mongolia's largest bank, Khan Bank's green bond aligns with the country's ambition to increase green lending from 1.4 per cent in 2023 to an impressive 10 per cent of total lending by 2030. The IFC contributed US\$ 15 million (€14.2 million), while an additional US\$ 45 million (€42.59 million) was attracted from other international investors, including the Dutch entrepreneurial development bank (FMO) and MicroVest Capital Management. With this investment, Khan Bank expects to expand its climate portfolio by funding projects in climate mitigation and adaptation. Further advancing Mongolia's green agenda, in July 2023, the EBRD and the Green Climate Fund jointly launched a Green Economy Financing Facility (GEFF), valued at US\$ 137 million (€129.67 million), to support Mongolia's green transition. Borrowers can access these funds through Khan Bank and XacBank, the EBRD's partner financial institutions. Lastly, Mongolia has cooperated with international organisations on the establishment of a Conservation Trust Fund. Launched in July 2023, the fund will finance environmental conservation projects, further underscoring Mongolia's commitment to addressing climate change-related challenges.