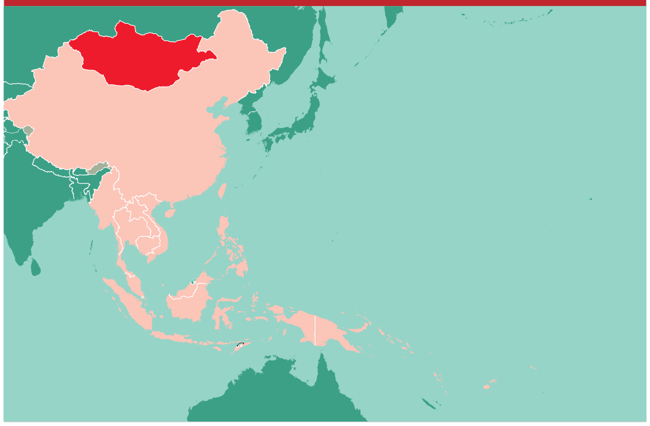
MONGOLIA



	2018
Population, million	3.2
GDP, current US$ billion	13.0
GDP per capita, current US$	4,103
National Official Poverty Rate[a]	28.4
Gini index[b]	32.0
School enrolment, primary (% gross)[c]	104.5
Life expectancy at birth, years[c]	69.5

Source: WDI, Macro Poverty Outlook, and official data.
Notes: a. National Statistics Office. Most recent value (2018). b. Most recent WDI value (2016). c. Most recent WDI value (2017).

Mongolia's growth momentum has continued in 2019H1 led by mineral exports, robust private investment and improved market sentiments. This has helped to reduce poverty, though high inflation rate has diminished the overall effect. Growth outlook remains positive in the near to medium term, driven by private consumption, and mining sector investment. Risks to the outlook include political uncertainty, commodity price shocks, cross-border bottlenecks, implementation delay involving mega projects and slower implementation of banking sector reforms.

Recent Developments

The growth momentum continued in 2019 H1, as real GDP at market price rose to 7.3 percent from 6.8 percent in 2018 and 6.6 percent in 2018 H1. This robust economic performance has largely been supported by a strong coal sector (boosted by higher prices and volume) and increased private investment. Improved market confidence following a $5.5 billion multi-donor support package, skillful management of the macroeconomy, especially on the fiscal side, and steady progress on structural reforms have contributed to this strong economic performance. The solid recovery of private consumption, which started in 2017-18, continued in 2019 H1, largely on the back of positive developments in the labor market (e.g., decline in the unemployment rate) and accommodative credit policy. Meanwhile, inflation accelerated to 8.1 percent in 2019 H1 (close to the central bank target of 8 percent), driven by rising food and oil prices and strong domestic demand. However, the gradual tightening of the monetary stance since late-2018 has sharply decelerated credit growth (particularly individual loans), which fueled inflation and imports in most of 2018. The average real household income has also continued to grow strongly by 10.3 percent in 2019 H1, mainly driven by the public sector wage increase, and strong rural income growth.

The fiscal overperformance continued in 2019 H1, supported by a robust revenue performance and a steady implementation of fiscal consolidation reforms. The capital budget under-execution also played a role. Overall fiscal balance turned around from a record high deficit of 15.3 percent of GDP in 2016 to a surplus of 2.6 percent in 2018 and 3.4 percent in 2019 H1. Substantial improvements in the fiscal balance contributed to the sharp reduction in government debt in 2017-18.

After an escalation in 2018, external sector pressures have eased, largely driven by a rapid deceleration of import growth (goods and services), bank credit growth and robust FDI and portfolio investment inflows. The current account balance improved to a deficit of 4.9 percent of GDP in 2019 H1 from 6.7 percent in 2018 H1. Mineral exports (mainly coal and iron ore) supported exports growth of 2019 H1. Strong FDI inflows and a bond issuance of US$300 million by private sector in 2019 H1 resulted in a moderate surplus in the balance of payments (BoP). Gross international reserves continued to rise, reaching US$ 4 billion (about 5 months of imports) in 2019 H1. Despite limited reserves, extensive BoM foreign exchange interventions of 2018 have continued in 2019 H1. Increased foreign exchange interventions has led to only a moderate depreciation of the tugrug against the US$ in 2019 H1 and a slight appreciation against the Chinese RMB, unlike many regional peers.

Meanwhile, with a higher inflation compared to major trading partners (China and Russia), real effective exchange rate appreciated by 4.2 percent in 2019 H1, which may affect the export competitiveness of the non-mining sector.

Outlook

Supported by strong domestic demand, sustained FDI flows, and robust commodity exports, real GDP growth at market price is projected to slightly accelerate to 6.9 percent in 2019 (revised downward from our initial projections of 7.2 percent), from 6.8 percent in 2018. The latest downward revision can be explained by recent fall in copper prices and expected lower gold content of Oyu Tolgoi (OT)'s copper production. Growth will decelerate to about 6 percent in 2020–21, as OT's first production date is delayed beyond 2022. Private investment supported by FDI and domestic credit (particularly corporate loans) will remain a key driver for growth in the medium-term, especially in mining, manufacturing, and transport services. Inflation is likely to remain elevated in 2019, before moderating gradually in 2020–21. Private consumption will be a key driver of medium-term growth and poverty reduction. The base case assumes a gradual tightening of monetary policy to contain inflation.

Agriculture sector growth is projected to average 4.7 percent in the medium term. Meanwhile, industry would grow by about 5.5 percent in 2019–21, due to declining commodity prices and potential implementation delay of mega mining projects. Strong linkages with mining would continue to support the services sector growth.

The base case assumes that fiscal deficit would average about 1.5 percent of GDP in 2019–21, consistent with a lower debt path. The growth of investment related imports is expected to moderately decelerate in 2020–21, gradually reducing current account deficit. Foreign exchange market pressures will likely ease with the disbursement of donors' support and further inflows of FDI. Gross international reserves would continue to improve to 5.3 months of imports in 2019 from 4.9 months in 2018. In this context, BoM should encourage greater flexibility of the exchange rate through limited interventions to support economic diversification.

The robust medium-term macro outlook is expected to contribute to further poverty reduction.

Risks and Challenges

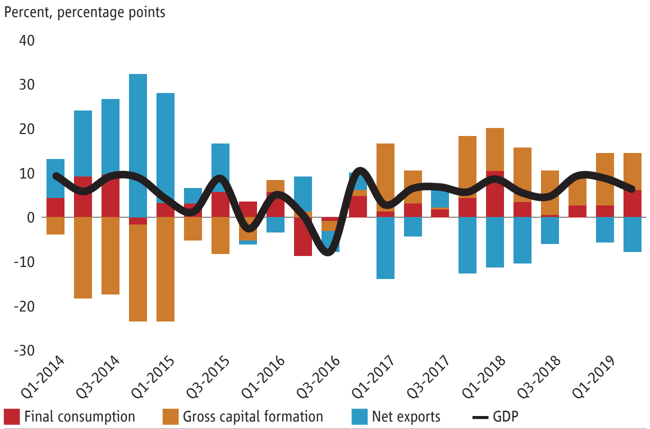
The risks to the medium-term growth outlook include political uncertainty with the 2020 election, the escalation of the trade war between China and USA, climate shocks (drought/flooding, harsh winter), bottlenecks at the China border and lack of progress on recapitalization of the banking sector and anti-money laundering (AML) issues.

Growing political uncertainty could induce a sudden relaxation of the government's commitment to reforms, thereby affecting market sentiments and FDI flows. So far, the government has made an unprecedented effort to break-out of the stimulus and austerity cycle surrounding past elections. Growth prospects could be adversely affected by an escalation of the trade war and its impact on the price of key exporting commodities (particularly copper).

Weather related shocks and resumption of non-trade barriers at the border with China could affect Mongolia's coal exports. Inability to recapitalize the banking sector adequately could create instability and delay the disbursement of official support.

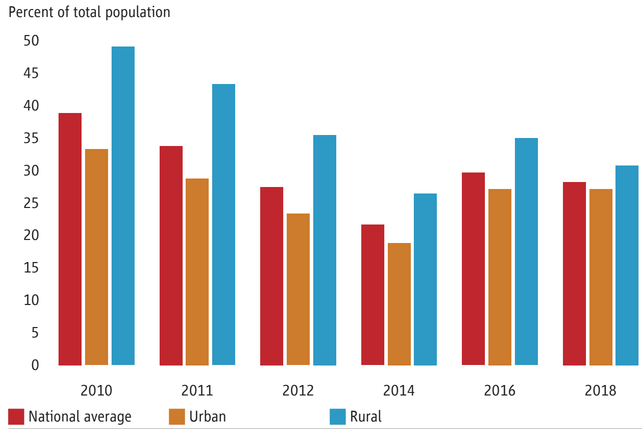
Mongolia's limited progress on AML issues (particularly in implementation part) is an additional risk, given its potential effect on FDI, and the financial sector. An emerging upside risk to the outlook is the accelerated progress on the construction of the oil-refinery project and progress on US-Mongolia trade agreement following the July 2019 visit of the Mongolian President to the USA.

Figure 1. Real GDP growth and contributions to real GDP growth



Source: National Statistics Office.

Figure 2. Poverty rate (official poverty line): 2010–18



Source: National Statistics Office.

MONGOLIA Macro Poverty Outlook Indicators	*2016*	*2017*	*2018*	*2019e*	*2020f*	*2021f*
						Annual percent change unless indicated otherwise
Real GDP growth, at constant market prices	1.4	5.4	6.8	6.9	6.3	5.9
Private Consumption	-2.2	5.3	6.2	5.7	6.0	6.3
Government Consumption	10.6	-1.8	0.5	5.4	6.3	7.8
Gross Fixed Capital Investment	0.5	35.6	22.4	10.0	5.7	4.5
Exports, Goods and Services	13.8	14.8	13.4	5.4	2.6	4.9
Imports, Goods and Services	12.7	24.8	20.8	4.8	1.9	4.4
Real GDP growth, at constant factor prices	1.2	5.3	7.2	6.9	6.3	5.9
Agriculture	6.2	1.8	4.5	5.0	4.5	4.5
Industry	-0.4	0.7	7.4	6.2	5.3	5.0
Services	1.0	11.0	7.9	8.2	7.8	7.1
Inflation (Consumer Price Index)	1.3	6.4	8.1	8.5	8.3	7.2
Current Account Balance (% of GDP)	-6.3	-10.1	-17.0	-14.4	-12.5	-11.9
Net Foreign Direct Investment (% of GDP)	1.3	12.6	15.8	13.0	11.4	11.2
Fiscal Balance (% of GDP)	-15.3	-3.5	2.6	-1.3	-1.7	-1.5
Debt (% of GDP)	87.6	84.7	74.4	71.4	68.0	62.4
Primary Balance (% of GDP)	-11.4	0.3	5.7	1.2	0.5	0.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate; f = forecast.