CHAPTER 2

FISCAL SECTOR

2.1 Budget performance
2.2 Fiscal policy
2.3 Government debt sustainability

2. FISCAL SECTOR

OVERVIEW

The budget balance recorded a surplus of MNT 2.5 trillion in the first three quarters of 2024, reflecting robust economic activity and increased export volumes of mining products. However, the decline in coal prices is putting pressure on royalty revenues.

Capital expenditure in the 2024 Budget was increased by MNT 1.8 trillion, or 11.4 percent, compared to the initially approved amount, reflecting the newly formed coalition government's focus on addressing key development challenges outlined in long- and medium-term policy documents.

The government nominal debt-to-GDP ratio increased to 38.9 percent at the end of the third quarter of 2024. However, the government debt burden is expected to increase in the medium-term due to bonds issued by the Capital city in both domestic and international markets.

CHAPTER 2

2.1 BUDGET PERFORMANCE

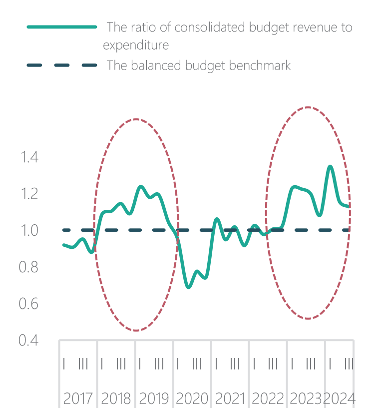
25. The rise in export volumes of mineral products boosted budget revenues, leading to a budget surplus. The consolidated budget revenue reached MNT 22.3 trillion in the first three quarters of 2024, an increase of 26.6 percent compared to the same period of the previous year. Meanwhile, consolidated budget expenditures amounted to MNT 19.8 trillion, a 34.4 percent rise year-on-year. As a result, the consolidated budget balance posted a surplus of MNT 2.5 trillion, the adjusted balance a surplus of MNT 1.5 trillion, and the primary balance a surplus of MNT 3.5 trillion.

26. Robust economic activity and increased export volumes of mineral products contributed to higher corporate income tax (CIT) and value-added tax (VAT) revenues. The structural budget revenues for the first three quarters of 2024 totaled MNT 21.3 trillion, up by 26.0 percent compared to the same period last year. The mining sector activity remained strong, with coal export volumes reaching 61.2 million tons in the first three quarters, an increase of 25.2 percent year-on-year. As a result, the sector's corporate income grew, leading to CIT revenue reaching MNT 4.8 trillion, a 50 percent increase year-on-year. Additionally, the increases in wages, pension, and benefits introduced at the start of the second quarter of 2024 stimulated government and household consumption. Consequently, VAT revenues reached MNT 4.3 trillion, up by 27 percent compared to the same period last year.

27. Despite high export volumes of mineral products, the decline in prices adversely affected royalties from mineral resources. Royalty revenue for the third quarter of 2024 amounted to MNT 3.6 trillion, a decrease of 11.5 percent year-on-year. The majority of royalty revenues stem from the mining sector, with coal representing 70 percent, copper concentrates 22 percent, gold 4 percent, and iron ore 1 percent. Despite the increase in coal export volumes, the decline in prices was the primary factor driving the decrease in royalty revenue.

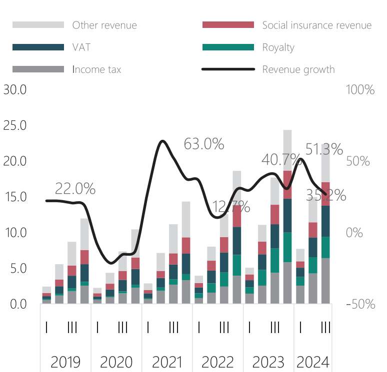
Figure 2.1. Budget revenue

1. Budget revenue-expenditure ratio (unit)



Source: Estimations of MED, MOF

2. Tax revenue by type (percent)



Source: MOF

3. Royalty income and export products

Royalty income /export products/	2024 Q1	2024 Q2	2024 Q3
Coal /billion MNT/	1,087	884	510
Export volume /million ton/	18.1	22.5	20.6
Average price /$/ton/	312	243	212
Copper /billion MNT /	310	235	291
Export volume /thousand ton/	367	418	401
Average price /$/ton/	8,443	9,745	9,208

Source: General department of taxation

Note: The ratio of total budget revenue and aid to total expenditure and net borrowing is calculated as the quarterly growth rate for the year.

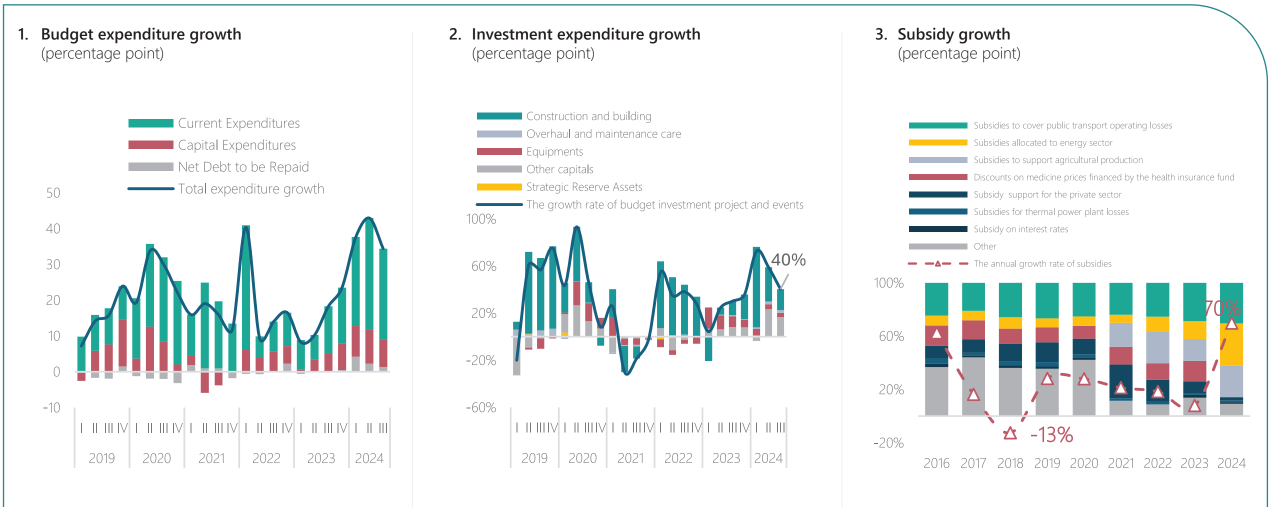
28. The increase in passenger car imports had a positive impact on excise tax revenues. The number of imported passenger cars reached 93,600 by the third quarter of 2024, marking a 75.8 percent increase compared to the same period last year. This surge was the main driver of excise tax revenues, which surpassed the projected amount by 13.8 percent.

29. Amendments were made to the Law on the 2024 State Budget of Mongolia. Following the constitutional amendment on May 31, 2023, Mongolia adopted a mixed electoral system, resulting in the establishment of the first 126-member State Great Khural. This marked the formation of Mongolia's first coalition government, consisting of three parties, ensuring that citizens' votes are adequately represented. The coalition government aims to address urgent development challenges swiftly by incorporating key elements from the "Vision 2050" long-term policy, the New Revival Policy, and the distinctive aspects of the political parties' platforms. Additionally, the government aims to accelerate key development projects. As a result, amendments to the Law on the 2024 State Budget included an increase of MNT 1.2 trillion in current expenditure and MNT 1.8 trillion in capital expenditures. As a result, total expenditure increased by 11.4 percent compared to the initially approved budget and by 35.4 percent compared to the same period last year, reaching MNT 30.5 trillion.

30. The increase in wages and pensions contributed to the expansion of budget expenditure and improvements in household real incomes. Total budget expenditures amounted to MNT 19.8 trillion as of the third quarter of 2024, an increase of MNT 5.1 trillion or 34.4 percent compared to the same period last year. The increase in expenditure was driven by a rise in current expenses by MNT 3.7 trillion (25.3 percentage points), capital expenses by MNT 1.1 trillion (7.7 percentage points), and net loans after repayments by MNT 0.2 trillion (1.4 percentage points). To support household incomes, the government increased pensions, allowances, and wages for public sector employees by an average of 10 percent, effective April 1, 2024, in line with inflation. Consequently, wage expenditures increased by MNT 2.2 trillion or 2.4 times compared to the same period last year, and pension and allowance expenditures rose by 31.6 percent. These adjustments were the primary contributors to the growth in current expenditures. Also the average monthly real income of households increased by 10 percent in the third quarter of 2024, with the average nominal income reaching MNT 2.6 million.

31. The execution of capital investments in construction projects has slowed. By the third quarter of 2024, cumulative financing execution for consolidated budget investments reached MNT 4.0 trillion, a 2.4-fold increase from the same period last year, with an overall investment execution rate of 49 percent. By economic classification, execution rates were as follows: 97.0 percent for major repairs, 58.3 percent for strategic reserve funds, 60.0 percent for equipment, and 51.0 percent for others, all recorsing improvements compared to the same period last year. However, the execution rate for construction projects was 46.0 percent, a decline of 20.6 percentage points from the previous year. The primary cause of the slowdown in the execution of construction-related capital investments was the addition of MNT 1.0 trillion to the budgeted costs for construction investments in the revised budget. Amendments to the Law on the 2024 State Budget, approved on August 30, 2024, prioritized implementation of major development projects, including allocation of

Figure 2.2. Budget expenditures



Source: Estimation of MED, MOF
Note: The growth rate of the consolidated budget expenditures was determined by the quarterly increase.

Source: Estimation of MED, MOF
Note: The budget investment expenditure was calculated as the quarterly increase.

Source: Estimation of MED, MOF
Notes: The distribution of subsidies provided by the consolidated budget to state-owned and private organizations is calculated as a percentage of the annual growth in total subsidies.

funds for feasibility studies. These amendments also focused on directing budget investments toward regional development, mitigating urban congestion in Ulaanbaatar, and addressing infrastructure bottlenecks. Moving forward, budget financing will be redirected toward major developmental infrastructure projects.

32. Subsidies to the energy sector and public transportation constituted the majority of total subsidies. By the third quarter of 2024, MNT 649 billion in subsidies had been disbursed from the consolidated budget, a 69.7 percent increase compared to the same period last year. By ownership type, MNT 253 billion (39.0 percent) was allocated to state-owned entities, while MNT 396 billion (61.0 percent) was granted to private sector entities. Subsidies accounted for 3.3 percent of total budget expenditure, an increase of 0.7 percentage points from the previous year. Specifically, subsidies to cover losses in the energy sector and public transportation constituted approximately 62 percent of total subsidies as of the third quarter of 2024. Of these, subsidies for public transportation losses totaled MNT 200 billion, a 78 percent increase from the previous year, while subsidies for energy sector losses also reached MNT 200 billion, nearly tripling compared to the same period last year. Additionally, MNT 153.5 billion was allocated in the third quarter of 2024 as incentives to support agricultural production, marking a threefold increase compared to the previous year. Although the share of total subsidies in consolidated budget expenditures has remained at 2–3 percent over the past decade, it is crucial to implement comprehensive reforms in the energy sector, privatize the public transportation sector, and eliminate the inefficient subsidy system. Reallocating these resources toward more productive and efficient investments will be key to reducing budget expenditures in the future.

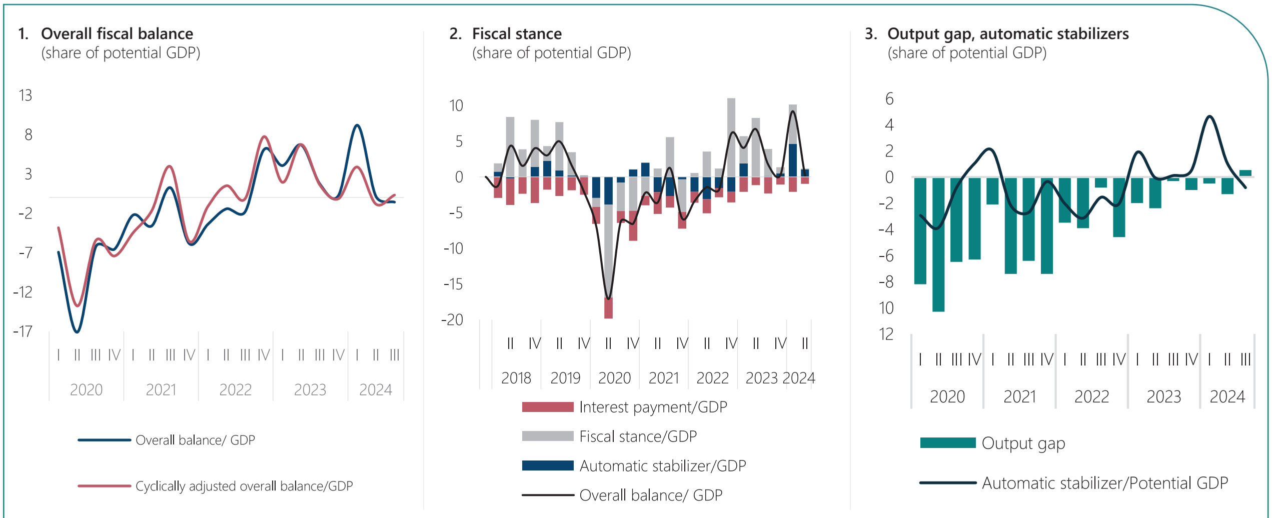
CHAPTER 2

2.2 FISCAL POLICY

33. The strength of economic activity played a crucial role in achieving a surplus in the overall fiscal balance. When evaluating fiscal policy, it is essential to account for and eliminate seasonal and cyclical effects on the fiscal balance. Seasonal effects reflect periodic influences on economic activity, while cyclical effects represent irregular impacts driven by economic cycles. For instance, heightened activity in the trade and services sectors, coupled with an increase in tourist numbers during the warmer months boosted VAT revenues, contributing significantly to the overall fiscal surplus of MNT 492 billion for the third quarter (based on quarterly data).

34. The seasonally adjusted overall balance recorded a deficit of MNT 110 billion. The factors affecting the fiscal deficit are depicted in Figure 2.3, where the impacts of discretionary fiscal policies are represented by the fiscal stance, the effects of the economic cycle independent of fiscal policy are shown as automatic stabilizers, and the debt service burdens are reflected in interest costs. The fiscal stance positively contributed MNT 421 billion or 2 percent of potential GDP to the seasonally adjusted overall balance. However, interest payments, amounting to MNT 363 billion or 1.8 percent of potential GDP reduced fiscal balance. Although the negative output gap has closed, the pace of economic growth slowed and declining commodity prices adversely impacted revenues, leading to a negative cyclical effect of MNT 168 billion or 0.8 percent of GDP on the fiscal balance.

Figure 2.3. Fiscal balance, fiscal stance, and automatic stabilizers



Source: Estimation of MED

Source: Estimation of MED

Source: Estimation of MED

CHAPTER 2

2.3 GOVERNMENT DEBT SUSTAINABILITY

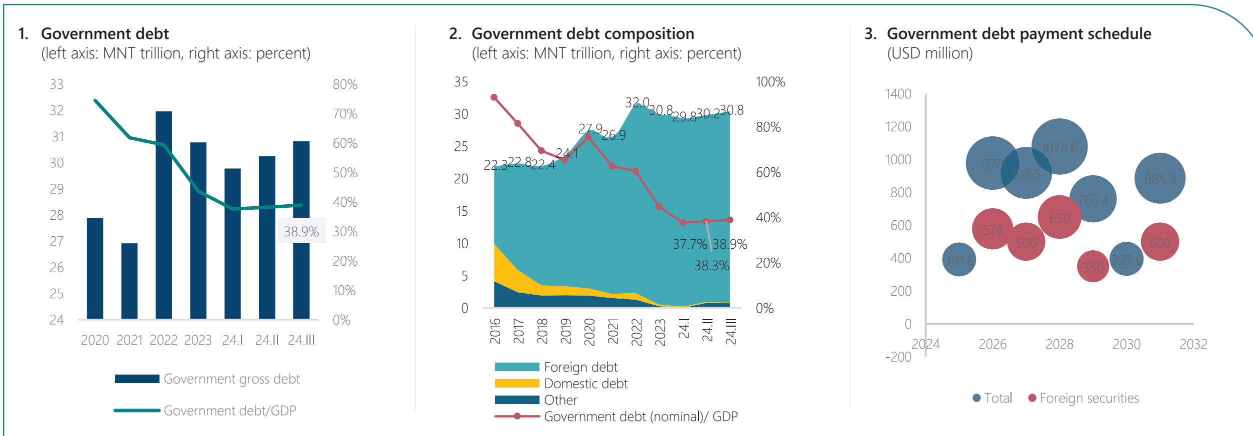
35. The nominal value of government debt rose. After four consecutive quarters of decline due to external bond and loan repayments, government debt rose for two consecutive quarters, reaching MNT 30.8 trillion in the third quarter of 2024, the same level as in the corresponding period last year. Local government borrowing has grown by MNT 513.5 billion since the beginning of the year. Although government-guaranteed debt decreased by MNT 535.5 billion, or 72 percent, compared to the same period last year, it rose by MNT 179.1 billion, or 6.1 times, compared to the first quarter of 2024. Meanwhile, domestic government debt decreased by MNT 437.3 billion year-on-year and by MNT 99.8 billion compared to the first quarter of 2024.

36. The capital city's domestic and foreign bonds, intended to finance social and infrastructure projects and measures, are expected to increase the government's debt. Under Government Resolution No. 201, dated May 8, 2024, and Resolution No. 264, dated June 6, 2024, it was decided to issue securities worth 1.0 trillion tugriks in the domestic market to finance infrastructure projects in 2024. Pursuant to this decision, securities worth 500 billion tugriks were issued on June 25, 2024. Additionally, plans include issuing another 500 billion tugriks in the domestic market and 500 million USD in the foreign market to finance projects such as the "Selbe Sub-Center-Based Ger Housing Project," "Buuruljuut Thermal Power Plant," "Battery Storage Station," "Repair and Modernization of Highways and Road Facilities," and "Tuul-1 Sewage Collector and Flood Facilities."

37. External debt is expected to raise total government debt level. As of the third quarter of 2024, external debt accounts for 97.3 percent of the total government debt, making it highly sensitive to exchange rate shocks and other external factors. Of the total external loans, 54.2 percent are denominated in USD, exposing the government to risks such as increased debt servicing costs due to changes in the USD/MNT exchange rate and potentially higher refinancing expenses. Moreover, the government is scheduled to repay a total of USD 3.4 billion in external loans and securities between 2025 and 2028, underscoring the need for sound debt management in the coming years.

38. The primary balance significantly influences the medium-term outlook for government debt. Debt sustainability analysis provides insights into how sensitive the medium-term trajectory of government debt is to key macroeconomic indicators. The analysis

Figure 2.4. Government debt



Source: MOF

Source: MOF

Source: MOF
The government's external debt comprises external securities and foreign loans. .

assumes the following conditions: 1)No policy or structural changes; 2)All variables other than those impacted by shocks remain constant; 3)The baseline levels for years other than the shock year remain unchanged. According to the baseline projections, GDP growth rates are expected to be 5.6 percent, 8.0 percent, 6.5 percent, and 6.5 percent for 2024–2027, respectively. Inflation is projected at 6.5 percent, 7.5 percent, 5.0 percent, and 4.0 percent during the same period, while exchange rate depreciation is assumed to follow the 10-year average trend. The primary balance is forecast to remain near its projected level, and other macroeconomic indicators are assumed stable at 2023 levels. Under these conditions, government debt is expected to reach 42.7 percent of GDP by 2027. When a one-standard-deviation shock is applied to key indicators in 2025 and 2026, the resulting impact suggests that government debt could increase by 15.4–28.8% above the baseline level by 2027, with a 25 percent likelihood. This indicates that government debt is highly sensitive to macroeconomic uncertainties and the effects of external shocks.

38. Primary balance surpluses are essential for ensuring the sustainability of government debt. In 2016, the nominal government debt-to-GDP ratio increased by 30.6 percentage points, with the primary deficit accounting for 11.2 percentage points of this rise. Conversely, in 2020, the nominal debt rose by 10.1 percentage points, of which the primary deficit contributed 6.9 percentage points. By 2023, the nominal government debt-to-GDP ratio decreased by 15.8 percentage points, driven by a 6.4 percentage-point effect from changes in the real interest rate and a 4.3 percentage-point contribution from the primary surplus. Going forward, real GDP growth and the primary deficit are expected to play a key role in ensuring debt sustainability. Therefore, it is crucial to continue implementing policy measures aimed at maintaining macroeconomic stability.

Figure 2.5. Government debt sustainability