Public Disclosure Authorized
Public Disclosure Authorized
Public Disclosure Authorized
Public Disclosure Authorized

MONGOLIA ECONOMIC UPDATE

THE WORLD BANK
IBRD • IDA | WORLD BANK GROUP

May 2024

MONGOLIA ECONOMIC UPDATE

May 2024

World Bank with external contributions. The findings, interpretations, and conclusions expressed in this report do not necessarily reflect the views of the World Bank, the Executive Directors of the World Bank or the governments they represent. The World Bank does not guarantee the accuracy of the data included in this report.

Rights and Permissions

The material in this publication is copyrighted. Copying and/or transmitting portions or all of this work without permission may be a violation of applicable law. The International Bank for Reconstruction and Development/ The World Bank encourages dissemination of its work and will normally grant permission to reproduce portions of the work promptly. For permission to photocopy or reprint any part of this work, please send a request with complete information to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, USA, telephone 978-750-8400, fax 978-750-4470, http://copyright.com/. All other queries on rights and licenses, including subsidiary rights, should be addressed to the Office of the Publisher, The World Bank, 1818 H Street NW, Washington, DC 20433, USA, fax 202-522-2422, email pubrights@worldbank.org.

Contents

List of boxes, figures, and tables

Boxes

Figures

Tables

ABBREVIATIONS

BOM	Bank of Mongolia
CIT	Corporate income tax
CPI	consumer price index
DBM	Development Bank of Mongolia
FDI	foreign direct investment
FHF	Future Heritage Fund
FSF	Fiscal Stabilization Fund
GDP	gross domestic product
GOM	Government of Mongolia
LFPR	labor force participation rate
MOF	Ministry of Finance, Mongolia
NSO	National Statistics Office, Mongolia
OT	Oyu Tolgoi
PBOC	People's Bank of China
PIT	Personal income tax
SEC	State Emergency Committee
SOE	state-owned enterprise
SSC	Social security contribution
VAT	value added tax

ACKNOWLEDGEMENTS

This edition of the Mongolia Economic Update (MEU) was prepared by Undral Batmunkh (Economist), Andrew Blackman (Senior Economist), Dulmaa Enkhtuya (Extended Term Consultant), and Anna Twum (Young Professional). The MEU was prepared under the guidance of Mara K. Warwick (Country Director), Sebastian Eckardt (Practice Manager), Tae Hyun Lee (Country Manager), Elitza Mileva (Lead Economist), and Jose Luis Diaz Sanchez (Senior Economist). The team is grateful to Javkhlan Bold-Erdene (External Affairs Associate) for her support on communication affairs.

The findings, interpretations, and conclusions expressed in this update are those of World Bank staff and do not necessarily reflect the views of the Executive Board of the World Bank or the governments they represent. For information about the World Bank and its activities in Mongolia, please visit https://www.worldbank.org/en/country/mongolia. For questions and comments on the contents of this publication, please contact Undral Batmunkh (ubatmunkh@worldbank.org). The cutoff date for this edition of the MEU is March 31, 2024.

Executive Summary

Mongolia's economy has recovered but the current economic expansion was largely driven by strong coal exports. Despite the contraction in agricultural production attributed to harsh weather conditions, the economy expanded by 7.1 percent in 2023. Growth was mainly driven by coal mining and related transportation services. Indeed, coal exports rose to 91 percent above their pre-pandemic (2018-2019) average. This was primarily driven by higher demand for coal from China.

Public and private consumption growth also supported the economy, spurred by rising household income and the 2023 supplementary budget. Public consumption increased by 5.4 percent in 2023, boosted by an acceleration in the third quarter of the year reflecting the 2023 supplementary budget that increased public spending on goods and services. Private consumption also accelerated in the second half of the year, supported by rising wages (including public wages) and declining inflation. In particular, headline inflation declined to 7.9 percent in December 2023 (and to 7.0 percent in March 2024). The inflation rate of imported goods decelerated as supply bottlenecks, transportation costs, international energy and food prices, and exchange rate depreciation eased. However, prices of domestically produced food, particularly meat, remained elevated.

Despite increased public spending, the government's fiscal position improved in 2023, driven by higher mining revenues, resulting in a reduction in public debt. The budget registered a surplus of 2.6 percent of GDP in 2023, as higher revenues—mainly from coal exports—more than offset an increase in spending. This supported a reduction in public debt, which stood at 44.1 percent of GDP by the end of 2023 (excluding the Bank of Mongolia's swap agreement with the People's Bank of China (PBOC)).

Higher coal exports also improved the external position. Robust coal exports were partially offset by increased imports of services and consumption goods, leading to a modest current account surplus. Gross international reserves stood at US$4.9 billion by end-2023, rebounding from their low of US$2.7 billion in August 2022, despite weaker net capital inflows and some payments on external debt obligations by the government, the Development Bank of Mongolia (DBM, a state-owned enterprise, SOE), and the central bank.

Looking ahead, economic growth is expected to slow to 4.8 percent in 2024 as coal exports decline from their peak in 2023 and the agriculture sector continues to be affected by harsh climate conditions. The mining sector is expected to expand but at a slower pace in 2024 compared to 2023, as higher production of copper and gold more than offsets a normalization in coal exports. However, the contraction in the agriculture sector is projected to worsen as the *dzud*—a weather phenomenon characterized by extreme cold temperature and heavy snowfall—extends into a second year, with the sector suffering its largest livestock losses since 2010. On the demand side, robust private consumption and fiscal expansion—including higher public wages, pensions, and investment—will support growth. Private investment is also expected to recover due to higher bank lending and a stabilization in production costs.

Fiscal expansion and rising household incomes are expected to elevate inflationary pressures in 2024. Supply constraints from the expected agricultural contraction are poised to elevate domestic food prices, pushing average headline inflation to 8.5 percent in 2024, slightly exceeding the central bank's target range of 4.0-8.0 percent. Deficits in the fiscal and current account balances are expected to reemerge in 2024 as coal exports normalize, export commodity prices decline, elevated government spending persists, and demand for imports builds.

The medium-term growth outlook remains favorable, mainly supported by the mining industry. Economic growth is expected to reach an average of 6.4 percent over 2025-2026, driven by a substantial increase in mineral production of the Oyu Tolgoi (OT) mine, the largest copper mine in Mongolia, which is planning to more than double its 2023 production by 2025 (Table 1).

The outlook is subject to significant risks. The economy could face negative spillovers from weaker-than-anticipated growth in the Chinese economy (including due to a protracted real estate market slowdown which could dampen steel demand for which Mongolian coal is a major input), and an escalation of geopolitical tensions resulting in a higher price of imported oil. Domestically, a more severe and prolonged *dzud* would lead to a greater contraction in agriculture production, while a greater-than-expected fiscal expansion would lead to wider fiscal and current account deficits and elevate inflationary pressures.

While the recent mining-led boom resulted in an improved macro-fiscal situation in 2023, structural reforms remain fundamental for achieving macroeconomic resilience and fostering inclusive and resilient growth. Fiscal and structural reforms can help mitigate the above risks and enhance Mongolia's economic resilience, stability, and productivity. Prudent fiscal and monetary policies to increase macroeconomic resilience and structural reforms to develop the non-resource economy led by the private sector are crucial to decoupling the economy from the commodity boom/bust cycle and achieving the *Vision 2050* ambitions. Increasing frequency and intensity of natural disasters, as evidenced by the harsh winters of two consecutive years and last year's floods, call for attention to institutions, policies and investments to make the country more resilient to the adverse impacts of climate change.

Table 1. Key macroeconomic indicators

	2021	2022	2023	2024f	2025f	2026f
Real GDP Growth, at constant market prices	**1.6**	**5.0**	**7.1**	**4.8**	**6.6**	**6.3**
Private Consumption	-5.9	8.1	7.4	8.6	5.3	6.5
Government Consumption	9.2	6.9	6.6	17.7	4.8	6.8
Gross Fixed Capital Formation	17.7	13.2	7.0	17.1	9.8	6.1
Exports, Goods and Services	-14.6	32.3	42.9	3.5	16.0	6.3
Imports, Goods and Services	13.6	29.1	21.0	9.2	14.7	6.6
Real GDP Growth, at constant factor prices	**0.4**	**4.2**	**7.0**	**4.8**	**6.6**	**6.3**
Agriculture	-5.5	12.0	-8.9	-9.5	8.0	6.5
Industry (including mining)	-2.2	-4.5	12.6	6.4	11.2	7.8
Services	3.9	6.9	9.0	7.7	3.8	5.3
Inflation (CPI, period average)	**7.3**	**15.2**	**10.6**	**8.5**	**8.3**	**7.5**
Current Account Balance (% of GDP)	-13.4	-13.2	0.7	-11.5	-10.2	-10.1
Fiscal Balance (% of GDP)	-3.0	0.7	2.6	-1.0	-0.7	-0.5
Debt (% of GDP)	64.5	62.1	44.1	43.8	42.0	40.1

Source: World Bank staff estimates.
Note: Public debt does not include contingent liabilities or the BoM's liability under the PBOC swap line (8 percent of GDP in 2023).

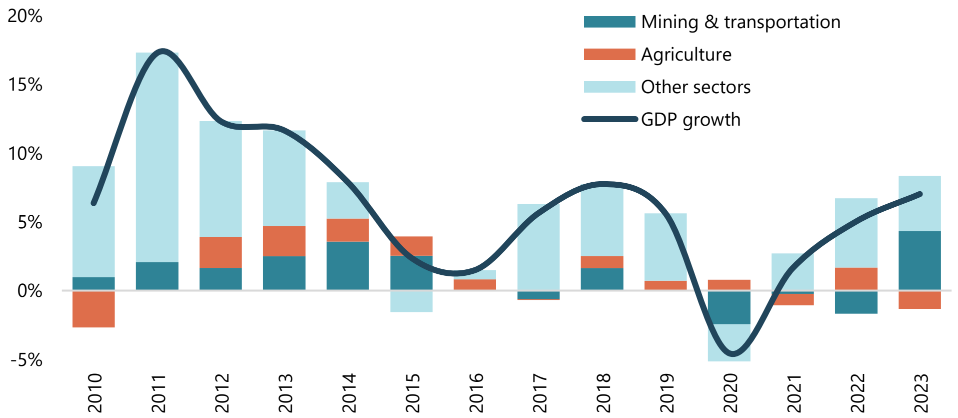
1. Recent Economic Developments

1.1. Growth in 2023 reached 7.1 percent led by mineral production and private consumption, but there are signs of deceleration

A rebound in mineral production and transportation services for mineral exports were key drivers of growth in 2023. With coal production more than doubling and copper production increasing by 17.3 percent, mining output expanded by 23.4 percent y-o-y in 2023. An exceptional increase in China's demand for coking coal in 2023 and the start of production at the OT underground copper mine in March 2023 propelled the growth in mining. Together with transportation services for coal exports, mining contributed over 60 percent of GDP growth in 2023 (Figure 1).

Figure 1. Mining and transportation services pulled up growth in 2023, compensating for the contraction in agriculture

Y-o-y growth of GDP, and growth contributions by key sectors (percentage points)



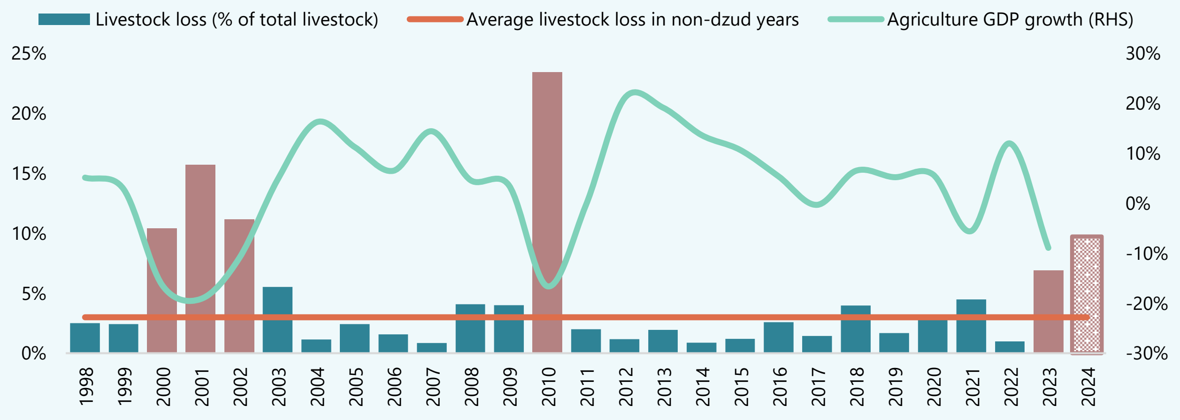
Source: NSO.

The agriculture sector was hit hard by harsh weather conditions (*dzud*) in the spring of 2023 and again in the 2023-24 winter/spring season. Agricultural production contracted 8.9 percent in 2023, its largest contraction since the 2010 *dzud*. The livestock industry was buffeted by the colder-than-usual weather conditions in April-May 2023, which led to the loss of 4.9 million livestock (6.9 percent of the total livestock) and 27.9 percent fewer offspring compared to 2022. The heavier-than-usual snowfall in late 2023 and early 2024 is currently straining the livestock industry for the second year in a row. Agricultural production contracted by 33.1 percent y-o-y in the first two months of 2024 (see Box 1).

Box 1. The ongoing *dzud* is causing livestock losses on a scale not witnessed since 2010

Affected by the ongoing *dzud*, Mongolia has suffered its largest livestock losses since 2010, which poses significant challenges for herders and the agricultural sector as a whole. As of end-March 2024, the ongoing *dzud* had resulted in a total loss of 6.3 million livestock (9.7 percent of the total livestock). Despite recent temperature rises, further losses are expected in the spring season due to the weakness in the surviving livestock. These losses compare to an average livestock loss during non-*dzud* years in 1995-2023 of about 3.0 percent of the total (Figure B1). The sector is also expected to be negatively affected by fewer births and weaker survival of offspring in the following months, as many of the breeding stock are reported to have miscarried.

Figure B1. Livestock loss as of end-March 2024 has already exceeded the annual loss in 2023



Source: National Statistics Office (NSO) and State Emergency Committee (SEC).
Note: The value for 2024 represents livestock loss between January–March, while the values for previous years represent the whole year.

Despite an increase in livestock insurance since the *dzud* in 2010, most Mongolian herders remain uninsured. Only 14.4 percent of the nearly 250,000 herder households and 9.9 percent of the total livestock were insured in 2023, making herders highly vulnerable to the impact of the *dzud*. A state of emergency was declared on February 14 and cash and in-kind support, including animal feed and medical supplies, are being provided to the herders from both public sources and private fundraising, as well as from development partner donations.

Growth outside of mining, agriculture and transportation started to accelerate in the last quarter of 2023, reflecting a rebound in domestic demand. Economic growth in the sectors excluding mining, agriculture, and transportation services reached 5.8 percent in 2023, slightly lower than the 7.4 percent expansion recorded in 2022. Activities in trade and other services, in particular, recovered rapidly in Q4 as higher wages and fiscal expansion drove an increase in domestic demand. Growth contributions from other industries were weaker, despite some rebound in meat processing activities with the removal of the export quota in 2023.

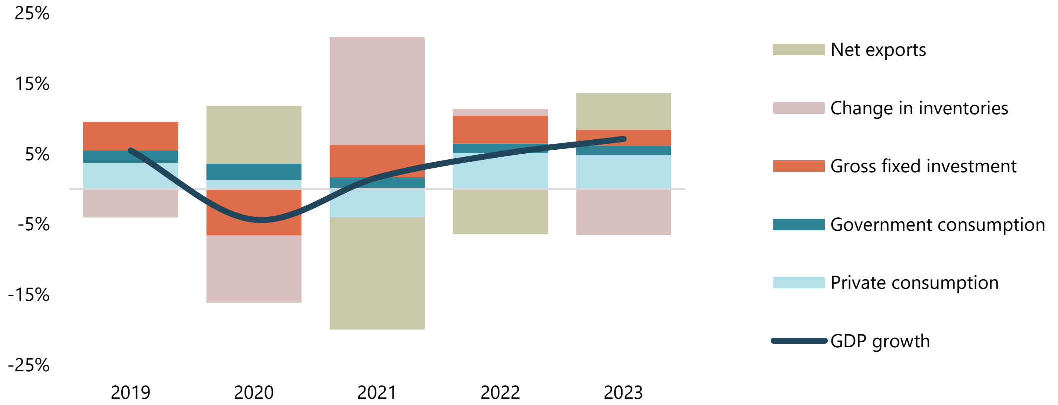
Net exports were the key driver of growth in 2023 due to a large increase in external demand for coal. Net exports contributed 5.2 percentage points of growth in 2023 as record-high coal volumes more than offset robust demand for imports of transportation services, durable consumption goods, investment inputs, and fuel (Figure 2). In particular, the rebuilding of Chinese coal stocks and increased steel production in northern China (in part driven by strong steel exports) led to unprecedented demand for Mongolia's coking coal. Following the resolution of pandemic-related trade disruptions in H2 2022, Mongolia's coal exports in 2023 almost doubled relative to the amount exported in 2019, a previous record year for Mongolia.[1] However, the

[1] More than half (52.9 percent) of China's coking coal imports in 2023 originated from Mongolia, an increase from 44 percent during 2018-2019, Mongolia's previous record years for coal exports.

growth contribution from net exports turned negative in Q4 2023 mainly due to a high base effect from Q4 2022 when coal exports had started to surge.

Figure 2. Net exports and private consumption were key drivers of growth from the demand side

Demand-side contribution to GDP growth (percentage points)



Source: NSO.

Fiscal policy also supported growth due to higher spending on goods & services and public investment, while private investment remained muted. Public consumption of goods and services accelerated in H2 2023—and contributed 1.3 percentage points to annual growth. This was driven by public sector wage hikes adopted in July as part of the 2023 supplementary budget. In addition, public investment (excluding SOEs) also increased to 10.7 percent of GDP in 2023, up from 9.7 percent in 2022. Meanwhile, private investment remained subdued due to a 30.7 percent reduction in net foreign direct investment and persistently high lending rates that continued to weigh on business borrowing throughout 2023. Finally, fewer offspring in the livestock industry reduced inventories, resulting in a negative GDP growth contribution.

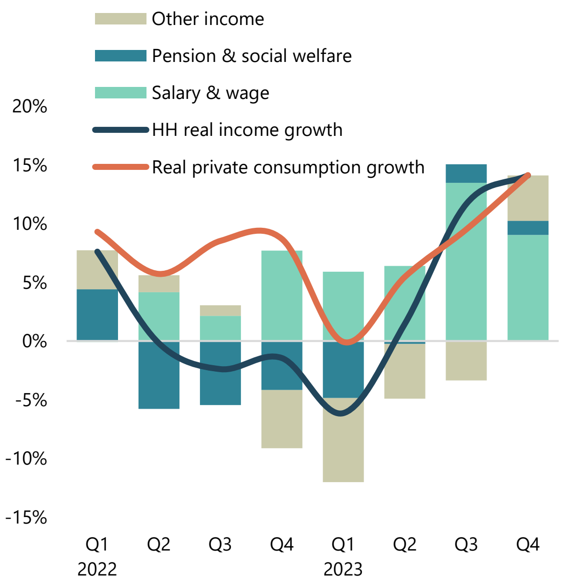
Household real income accelerated in H2 2023 and supported a 7.4 percent expansion in private consumption. Household real income growth accelerated in H2 2023 and reached 14.1 percent y-o-y in Q4 (Figure 3). This was primarily driven by higher salaries and wages, predominantly due to the significant raise in public sector wages enacted through the supplementary budget. In addition, household spending was boosted by increased benefits of the social security pension and social welfare programs via the supplementary budget, alongside the substantial growth in personal loans. Finally, the gradual decline in headline inflation also bolstered households' purchasing power. Combined, these factors contributed to a significant rise in private consumption during 2023.

Household consumption was also supported by an improvement in the labor market, though the recovery has been uneven. Total employment expanded by 3.3 percent in Q4 2023, mainly driven by the creation of permanent jobs in non-agriculture sectors (Figure 4). In contrast, agriculture sector employment declined due to the *dzud*. Reflecting the uneven recovery, the labor force participation rate averaged 57.7 percent in 2023, still below the pre-pandemic average of 61.0 percent (2015-19 average).[2]

[2] The decline in 2023 is mainly the result of young female workers leaving the labor force for education purposes and women in their early 50s going into early retirement. The female labor force participation rate declined to 50.4 percent in 2023, compared to 51.5 percent in 2022 and 54.3 percent during the pre-pandemic period (2015-19).

Figure 3. Private consumption growth accelerated in H2 2023 as higher salaries supported household income

Y-o-y growth of household real consumption and real income, percentage contributions to real income growth



Source: NSO.

Figure 4. Despite rising wages, total employment growth has been uneven

Y-o-y growth of total employment and percentage contributions

Source: NSO.

1.2. Headline inflation gradually declined, coming within the central bank's target range

Moderating price increases of imported goods supported a gradual decline in consumer price inflation, despite the continued rise of domestic food prices. Nationwide headline inflation gradually declined from 12.3 percent in January 2023 to 7.0 percent by March 2024, falling within the Bank of Mongolia (BOM)'s target range of 4.0-8.0 percent for 2024 (Figure 5). The inflation reduction is mainly attributed to a moderation in import prices (from 12.4 percent in January 2023 to 5.1 percent in March 2024), as international prices of food and fuel stabilized and transportation costs declined following the resolution of pandemic-related bottlenecks in late 2022. A broad-based appreciation in the nominal exchange rate also dampened import prices.

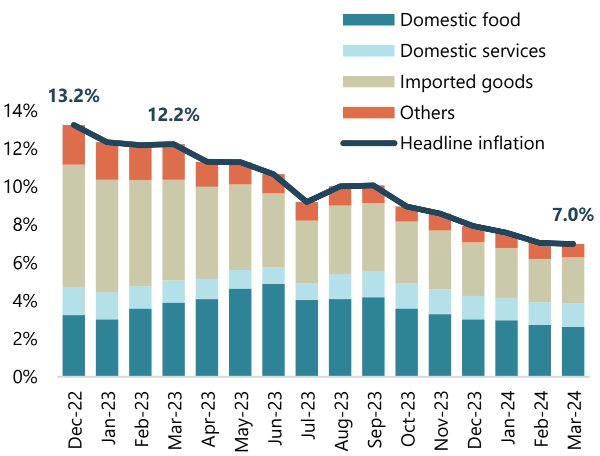
Meanwhile, inflation of domestically produced food was persistently high throughout 2023 (averaging 18.9 percent) reflecting higher production costs of flour and flour-based goods[3] and a lower supply of meat.[4] While the prices of meat and other livestock-related food items remain elevated due to the contraction in agricultural production, inflation of domestically produced food declined to 12.1 percent in March 2024, mainly reflecting a lower contribution from flour and flour-based goods, due to a high base year effect in early 2023 (Figure 6).

[3] Prices of imported inputs including fertilizers and diesel fuel went up in late 2022 and created supply-side pressure on flour producers, who had kept their prices relatively stable in 2022.

[4] The *dzud* effect on the livestock industry was the strongest in Q2 of 2023 and its inflationary effect persisted throughout the year.

Figure 5. Inflation pressure from imported prices moderated ...

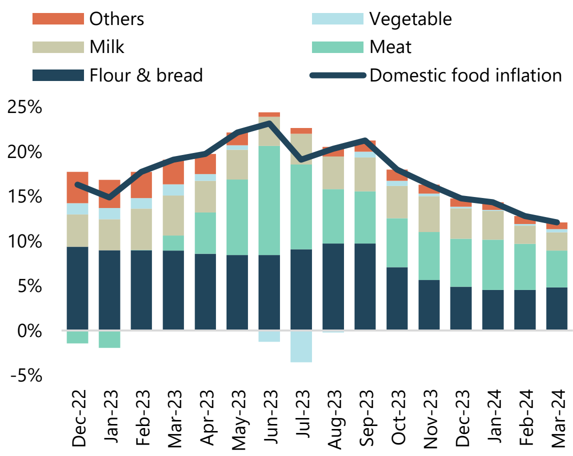
Contributions to headline inflation



Source: NSO.
Note: Areas reflect percentage contributions to y-o-y headline inflation.

Figure 6. ... while domestic food prices remain elevated

Contributions to domestic food inflation



Source: NSO.
Note: Bars reflect percentage contributions to y-o-y domestic food inflation.

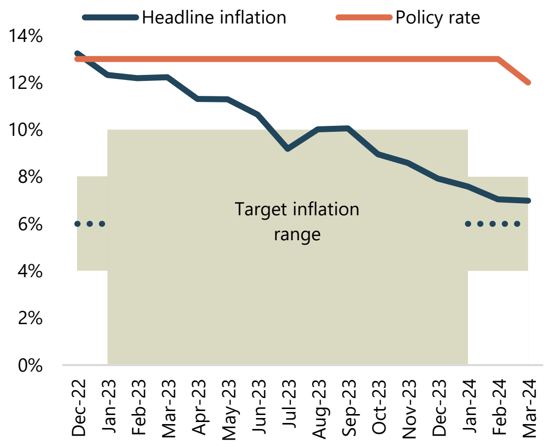
Cautious of growing demand-side inflationary pressures, the central bank kept its policy rate high throughout 2023. The rapid acceleration in household consumption supported by increased incomes and consumption loans (see Section I.1) and the fiscal expansion, particularly on goods and services (see Section I.3), is fueling demand-driven price pressures and presents risks to further reduction in consumer inflation. Cautious of these reemerging demand pressures, the central bank kept its policy rate fixed at 13 percent in 2023. However, with headline inflation coming within the BOM's target range of 4.0-8.0 in recent months, the policy rate was cut by 100 basis points in March 2024 (Figure 7).

Banks have remained risk-averse but there are early signs of a recovery in lending to businesses. Credit growth has picked up and reached 25.7 percent y-o-y by March 2024, up from 5.2 percent y-o-y in March 2023 (Figure 8). Nearly half of the March credit growth was associated with faster growth of personal loans which reached 35.7 percent y-o-y, as banks continued to aviod lending to businesses due to higher risk. To limit the excessive growth in personal loans the BOM tightened its macroprudential measures on pension-backed loans starting in January 2023. Meanwhile, the share of troubled loans in total loans declined from 15.6 percent in March 2023 to 11.4 percent in March 2024. This improvement in the quality of business loans—especially to those in trade, mining, and manufacturing sectors following the economic recovery—is expected to have prompted some recovery in lending to businesses. While persistently high lending rates[5] curbed business lending in 2023, the recent BOM decision to cut the policy rate is likely to ease this pressure to some degree.

[5] With the end of the COVID law, banks reverted to paying interest to demand deposit holders, which resulted in a higher average deposit interest rates.

Figure 7. Headline inflation fell within the BOM's target range, prompting a reduction in the policy rate

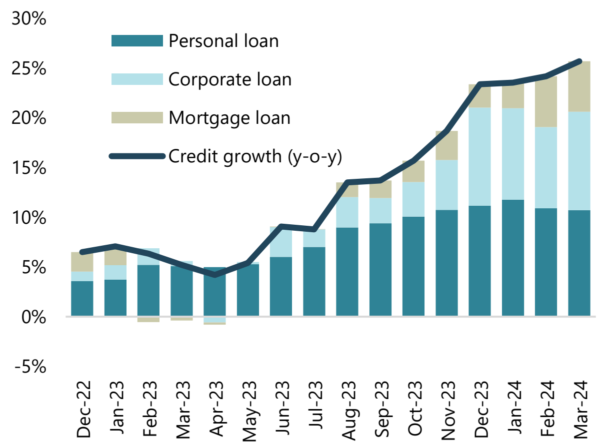
Monetary policy rate, inflation target, and headline inflation



Source: BOM and NSO.

Figure 8. Lending to businesses shows early signs of a recovery

Y-o-y growth of total outstanding credit



Source: BOM.

Note: Areas reflect percentage growth contributions.

1.3. Mining-related fiscal revenues rose faster than spending, contributing to a reduction in public debt

Fiscal revenue increased significantly, buoyed by robust mining revenues. Budget revenue increased by 31.3 percent y-o-y in 2023 and reached 34.5 percent of GDP (up from 33.8 percent in 2022). Despite lower prices, the surge in mineral export volume supported the budget through higher royalties, corporate income taxes (CIT), and dividends of mining SOEs—which together formed about one-third of total revenue in 2023 (Figure 9a).[6] Higher revenues also led to an increase in the Fiscal Stability Fund (FSF) by 1.0 percent of GDP by end-2023, although this was only half the amount accumulated in 2022 reflecting a y-o-y decline in commodity prices. Meanwhile, rising wages (including in the public sector) and the acceleration in trade and services activities in the second half of the year led to higher revenue collection through personal income taxes (PIT), social security contribution (SSC) fees, and trade taxes including VAT (Figure 9b). In the 2024 approved budget, revenue is planned to increase by 14.1 percent y-o-y and reach 37.5 percent of GDP, driven by strong growth of both mining and non-mining activities. Revenue collection started 2024 strongly, recording a 78.4 percent y-o-y increase in the first two months of 2024, mainly driven by mining royalties, CIT, and SSC. The growth in revenue is expected to moderate over 2024 in line with the normalization in coal exports and the contraction in agriculture (which occurred after the 2024 budget was approved). Meanwhile, declining commodity prices have already started to dampen the accumulation in the FSF.[7]

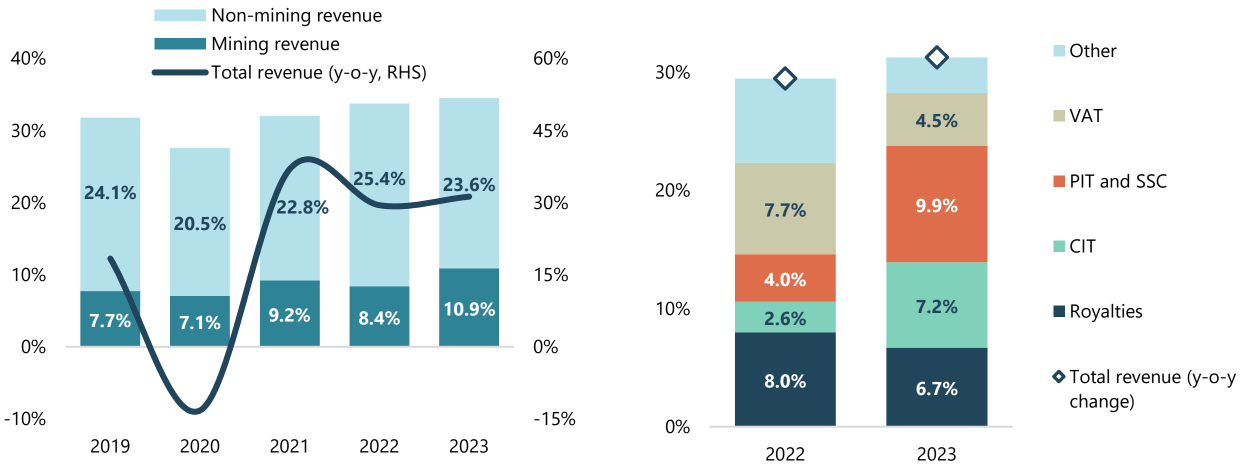
[6] More than half is attributed to the coal sector.

[7] In 2022, the fiscal saving rule was temporarily suspended and the Child Money Program was financed with funds (including mining royalties and dividends from SOEs) that otherwise would have been transferred to the Future Heritage Fund, an inter-generational saving fund. Starting in 2024, Mongolia is gradually returning to the original savings rule and 20 percent of royalties (after deducting transfers to the FSF) will be transferred to the FHF. The government plans to return to the original 65 percent rule starting in 2025.

Figure 9. Higher earnings from mineral activities primarily explain the strong budget revenue performance in 2023

a. Y-o-y growth of budget revenue and key components in percent of GDP

b. Y-o-y growth of budget revenue and its growth contributions



Sources: MoF; World Bank staff estimates.

Total expenditure accelerated in the second half of 2023 due to additional spending on wages, pensions, and social assistance. Despite increasing by 23.7 percent y-o-y, total spending declined to 31.9 percent of GDP, as nominal GDP grew faster than spending in 2023 (Figure 10). Public investment spending increased to 7.3 percent of GDP in 2023, up from 6.9 percent in 2022, as the government completed investment projects delayed from previous years. In addition, total expenditure accelerated in the second half of the year after the supplementary budget introduced additional current expenses worth 2.7 percent of GDP starting July 1, 2023. Notably, the supplementary budget included a 17.8 percent y-o-y increase in the public sector wage bill, a 17.9 percent y-o-y increase in social insurance pension payments, and an 8.4 percent y-o-y increase in social welfare benefits including the Child Money Program.

The public debt-to-GDP ratio declined owing to the strong growth in nominal GDP and net debt repayments. Mongolia recorded an overall budget surplus of 2.6 percent of GDP in 2023, as higher mineral revenues more than offset the increase in spending (Figure 11). The budget surplus contributed to a reduction in public debt, which reached 44.1 percent of GDP by end-2023, down from 62.1 percent in 2022.[8] Most of this reduction was due to the 28.4 percent y-o-y expansion in nominal GDP.[9] The public sector alsorepayed public and publicly guaranteed debt worth US$1.4 billion (6.8 percent of GDP) in 2023. This included refinancing through a new bond issued in January 2023 (3.2 percent of GDP or US$650 million), a net payment of US$94.1 million (0.5 percent of GDP) on two sovereign Eurobonds, and a full payment of US$654.4 million (3.2 percent) on external debt obligations of the DBM in late 2023. In addition, the BOM closed a swap line worth US$210 million with the PBOC. The government also repaid a

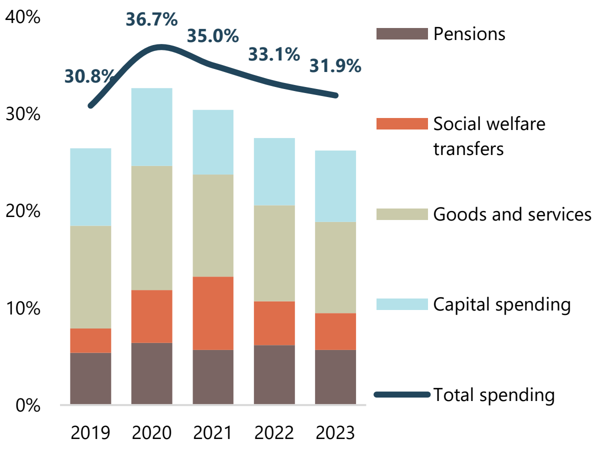
[8] The public debt includes publicly guaranteed debt of the DBM but does not include contingent liabilities or the BoM's liability under its swap line with the PBOC (equivalent to 8 percent of GDP in 2023).

[9] The public debt-to-GDP ratio declined by 17.9 percent of GDP in 2023, of which 3.4 percentage points are related to a nominal reduction in public debt supported by the fiscal surplus and net payments on maturing debt.

sovereign bond worth US$392 million in March 2024, of which US$350 million was refinanced with a bond issued in late 2023. The next debt amortizations are US$600 million for a sovereign bond due in September 2026 and US$1.5 billion for the PBOC swap line due in mid-2026.

Figure 10. Fiscal spending declined as a share of GDP despite expanding by 23.7 percent y-o-y in nominal terms

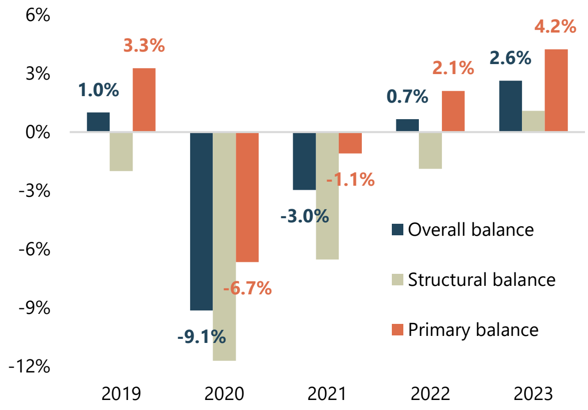
Budget expenditure and key components in percent of GDP



Sources: MoF; World Bank staff estimates.

Figure 11. A fiscal surplus in 2023 contributed to a reduction in public debt

Budget balance in percent of GDP



Sources: MoF; World Bank staff estimates.

1.4. A surge in coal exports led to a current account surplus and higher international reserves

The current account registered a surplus (0.7 percent of GDP) in 2023 owing to a surge in coal exports (Figure I.12). Merchandise goods exports increased to 68 percent of GDP (from 56 percent in 2022 and 50 percent on average during 2017-2019), buoyed by a 35 percent y-o-y increase in coal export revenues. Coal demand from China soared as its steel exports reached a six-year high in 2023,[10] and the elimination of pandemic-related border restrictions allowed for the resumption of coal imports. Consequently, Mongolia's coal export volumes rose 111 percent y-o-y in 2023, outweighing a 24 percent y-o-y reduction in prices (Figure 13). On the other hand, copper export earnings declined, dragged down by 8.5 percent lower prices, despite a 5 percent increase in volumes stemming from the start of operations at the OT underground mine in March 2023. Despite a harsh winter, agricultural exports (around 5 percent of total exports) increased by 40 percent (y-o-y) in 2023, driven by higher shipments of processed meat from inventory built up in late 2022. Nevertheless, higher merchandise export revenue was partially offset by a large services deficit. While tourism exports doubled y-o-y, surpassing pre-pandemic levels, the services balance was still in a deficit of 13 percent of GDP partly owing to higher demand for mineral-related transport services.[11] More recently in Q1 2024, coal and copper exports remained robust, even as

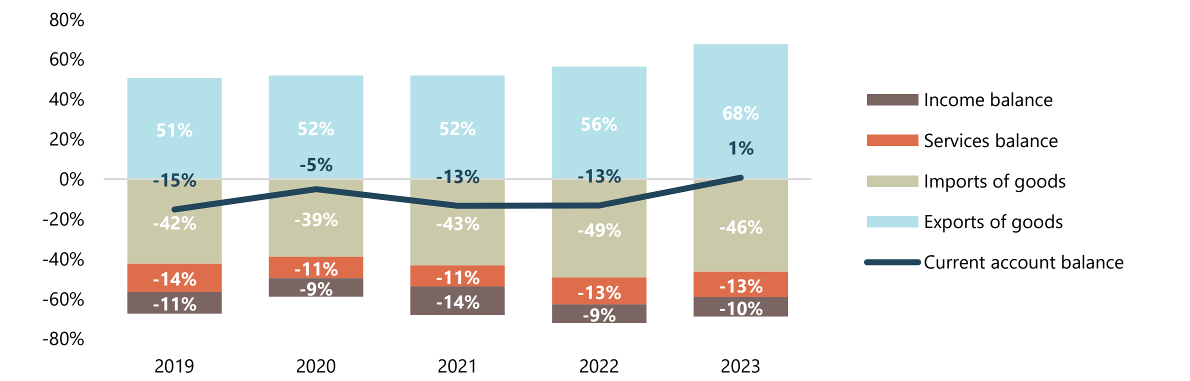
[10] Coking coal imports to China are used in steel production for domestic use and exports.
[11] International airline passenger arrivals in 2023 were 9 percent higher than in 2019. Source: OAG Traffic Analyzer.

the price of coal continued on a downward trajectory (a y-o-y decrease of 23 percent).

Declining prices of imported goods also supported the current account. Goods imports stood at 46 percent of GDP in 2023 (compared to 49 percent of GDP the year prior) (Figure 12). On the one hand, the recovery in domestic demand bolstered the imports of machinery and equipment for investment projects and mining activities, fuel, and consumer durable goods including passenger vehicles (Figure 14). On the other hand, import prices—especially international prices of food and fuel—declined steadily in 2023 as supply chains normalized after the pandemic and energy and food markets adjusted following the initial shock from Russia's invasion of Ukraine. Food prices fell by 9 percent while oil prices declined by 17 percent despite the ongoing geopolitical tensions.[12] Import data in Q1 2024 point to an uptick in prices, as oil and other commodity prices remain volatile.[13]

Figure 12. Strong export growth resulted in a current account surplus in 2023

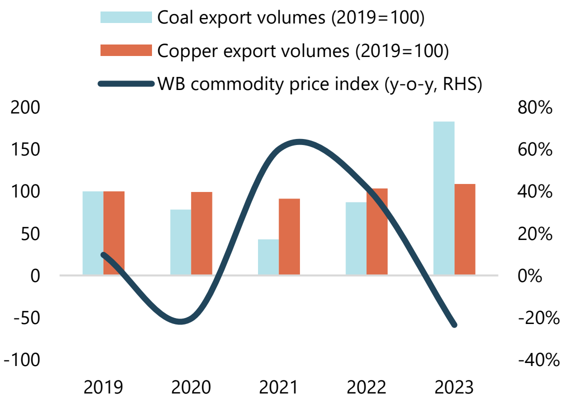
Current account balance and its components, in percent of GDP



Source: BoM.

Figure 13. Export earnings rose in 2023 as higher coal and copper volumes more than offset lower prices

Export volume and prices of key minerals, coal and copper

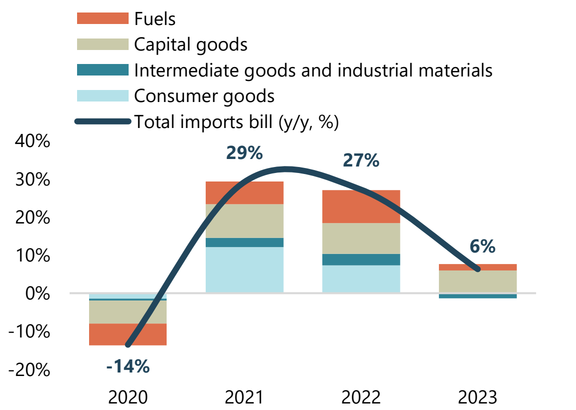


Source: BoM and the World Bank Commodities Outlook 2024

Note: Coal and copper exports constitute about 75 percent of Mongolia's export basket in 2023.

Figure 14. The import bill increased modestly, driven by higher fuel and capital goods

Goods imports bill growth and percentage contributions of key items



Source: BoM.

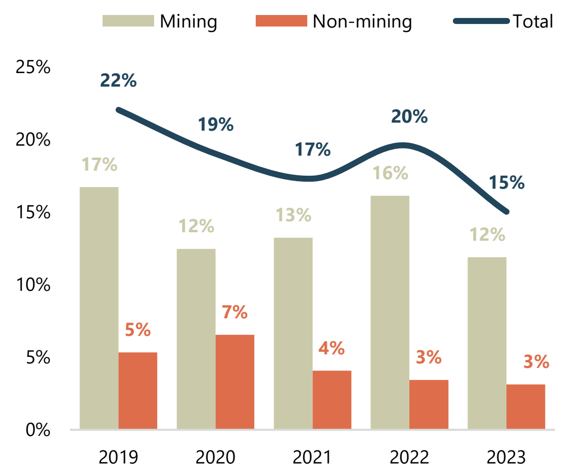
[12] Food price trends from World Bank's Global Economic Prospects (January 2024). Oil price changes calculated from World Bank Commodity Outlook Annual Commodity Price dataset (March 2024).

[13] World Bank Commodities Price Data (May 2024).

Despite weaker net capital inflows, the current account surplus supported a rebound in gross international reserves. In 2023, FDI inflows declined by 10 percent (y-o-y) to 15 percent of GDP, compared to 20 percent in 2022—still well below pre-pandemic levels (Figure 15). Alongside the impact of financial tightening in advanced economies on global capital flows, net financial inflows declined because of lower investment needs for the OT underground mine development. Taking advantage of narrower sovereign bond spreads, the government refinanced most of the sovereign Eurobonds due in 2023 and early 2024 which helped to limit net capital outflows (see Section 1.3). Consequently, gross international reserves increased from US$3.4 billion in December 2022 (about three months of import coverage) to US$4.9 billion (a little over four months of import coverage) in December 2023, and further to US$5.2 billion in March 2024 (Figure 16). With less pressure on the external balance, the nominal MNT exchange rate experienced a broad-based appreciation in 2023, following a steep depreciation of 21 percent against the US dollar in 2022.

Figure 15. FDI inflows have slowed as investment in a key copper mine declined and global financial market uncertainties persisted …

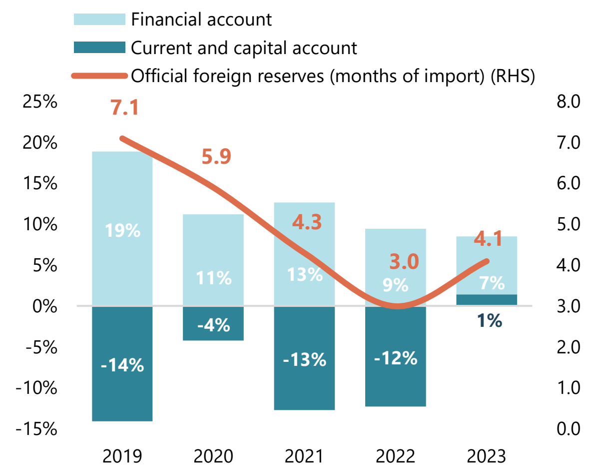
Foreign direct investment inflow, percent of GDP



Source: BoM.

Figure 16. … even so, robust exports and the rollover of some external debt supported an accumulation of reserves

Balance of payments (percent of GDP) and gross international reserves (million US$)



Source: BoM.

2. Outlook, Risks, and Challenges

The global economic outlook is expected to be challenging in 2024 with global growth and commodity prices projected to decline from last year. Global growth, weighed down by tight financial conditions and weak trade and investment, is expected to decline to 2.4 percent in 2024 (far below the 3.1 percent average of the 2010s). Growth in China is also expected to moderate to 4.5 percent in 2024 from 5.2 percent in 2023, due to the continued weakness in the property market, and weak consumer confidence.[14] Global commodity prices are also projected to decline in 2024, with annual average prices of crude oil and metals & minerals down by 1.2 percent and 2.2 percent, respectively.[15]

Mongolian economic growth is projected to moderate in 2024, hampered by harsh weather conditions affecting the agriculture sector and coal exports declining from their peak in 2023. After expanding by 7.1 percent in 2023, the economy is expected to grow by 4.8 percent in 2024 (Table 2). On the supply side, this slowdown is primarily attributed to a worsening downturn in the agriculture sector caused by the ongoing *dzud*, which is expected to be as severe as the *dzud* cases in the early 2000s. Meanwhile, the mining sector is expected to continue to expand but at a slower pace in 2024 compared to 2023, as coal exports moderate from their peak in 2023 while higher production of both copper and gold at OT more than offsets this decline. On the demand side, net exports are anticipated to decrease, as coal exports revert to historical levels and imports of investment and consumer goods rise. Hence, growth in 2024 will be underpinned by robust private consumption and investment. In particular, household incomes and private consumption are expected to be boosted by the increase in public sector wages and pension benefits, introduced as part of the 2024 budget and effective on April 1, 2024, along with dividends distributed by a state-owned coal mine.[16,17] While public sector investment (planned to increase by 21.2 percent y-o-y in the 2024 budget) is expected to dominate gross fixed capital formation, private investment is also expected to recover due to a stabilization in production costs and a higher bank lending to businesses amid declining interest rates and improving asset quality.

A moderate fiscal deficit is expected in 2024. Budget revenue as a share of GDP is expected to decline to 33.7 percent in 2024, down from 34.5 percent recorded in 2023. While this is still a strong performance compared to the 2010-2019 average of 29.6 percent, the normalization in mining export volumes and declining commodity prices are expected to weigh on budget revenue this year. Total expenditure is planned to increase to 34.7 percent of GDP, up from 31.9 percent in 2023, mainly reflecting increased public wages and bonuses, transfers to the pension fund, and capital expenditure. As a result, a deficit of 1.0 percent of GDP is anticipated in 2024. Nevertheless, public debt is expected to decrease slightly owing to strong nominal economic growth and a partial payment of a

[14] Global Economic Prospects, January 2024.

[15] The November 2023 edition of the Mongolia Economic Update bases its price projections on the forecasts released in the World Bank Commodities Outlook from October 2023, and current projections are based on the Commodities Outlook from April 2024.

[16] Erdenes Tavan Tolgoi (a state-owned coal miner) distributed dividends from its 2022 retained earnings to 3.4 million Mongolians (a total of MNT351 billion or US$30 per person) in February 2024 and dividends from its 2023 earnings (a total of MNT760 billion or US$65 per person) in April 2024.

[17] As approved in the 2024 budget, public sector wages are planned to increase by 10-20 percent (higher raise for lower wages) and additional bonuses (equivalent to 20-40 percent of the wage) will be introduced for employees in rural areas. Monthly pensions of about 500,000 retirees will be increased by MNT100,000 each, and social welfare pensions and welfare for the caretakers will rise by 10 percent.

sovereign bond on March 9 (a net payment of US$42.6 million).

Inflationary pressures will likely build in 2024 due to supply constraints for some domestic foods and demand pressures. Continued lower prices of food and fuel at the international market are expected to keep imported inflation down. However, inflation is expected to accelerate in H2 2024 from 7.0 percent in March and reach an average of 8.5 percent in 2024. The contraction in domestic agricultural production could create supply constraints (especially for meat), while the expansion of domestic demand mentioned above is projected to create demand pressures, mostly in the second half of 2024. Rising food prices pose greater risks to poor non-agricultural households, who spend a larger share of their budget on food. In addition, high reliance on agricultural income among herder households means that the agricultural contraction can impede further poverty reduction.

The current account is expected to turn into a deficit in 2024, weighing on the balance of payments. Normalization in China's demand for imported coal following its peak in 2023 and declining commodity prices are projected to reduce exports revenue. Meanwhile, imports of goods and services are expected to remain elevated close to the 2023 level as declining import prices more than offset increased demand. Upcoming large external payments include US$600 million in a sovereign bond and US$1.5 billion in the BOM's FX swap deal with the PBOC due in 2026.

The medium-term outlook remains favorable, mainly supported by the expansion in OT's underground mining activities. Economic growth is expected to accelerate to over 6 percent in 2025-2026, driven by a recovery in agricultural production following two years of contraction and the continued expansion in mineral production at OT, which plans to double output between 2023 and 2025. Stronger growth and increased mineral production are expected to support the fiscal revenue and current account balance, resulting in narrower deficits.

Downside risks remain, both domestically and externally. A more severe and prolonged *dzud* would lead to a greater contraction in agriculture production and larger spillover effects, including on cashmere and meat manufacturing and on herders' livelihoods. Meanwhile, a greater-than-expected fiscal expansion (including through SOE investments) could result in larger fiscal and current account deficits and further add to inflationary pressures. Externally, Mongolia could face large negative spillover effects from: (i) slower-than-expected growth in China leading to lower external demand for Mongolia's exports; (ii) an escalation of geopolitical tensions resulting in higher prices of imported oil; and (iii) a shortage in Russia's domestic gasoline supply leading to a reduction in Mongolia's imports. Alternatively, earlier- and larger-than-expected production at OT's underground mine and stronger global economic growth, especially improvements in China's economic outlook, would support activity in Mongolia through higher commodity prices and larger mineral exports.

On the policy side, fiscal and structural reforms can enhance Mongolia's economic resilience, stability, and productivity. Achieving the nation's *Vision 2050* ambition will require prudent fiscal and monetary policies to increase macroeconomic reslieince and structural reforms to develop the non-resource economy. Implementing countercyclical fiscal policies—supported by transparent and credible fiscal rules and a well-functioning stabilization fund to smooth consumption over the business cycle—can help achieve both higher, less volatile growth and improved debt sustainability. Along with greater macroeconomic resilience, building the foundations towards a more diversified, high-income economy will require: (i) microeconomic reforms to enhance competition, secure investor rights, and create a more level playing field that enables productive firms to invest and grow; and (ii) better utilization of its young and educated (especially female) labor force by creating better-quality jobs and better aligning the supply of skills from education institutions to the demand from employers. Increasing frequency and intensity of natural disasters, as evidenced by the harsh winters of two consecutive years and last year's floods, call for attention to institutions, policies and investments to make the country more resilient to the adverse impacts of climate change.

Table 2. Selected macroeconomic indicators

	2021	2022	2023	2024f	2025f	2026f
Real GDP Growth, at constant market prices	**1.6**	**5.0**	**7.1**	**4.8**	**6.6**	**6.3**
Private Consumption	-5.9	8.1	7.4	8.6	5.3	6.5
Government Consumption	9.2	6.9	6.6	17.7	4.8	6.8
Gross Fixed Capital Formation	17.7	13.2	7.0	17.1	9.8	6.1
Exports, Goods and Services	-14.6	32.3	42.9	3.5	16.0	6.3
Imports, Goods and Services	13.6	29.1	21.0	9.2	14.7	6.6
Real GDP Growth, at constant factor prices	**0.4**	**4.2**	**7.0**	**4.8**	**6.6**	**6.3**
Agriculture	-5.5	12.0	-8.9	-9.5	8.0	6.5
Industry (including mining)	-2.2	-4.5	12.6	6.4	11.2	7.8
Services	3.9	6.9	9.0	7.7	3.8	5.3
Inflation (CPI, period average)	**7.3**	**15.2**	**10.6**	**8.5**	**8.3**	**7.5**
Current Account Balance (% of GDP)	-13.4	-13.2	0.7	-11.5	-10.2	-10.1
Net FDI, Inflow (% of GDP)	13.1	13.9	7.3	7.0	7.1	6.3
Fiscal Revenue (% of GDP)	32.0	33.8	34.5	33.7	34.8	33.9
Fiscal Expenditure (% of GDP)	35.0	33.1	31.9	34.7	35.5	34.4
Fiscal Balance (% of GDP)	-3.0	0.7	2.6	-1.0	-0.7	-0.5
Primary Balance (% of GDP)	-1.1	2.1	4.2	0.2	0.4	0.5
Debt (% of GDP)	64.5	62.1	44.1	43.8	42.0	40.1

Source: World Bank staff estimates.
Note: Public debt does not include contingent liabilities or the BoM's liability under the PBOC swap line (8 percent of GDP in 2023).

May 2024