ECONOMIC OUTLOOK OF MONGOLIA 2025

TDB SECURITIES

Introduction

Despite the global pandemic, declining agricultural sector exacerbated by extreme weather events, and geopolitical tensions caused by the Russian invasion of Ukraine, Mongolia has still managed to sustain a robust economic growth for the last five years to become one of the fastest growing economies in the world.

Whether this growth will be sustained in the future or not will depend on a successful diversification of the economy that encourages greater involvement of the private sector, sustaining current levels of foreign direct investments to the mining sector while boosting it to other sectors, and effective management of revenue from natural resources to increase public investment efficiency.

Inflation has stabilized in 2024, entering the target interval of ±6 percent, and the Bank of Mongolia has cut the policy interest rate by three percentage points. Foreign exchange reserves have revived from its historic lows reached in 2020, strengthening the Mongolian tugrug against the US dollar. FDIs are expected to increase as international credit rating agencies, such as Fitch, Moody's, and S&P Global ratings, have improved Mongolia's credit rating to "B+".

We have focused on 5 main topics in this outlook, capturing the economic state of Mongolia and providing useful insights to investment opportunities:

- Recent developments of the Mongolian economy
- Macro-economic outlook and market implications
- Key themes
    - FX reserve
    - Coal market
    - Inflation
- Monetary policy and fiscal policy implications
- Investment guide for 2025

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Section 1

01 GDP growth has reached 7.4 percent, bringing Mongolia to be one of the fastest growing economies in the world. Recovery from COVID-19 was rapid and efficient. Economy's growth, driven by the commodity price increase, has been held back slightly by the agricultural sector - around 2 million livestock were killed, devastating livelihood of many herders.

02 Inflation has fallen to the Bank of Mongolia's target interval of 4-8 percent. Core inflation remains sticky, while education sector was mainly responsible for the headline inflation growth.

03 Successful debt management programs and refinancing strategies have reduced debt pressure on government budget.

04 Exports have doubled in last five years reaching 11.8 billion US dollars by the third quarter of 2024, mineral products comprising 87.4 percent of total. Foreign trade balance has reached approximately 3.2 billion US dollars in the third quarter of 2024.

05 FDI flow has fallen by 40 percent in 2023 from last year, but by the second quarter of 2024, the inflow has increased by around 33 percent from the same period of 2023. Around 80-90 percent of the investment is directed towards the mining sector.

The economy grew by 7.4 percent in 2023, increasing from an already high growth of 5.0 percent in 2022.

The growth of real gross domestic product has been stellar since shrinking by 4.6 percent in 2020. In 2021, despite border restrictions due to the COVID-19 pandemic and Chinese zero-COVID policy, the economy has managed to grow by 1.6 percent. This growth was driven by the financial and insurance sector along with the information and communication sector, expanding by 9.7 percent and 20.7 percent respectively. Overall growth in the last five years have been largely driven by the mining sector as commodity prices surged, commencement of Oyu-Tolgoi's underground mine, one of the largest copper mines in the world, developments in Tavantolgoi coal mine along with growing coal demand from China.

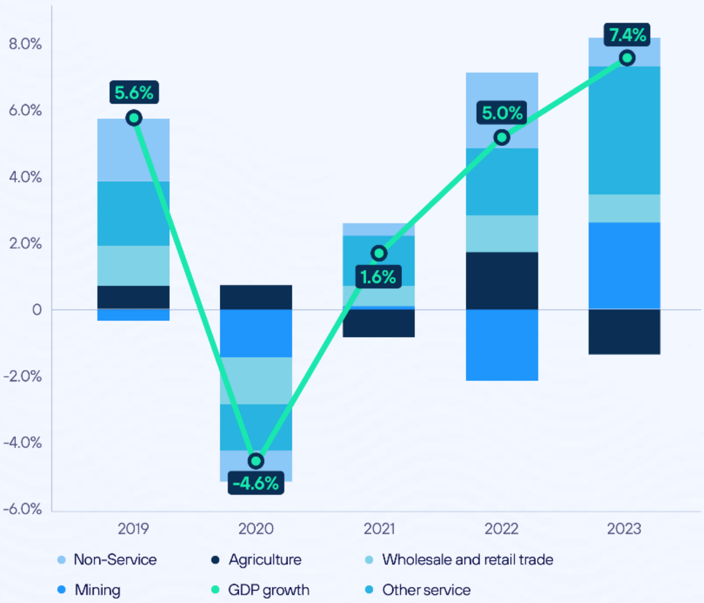


Figure 1. Growth rate of GDP, by sectors. Mining remains the main driver of growth, followed by the wholesale sector

In 2023, the economy expanded by 7.4 percent, with the mining sector and the transportation and storage sector contributing 2.6 and 1.8 percent to this growth respectively. Following the growth in mining, related sectors including the transportation and storage as well as service sectors have been flourishing. However, the growth has been held back by the agricultural sector suffering from dzud, a periodic crisis of extreme cold in the winter, with a contraction of 8.9 percent. This has impacted the gross domestic product growth by 1.3 percent, as the agricultural sector is responsible for around 10 percent of the GDP.

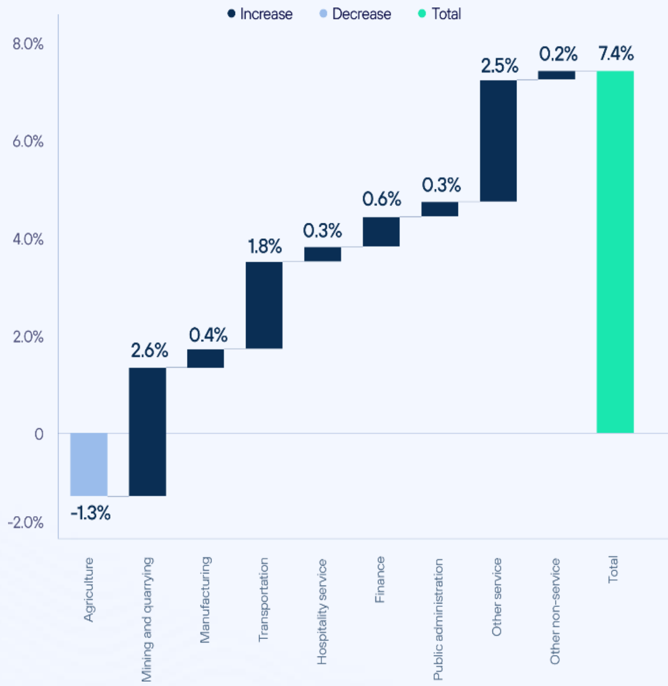


Figure 2. Contribution of sectors to the GDP growth of 2023- Agriculture has set back the growth due to the extreme cold wave.

Source: National Statistics Office

Inflation has decreased, hovering around the upper level of the target interval. Bank of Mongolia has decreased the policy rate by 3 points in 2024, easing the tight monetary policy.

During the COVID-19 pandemic, global inflation levels have soared, with developing countries taking the biggest hit. After reaching the highest level of 16.1 percent in 2022, Mongolian inflation has diverged into Bank of Mongolia's target level of 6±2 percent by November 2023. Inflation reached its lowest level at 5.1 percent just before the parliamentary elections held in June 2024. After the election, increased private consumption due to the permanent increase in pensions and minimum wage along with public wages, drove inflation started to increase slightly, reaching 7.0 percent by October 2024.

From June 2022, food and beverage CPI has increased by 20.1 percent while the general CPI has increased by 17.3 percent. Price increase in education was the main driver of the general CPI growth last year, as universities' and private high school's tuition fees have increased by almost 16 points at the beginning of 2023-2024 school year, higher than any other product in the CPI basket. The average household spends around 20 percent of their monthly income solely on one child's university tuition.

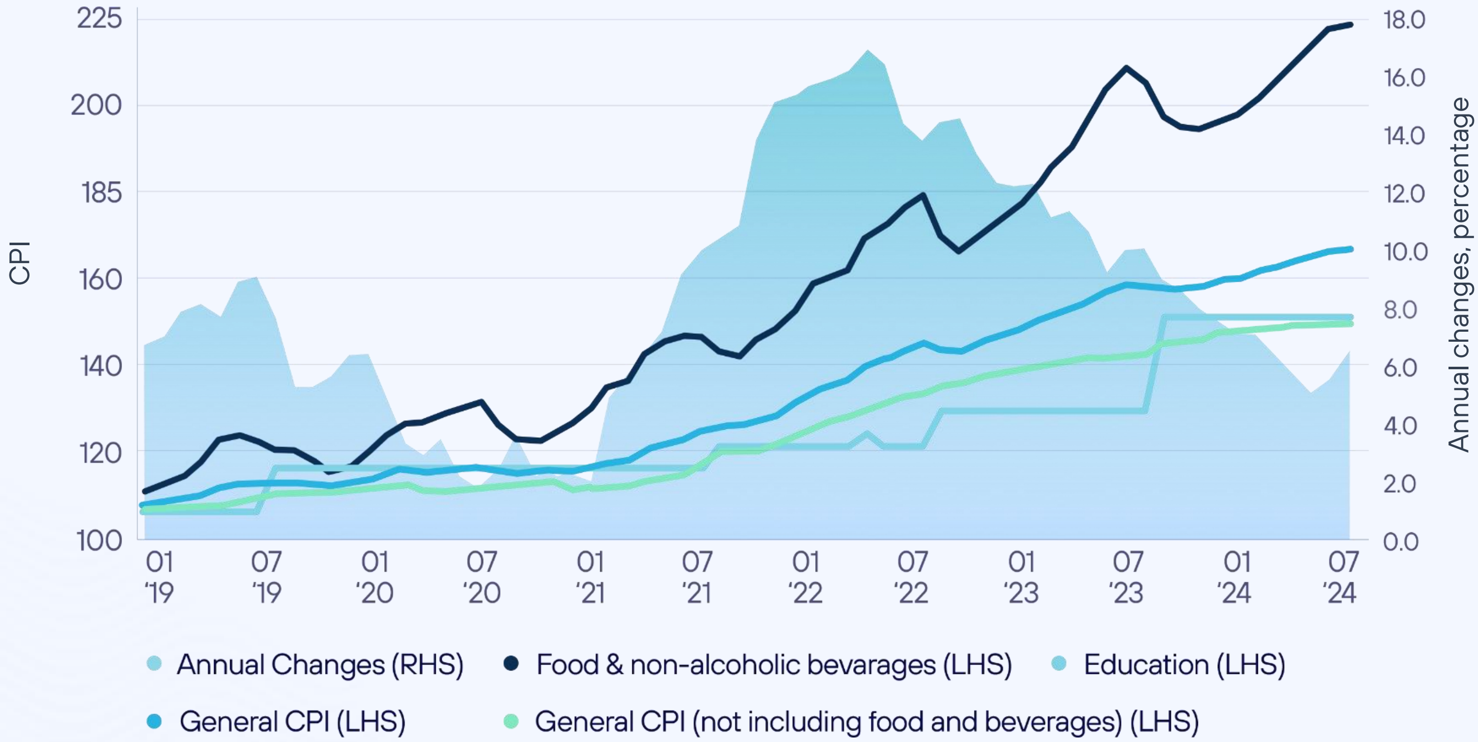


Figure 3. Annual inflation rate on the right-hand side, general and sectors' CPI on the left-hand side. Core inflation remains sticky; food and non-alcoholic beverages and education have been pushing the inflation to the upper level of the target interval.

Source: Bank of Mongolia, Statistical bulletin 2024-09

Fiscal balance had a surplus of 785.9 billion tugrugs in 2023 after 5 years of deficit. Total government revenue has increased by 31.7 percent while expenditure has grown by 23.7 percent.

In the last four years, the fiscal balance was in deficit. In 2020, the deficit reached 4.5 trillion tugrugs, equal to 12 percent of the GDP. Since then, the gap between revenue and expenditure has been shrinking, reaching 2 percent of the GDP in 2022, and turned positive in 2023.

Mining led growth of the revenue has been caught up by the increased public spending due to the increased social welfare and transfer before the parliamentary elections. The budget for 2024 has been amended by the government in August, increasing the government expenditure.

In 2023, government expenditure has increased by 23.7 percent in year over year, with capital expenditure, goods and services, and subsidies and transfers each contributing around 7 percentage points of the growth. Interest payments have also increased by approximately 42 percent.

Social security expenditure has increased by 53 percent as pensions increased last year. In 2020, there were 4 pensioners for 10 workers, but this number is forecasted to reach 7 in 2030 as the mean age of the population has increased by 8.3 years from 2000. This along with large dividend payments of Erdenes Tavantolgoi mine and minimum wage hikes has increased the public transfer by 12.7 percent. Domestic investment has also increased by 36 percent. Despite substantial increase in expenditure, fiscal balance still managed to be in surplus.

Government revenue has grown by 31.7 percent, almost double the compound annual increase in the last 5 years. Income tax has contributed 10.1 percentage point of the growth, and along with value added tax, social security contributions, and other taxes add up to 32.5 percentage point of growth, while reductions in the stabilization fund has held back the revenue growth by 3.9 percentage points.

Debt management strategy has been successfully implemented, bringing the public debt to GDP ratio down to 47 percent in 2023.

Increased stimulus during the COVID-19 pandemic has led to macroeconomic instability, and has pushed public debt to the nominal GDP ratio above the ceiling level of 60% mentioned in the Fiscal stability law. However, through successful implementation of debt management measures between 2022 and 2024, under the Century I, II and III projects, the government has managed to secure financing with relatively low interest rates. This was used to refinance the overdue portion of the Khuraldai bonds and was set to mature in March 2024, bringing the debt-to-GDP ratio down to around 47 percent by the end of 2023. By the second quarter of 2024, government gross debt stands at 29.7 trillion tugrugs. Over 90 percent of the government debt is external, and the government has managed to bring the build-transfer concession down to 0 in the first two quarters of 2024, although the debt guarantee has increased slightly.

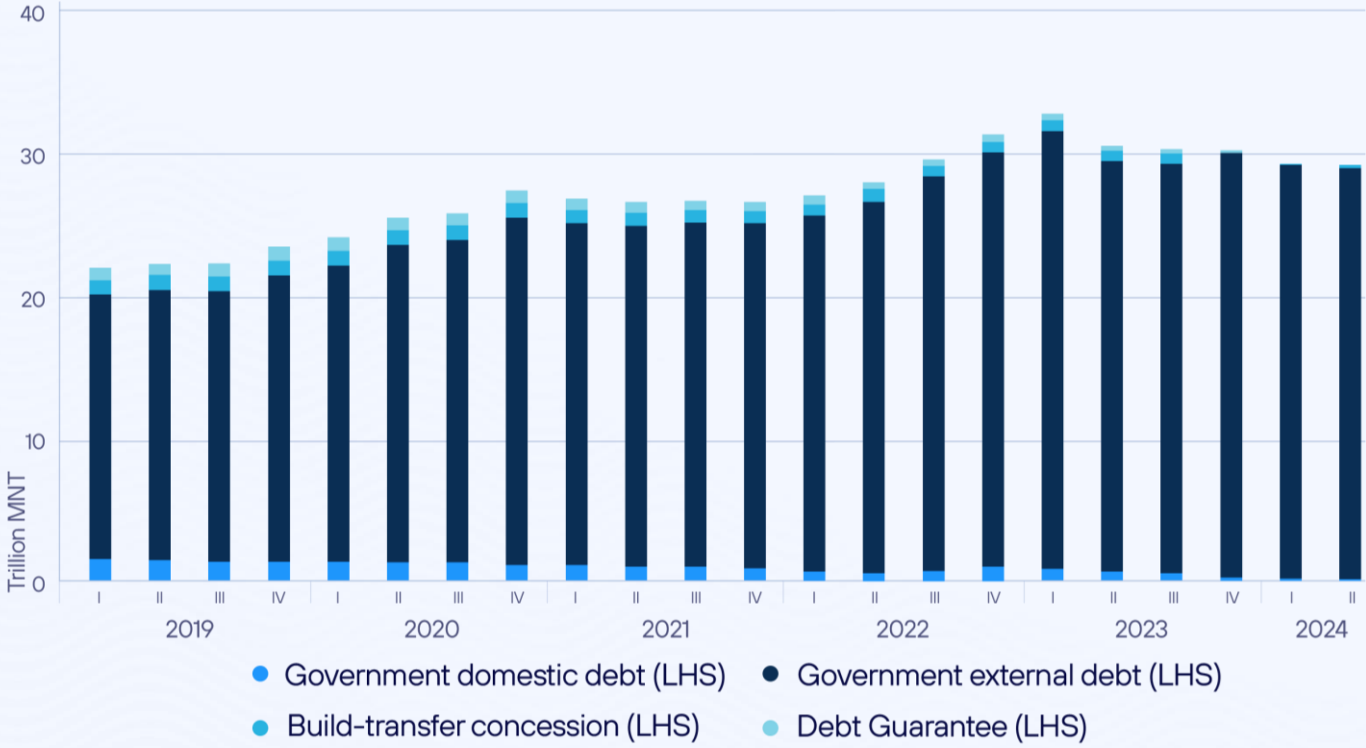


Figure 4. Government debt by debt types.

Source: Ministry of Finance, Debt bulletin 2024

Exchange rate against USD has stabilized. By the end of the third quarter of 2024, MNT has strengthened by 0.8 percent against USD compared to the beginning of the year.

The tugrug has lost around 20 percent of its value against US dollar in 2022. Due to China's zero-COVID-19 policy closing the border along with increased import price of petroleum oil as a result of the geopolitical tensions between Ukraine and Russia, tugrug has weakened drastically during the pandemic. After hitting the peak of 3,524.98 per dollar in March 2023, the tugrug has appreciated by 0.3 percent monthly on average against the US dollar for the last six quarters. This stabilization was mainly driven by the dissipation of the geopolitical tensions, opening of the border with China and softer import prices.

As of August 2024, Mongolian foreign exchange reserves sit at 4.7 billion USD, enough to cover around 5 months of imports. This is a 23.8 percent increase year over year though a slight drop from the 5.2 billion USD high in March of the same year. With the account surplus from the previous year, effective debt management, and refinancing has encouraged this growth in the foreign exchange reserves. In an effort to reduce interest payments, Bank of Mongolia has repaid 6 billion Chinese yuan from the swap agreement with China by the end of 2023. In the last three years, the compound annual growth rate of the international reserves was 18.6 percent.

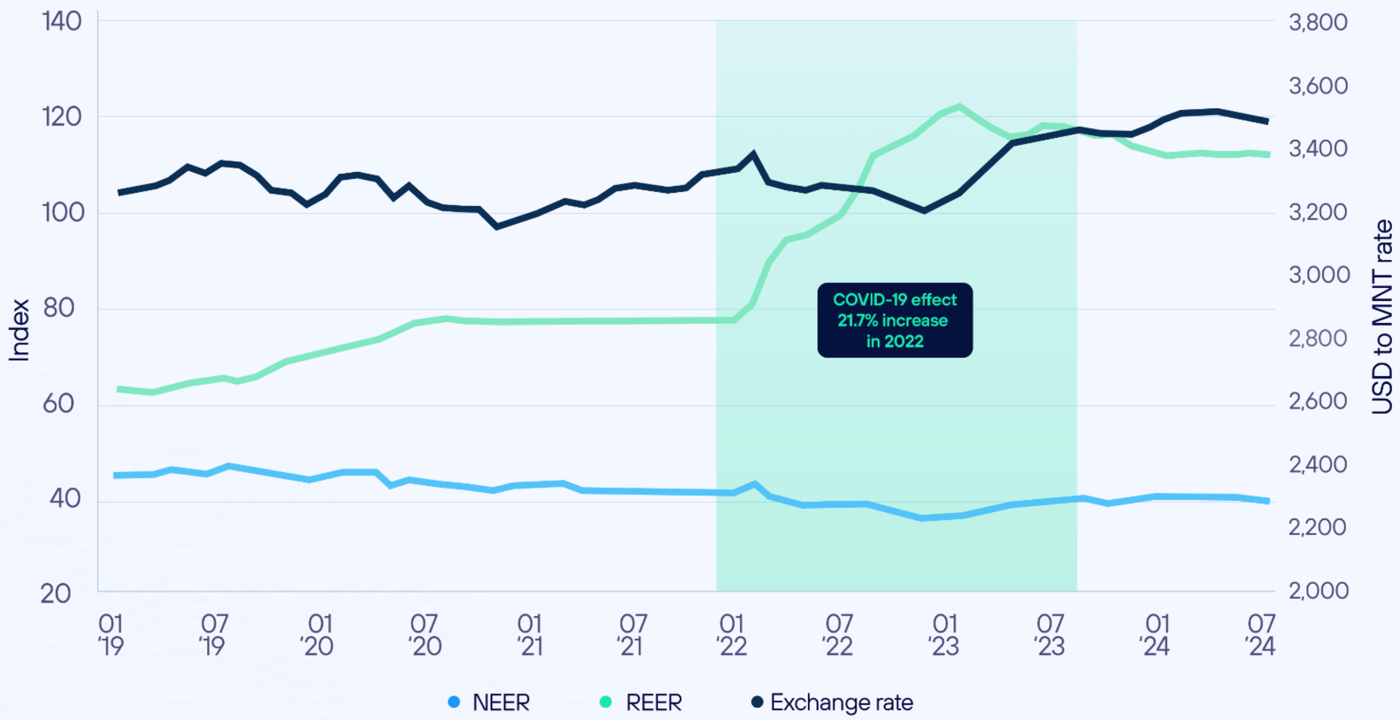


Figure 5. Exchange rate on the right-hand side, REER and NEER indices on the left-hand side

Source: Bank of Mongolia, Statistical bulletin 2024-09

Foreign trade balance was equal to 28.4 percent of GDP in 2023, highest performance in the last decade.

By the end of the first half of 2024, Mongolia's foreign trade turnover has increased by 12.2 percent from last year, reaching 13.2 billion US dollars. Exports have exceeded imports by 2.5 billion dollars, mainly driven by the mining sector, which accounts for around 90 percent of the exports. Mineral products' exports have increased by 6.6 percent last year, with copper ores and concentrates, and coal exports increasing by 9.4 percent and 7.5 percent respectively.

On the other hand, imports have increased by 25.8 percent compared to the same period last year, amounting to 5.4 billion US dollars. Mongolia relies solely on imported petrol and diesel which amounts to around 20 percent of total imports and geopolitical tensions have increased the prices of these commodities, leading to an increased spending on imports.

Machinery, equipment, and electric appliances' imports along with vehicle imports is responsible for 21 percent of total imports each and has grown by 45.8 and 36.3 percent respectively.

Mining sector dominates the flow of foreign direct investments.

In the last five years, the compound annual growth rate for total foreign direct investments was 5.3 percent. Around 70 percent of the FDI flow is directed into the mining sector. After falling slightly during the COVID-19 pandemic due to increased public debt, the inflow has picked up in the last quarter of 2022.

In 2022, the total FDI inflow was 3.4 billion US dollars, 26.0 percent increase year over year. FDIs fell slightly at the beginning of 2023, as can be explained by reduced financing needs in Oyu-Tolgoi mine once the underground portion was fully operational. However, in 2023, Mongolia has successfully issued 650 million and 350 million US dollars worth of bonds, indicating a successful economic recovery from the pandemic.

By the end of 2023, FDIs to the non-mining sector is equal to only around 6.9 percent of the GDP. In order to attract more foreign investors, Mongolia has been imposing investor friendly policies, including minimal restrictions in market entry, same tax rules for both domestic and foreign investors. Foreign investors enjoy the same rights as Mongolians to establish, transfer, and securitize legal entities except for real estate properties. Foreign investors are barred from land ownership, though they can obtain the right-to-use licenses

Section 2

01 GDP growth outlook is stable, to average about 5 percent in 2025-2027. The outlook depends heavily on the commodity production of the country as well as the market price movements. Successful management of the mining revenue to the infrastructural construction projects will have an impact

02 Fiscal balance is set to go in slight deficit with increased government expenditure, led by the new coalition government's mega project budgets catching up to the mining revenue.

03 Even though the natural resources' revenue is predicted to keep flowing into the country as well as foreign direct investment, fiscal balance is set to be in slight deficit in 2025. Government expenditure, mainly the public investment to the 14 mega projects, proposed by the new coalition government is forecasted to catch up to the mining revenue.

04 Total turnover of foreign trade to reach around 36.1 billion US dollars in 2025, with trade balance of 5.1 billion US dollars. Exports are predicted to have compound annual growth rate of 13.2 percent in 2023-2027, slightly lowered from 15.1 percent from last five years. As for imports, the growth rate will decline slowly, hovering around 15 percent in the next five years, mainly driven by machinery and technical import for the growing mining industry. Natural resources' revenue will continue to support growth with commencement of the Oyu-Tolgoi mine's underground project along with sustained coal demand from China.

GDP growth driver assumptions.

Forecasting the GDP for countries like Mongolia, rich with natural resources, is highly dependent on output and revenue of natural resources as well as its usage effectiveness. Out of the 14 indicators that have been used to predict the growth of the economy, the most significant ones include natural resources production, namely copper, coal, and gold production which constitute most of the mineral exports, public investment, transfer, and consumption levels as well as tax rate assumptions. Effective use of the revenue from natural resources determines whether the growth will be sustained as it is common to see the 'resource curse'- quick and marked downfall after short term of sudden growth.

To manage mining revenue more efficiently the Mongolian government has inaugurated the Sovereign Wealth fund as the corresponding law was implemented at the beginning of 2024. The fund is comprised of three accounts - Future Heritage fund, Development fund, and Savings fund. Several major mining corporations will contribute a share of their revenues to the fund. Successfully diversifying the economy to hedge the risk of vulnerability to commodity market fluctuations, translating the revenue from natural resources and foreign direct investments into projects aimed at reducing poverty, creation of well-paying jobs, as well as developments of the high value-added sectors will assure sustained growth in the long term.

Natural resources production assumptions: Copper production to increase by around 6 percent annually, with slight decline in 2025, modeled using ARIMA. Oyu-Tolgoi mine's underground production is predicted to drive the copper output growth. Copper price is forecasted to reach a little above 10 thousand US dollars per ton by the end of 2027. As for coal, the production level is predicted to hover around same level of 2024, which has increased by 14 percent from 2023. Coal price has also seemed to reach a plateau state. Aside from the slight decline in 2025, the price is assumed to be quite stable.

Public investment level assumptions: Public investment growth is projected to peak in 2024 and stabilize at around 4 percent annual growth.

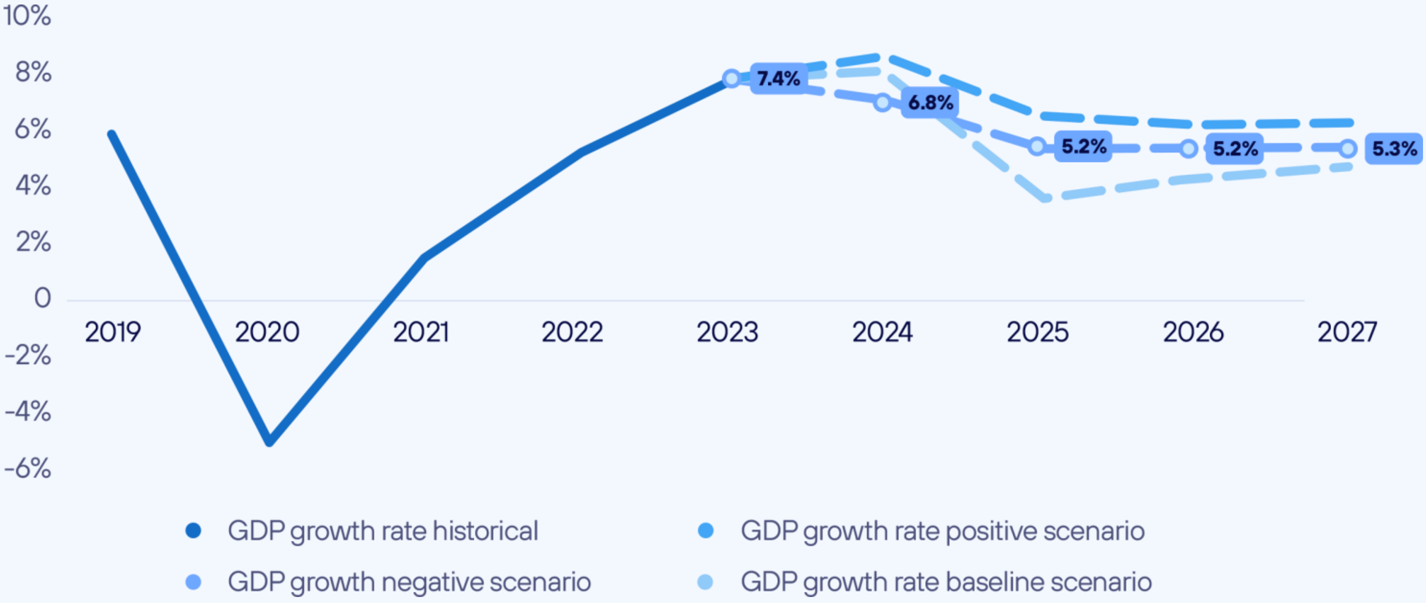
Tax rate assumptions: As in the government expenditure budget for 2025, we have assumed that labor tax rate along with the consumption tax rate would be constant in the next three years.

Public consumption assumptions: Percentage of public consumption to GDP has been converging to the average of upper middle-income countries. We have projected that the compound annual growth rate of public consumption will be around 8.2 percent and reaching around 15.8 billion US dollars by the end of 2027, constituting about 14.6 percent of the GDP. Globally, 16.5 percent of the GDP is public consumption, 15.3 for East Asian and Pacific countries and 14.6 percent for middle income countries.

Public transfers assumptions: Public transfers have doubled in value since 2020, as stimulus increased during the COVID-19 pandemic followed by dzud in the winter. During the pandemic, public transfers increased sharply. In addition to the onetime 300 thousand tugriks to every Mongolian in an effort to keep the economy from shrinking further, country-wide mandatory testing along with other preventative measures have increased public transfers. With the assumption that such extreme events won't happen in the near future, we have forecasted that percentage of public transfers to the GDP will decrease slightly through the next 3 years to reach 12.7 percent in 2027.

GDP growth to slightly drop in 2025, then flatline through 2027. Mining sector will be a key in keeping the growth stable.

Commodity market outlook is positive in the next three years, keeping the mining sector growth stable in Mongolia. However, the outlook shows stable growth, unlike the boom in 2022-2023. We have forecasted GDP growth to be around 6.8 percent in 2024, a little less than the year before. From 2025 to 2027, GDP growth is predicted to hover around 5.2-5.3 percent with little deviation.



Source: Analyst's estimation

Figure 6. GDP growth rate forecast scenarios

With every driver held constant, except commodity net export price index, we have simulated three scenarios where the commodity net export price index is held at the value of second quarter of 2024, one where it increases by 5 percent annually, and another where it decreases by 5 percent annually.

The net export price staying constant has a positive effect on GDP growth than when it increases annually, despite mineral products comprising around quarter of total imports, compared to the 80-90 percent of exports, and Mongolia's dependence on imported petrol and diesel fuel. If the net export price flatlines, the growth outlook is projected to reach 9.7 percent by the end of 2027, compared to the 5.3 percent in the baseline forecast.

If the commodity net export price decreases annually, which is an unlikely case in the near future in consideration of the outlook on the commodity prices, GDP growth is forecasted to shrink to 3.8 percent.

Figure 7. GDP growth rate based on commodity net export index

Exports are projected to grow by 5.2 percent annually on average, reaching around 19 billion US dollars by the end of 2027.

While the commodity price outlook looks stable, ranging from 5 percent decrease to 8 percent increase on average annually, Mongolian exports outlook still shows growth potential. Coal production growth is forecasted to increase modestly after almost tripling in the last three years. The coalition government has proposed 14 mega projects focused on development and infrastructure in the budget proposal for the next four years. In order to further develop the mining sector to capitalize the commodity market rally more efficiently, the 14 projects include:

- Completion of Gashuunsukhait-Gantsmod cross-border connection, increasing coal transportation from Tavantolgoi mine by 40 million tons
- Construction of 450 MW thermal power plant connected to Tavantolgoi coal mine

Out of the 14 proposed projects, five are planned to commence in 2025. With an improved port access, exports revenue is anticipated to reach around 18.3 billion US dollars by the end of 2027.

By the third quarter of 2024, with the commencement of underground mine of Oyu-Tolgoi mine copper production has increased by 45 percent compared to the same period of 2022. However, the peak production of the mine is expected to happen between 2028-2032, accelerating the mine's production and sustaining a growth rate of around 5 percent in the next three years.

By 2027, the copper production is projected to reach around 1.9 million tons and copper price is projected to reach around 10 thousand US dollars per ton by around that time.

As for iron, the production is forecasted to increase by around 20 percent but it is offset by the decrease in its price, leaving total revenue largely unaffected. From the peak of 307 dollar in the second quarter of 2021, iron price has been halved by the end of the third quarter of 2024. In the upcoming three years, the price of iron is predicted to fall slightly by around 4 percent annually.

Mongolian mining sector is an integral driver of the economic growth. With an ample supply of copper, coal, iron, and gold reserves, the mining sector made up about 25 percent of GDP, 78 percent of FDIs and 87 percent of exports. Mongolia's economic dependence on the mining sector has been growing in the recent years. Despite the commodity market boom, commencement of the underground portion of Oyu-Tolgoi mine and increased coal demand from China has driven the exceptional growth last year, the economy remains vulnerable to any price shock.

In the last five years, the compound annual growth rate for total trade turnover was 15.1 percent. For the 2023-2027 period, this growth rate is forecasted to be around 14.3 percent.

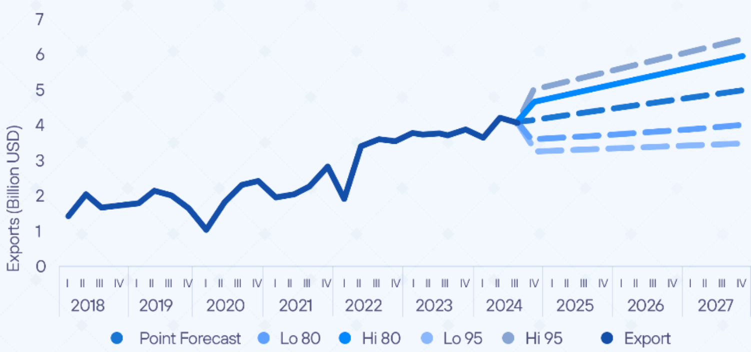


Figure 8. Exports forecast

Source: Analyst's estimation

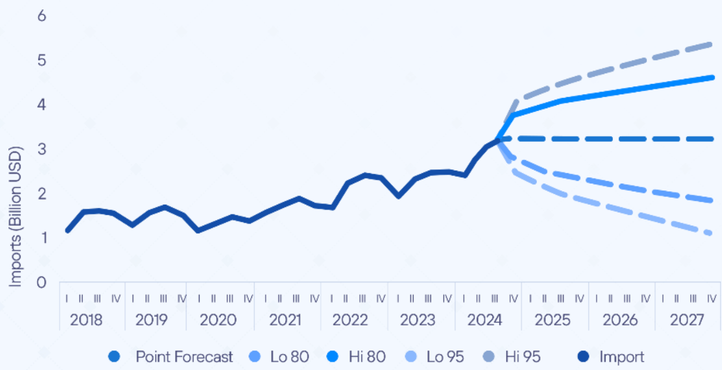
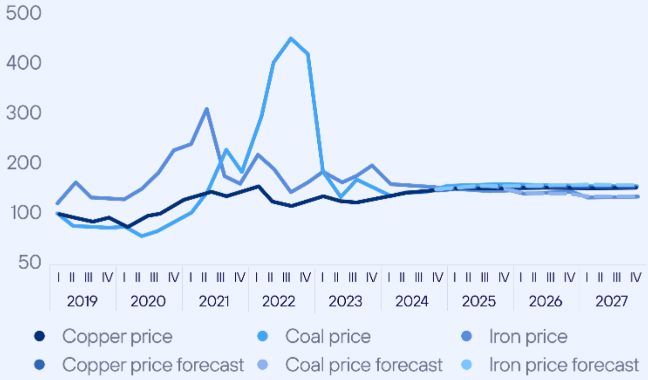


Figure 9. Imports forecast

Source: Analyst's estimation

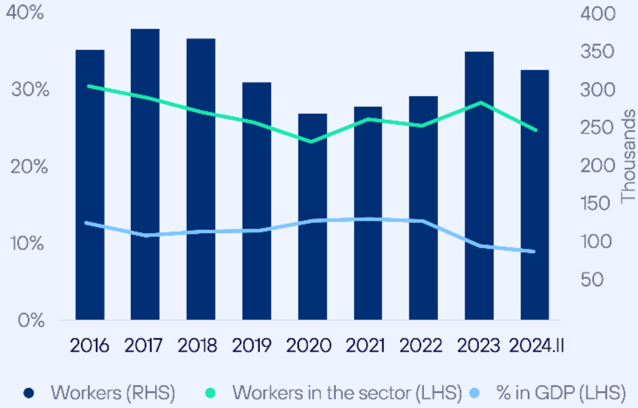
Figure 10: Foreign trade forecast

Source: Analyst's estimation



Copper, coal, and iron ore are main mineral export products of Mongolia. For the upcoming three years, commodity prices outlook is positive with:

- Copper price to reach 10 thousand per ton US dollars by 2027.
- Coal price will increase to reach 150 US dollars in 2026, then flatline.
- Iron price will fall slightly by 3.6 percent quarterly.



Approximately quarter of the Mongolian workforce is employed in the agricultural sector, which makes up roughly 10 percent of the GDP. With limited technological and industrial developments in the sector, the well-being of the sector is highly vulnerable to weather events. An extreme cold winter in 2023 has hindered GDP growth by 1.3 percent. However, the frequency of dzud - an extreme cold wave - tends to be around once in a decade.

Commodity prices

Extreme weather events

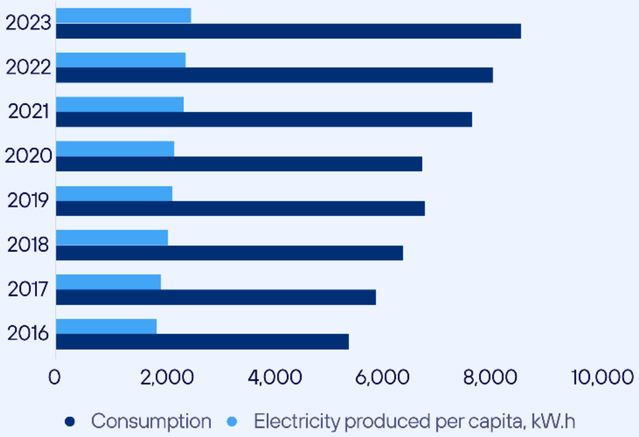
Risks to the outlook is balanced

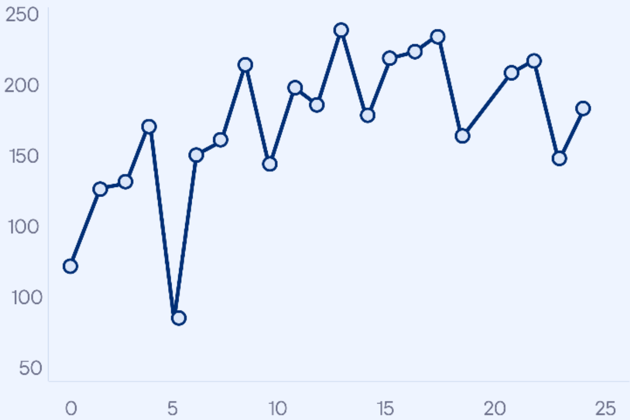
Energy deficiencies

Chinese production index

Mining establishments take up the majority of the energy consumption in Mongolia. Mongolia generates around 80 percent of the country's energy consumption domestically; the rest is imported mainly from the two bordering countries - China and Russia. In the last ten years, the compound annual growth rate of the energy consumption was 6.2 percent, and 5.4 percent for the gross generation. The difference is made up from the imported energy sources, exposing the country to dependency to other countries.

As of the second quarter of 2024, coal represents roughly 60 percent of total exports. With China receiving around 90 percent of the total coal exports, the impact of Chinese coal demand from Mongolia is significant for the economic growth.





Mongolian macroeconomic indicators' forecast (TDB Securities)

	Macroeconomic indicators	2024	2025	2026	2027
1	GDP growth	6.8%	5.2%	5.2%	5.3%
2	Public investment, trillion MNT	3.8	4.0	4.3	4.5
	Public investment/GDP	4.9%	4.6%	4.4%	4.2%
3	Public consumption, trillion MNT	10.8	12.5	14.2	15.8
	Public consumption/GDP	13.8%	14.2%	14.5%	14.6%
4	Public transfer, trillion MNT	11.8	12.5	13.2	13.8
	Public transfer/ GDP	15.0%	14.2%	13.5%	12.7%
6	Export, billion USD	16.7	20.2	21.7	23.3
7	Import, billion USD	12.4	16.1	17.2	18.2
8	Foreign trade balance, billion USD	4.3	4.0	4.4	5.1
	Foreign trade balance/GDP	18.5%	14.5%	14.2%	14.3%
9	Labor participation rate	61.9%	63.2%	64.1%	64.8%

Mineral products output indicators

	Commodity indicators	2024	2025	2026	2027
1	Coal output, kilotons	84,014.8	80,517.1	80,601.3	82,318.2
	Coal price, US dollars*	250.0	228.0	206.5	212.0
2	Copper output, kilotons	1,618.9	1,656.8	1,779.1	1,918.2
	Copper price, US dollars*	9,331.4	9,856.0	10,034.1	10,109.0
3	Iron output, kilotons	5,951.7	5,563.9	6,800.3	8,311.3
	Iron price, US dollars*	109.6	102.4	96.9	92.9
4	Gold output	13.5	16.1	16.0	16.0
	Gold price, US dollars*	2,423.9	2,821.8	2,941.3	3,059.9

**Bloomberg analysts' estimation*

Section 3

01 Coal production is predicted to reach 80.5 million tons in 2025, around the same level as 2024, with negligible change to the price.

02 Bank of Mongolia has increased the required level of foreign exchange reserve by 1 percent.

03 Domestic currency is forecasted to depreciate by approximately 8 percent next year, around the same level as inflation.

04 Bank of Mongolia has set the target interval for inflation to 5±2 percent, and then lower it to 5 percent in 2027.

05 Increased government spending, strong domestic demand and electricity price increase will likely keep the inflation little above the upper level of the target interval.

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Mongolian economic outlook is positive with stable economic growth prospects in sight but nonetheless risks persist. Investors should closely follow three key forces that move the economy: foreign exchange reserves, inflation, and the coal market. We hold a moderately optimistic outlook for each factor, foreign exchange reserve levels should be maintained with little hindrance, inflation should hover in the upper level of the target interval set by the Bank of Mongolia, and demand in the coal market from China would remain at the same level as last year. Maintaining a comprehensive understanding of developments in each area is essential for making informed investment decisions in Mongolia.

Coal market price

During the Australian coal ban, Mongolia has risen as a prospective main supplier of coal for China. Since then, two governments have been working on improving the transportation links. Coal production is predicted to reach 80.5 million tons in 2025, around the same level as 2024. However, coal prices are predicted to decrease by around 8-9 percent annually for the next two years, then increase slightly by 3 percent in 2027.

Foreign exchange reserve

Bank of Mongolia has increased the minimum foreign exchange reserve levels by one percentage point to 16 percent. With the new requirement, foreign exchange reserves should be able to cover around 6 months of imports. Even with the increased foreign exchange levels, due to the significantly higher level of import expectations, keeping the strength of the domestic currency proves to be a challenge - making an investment in foreign currencies a more viable option.

Inflation

By the end of 2024, annual inflation rose to 8.1 percent, a little above the target level set by the Bank of Mongolia, mainly due to 30 percent increase in electricity price. Driven by increased government spending inflation is expected to be around 9-10 percent, little above the upper level of target interval. With steady inflation in sight, we believe that fixed income investments should be an investment priority in 2025.

Coal market price

Mineral products make up around 80 percent of Mongolia's exports, with coal being the dominant contributor. The share of coal within the mineral exports has been steadily growing, especially in the last two years to an average of 65 percent. This growth is driven largely by increasing demand from China, as the country largely relies on coal for energy. The bottleneck transport point problems have been remedied by the simplification of the customs clearance process and additional truck lanes, increasing the coal export to China by almost 40 percent from 2022.

Law on Mining Products Exchange was approved in December 2022, with the first successful trade happening in 2023. Establishing the mining product exchange enabled foreign buyers to purchase mining products directly from the companies. By the third quarter of 2024, the exchange has 21 supplier companies, 11 registered commodity brokers, and has made over 450 deals for a total of 19.6 tons of mining products.

Only coal was traded in the exchange for the first 8 months, which was then followed by iron ore, copper concentrate, and fluorite products. Still coal trade dominates the trade amount making up around 95.5 percent, with iron contributing 4.1 percent, copper 0.3 percent, and fluorite making up the last 0.1 percent.

The shift to exchange trading has brought up possibilities of selling at fair international market prices. Commencement of the mining exchange has coincided with the rally of commodity prices and has brought up the coal prices to 160-180 US dollars per ton compared to 70-90 US dollars before. By the second quarter of 2024, around 20 percent of the coal export was traded through the exchange market. There are 143 more auction calls for trades scheduled for the last quarter of 2024 on the mining products exchange. Around half of the calls are for coal with an average call price of 450-1050 Chinese yuan depending on the category, around third for iron ore with average call price of 56-87 US dollars, and the rest was for copper and fluorite.

Coal consumption demand from China is still high but is expected to flatline in 2025. With the hydropower decline due to the drought and post-COVID economic bounce back, China's coal demand has increased by 7 percent in 2023. China's effort to implement renewables as a new energy source will put the demand growth into a slight decline, but coal still remains the main source of the country's energy system. Demand from non-energy sectors such as cement and coal-to-chemical processes are also increasing. Lower gas prices and increased production after COVID-19 has caused the coal price to fall by about one-third in 2024 from its peak in 2022. There might be further decline as renewables start to meet the electricity demand but the price seems to be reaching its plateau state, averaging around 5 percent change interval

Coal production is predicted to be around 80.5 million tons in 2025.

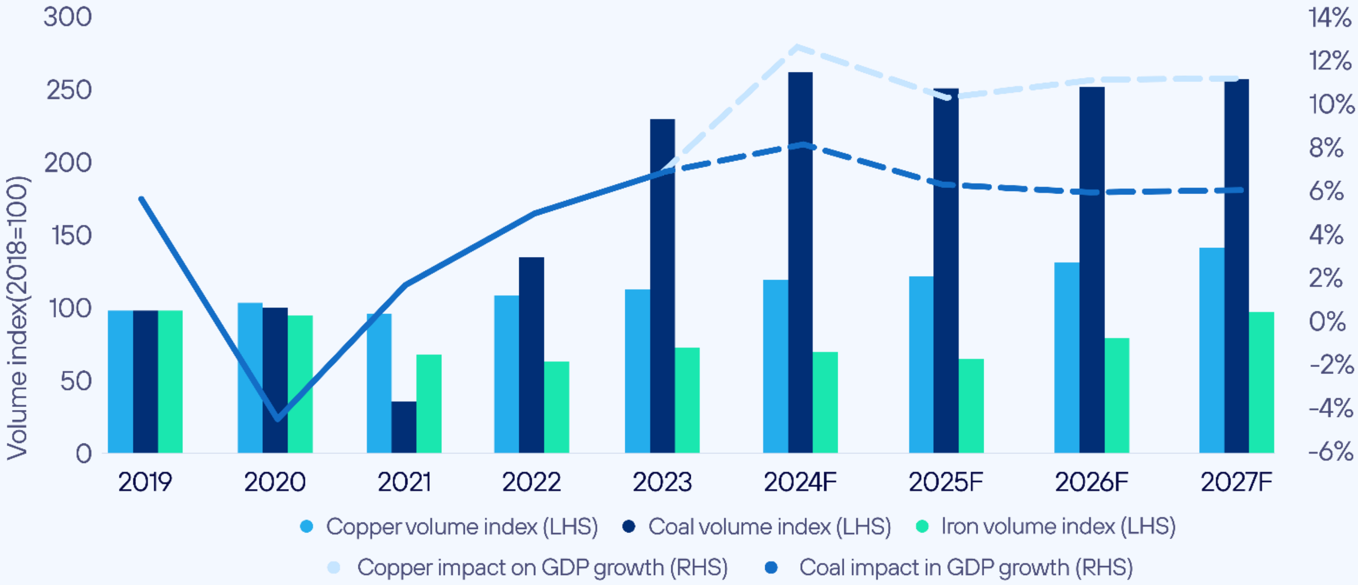

Figure 11. GDP growth forecast based on mineral products' production

Source: Analyst's estimation

Mongolian coal production is expected to slightly decline in 2025 while still hovering above the 2018-2023 average, and then become stable. In October 2024, Mongolia and China have agreed upon the long-awaited joint construction of the cross-border infrastructure, which promises to increase bilateral trade to 20 billion US dollars annually in the near future. With China receiving around 90 percent of the coal output and the successful completion of this project, coal export is expected to increase significantly in the next couple years.

Foreign exchange reserves

As of the third quarter of 2024, Mongolia's foreign exchange reserves have reached almost 5 billion US dollars, 15 percent increase from the same period last year. Despite increasing three-fold since 2016, the coverage remains the same as in the past, at 5 months of the country's imports. Mongolia's foreign exchange reserves have dipped to 2.6 billion dollars in August 2022, due to the slowing of the foreign direct investments and decreased exports revenue due to the border restrictions. Since then, the reserves have been steadily recovering, and has exceeded 5 billion US dollars in the first quarter of 2024.

In December 2024, the Bank of Mongolia has increased both the domestic and foreign currency reserve requirement level by one percent - 11 and 16 percent for domestic and foreign currency respectively in order to hedge the risk of sudden weakening of the domestic currency against US dollar. In 2025, the central bank expects a higher level of revenue from exports, increased demand for the global interest in the Mongolian mining sector, and the reserves to continue to grow steadily. Currency swap agreements which has amounted to 7.25 trillion tugrug, or 15 billion yuan between China and

Mongolia has been renewed for another three years in 2023.

Making sure to keep themselves informed on any bond repayments in the future as well as the swap agreements mentioned above would help investors make effective decisions. Despite the required level of foreign exchange reserves being maintained, the Mongolian tugrug is expected to weaken slightly against the US dollar throughout the next year.

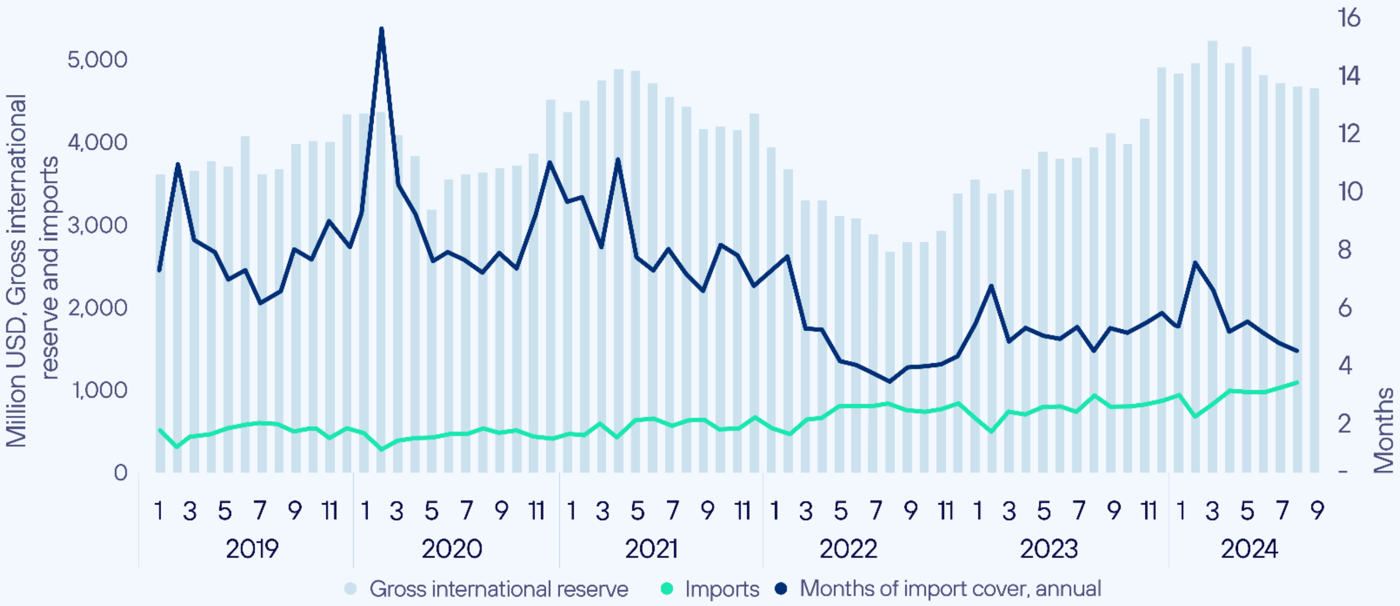

Figure 12. Gross international reserve and months of import cover

Source: National statistics' office of Mongolia

Inflation

Due to the lack of diversification in the economic sectors, Mongolian economy follows the commodity boom and bust cycle closely. As the government revenue increases, backed by the revenue from natural resources, fiscal spending increases, and shrinks when the market falls.

Bank of Mongolia has set the target interval for inflation to 5±2 percent, and then lowered it to 5 percent in 2027. However, the effect of a significant increase in the electricity prices will likely spill into the first half of 2025, keeping the inflation at around 7 percent, in a positive scenario.

Increased government spending as well as strong domestic demand will keep inflation a little above the target level for at least the first half of 2025. Supported by steady exchange rate and lower import prices as a result – inflation has abated significantly in 2024, leading to policy rate cuts. However, with the electricity and education CPI increasing the general inflation to the upper level of the target, it's unlikely for the central bank to cut the rate any lower.

With the ease of use of non-banking financial institutions, household debt has been stacking up significantly, pushing the average loan to income ratio to around 70 percent for an average lender. Domestic demand increase will likely continue in the next year, with credit growing faster than ever before.

Government spending is also predicted to increase significantly, mainly to finance the mega projects proposed by the new coalition government.

Section 4. Policy implications- Monetary policy rate and fiscal policy

As with other natural resource rich countries, Mongolia's economy tends to follow the commodity market cycle. It is evident from the historical data, especially during the mid-2008's commodity price boom when commodity prices rose by average of 75 percent in real terms. Mongolia's economy growth has reached a historical high in the following years, nearing almost 18 percent in 2011 and was hailed as the Saudi-Arabia of Asia. Unfortunately, a study conducted by International Monetary Fund shows that around one third of the booms are followed by busts, usually with the same deviation- the sharper the price increase, the larger the subsequent bust. This was evident in 2015-2016, when Mongolia's GDP growth has fallen to 1.5 percent from 17.3 in 2011. With the country's economy highly dependent on commodity market, which is known to be quite volatile, long-term stable fiscal policy along with efficient public spending is crucial.

In 2017, Mongolia has secured an economic stabilization package worth of 5.5 billion US dollars, after the commodity prices have fallen sharply, exports slowed down and public debt has become unsustainable. Mongolian authorities have promised an implementation of a program to maintain macroeconomic stability, fiscal consolidation being the critical pillar.

2017-2019 were transformative years in the fiscal policy. In order to reduce the debt pressure, the government has aggressively reduced debts with higher interest rates, and principal payments for the total debt almost doubled in 2017 compared to year before. Debt service has reduced significantly since then, and by the second quarter of 2024, debt-to-GDP ratio stands at 77.6 percent, almost tripled down from 2016.

The commodity market boom, increased FDIs to the country, and the current fiscal surplus after a long period of deficit reminds economists of the 2010-2015 cycle of boom. Even though the commodity price increase is not as steep as in 2008, the global economy bouncing back after COVID-19, coupled with geopolitical tensions have increased the price by almost 200 percent in 2022.

However, mainly due to political convenience, public transfer has increased significantly in the years following the growth peak. Around 1 percent of the natural resources' revenue was being saved, while the majority of the revenue was spent on social transfer, wages, and salaries. Despite increased social welfare spending, labor participation rate and human capital index has not improved, implying inefficiency in the spending. In order to finance the increased social transfer and public spending, government debt has increased.

Mongolia has missed the beginning of the boom due to the border restrictions and bottleneck problems in the transport points but has benefitted from it nevertheless. Developments in the railway connecting the Tavantolgoi coal mine to the border, starting of the underground mining of Oyu Tolgoi mine along with the commencement of mining products exchange in the beginning of 2023, the macroeconomic conditions of Mongolia have improved substantially in just one year.

As exports have increased by 64 percent in the last three years resulting in the gross international reserve to reach around 5 billion US dollars, ensuring that reckless public transfer and inefficient social welfare system doesn't catch up to the mining revenue is vital with the inevitable of fall commodity prices.

In an effort to manage mining revenue more efficiently, the Mongolian government has inaugurated the Sovereign Wealth fund as the corresponding law was ratified in the beginning of 2024. The fund is comprised of three account- Future heritage fund, Development fund and Savings fund, and several major mining corporations' share of revenue will be transferred into it.

The outlook looks much more promising with government efficiently spending the mining revenue more on infrastructure developments and the significantly decreasing inefficient public transfers.

Section 5

01 Government and corporate US dollar bonds of Mongolia have an average of 7 percent and 10 percent yield respectively.

02 Both domestic and foreign currency deposit rates are likely to be cut, following the rate cuts in 2024.

03 Inflation is predicted to be steady, even though a little above the target level – making fixed income instruments more attractive option for 2025.

TDB SECURITIES

By the third quarter of 2024, the Mongolian capital markets has experienced exceptional growth and diversification. Market capitalization has exceeded 12 trillion tugrugs, equal to 17.2 percent of the GDP, marking a 3.5-fold increase over the last five years. Trading volumes have quadrupled in the same period, with the most recent figure at 1,058.7 billion tugrug, a 61.7 percent increase compared to the same period last year.

The market's development has been bolstered by the introduction of new securities, including asset backed securities (introduced in 2021) and exchange traded funds (introduced in 2024), expanding investment options for both retail and institutional investors. Company bonds dominate the trading landscape, contributing over half of the total volume, followed by equities (23%), asset-backed securities (12.4%) and funds (6.1%). Currently, 10 active company bonds are available on the Mongolian Stock Exchange, showcasing the growing demand for these instruments.

This growth has been accompanied by a significant increase in interest in the capital markets, driven by regulatory improvements and market performance. The need for investment instruments was vital, with the tugrug depreciating by almost 30 percent in the last 5 years, and by around 20 percent in just 2022 due to the pandemic. The exchange rate has stabilized since then but the need for the alternative investments remain. Considering the vulnerability of the Mongolian tugrug's strength against US dollars, diversifying the investment portfolio to include foreign currency instruments would be a more attractive option.

We anticipate a lower deposit rate, considering the lagged effect of policy rate cuts.

In the last five years, the growth rate for the deposit in commercial banks have been steadily decreasing, implying the interest of the investors in the alternative savings methods. Due to the uncertainty in the macroeconomic fluctuations and vulnerability of the financial sector of Mongolia to the external impacts, investors have been exploring other opportunities than deposits. Average deposit rate for the US dollar is approximately 4 percent. Deposit rate for domestic currency is approximately 12.8 percent. Since the Bank of Mongolia has lowered the monetary policy rate by 3 percentage points from 13 percent, the average deposit rate has not followed accordingly. Inflation rate has hiked to 8.1 percent in December 2024, mainly due to the electricity price increase. In the monetary policy for 2025, the central bank has declared that in order to keep the sustainable growth and prevent another boom-and-bust cycle, it will implement tighter monetary policy. We anticipate lowered weighted average deposit rate, considering the lag effect of the monetary policy.

USD Bonds should be the investment priority in 2025.

Over the counter market in Mongolia has been rapidly expanding. In the first half of 2024, 62 bonds worth of 714.7 billion tugrugs, almost double the amount of bonds issued in Mongolian stock exchange, has been issued in the OTC market. Average coupon rate and yield of the Mongolian corporate bonds denominated in US dollars exceed 10 percent, and government bonds average around 7 percent yield, higher than average for US dollar investment instrument. Despite the significant uptick of the fiscal spending, we cautiously anticipate that the fiscal balance will be in surplus for next year, supported by the substantial fiscal revenue due to the natural resources' revenue. However, keeping the foreign exchange reserves in the required level will not be an easy task, more so with the recent policy to keep it at 16 percent. Thus, keeping the domestic currency's strength against US dollar might prove to be a problem. Overall, we believe that including US dollar bonds is vital for the investors to get the advantage of higher than average yields while protecting the portfolio from devaluation. Commercial banks in Mongolia have been enjoying better credit ratings – couple of the strategic banks have issued USD bonds in 2024, with a high possibility of the remaining three to follow the trend in the next year.

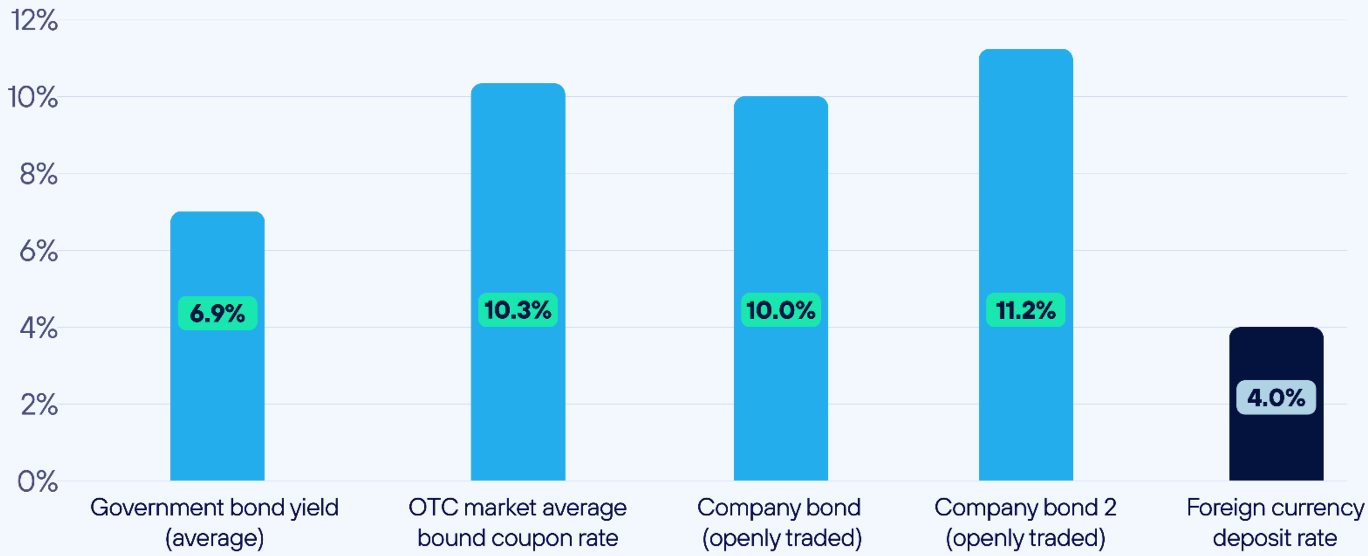

Figure 13. Interest and coupon rates of alternative investment instruments in US dollar

In the last couple years, in addition to the government bonds, companies in the private sector have successfully issued bonds in US dollar, promising higher than average coupon rates of around 10 percent in the open exchange, and 10.3 percent on average for over-the-counter exchange.

Including MNT bonds in the portfolio will guarantee investors a higher return as well as better liquidity.

Starting from 2014, in order to develop the capital market, the government has started issuing bonds through Mongolian Stock Exchange. Since then, government bonds were one of the most actively traded instruments in the market, mainly because government bonds are exempt from tax. This increased interest in the debt instrument has allowed the corporate to start offering their own bonds in the market. At the start, the majority of the investors were retail investors, forcing the privately placed debt instruments' maturity date to be especially short. Developments of the over-the-counter market and eased legislations for issuance and has allowed institutional investors to easily invest in the market, leading to corporate bonds the most popular investment instrument. By the end of 2024, there are more than 60 active corporate bonds traded in the OTC market, promising around 16-20 percent coupon rate. At the same time there are 8 active corporate bonds in Mongolian Stock Exchange, with an average of 17.4 percent coupon rate and maturity date of 12-36 months.

In 2024, International Finance Corporation has issued its first MNT bonds for a supranational, which demonstrates an increased interest in Mongolia. Significant commodity boom in 2023, which has proven to be sustainable in 2024 and will likely continue in at least the near future has attracted the interest of the potential investors, and these bonds will allow them to get the exposure of investing in country's currency.

With relatively higher rates and liquidity than any deposit in the country and significantly less risky than equities, MNT bonds are considered one of the most attractive securities in the country.

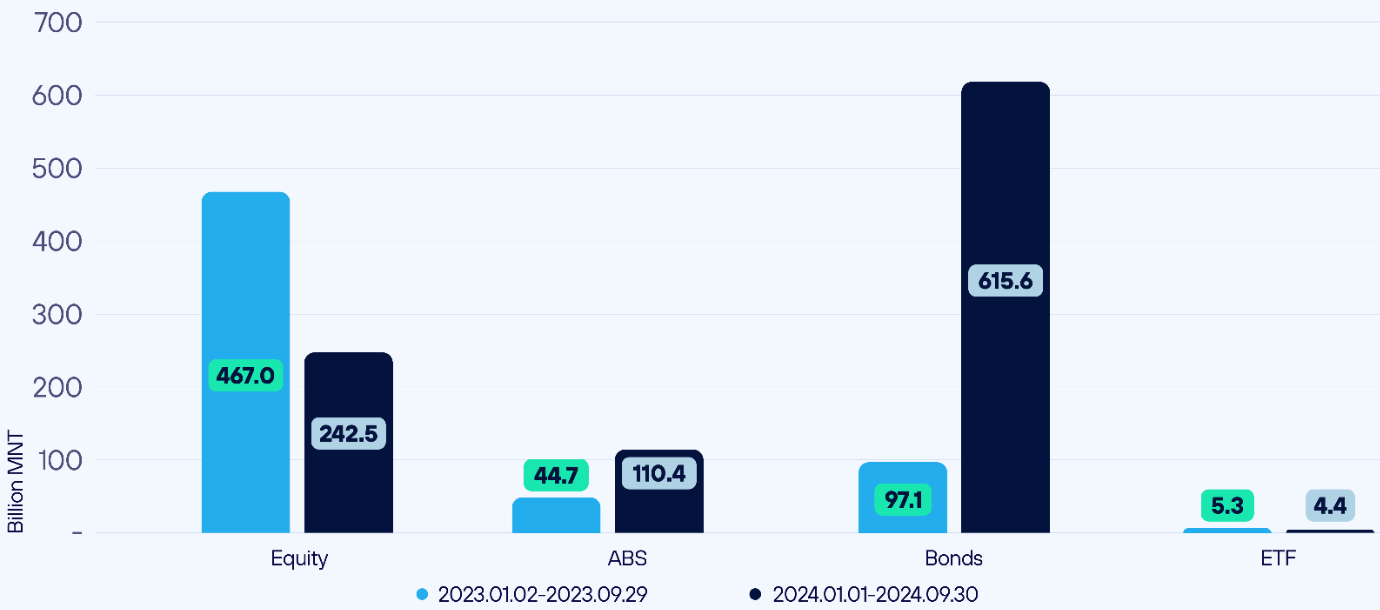

Figure 14. Trade volume by securities' type in Mongolian Stock Exchange

Improvements in the regulatory environment as well as increased investor appetite have allowed the bond market to develop rapidly in the last decade. With an effort from both the issuers and investors to address the challenges in the bond market, the market is expected to grow even further in the next years.

We see opportunities in the bond market and promising developments in the near future. Fixed-income investment instruments such as USD and MNT bonds are attractive options to build a portfolio with substantial return and lower risk.

Investors should carefully consider risks, charges, and expenses associated with the investment before investing. Historical performance doesn't guarantee future results. This publication has been prepared on the basis of historical performance as well as likely economic developments in the future, which should be taken as a general information, not as a recommendation on any specific security.