MONGOLIA

Table 1	2021
Population, million	3.3
GDP, current US$ billion	15.5
GDP per capita, current US$	4647.3
National Official Poverty Rate[a]	28.4
Gini index[a]	32.7
School enrollment, primary (% gross)[b]	103.4
Life expectancy at birth, years[b]	69.9
Total GHG Emissions (mtCO2e)	62.4

Source: WDI, Macro Poverty Outlook, and official data.
a/ National Statistics Office. Most recent value (2018).
b/ Most recent WDI value (2019).

After posting 1.4 percent real GDP growth in 2021, growth will remain modest at 2.5 percent this year. Despite continued policy support and higher commodity prices, the recovery is dragged down by protracted logistical bottlenecks and the effects of the war in Ukraine. Additional significant risks include inflationary pressures, dwindling fiscal space, and widening external imbalances. Amid the modest recovery, poverty will only fall back to pre-COVID levels in 2023.

Key conditions and challenges

Mongolia's recovery remained subdued in 2021 despite high commodity prices, as COVID-related restrictions on cross-border traffic imposed by China especially during H2 weighed on exports and disrupted imports of production inputs and consumer goods. While domestic activities were supported by continued fiscal relief and stimulus measures as well as a rollback of mobility restrictions enabled by high vaccination rates, the economy remains below its pre-pandemic level and far from its potential. Meanwhile, sustained policy support has eroded fiscal space, and public debt – already high before COVID-19 – has increased sharply, now standing at 92 percent of GDP (including the central bank's liability under the People's Bank of China swap line). Public debt risks are further aggravated by sizable contingent liabilities including the Development Bank of Mongolia's external bond (US$800 million). External pressures could be compounded by rising fuel prices associated with the war in Ukraine as well as tighter global financing conditions that could complicate the rollover of upcoming large foreign debt repayments. Rapidly accelerating inflation and the appreciation of real exchange rate are further constraining available policy space. The pandemic exacerbated vulnerabilities associated with Mongolia's limited diversification of trade and trading partners and overreliance on imported inputs and consumer goods, reinforcing the need for structural reforms.

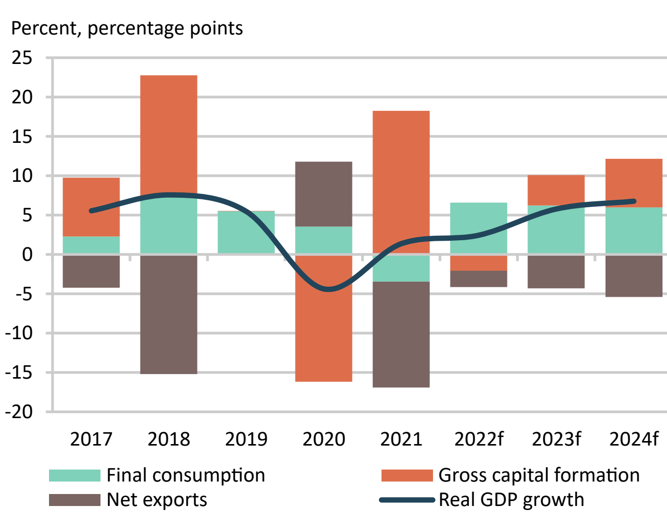
Recent developments

After a strong economic rebound in early 2021, the recovery stalled in the last three quarters due to trade disruptions. Growth consequently was disappointing, reaching only 1.4 percent following the contraction of 4.4 percent in 2020. Economic growth was mainly supported by a strong rebound of coal mining in Q1, significant improvement in copper ore grade, and recovery in the services sector. In contrast, the manufacturing sector stagnated, and construction contracted significantly, amid supply shortages caused by border disruptions. Agriculture also contracted reflecting an outbreak of foot-and-mouth disease and harsh weather conditions.

Despite continued income support, private consumption declined as COVID-19 restrictions constrained mobility, rising inflation weighed on real incomes, and households increased precautionary saving amid persistent uncertainty. Investment recovered strongly, but this was mainly driven by a build-up of coal inventories as exports to China were stalled due to border frictions. FDI and subsidized loans under the government stimulus program also supported private investment in the mining and services sectors.

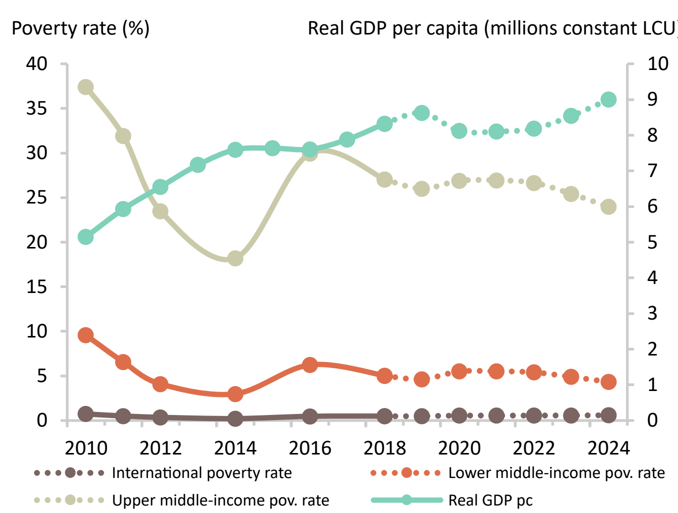
Following two years of expansionary fiscal policies, policy space has eroded with persistent fiscal imbalances threatening sustainability. Public spending increased in

FIGURE 1 Mongolia / Real GDP growth and contributions to real GDP growth



Sources: National Statistics Office and World Bank.

FIGURE 2 Mongolia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

2021 mostly driven by the generous but poorly targeted Child Money Program (CMP). The headline budget deficit nonetheless narrowed to 3.1 percent of GDP amid a one-off tax arrears collection (2.3 percent of GDP). The budget deficit is projected to increase in 2022, driven by increases in capital spending, the continuation of some COVID-related stimulus measures, and a discretionary pension increase (of around 1.5 percent of GDP). Meanwhile, the financing of the CMP through the Future Heritage Fund has weakened the fiscal framework and long-term sustainability. Public debt is expected to increase and fiscal buffers to further erode.

Inflation accelerated sharply to 14.2 percent (y/y) by February 2022, due to supply bottlenecks amid border closures as well as accelerating credit growth. Substantial real exchange rate appreciation and weak exports led to a widening current account deficit and the erosion of gross international reserves from over 7 months (in mid-2021) to 3.7 months of imports as of February 2022. The erosion of confidence related to the war in Ukraine and the persistent border frictions fueled increasing demand for foreign exchange, prompting banks to ration FX liquidity. This has started to affect some import payments. To stem these pressures the central bank raised its policy rate by 250 basis points.

Outlook

Economic growth is projected to remain modest at 2.5 percent in 2022. This forecast reflects the impact of the war in Ukraine through higher prices of imported food, fuel and fertilizers coupled with lingering border frictions with China. Coal exports are expected to only recover towards the end of the year when border frictions with China may ease, following investments in upgrading border crossing and logistics facilities and an anticipated gradual loosening of COVID-related restrictions. As labor market conditions improve with the reopening of the economy, domestic demand is expected to recover driven by continued government support, rising investment and strengthening household consumption. The recent agreement with Rio Tinto over Mongolia's largest copper mine, Oyu Tolgoi (OT), will continue to support steady FDI inflows. While the anticipated drop in the quality of OT mining output - following last year's improvement - will weigh on mining output this year, the acceleration of investments will provide short-term support to the construction and services sectors and expand mining capacity in the long run. Over the medium-term, economic growth is expected to accelerate to above 6 percent in 2023-2024, as the underground mining phase of OT becomes operational during H2 2023. Poverty measured at the poverty line recommended for lower-middle income countries ($3.20 PPP) is projected to return to the pre-COVID level in 2023.

Risks are significant and tilted to the downside. In a downside scenario, economic growth could fall to 0.7 percent in 2022 if border restrictions with China persist throughout the year, and if the war in Ukraine leads to persistently higher energy prices and tighter global liquidity. Moreover, rising food inflation pressure could prompt poverty to remain above the pre-COVID level as the urban poor spends nearly 40 percent of their consumption on food. Heightened risks put a premium on preserving macroeconomic policy space. Better targeting fiscal measures to the poor would help contain fiscal imbalances and preserve valuable policy space in view of significant risks. Once the recovery is more entrenched, Mongolia should shift towards fiscal consolidation to ensure external and public debt sustainability. Structural reforms, including measures to reduce trade and transport costs, and facilitate foreign investment and domestic entrepreneurship, would help lay the foundation for more diversified and hence more resilient growth in the medium term.

TABLE 2 Mongolia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021e	2022f	2023f	2024f
Real GDP growth, at constant market prices	5.5	-4.4	1.4	2.5	5.8	6.8
Private Consumption	5.8	2.1	-6.5	8.9	7.6	7.0
Government Consumption	12.3	14.6	5.3	5.3	5.8	6.1
Gross Fixed Capital Investment	14.0	-21.1	14.0	16.3	17.5	16.2
Exports, Goods and Services	12.0	-5.3	-14.5	4.0	18.0	17.1
Imports, Goods and Services	8.6	-15.5	9.6	5.7	17.5	17.8
Real GDP growth, at constant factor prices	5.1	-3.9	0.0	2.5	5.8	6.8
Agriculture	5.2	5.8	-5.5	3.0	4.1	5.5
Industry	3.1	-4.4	-2.8	1.2	7.9	6.1
Services	6.4	-6.5	3.6	3.0	5.1	7.6
Inflation (Consumer Price Index)	7.3	3.7	7.1	10.5	7.5	6.8
Current Account Balance (% of GDP)	-15.2	-4.3	-12.7	-15.6	-13.8	-11.6
Net Foreign Direct Investment (% of GDP)	16.4	12.2	13.1	12.6	11.8	11.1
Fiscal Balance (% of GDP)	1.4	-9.4	-3.1	-4.8	-4.8	-4.4
Debt (% of GDP)[a]	68.4	77.3	79.5	83.6	81.7	80.0
Primary Balance (% of GDP)	3.6	-6.8	-1.1	-2.8	-1.9	-1.1
International poverty rate ($1.9 in 2011 PPP)[b,c]	0.5	0.6	0.6	0.6	0.6	0.6
Lower middle-income poverty rate ($3.2 in 2011 PPP)[b,c]	4.6	5.5	5.5	5.4	4.9	4.3
Upper middle-income poverty rate ($5.5 in 2011 PPP)[b,c]	26.0	26.9	26.9	26.7	25.4	24.0
GHG emissions growth (mtCO2e)	6.9	1.3	3.5	4.3	5.3	5.6
Energy related GHG emissions (% of total)	41.7	40.8	41.7	42.1	43.3	44.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
a/ Debt excludes contingent liabilities (DBM bond of 5% of GDP) and central bank's liability under the PBOC swap line (12% of GDP) by 2021.
b/ Calculations based on EAPPOV harmonization, using 2016-HSES and 2018-HSES.Actual data: 2018. Nowcast: 2019-2021. Forecasts are from 2022 to 2024.
c/ Projection using annualized elasticity (2016-2018) with pass-through = 1 based on GDP per capita in constant LCU.