Mongolia Monthly Economic Brief
May 2015

The Monthly Economic Brief was prepared by the MFM GP Mongolia Team, composed of Taehyun Lee (Senior Country Economist), Altantsetseg Shiilegmaa (Economist), Davaadalai Batsuuri (Economist), under the guidance of Chorching Goh (Lead Economist) and Mathew A. Verghis (Practice Manager).

- Slowing industrial production growth and continued import compression indicate that Mongolia’s economic growth continues to slow.
- Sharper-than-expected declines in imports led to a current account surplus in Jan-Mar, yet further dampening of FDI strained the balance of payments.
- Deterioration of banks’ asset quality escalated in March with NPLs rising 9.4% from the previous month.
- Monetary policy remained tighter in March with the Price Stabilization Program being phased out. Discounted housing mortgage loans continued to grow.
- Revenue shortfalls are undermining the credibility of the 2015 budget. A supplementary budget seems needed to meet the FSL’s deficit ceiling.

Key Economic Developments

Industrial production data in the first three months of 2015 indicates that Mongolia’s growth continues to slow. Industrial production growth softened to 13% in the first quarter of 2015, from 16% of the previous quarter, on account of slower growth in mining and electricity production.

Mining industrial production growth slowed to 14% (y/y) in the first quarter of 2015, down from 21% of the previous quarter. Copper concentrate production growth (y/y) in the first quarter declined to 13% from 26% the previous quarter, reflecting the waning high growth effect from the production of OT mine that entered into the second year of full production. Coal production increased 16% from a year ago, signaling the possibility of gradual recovery after continued contractions in the previous two quarters. Crude oil production growth also slowed but maintained a robust 20.3% growth. Gold production contracted by 10% for the first three months from the same period the previous year.

Manufacturing production and sales data in recent months signal slowing consumption. Manufacturing production growth picked up to 9% (y/y) in the first three months, from 3% growth the previous three months. However, unsold production of manufacturing goods reached 11.3% of gross manufacturing production in the first three months, up from 7% in the previous quarter, indicating that increased production is absorbed by growing inventories due to weakening consumption. Production of electricity and energy grew 6% (y/y), moderately down from 8% the previous quarter.

National headline inflation slowed to single digits in 2015, decelerating from 11% (y/y) at the end of 2014 to 9.3% in March 2015. Overall food price inflation (UB) declined to 3.7% in March from 6.9% in December 2014. Core inflation (UB) still remains in a double digit territory but also decelerated to 11.9% from 12.6% over the same period.
The current account balance deteriorated in February and March due to weakening export growth. The current account recorded a surplus of $117 million in January but deteriorated to a deficit of $97 million in February and March. Export growth dropped sharply from 54% in January to negative 11% in March. Exports of copper concentrates and crude oil dropped by 8% and 40% (y/y) respectively in March due to lower prices despite increasing export volumes.

Coal exports continued to drop 23% (y/y) in the first three months due to declines in export volume and price. Imports continued to sharply decline. Total imports (free-on-board term) dropped 28.5% (y/y) in the first three months, driven by a 30.8% drop in oil product imports. Non-oil imports also dropped 29% during the same period signaling continued weak domestic demand for consumption and investment.

Further dampening of FDI strained the balance of payments in the first three months. FDI recorded a net outflow of $72 million in the first quarter, a significant deterioration from a net inflow of $294 million in the same period a year ago. In March, FDI slightly recovered to a net inflow of $5.7 million. Portfolio investment and loans also displayed a net outflow of $29 million in the first quarter. A significant net capital outflow of $320 million was recorded under net errors and omissions account which is usually caused by discrepancies across different data sources. The data discrepancy is expected to be corrected by a revision of the BoP data. A net financial inflow of $136 million through currency and deposit account helped ease the mounting BoP pressure. As a result, overall balance of payments deficit reached $271 million in the first quarter.

Gross international reserves remained stable in February and March and the currency depreciation slowed in April. Gross reserves
Bank asset qualities continued to deteriorate in Jan-Mar. Outstanding NPLs and past-due loans have increased by 63% and 108% respectively over the past twelve months. Deterioration of asset quality intensified in March. NPLs increased 9.4% and past-due loans increased 41% in March compared with February. NPL ratio to bank loans climbed to 3.9% in March, up from 3.1% at the end of 2014 and 2.5% at the end of 2013. Past-due loans ratio also rose to 4.6% of bank loans in March from 2.5% a year ago.

Credit and liquidity conditions became tighter in March. Bank credit growth (including securitized mortgage loans) continued to decelerate to 15% (y/y) in March from 20% at the end of 2014 and 58% in the same month last year. Slowing credit growth reflects tighter tugrik liquidity conditions and continued weak foreign currency loan growth on account of sluggish domestic currency deposit growth, unwinding of the Price Stabilization Program, and persistent wariness over currency depreciation pressure. Net domestic credit growth also slowed but maintained robust 27% growth (y/y) in March, reflecting increasing net credit to the government and BoM's liquidity support to the corporate sector provided via banks in late 2014. Despite the robust net domestic credit growth, broad money growth slowed to a negative 0.5% growth (y/y) in March due to continued large declines of net foreign assets reflecting persistent BoP pressure on net international reserve positions of depository corporations.
The BoM continued to unwind the Price Stabilization Program (PSP) in March and strengthened capital requirement of banks in April. BoM’s credit to the PSP has been gradually withdrawn since late 2014 as one of the measures to phase out unconventional policy lending programs. Outstanding BoM’s credit to the PSP declined 10% over the first three months of 2015. A working group was formed to transfer the PSP to the government by June. Outstanding loans under the Housing Mortgage Program, however, grew 8.3% over the first quarter, reaching MNT 2.2 trillion in March. MNT 1.2 trillion of the mortgages were securitized by Mongolia Mortgage Corporation (MIK) as of March and 90% of securitized mortgages were purchased by the BoM. Plans to phase out and transfer the mortgage program to the government are yet to be announced. BoM’s outstanding credit to banks declined to MNT 1.8 trillion in March from MNT 2.6 trillion at the end of 2014, reflecting the continued unwinding of PSP loans and securitizations of mortgage loans. BoM’s outstanding credit to non-bank sectors (including MIK), however, increased to MNT 2 trillion in March from MNT 1.7 trillion at the end of 2014 amidst increasing purchases of securitized mortgages loans via MIK. On April 1, the BoM announced to raise the minimum paid-in capital of banks from MNT 16 billion to MNT 50 billion, from 2016 for systemically important banks and from 2018 for other banks.

Weak budget revenue performance continued to strain the fiscal space in March. Budget revenues increased by 7.9% in Jan-Mar, compared with the same period the previous year. Budget revenues of the first three months, however, fell short of the planned revenue receipts by 7.2%. The revenue shortfall largely came from foreign trade taxes (customs duties, VAT and excise tax on imported goods) and corporate tax that fell short of the budget plan by 25.6% and 12.8% respectively. Facing weak revenue receipts, the MoF has been containing budget executions through tighter payment control. Budget spending executions in the first three months increased by 6.9% from the previous year but remained at 70% of the spending plan of the 2015 budget. In particular, only 29% of the budget’s capital spending plan was executed, taking the brunt of revenue shortfalls. Tighter fiscal situation was further compounded by rising sovereign borrowing costs amidst tighter liquidity of the banking system, with one-year government bond yields hovering over 16% since last September. Despite the MoF’s hard efforts to contain the spending, another amendment of the 2015 budget seems necessary in the coming months to meet the FSL’s structural deficit ceiling (5% of GDP), through proper commitment controls of budgetary projects to avoid possible payment arrears that have to be eventually paid by the budget later.
Monthly Focus
Mongolia’s External Debt Positions in 2014

Annual external debt statistics released by the BoM shows that Mongolia’s external debt rose 10.1% to $20.9 billion at the end of 2014, from $19 billion in 2013. The external debt of Mongolia rose to 175% of GDP in 2014, up from 152% in 2013. External debt has increased steeply over the past four years from 92.5% of GDP in 2011 amidst growing public external financing and FDI-related intercompany debts. Intercompany borrowings of foreign-invested companies took up 51% of external debt in 2014, followed by general government debt and guarantees (24%), private sector debt (18%), and central bank foreign liabilities (7.5%).

Public and publicly guaranteed (PPG) debt continued to increase in 2014. External PPG debt more than doubled in 2012 due to the issuance of Chinggis bond ($1.5 billion) and DBM’s euro bond ($580 million), and further increased in 2013-14 reflecting growing government guarantees and BoM’s foreign liabilities. External PPG debt to GDP ratio climbed to 54% in 2014, from 21% in 2011 and 43% in 2013. Outstanding government guarantees almost doubled from $0.7 million in 2013 to $1.3 billion in 2014, due to new guarantees issued to DBM’s external financing including samurai bonds (30 billion yens), loans from Credit Suisse ($300 million) and China Development Bank ($112 million). BoM’s foreign liabilities significantly increased in 2013-14, from $413 million in 2012 to $1,567 million in 2014.

Private external debt also steeply grew over the last two years. Private external debt excluding intercompany lending rose from 19.1% of GDP in 2012, to 25.7% in 2013 and 31.7% of GDP in 2014. Banks’ external debt rose 52% and non-bank private sector debt rose 71% over the last two years reflecting increasing loans and bond issuances of major banks and companies. Intercompany lending – which accounted for 56% of external debt increase in 2011-13 in tandem with large FDI inflow – increased only by $273 million in 2014, a sharp slowdown from $1.9 billion increase in 2013, amidst declining FDI inflow.

Short-term external debt markedly increased in both public and private sectors in 2013-14. Short-term external debt reached $2.4 billion (19.8% of GDP) in 2014, up by 163% from $902 million (7.3% of GDP) in 2012. BoM’s short-term foreign liabilities sharply increased over the last two years, from $336 million in 2012 to $1,497 million in 2014 reflecting increasing drawings on a bilateral swap line between the central banks of Mongolia and China. Private sector’s short-term external debt increased 44% to US$ 877 million in 2014 from $605 million the previous year. Short-term debt accounted for 23% of private sector’s external debt in 2014. Reflecting the increasing short-term debt and weakening FX reserves, short-term debt to reserve ratio deteriorated to 144% in 2014 from 71% in 2013.

Figure 11. External debt climbed to 175% of GDP in 2014 driven by rising PPG debt and private external debt.

Source: External Debt Position 2014 (BoM), 2015 Budget (MoF), WB staff estimates