MONGOLIA

Highlights

- **Mongolia's growth has been decelerating.** GDP growth slowed from double-digits in 2011-13 to 7.8 per cent in 2014 and is likely to decelerate further in 2015 as a result of lower foreign direct investment (FDI) in the mining sector, subdued demand from China and a slow-down in the real estate sector.
- **The government and Rio Tinto reached a provisional agreement on the modalities of the second phase of Oyu Tolgoi**, a major copper and gold deposit. The final agreement, if completed, paves the way to re-launch the second phase of this multi-billion-dollar project, which has effectively been suspended since 2013.
- **A new law is set to increase transparency of fiscal accounts at the national, regional and local levels.** The "Glass Account" law, which came into effect in January 2015, mandates publication of all budgets, state guarantees and accounts of special development funds.

Key priorities for 2016

- **Mongolia's high infrastructure requirements need greater private sector involvement.** The establishment of a strong framework for concessions/public-private partnerships should be combined with further strengthening of the project assessment and implementation capacity of the Development Bank of Mongolia.
- **Efforts to attract FDI need to focus on further improvements to the business environment.** Given the current outlook for softer commodity prices, establishing a track record of a transparent, rule-based approach to awarding mining licences and concessions will be key to leveraging such investment.
- **Further steps need to be taken to strengthen banking sector regulation and supervision.** Rules governing loan provisioning and risk weighting need to be reviewed to ensure that the banking sector maintains resilience amid decelerating growth.

Main macroeconomic indicators %

	2011	2012	2013	2014	2015 proj.
GDP growth	17.5	12.3	11.7	7.8	3.3
Inflation (average)	7.7	15.0	8.6	12.9	8.2
Government balance/GDP	-4.0	-9.1	-8.9	-10.9	-9.7
Current account balance/GDP	-26.5	-27.4	-25.4	-8.2	-8.4
Net FDI/GDP [neg. sign = inflows]	-44.4	-35.9	-15.9	-3.4	-1.3
External debt/GDP	37.2	57.2	69.0	85.8	n.a.
Gross reserves/GDP	25.3	33.6	17.8	13.7	n.a.
Credit to private sector/GDP	47.0	49.6	60.9	56.8	n.a.

CONTINUES

Macroeconomic performance

Growth has been decelerating. From the peak of 17.3 per cent in 2011, economic growth slowed to 7.8 per cent in 2014 and 3.0 per cent in the first half of 2015. Growth has been supported by growing production at the first phase of Oyu Tolgoi, one of the largest copper and gold deposits in the world, which began operations in the second half of 2013.

Mongolia's external position has been adversely affected by a combination of lower commodity prices and a drop in inward FDI. Such inflows dropped from an average of 35 per cent of GDP in 2011-13 to around 6 per cent of GDP in 2014, owing to the earlier suspension of Phase II of Oyu Tolgoi, and a decline in commodity prices. As investment activity slowed, the current account deficit has declined from around 26.0 per cent of GDP in 2011-13 to 8.2 per cent of GDP in 2014. Nonetheless international reserves have declined significantly since early 2014 to a level of US$ 1.6 billion in May 2015, and external debt rose rapidly, reaching around 85.8 per cent of GDP at the end of 2014 (excluding inter-company lending).

Fiscal policy has remained accommodating; monetary policy is tightening. The Fiscal Stability Law, which came into force in 2013 and limits structural budget deficits and the level of public debt, has not been adhered to in spirit. In January 2015, the public debt ceiling was raised from 40 to 58 per cent of GDP, with the definition of debt amended to exclude that deriving from state-owned enterprises and government-guaranteed debt. Structural fiscal deficit limits were also amended to 5 per cent of GDP in 2015, 4 per cent in 2016 and 3 per cent in 2017, with Development Bank of Mongolia spending included in the calculation of the deficit. Monetary policy remained loose, with major provision of liquidity in the context of the Price Stabilisation Programme (PSP), involving subsidised loans for housing, selected sectors of the economy and other pre-agreed purposes. In February 2015 parliament approved a Comprehensive Macro Adjustment Plan (CMAP), which comprises macro-financial adjustment and structural policies to phase out the Bank of Mongolia's (BoM's) Price Stabilization Program and the transfer of remaining PSP loans to the government. This programme is expected to be finalised in the second half of 2015. As a result of the loose fiscal stance, inflation in 2014 was persistently high, averaging 12.9 per cent. Monetary policy has been tightening since July 2014, with the refinancing rate reaching 13 per cent in January 2015, compared with 10.5 per cent the year before, and this has helped to ease inflation to 3.9 per cent in September 2015 year-on-year.

Output growth is expected to decelerate to 3.3 per cent in 2015, but to improve to 5.0 per cent in 2016. Lower FDI into the mining sector, low commodity prices, weaker demand for commodities from China, as well as the slow-down in the domestic real estate sector are contributing to declining growth in 2015. The likely restarting of the second phase of Oyu Tolgoi late in 2015, with significant investment expected in 2016 (and thereafter), can be expected to push up growth in 2016.

Major structural reform developments

In May 2015 the government and Rio Tinto reached a provisional agreement on the modalities of the second phase of Oyu Tolgoi. The agreement covered tax liabilities of Oyu Tolgoi following an earlier audit, the calculation of royalty payments and a number of other issues. The agreement, if completed, paves the way to re-launching the second phase of the project, which has been effectively suspended since 2013, subject to the availability of the market financing needed to cover capital costs, which is estimated at around US$ 6 billion. Global mining company Rio Tinto plans to invest up to US$ 300 million to build the underground section of the US$ 5.4 billion Oyu Tolgoi copper and gold mine. It plans to start the second phase of construction at the mine in November 2015. Resumption of the second phase of Oyu Tolgoi may be seen as a positive signal by other foreign investors.

CONTINUES

The new "Glass Account" Law aims to increase the transparency of fiscal accounts at the national, regional and local level. The law, which came into effect in January 2015, mandates publication of all budgets as well as items such as state guarantees or special development funds. These documents should be available online from the middle of 2016.

A number of recently implemented reforms aim to improve the business environment. An electronic tax payment system was launched in May 2014, enabling taxpayers to view their tax history, submit reports and make payments online, and a new system of electronic identification cards is being rolled out. There is scope for streamlining various regulations further as Mongolia ranked 56th out of 189 countries in terms of ease of doing business according to the World Bank Doing Business 2016 report. Access to finance, access to land, trade regulations and customs, and inadequate workforce skills are all perceived as key obstacles to doing business, according to the latest round of the Business Environment and Enterprise Performance Survey (BEEPS V) conducted by the EBRD and the World Bank.

In October 2014 the parliament reviewed Mongolia's railway policy. For the first time, a gauge compatible with China's standard was adopted for two routes from coal mines to the border with China, in parallel with the Russian standard used elsewhere in the country. The use of the narrow gauge is expected to significantly reduce the cost of shipping coal to China.

The financial supervisory authorities took steps to strengthen prudential regulations. The new rules, which came into effect in January 2015, increase the rate of mandatory provisioning for loans and impose higher risk weights on loans denominated in foreign currency and extended to unhedged borrowers. At the same time, loans extended within the framework of the price stabilisation programme remain subject to zero risk weighting, indicating continued regulatory forbearance with respect to these loans.