Research Update:

Mongolia 'B' Ratings Affirmed; Outlook Stable

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Overview

- We expect Mongolia's commodity-reliant economy to expand by a modest 2.5% in 2022 amid extended border restrictions with China. Growth should rebound to 6.0% next year, fueled by normalization of border access and a recovery in exports.
- We believe the government will maintain its fiscal consolidation trajectory, which would benefit credit metrics.
- We affirmed our 'B' long- and short-term sovereign credit ratings on Mongolia.
- The stable outlook reflects our expectations that the economic recovery remains on track and Mongolia's fiscal, debt, and external settings will improve from 2022 onward.

Rating Action

On July 21, 2022, S&P Global Ratings affirmed its 'B' long- and short-term sovereign credit ratings on Mongolia. The outlook on the long-term rating is stable.

Outlook

The stable outlook balances pandemic-related risks to Mongolia's commodity export and growth prospects against our expectation that the country's nascent economic recovery will become more entrenched over the next 12 months. This latter trend will lead to improvements in Mongolia's external, fiscal, and debt metrics.

Downside scenario

Downward pressure could emerge if the economic recovery is derailed, leading to a material degradation of Mongolia's fiscal and debt metrics.

Upside scenario

We could raise the rating on Mongolia if the economy outperforms our current projections such that we expect its long-term trend growth to be significantly stronger than sovereign peers of similar income levels. This would lead to fiscal, debt, or external metrics improving more rapidly than we expect. We could also raise the rating if we observe that Mongolia's institutional settings achieve material improvements, especially in the predictability of policymaking.

Rationale

Our ratings on Mongolia reflect the country's modest per capita income, evolving institutional settings, and elevated external imbalances. We weigh these factors against steady access to concessional funding from multilateral and bilateral partners. The government's recent track record of fiscal discipline also supports the rating. Nevertheless, Mongolia continues to face significant vulnerabilities stemming from a concentrated economic base and elevated external and public indebtedness.

Institutional and economic profile: Economic recovery to be weak amid ongoing border closures with China, though medium-term prospects are favorable

- We expect Mongolia's real GDP to grow only modestly by 2.5% in 2022, following a tepid recovery in 2021, due mainly to border closure-induced disruption to exports.
- Economic prospects over the next two to three years, however, remain positive and will likely continue to be propelled by strong foreign direct investment in the mining sector.
- Political stability should be supported by the alignment of leaders from the executive and legislative branches, following the election of the former prime minister as president.

We forecast Mongolia's real GDP will expand by 2.5% in 2022, following lukewarm growth of 1.6% in 2021, primarily caused by disruptions to exports of goods as a result of border closures with China due to the latter's zero-COVID 19 policy. The Mongolian economy is off to a weak start after contracting by 3.8% year on year in the first quarter of 2022, amid continued poor performance of exports. A rebound in private consumption prevented a sharper downturn. Mongolia's long-term economic performance has been dented by the weak recovery in 2021 and subdued outlook for 2022. As a result, we no longer assess Mongolia to benefit from having stronger economic performance than peer countries.

Mongolia's near-term growth prospects face risks from a much more severe outbreak of infections in China this year than in 2020, alongside China's continued adoption of a strict zero COVID-19 policy stance. Mongolia remains driven by its external trade orientation and restrictions at the Chinese border are making it difficult for the country to capitalize on high commodity prices. This situation is exacerbated by the ongoing Russia-Ukraine conflict, which has added to inflationary pressures. We believe high inflation will act to constrain consumption growth while extended border restrictions with China will continue to pressure Mongolian exports. Offsetting this to some extent would be a strong growth in investments, propelled by resumption of the underground mining phase at the Oyu Tolgoi copper-gold mine.

Notwithstanding the weak prospects for this year, Mongolia's economic outlook looks promising. We forecast real GDP growth to thereafter average approximately 6.4% annually through 2025, on the back of sustained investment in the Tavan Tolgoi and Oyu Tolgoi mining projects. Earlier this year, the government of Mongolia concluded negotiations on the Oyu Tolgoi project including loan waivers, cost overruns, development delays and power supply issues with Rio Tinto. This has enabled expansion work to begin at the underground site and larger sustainable production is now expected by 2023.

The government has made considerable progress on developing key infrastructure projects including the Tavan Tolgoi-Zuunbayan and Tavan Tolgoi-Gashuunsukhait railway lines, which will significantly increase transport capacity for coal export volumes going forward. Once operational, these railway lines will lead to substantial cost reduction and most importantly, ease the trucking transport bottleneck caused by periodic restrictions at the China-Mongolia border.

Nevertheless, there remain important downside risks to the economy's growth trajectory. Mongolia's economy is highly vulnerable to exogenous shocks due to its heavy dependence on commodity exports to China. Acute shifts in commodity prices could also lead to heightened volatility in economic and fiscal outcomes.

With the ruling Mongolian People's Party (MPP) maintaining a strong parliamentary majority, and likely policy alignment with newly elected President Ukhnaagiin Khurelsukh, we expect policymaking and stability to gradually improve, which should be positive for foreign investor confidence.

We expect the government to maintain its recent track record of constructive economic policymaking after the ruling MPP strengthened its political dominance with the election of the former prime minister as the new president in June 2021. This includes a return to prudent fiscal settings post-pandemic, and close collaboration with multilateral and bilateral partners to institute reforms and ensure continued access to concessional financing. The alignment of the executive branch and the ruling party's strong parliamentary majority (with 62 out of 76 seats in parliament, the State Great Khural) should support policy continuity.

Flexibility and performance profile: Fiscal deficit to widen in 2022 against the backdrop of a modest growth outlook, but consolidation will follow as the economy recovers over medium-term

- Mongolia's fiscal metrics will deteriorate slightly in 2022 but improve thereafter, as the government gradually pares back its deficit in line with its medium-term fiscal framework.
- Mongolia's external indebtedness relative to its current account receipts improved in 2021, and the expected recovery in commodity exports should gradually strengthen external metrics over the next four years.
- The sovereign's steady access to concessional funding mitigates some credit risks associated with elevated levels of public and external indebtedness.

We expect Mongolia's fiscal metrics to deteriorate in 2022, following some consolidation in 2021, as weaker economic growth weighs on government revenues while spending accelerates to restart the economy post-pandemic. Nevertheless, we believe this deterioration will be temporary and that the government will resume consolidation starting next year. Mongolia's fiscal and external settings improved in 2017-2019, but the onset of the COVID-19 pandemic derailed some of the progress made by the MPP government since its electoral win in June 2016.

Prudent fiscal management adopted by the government led to a considerable reduction in general government deficit to 3.1% of GDP in 2021 from 9.4% of GDP in 2020. Government revenues were bolstered by higher tax collection which, in turn, was supported by higher commodity prices and nascent economic recovery. The robust revenue performance enabled Mongolia to reduce its cost of public indebtedness, as measured by the ratio of interest to revenues, considerably. Mongolia's borrowing costs are also capped by strong market demand for its debt, and a considerable concessional component.

High nominal GDP growth alongside fiscal consolidation has enabled Mongolia to substantially reduce its indebtedness. Net general government debt to GDP declined by about 10 percentage points to 67.5% of GDP in 2021. We forecast that this ratio will decline to 65% in 2022 and go below 60% by next year. This will entail the government reducing its deficit to about 2.8% of GDP by the end of 2023.

Mongolia's current account deficit widened significantly to 12.2% of GDP in 2021, from 5.0% in 2020, as growth in imports far outpaced that in exports, leading to a decline in its trade surplus. We expect the current account to record a relatively large deficit in 2022 as well. Consequently, external indebtedness, net of liquid assets held by the public and financial sectors as a share of current account receipts, will decrease only modestly in 2022. Further, Mongolia's external liquidity position as measured by its gross external financing needs (current account payments plus short-term external debt) will likely stay above 100% of current account receipts plus usable reserves, indicating that liquidity pressures will remain elevated.

That said, Mongolia's external position should benefit in the medium-term from strong growth of 10%-15% in exports as Chinese borders re-open and production from the underground phase of Oyu Tolgoi mine comes online. This will partially offset a surge in capital imports brought about by a revival of economic activity, in our assessment, thus guiding our forecast for the current account deficit to gradually narrow to 8.2% of GDP by 2025. In a similar vein, this should reduce Mongolia's narrow net external indebtedness, which we forecast to decline to 121% of current account receivables (CARs) by 2025.

Risks associated with Mongolia's high external indebtedness and financing needs are partially mitigated by strong donor and lending support from both bilateral and multilateral partners. In August 2020, the Bank of Mongolia (BoM) successfully extended a Chinese renminbi (RMB) 15.0 billion swap agreement with the People's Bank of China, valid until 2023. We include the drawdown on this swap-line in our calculation of Mongolia's general government debt stock.

Although we continue to assess BoM's currency regime as floating, persistent intervention over time could lead to lower reserve coverage and an overvalued exchange rate.

Mongolia's central bank has executed quasi-fiscal spending programs on behalf of the government previously and during the pandemic. Therefore, the bank's independence is deemed to be limited. Although central bank governance has been strengthened by ongoing reforms adopted from 2016 onward, BoM's track record of operational independence remains limited.

We consider government guarantees on Development Bank of Mongolia (DBM) obligations as part of government debt, following the government's provision of extraordinary support to meet DBM's debt repayments in 2017. Furthermore, the Ministry of Finance has become the sole shareholder of DBM as of April 2020. The adoption and ongoing implementation of more robust laws for DBM and the Deposit Insurance Corp. of Mongolia should curtail fiscal risks in future.

We view the rest of the financial and public enterprise sectors as posing limited contingent liabilities to the government, largely due to the modest size of Mongolia's financial sector. That said, the country's banks remain exposed to vulnerabilities associated with the undeveloped, primarily commodity-based, low-income economy. We also observe continued weaknesses in Mongolia's regulatory framework, transparency, and disclosures. Our Bank Industry Credit Risk Assessment for Mongolia is '9' (with '1' being the highest assessment and '10' being the lowest).

The adoption of the Amendments to Banking Act of Mongolia in January 2021 introduces sweeping reforms to the banking sector, including a 20% cap on single ownership for all banks, and a requirement for systemically important entities to become open joint-stock companies. While implementation has been delayed temporarily under the unfavorable economic conditions, this could lead to improvement in corporate governance and transparency, if duly executed. Nevertheless, insufficient progress in the recapitalization of some banks, as indicated by the IMF following the expiration of its Extended Funding Facility program in May 2020, suggests that there is further progress to be made in strengthening Mongolia's financial sector.

Key Statistics

Mongolia - Selected Indicators

Economic indicators (%)	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Nominal GDP (bil. LC)	23,931	28,011	32,583	37,839	37,883	44,091	49,975	56,893	64,711	73,645
Nominal GDP (bil. $)	11.2	11.5	13.2	14.2	13.5	15.5	16.8	18.5	21.2	24.1
GDP per capita (000s $)	3.6	3.6	4.1	4.3	4.0	4.5	4.9	5.3	6.0	6.7
Real GDP growth	1.5	5.6	7.7	5.6	(4.6)	1.6	2.5	6.0	6.3	6.8
Real GDP per capita growth	(0.5)	3.6	5.6	3.6	(6.1)	(0.2)	1.0	4.4	4.8	5.2
Real investment growth	7.7	28.2	31.8	14.0	(21.1)	14.0	8.0	8.0	8.0	8.5
Investment/GDP	22.6	27.4	39.4	35.6	22.1	35.2	36.3	36.8	37.1	36.6
Savings/GDP	16.4	17.3	22.6	20.4	17.1	23.1	26.0	28.2	28.7	28.5
Exports/GDP	50.9	59.2	58.2	59.2	57.0	58.4	58.3	58.1	57.1	56.8
Real exports growth	15.5	3.7	6.1	12.0	(5.3)	(14.5)	2.5	9.0	8.5	10.0
Unemployment rate	10.0	8.8	7.8	10.0	7.6	8.1	8.3	8.3	8.2	8.2
External indicators (%)										
Current account balance/GDP	(6.3)	(10.1)	(16.7)	(15.2)	(5.0)	(12.2)	(10.2)	(8.6)	(8.4)	(8.2)
Current account balance/CARs	(11.7)	(16.2)	(26.1)	(23.5)	(8.1)	(19.9)	(16.9)	(14.2)	(14.4)	(14.2)
CARs/GDP	53.5	62.2	64.2	64.6	62.1	61.1	60.6	60.2	58.4	57.4
Trade balance/GDP	12.0	13.0	5.1	8.2	13.0	11.2	10.6	9.0	7.3	7.3
Net FDI/GDP	(37.3)	12.6	16.2	16.3	12.6	9.5	7.8	8.5	8.6	8.6
Net portfolio equity inflow/GDP	0.0	0.2	(0.5)	0.0	(0.3)	0.2	(0.8)	(0.8)	0.0	(0.2)
Gross external financing needs/CARs plus usable reserves	146.2	149.4	130.6	123.6	104.9	114.5	119.2	125.9	128.5	126.6
Narrow net external debt/CARs	252.1	223.3	181.0	166.0	181.1	164.5	159.3	148.1	134.0	120.9
Narrow net external debt/CAPs	225.6	192.2	143.6	134.3	167.6	137.2	136.3	129.6	117.1	105.8
Net external liabilities/CARs	490.8	448.4	397.3	389.9	444.1	411.5	398.9	379.5	355.3	332.1
Net external liabilities/CAPs	439.4	386.0	315.1	315.6	411.0	343.1	341.3	332.2	310.6	290.7

Mongolia - Selected Indicators (cont.)

Short-term external debt by remaining maturity/CARs	60.8	56.4	51.1	47.8	51.5	49.7	53.6	51.7	49.2	44.6
Usable reserves/CAPs (months)	1.9	1.6	3.4	3.8	5.8	4.8	4.4	3.3	2.9	2.7
Usable reserves (mil. $)	1,108	3,018	3,550	4,359	4,547	4,383	3,543	3,382	3,531	3,579
Fiscal indicators (general government; %)										
Balance/GDP	(15.3)	(3.8)	2.6	1.3	(9.4)	(3.0)	(4.3)	(2.8)	(2.5)	(2.5)
Change in net debt/GDP	30.3	4.7	1.1	(0.2)	14.3	0.5	5.2	2.6	2.5	2.5
Primary balance/GDP	(11.2)	0.4	5.8	3.6	(6.9)	(1.2)	(2.2)	(0.8)	(0.6)	(0.7)
Revenue/GDP	24.4	28.4	31.2	31.5	27.5	32.3	32.5	32.0	32.0	32.0
Expenditures/GDP	39.7	32.2	28.6	30.2	36.9	35.4	36.8	34.8	34.5	34.5
Interest/revenues	16.9	14.5	10.3	7.2	9.0	5.8	6.4	6.3	5.8	5.5
Debt/GDP	105.5	97.0	82.8	75.6	87.5	73.4	70.0	64.1	58.9	54.3
Debt/revenues	432.9	341.3	265.2	239.7	318.5	226.9	215.3	200.4	184.0	169.6
Net debt/GDP	94.1	85.1	74.3	63.8	78.0	67.5	64.8	59.5	54.9	50.7
Liquid assets/GDP	11.5	11.9	8.5	11.8	9.5	5.9	5.2	4.6	4.0	3.6
Monetary indicators (%)										
CPI growth	0.7	4.3	6.8	7.3	3.7	7.1	14.0	11.0	9.0	8.0
GDP deflator growth	3.0	10.9	8.1	10.1	4.7	14.8	10.6	7.4	7.0	6.6
Exchange rate, year-end (LC/$)	2,490	2,427	2,644	2,734	2,850	2,849	3,100	3,050	3,050	3,050
Banks' claims on resident non-gov't sector growth	4.9	13.6	20.9	2.9	(4.9)	21.2	10.0	10.0	10.0	10.0
Banks' claims on resident non-gov't sector/GDP	56.4	54.8	56.9	50.4	47.9	49.9	48.4	46.8	45.2	43.7
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	32.5	22.6	22.7	24.7	26.3	21.1	23.0	23.0	23.0	23.0
Real effective exchange rate growth	(1.0)	(6.0)	3.0	5.5	(0.5)	0.7	N/A	N/A	N/A	N/A

Mongolia - Selected Indicators (cont.)

Sources: Mongolian Statistical Information Service, International Monetary Fund, Asian Development Bank (Economic Indicators); Central Bank of Mongolia (Monetary Indicators); International Monetary Fund, Central Bank of Mongolia (Fiscal Indicators); Central Bank of Mongolia (External Indicators).

Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Mongolia - Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	5	Future policy responses are difficult to predict because of frequently changing cabinets and internal conflicts. Inconsistent policies have in the past led to unsustainable public finances and imbalanced economic growth. Respect for the rule of law and transparency are not assured, owing to high perceived corruption and interference by political institutions in the free dissemination of information.
Economic assessment	5	Based on GDP per capita (US$) and growth trends as per Selected Indicators in Table 1.
External assessment	6	Based on narrow net external debt (% of CAR) and gross external financing needs/(CAR + usable reserves) as per Selected Indicators in Table 1.
		Mongolia's net external liability position is worse than the narrow net external debt position by over 100% of CAR, as per Selected Indicators in Table 1.
		The country is exposed to significant volatility in terms of trade, due to its dependence on coal and copper exports.
Fiscal assessment: flexibility and performance	4	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1.
		The sovereign has a volatile revenue base, due to its dependence on the mining sector.
Fiscal assessment: debt burden	4	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in Table 1.
		More than 40% of gross government debt is denominated in foreign currency.
		Nonresidents hold over 60% of government commercial debt.
Monetary assessment	4	The exchange rate regime is a managed float. Central bank intervenes intermittently in foreign exchange markets.
		Central bank independence can be limited by perceived political interference. Mongolia's real effective exchange rate can be volatile through the economic cycle.
Indicative rating	b	As per Table 1 of "Sovereign Rating Methodology."

Mongolia - Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanation
Notches of supplemental adjustments and flexibility	0	
Final rating		
Foreign currency	B	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt.
Local currency	B	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Global Sovereign Rating Trends Midyear 2022: Geopolitical Risks And Surging Inflation Wear On The Post-Pandemic Recovery, July 14, 2022
- Asia-Pacific Sovereign Rating Trends Midyear 2022: Resilience Amid Turbulence, July 14, 2022
- Sovereign Risk Indicators, July 12, 2022. An interactive version is also available at http://www.spratings.com/sri
- Sovereign Ratings History, July 8, 2022
- Sovereign Ratings Score Snapshot, July 6, 2022
- Economic Outlook Asia-Pacific Q3 2022: Overcoming Obstacles, June 27, 2022
- Default, Transition, and Recovery: 2021 Annual Sovereign Default And Rating Transition Study, May 5, 2022
- Sovereign Debt 2022: Asia-Pacific Central Governments To Borrow US$3.8 Trillion, April 6, 2022
- Credit FAQ: COVID And Conflict Strain Asia-Pacific Sovereigns, March 24, 2022

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed	
Mongolia	
Sovereign Credit Rating	B/Stable/B
Transfer & Convertibility Assessment	
Local Currency	B+
Mongolia	
Senior Unsecured	B