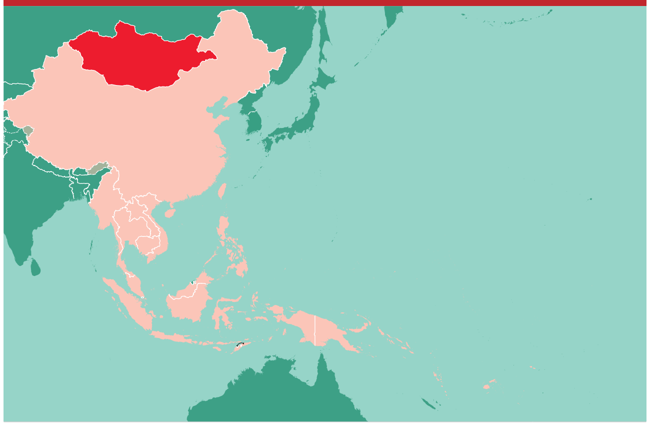
MONGOLIA



	2017
Population, million	3.1
GDP, current US$ billion	12.0
GDP per capita, current US$	3,909
School enrolment, primary (% gross)[a]	100.9
Life expectancy at birth, years[a]	69.1

Source: WDI, Macro Poverty Outlook, and official data.
Notes: (a) 2016. (b) Most recent WDI value (2015).

Summary

The Mongolian economy grew by 5.1 percent in 2017 exceeding expectations, following strong coal exports, strong foreign direct investment, and improved business sentiments. Growth outlook remains positive in 2018 and beyond, mainly supported by increased private investment in mining and a new impetus in trade and transport services. Improvements in household incomes and positive outlook augur well for poverty reduction after sharp increase of 2016. Risks to the outlook include political uncertainty, climate and commodity shocks, and border related issues.

Recent Developments

Mongolia's economy recovered strongly in 2017 as real GDP rose to 5.1 percent from 1.5 percent in 2016. Despite bottlenecks at the border with China and weather-related shocks, growth exceeded expectations in 2017, largely supported by a revived coal sector, and strong private investment including in non-mineral sector (trade and transport). Improved market sentiments following successful implementation of government's economic recovery plan also contributed to this performance. Following positive developments on the labor market, private consumption recovered strongly in 2017 (4.3 percent) following a contraction in 2016. Unemployment rate in Q4 2017 declined by almost 1.5 percentage points from 8.6 percent in Q4 2016. Although inflation remained below the central bank rate of 8 percent, it accelerated to 6.4 percent in 2017 with rising prices of meat, vegetables, fuel, and the effects of excise tax levied on vehicles. Despite regional differences, real average household income, which contracted in 2016, increased by 6.5 percent in 2017. Income improvements have translated into expenditures growth as real average household expenditures rose by about 7 percentage points in 2017 from 1.6 percent in 2016. As a result, poverty rates may have leveled off in 2017.

The fiscal stance improved substantially in 2017 as overall deficit dropped by almost nine folds to 1.9 percent of GDP from 17 percent of GDP in 2016. This was explained by a better than expected revenue performance from the rise in coal exports, and a commitment to spending control (e.g., reduction in interest payments, streamlining wage bill through hiring freeze, and rationalization of underperforming capital spending) in the context of its fiscal adjustment program. Substantial improvement in fiscal balance ultimately led to a sharp reduction in government debt in 2017. Despite positive terms of trade, current account balance slightly deteriorated in 2017 following a surge in investment income by non-residents due to large FDI inflows. Merchandise exports increased by 26 percent in 2017, with sharp rise in coal exports from 5.3 percent in 2016. This broadly positive external environment along with stronger official sector support, and other factors mentioned above, have helped strengthen Mongolia's external buffers. Gross international reserves increased to US$3 billion (4.9 months of imports) from US$1 billion reached in February 2017, its lowest level since August 2008. Bank of Mongolia (BoM) has implemented a prudent exchange rate policy resulting in a 2.3 percent appreciation of the Tugrug in 2017 from the 25 percent depreciation of 2016.

Outlook

Despite some base effects, economic growth is projected to further improve modestly to 5.3 percent in 2018 from 5.1 percent in 2017, and to accelerate to over 6 percent in 2019–20. Private investment will remain a key driver for growth in the medium-term, especially in mining, trade and transport services. Despite reduced depreciation pressure on the exchange rate, inflation will likely rise although modestly—putting at risk the BOM medium term target of 8 percent as food and petrol prices are expected to continue to increase. Private consumption is also projected to further improve over the medium term. Accordingly, BOM has started to gradually tighten monetary policy to contain inflation.

Agriculture is projected to grow around 4 percent over the medium term, but below its 2014–15 performance, due to the adverse effects of harsh winter. Industry is projected to grow around 7 percent in 2018–20, as substantial developments are expected in mining. Services sector growth would be supported by strong linkages between mining and transport. Moreover, trade and transport may also gain from the intensification of relations with Russia.

The fiscal deficit could decline further as long as government remains committed to implement its fiscal consolidation program agreed with development partners, despite recent policy reversals (see below). The declining deficit path will likely result in continued reduction on debt over the medium term. The balance of payments will continue to face structural vulnerabilities exacerbated by the country's debt situation. Despite robust export growth, investment related construction imports over the next two years will rise and put pressure on the current account balance. Exchange rate depreciation will continue to subside following the disbursement of outstanding official sector (donors) support and further FDI inflows. Moreover, gross international reserves would significantly improve to 6.8 months of imports in 2019 from 4.9 months in 2017.

Given the positive macro outlook, poverty rates are expected to start declining in 2018. However, gains in urban poverty reduction may be partially countered by protracted rural poverty unless economic activity improves in rural areas.

Risks and Challenges

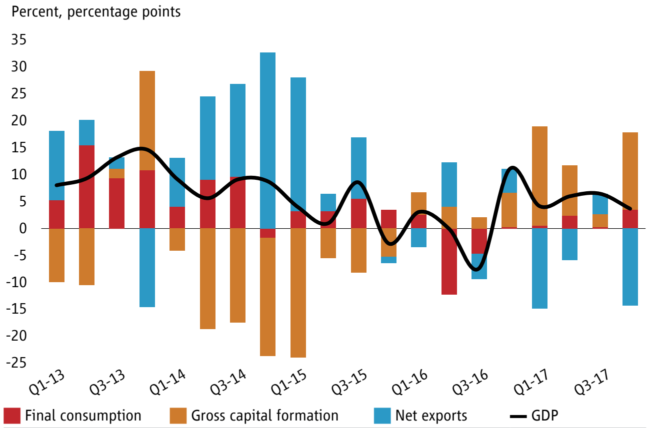
Mongolia's underlying structural issues remain despite its strong recovery of 2017. There are substantial domestic and external exogenous risks to the outlook. These risks include persistent political uncertainty which could trigger a delay of implementation of mega projects in mining sector; climate shocks; commodity market volatility; and bottlenecks at the border; as well as regional instability.

The recent policy reversals, including abandoning the progressive Personal Income Tax system, and modifying extension of retirement age, could raise concerns about policy stability, thereby affecting market sentiments and FDI. In contrast, if the government maintains fiscal discipline and promote policies to attract FDI, Mongolia's prospects for growth and poverty reduction further improve. Weather-related shocks will remain an important challenge to Mongolia's economy. Livestock is the main source of income in rural areas and further growth is key to raising living conditions in the countryside. Adaptation to climate change should also be prioritized to help mitigate primary sector production shocks.

Commodity market volatility is likely to affect Mongolia's growth prospects. Improving management of proceeds from minerals is therefore critical.

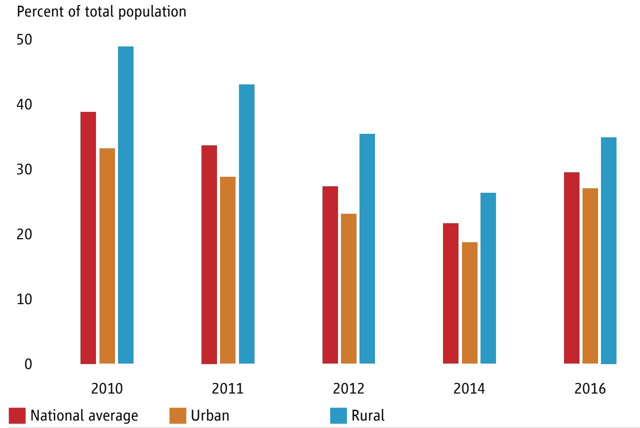
Worsening of non-trade barriers at the border with China and resumption of coal imports from North Korea could affect Mongolia's coal exports. Unless Mongolia addresses deficiencies in its anti-money laundering system, the country could find itself on the FATF grey list, posing an additional risk to FDI and the financial sector.

Figure 1. Real GDP growth, contribution to real growth



Source: National Statistics Office.

Figure 2. Poverty rate (official poverty line): 2010–16



Source: National Statistics Office.

MONGOLIA Selected Indicators	2015	2016	2017e	2018f	2019f	2020f
Real GDP growth, at constant market prices	2.5	1.5	5.1	5.3	6.4	6.5
Private Consumption	7.4	-7.9	4.3	3.7	6.7	6.9
Government Consumption	-4.7	11.0	-3.2	-1.7	1.9	4.2
Gross Fixed Capital Investment	-34.4	7.8	32.8	7.0	34.0	8.0
Exports, Goods and Services	1.2	12.6	13.4	9.0	8.0	8.5
Imports, Goods and Services	-11.4	12.4	25.0	7.3	15.4	8.0
Real GDP growth, at constant factor prices	5.6	1.6	3.8	5.3	6.4	6.5
Agriculture	10.7	6.2	2.3	3.5	3.6	4.0
Industry	9.9	-0.6	-1.4	5.0	7.0	9.0
Services	0.8	2.0	8.6	6.1	6.8	5.4
Inflation (Private Consumption Deflator)	1.1	0.9	6.4	8.0	6.9	6.5
Current Account Balance (% of GDP)	-7.3	-6.0	-10.2	-6.5	-8.4	-6.0
Financial and Capital Account (% of GDP)	3.0	7.8	24.9	10.9	16.1	6.3
Net Foreign Direct Investment (% of GDP)	1.5	1.0	11.8	11.8	14.9	12.2
Fiscal Balance (% of GDP)	-8.2	-16.7	-1.9	-5.6	-4.1	-1.7
Debt (% of GDP)	60.7	86.0	83.8	81.4	78.9	73.8
Primary Balance (% of GDP)	-5.4	-13.1	2.2	-1.5	-0.6	1.5

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