CHAPTER 3

MONETARY SECTOR

3. MONETARY SECTOR

OVERVIEW

Inflation stood at 6.7 percent in September 2024, remaining within the central bank target range. Inflation for domestic goods and services exhibited an upward trend, reflecting resilient economic activity, whereas import inflation remained stable. Credit growth reached a 10-year high, contributing to the increase in the money supply. Given the current rapid credit growth and fiscal expansion, lowering the policy rate to 10 percent could potentially increase demand-side inflationary pressures.

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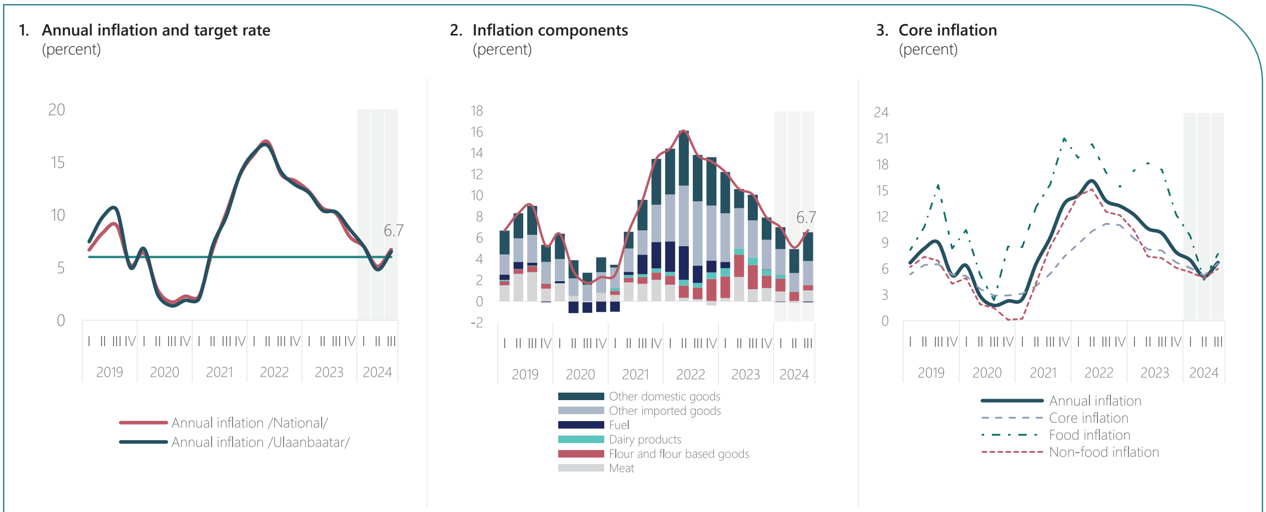
3.1 INFLATION

39. Inflation declined from a year earlier, remaining within the central bank's target band. Inflation reached 6.7 percent in September 2024, down by 3.4 percentage points compared to the same period last year. Food prices contibuted 2.2 percentage points, while prices of clothing, footwear, cloth contibuted 1.0 percentage point to total inflation. Contributions from educational services and from housing, water, electricity, and fuels accounted for 0.9 percentage points and 0.7 percentage points, respectively. Of the total decline in inflation, 2.4 percentage points were attributed to food, 0.6 percentage points to miscellaneous services, and 0.3 percentage points to restaurants. On the other hand, prices of clothing, shoes, housing, water, electricity, gas, fuels, and educational services put upward pressure on inflation.

40. As economic activity remained robust, demand-driven inflation accounted for the majority of inflation. Demand-driven inflation accounted for approximately 66 percent of the annual inflation and reached 6.6 percent, reflecting an increase of 1.4 percentage points from the previous quarter. The increase was This rise was driven by higher household consumption, fueled by increases in pensions, benefits, and salaries for government employees, alongside sustained domestic demand. Supply-driven inflation increased by 2.1 percentage points from the previous quarter, reaching 6.9 percent. Reduced meat supplies, due to adverse weather conditions and significant livestock losses, led to meat prices surpassing typical seasonal trends. Furthermore, the increase in fuelwood prices contributed to the rise in supply-side inflation.

41. Import inflation remained stable while inflation for domestic goods and services rose. Inflation from imported goods, representing 32.8 percent of total inflation, fell to 4.8 percent in September 2024, compared to 7.6 percent in the same period last year. Non-food goods accounted for about 95 percent of the inflation from imported goods and import inflation remained stable due to the moderation in price increases from trading partner countries. Inflation from domestic goods and services, which accounted for 67.2 percent of annual inflation, declined by 3.9 percentage points from the same period last year, reaching 8.3

Figure 3.1 Inflation



Source: National Statistics Office
Note: Quarterly inflation rates are calculated from the last months of the quarter.

Source: National Statistics Office
Note: The components of annual inflation are shown by goods and groups with high contributions to inflation

Source: National Statistics Office
Note: Core inflation is calculated by subtracting food, fuel, and solid fuel from total inflation

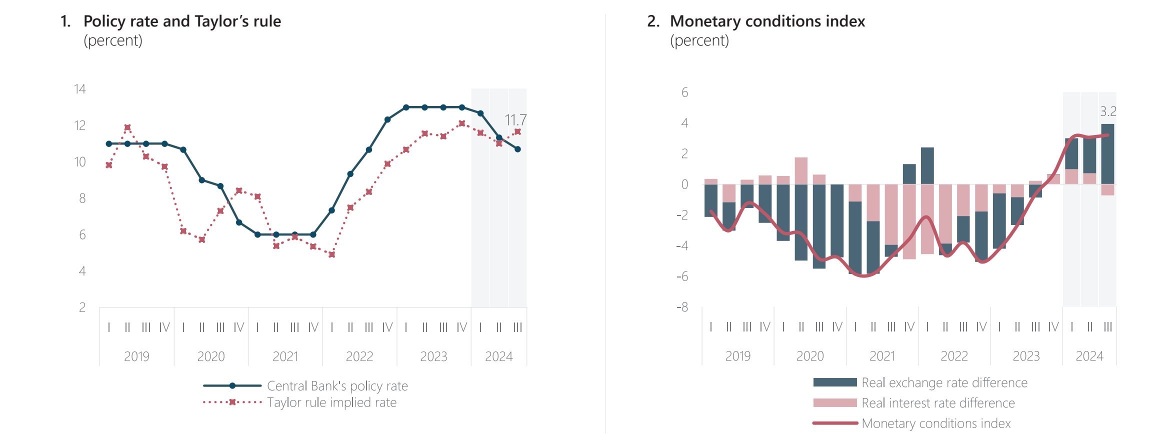
percent in September 2024, driven by lower prices of some food items. However, domestic inflation rose from the previous quarter, reflecting higher prices for meat and meat products, housing rents, and educational services.

42. World container shipping prices and the food price index increased. Drewry's World Container Index, which saw a sharp rise since February 2024 due to the Suez Canal blockage in the Red Sea, has been gradually declining since August 2024. By the end of the third quarter of 2024, global container shipping rates declined to USD 3,691 per 40-foot container, remaining 63 percent higher than the same period last year and 160 percent above pre-pandemic levels. The food price index increased by 2.1 percent year-on-year to 124.6 in September 2024, reaching its highest level since April 2023. Global prices for cereals, dairy products, vegetable oils, and sugar rose, while meat prices declined. Global inflation continued to ease, with inflation rates in both developed and developing countries approaching their target levels. Over the past month, China, Russia, Kazakhstan, Kyrgyzstan, Turkey, and Sri Lanka experienced disinflation, while inflation accelerated in South Korea, Georgia, the Eurozone, the United States, and the United Kingdom.

43. Inflation of both food and non-food goods and services accelerated compared to the previous quarter. In the third quarter of 2024, food inflation reached 7.7 percent, reflecting a 0.8 percentage point increase from the previous quarter. This rise was primarily driven by a 12.1 percent increase in meat prices, along with a 6 percent increase in flour product prices and a 9.2 percent rise in dairy products and eggs. Food inflation accounted for 2.2 percentage points of the overall inflation rate. Non-food goods and services inflation rose to 6.0 percent, marking a 0.9 percentage point increase from the previous quarter. This was primarily driven by an 8.2 percent rise in clothing, textiles, and footwear prices, a 14.6 percent increase in fuel prices, and higher costs for various services. Specifically, prices for services for individuals rose by 11.7 percent, residential rents increased by 23 percent, and educational services saw an 18.2 percent increase.

44. The policy rate is currently below the optimal level. In 2024, the central bank lowered the policy rate by 3 percentage points to 10 percent, with the average policy rate for the third quarter at 10.7 percent, which is 1 percentage point below the optimal level indicated by Taylor's Rule. This suggests limited room for further rate reductions. Additionally, starting from the third quarter of 2024, the real interest rate gap began to contribute to the easing of monetary conditions. Given the continued inflation risks stemming from rapid credit growth, fiscal expansion, geopolitical tensions, transportation and logistics disruptions, as well as the adverse effects of dzud, it is essential to maintain the policy rate at an appropriate level.

Figure 3.2 Taylor's Rule and monetary conditions index



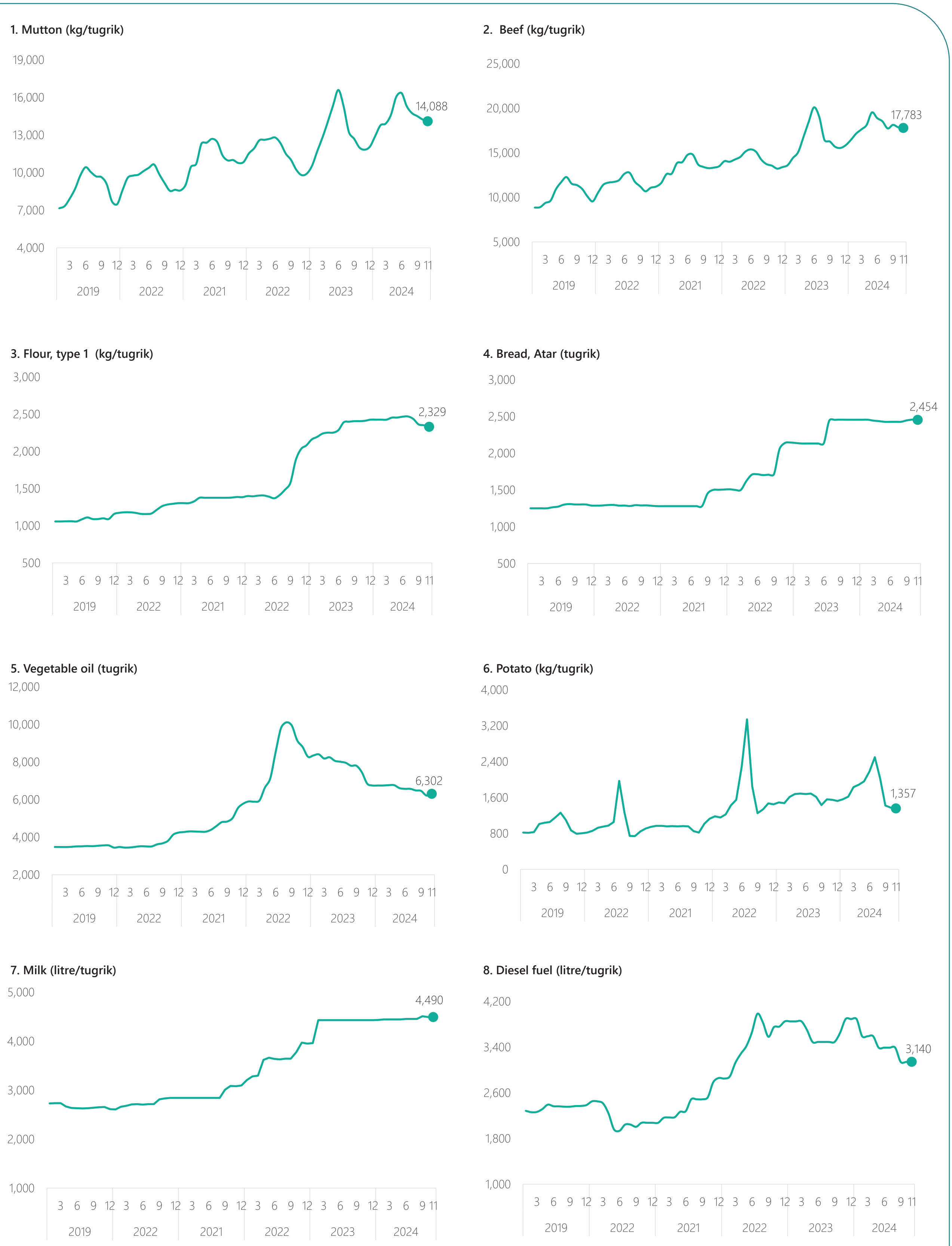
Source: MED estimation

Note: The implied rate calculated by Taylor's rule represents the appropriate value of the central bank's policy rate. It is an equation containing variables such as the policy rate set in the previous quarter, inflation, expected inflation, nominal interest rate, and a fixed coefficient. In connection with the renewal of the MED's methodology for calculating output gap, the Taylor Rule implied rate calculated in previous quarters has been updated.

Source: MED estimation

Note: The Monetary Conditions Index is an indicator that measures the impact of monetary policy in an economy. The Monetary Conditions Index was calculated using the GAP methodology of the Monetary Policy Analysis. It is calculated using real interest rates and exchange rates. A positive monetary condition index indicates monetary policy tightening, while a negative index indicates loosening.

Figure 3.3 Prices of selected items



Source: National Statistics Office

Note: This graph shows monthly fluctuations in the prices of some items within the consumer basket.

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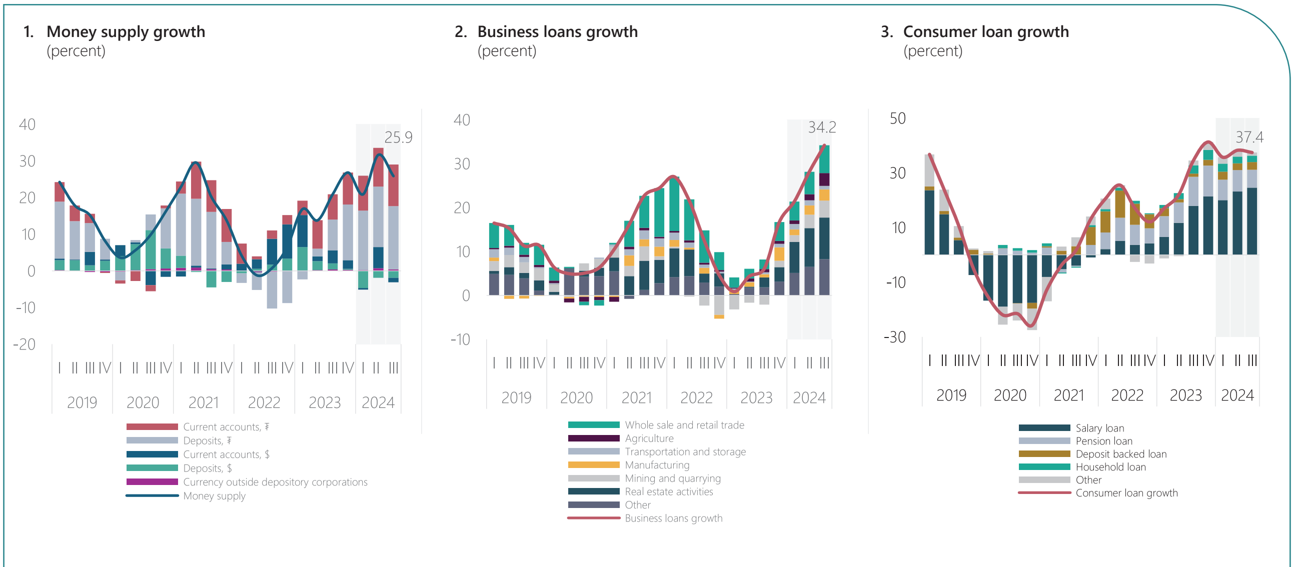
3.2 MONETARY AND FINANCIAL SECTOR

45. Money supply growth accelerated. At the end of the third quarter of 2024, money supply growth reached 25.9 percent, up by 4.9 percentage points from the same period last year. On the liabilities side, domestic currency deposits were the key driver, contributing 17.3 percentage points to the growth, followed by domestic current accounts, which added 11.3 percentage points, and currency outside depository corporations, which accounted for 0.4 percentage points. In contrast, foreign currency deposits and current accounts reduced the money supply growth by 1.9 and 1.2 percentage points, respectively. The appreciation of the exchange rate since August 2023, coupled with its stabilization throughout 2024, contributed to the decline in foreign currency accounts and deposits. On the asset side, net domestic assets contributed 20.4 percentage points to the growth of the money supply, while net foreign assets added 5.5 percentage points. The growth in net domestic assets was primarily driven by an acceleration in credit expansion.

46. Credit growth reached a 10-year high. At the end of the third quarter of 2024, the outstanding balance of credit issued by commercial banks reached MNT 35.0 trillion, marking a growth rate of 35.2 percent, the highest in the past decade. Of the total outstanding loans, 68 percent, or MNT 23.8 trillion, were business loans, while 32 percent, amounting to MNT 11.2 trillion, were consumer loans. The business loan growth reached 34.2 percent, up 5.6 times compared to the same period last year. The largest contributors to business loan growth were real estate loans, which increased by 46.4 percent, followed by wholesale and retail loans with a growth of 22.2 percent, mining and quarrying loans at

Figure 3.4 Money supply and credit indicators



Source: Estimation of MED, Bank of Mongolia statistics

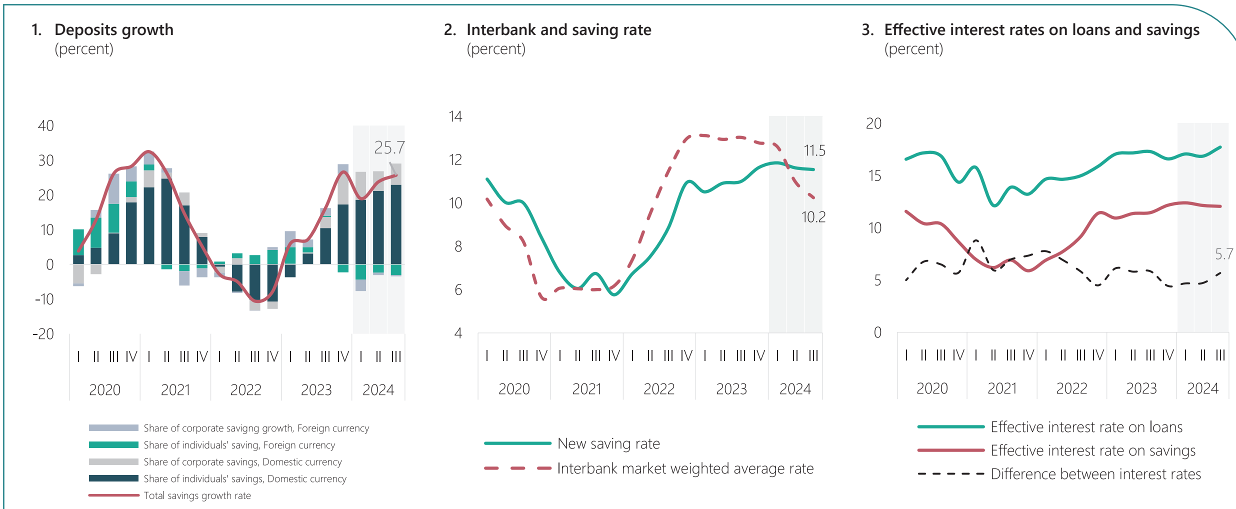
51.6 percent, agricultural loans, which surged by 97.1 percent, and manufacturing loans, which grew by 23.8 percent. In contrast, consumer loans growth reached 37.4 percent at the end of the third quarter of 2024, up by 2.9 percentage points from a year earlier, but down by 3.9 percentage points compared to the beginning of the year. The growth in consumer loans was largely driven by a 50 percent increase in salary loans, a 48.7 percent increase in pension loans, a 19.1 percent rise in loans secured by deposits, and a 66.7 percent increase in loans for household consumption.

47. Growth in newly issued loans accelerated for business loans but slowed for consumer loans. Newly issued loans totaled MNT 41.9 trillion, marking an increase of MNT 12.0 trillion, or 39.8 percent, compared to the same period last year. The annual growth rate for newly issued business loans surged to 45.1 percent, a notable acceleration of 23.8 percentage points from the same period last year. In contrast, newly issued consumer loans grew by 31.6 percent, reflecting a slowdown of 7.1 percentage points year-on-year. The substantial growth in business loans was largely driven by increased lending to mining, wholesale and retail trade, finance, insurance, and real estate sectors.

48. The mining and real estate sectors contributed positively to the improvement in credit quality. As of the third quarter of 2024, the total non-performing loans declined by 9.8 percent year-over-year to MNT 2.0 trillion. The decline was primarily driven by a reduction in non-performing loans in the mining, quarrying, and real estate sectors. In contrast, the balance of non-performing consumer loans, including salary, pension, and household consumption loans, rose by 13.5 percent compared to a year earlier. The share of non-performing loans in total loans continued to improve, falling to 5.7 percent, the lowest level recorded in the past eight years.

49. Domestic currency deposits increased for both individuals and corporations. As of the third quarter of 2024, total bank deposits reached MNT 25.0 trillion, reflecting a 25.7 percent increase compared to same period last year. Of this total, individuals' deposits accounted for MNT 20.8 trillion, marking a 23.3 percent year-on-year growth. Breaking this down further, individuals' domestic currency deposits amounted to MNT 17.6 trillion, which represents a substantial year-on-year increase of 34.9 percent. In contrast, individuals' foreign currency deposits stood at MNT 3.3 trillion, experiencing a decline of 16.0 percent compared to the previous year. Corporations' deposits reached MNT 4.2 trillion, showing a robust growth of 39.2 percent year-on-year. Corporations' domestic currency deposits grew to MNT 3.0 trillion, a notable increase of 65.1 percent, while foreign currency deposits reached MNT 1.2 trillion, reflecting a slight decrease of 0.4 percent year-on-year. The weighted average interest rate for domestic currency deposits was 11.8 percent as of the third quarter of 2024. Meanwhile, the weighted average interest rate for foreign currency deposits rose to 3.7 percent, representing an increase of 0.5 percentage points compared to the same period last year. The overall growth in domestic currency deposits, across both individuals and corporations, was primarily driven by the stability of deposit interest rates and the exchange rate.

Figure 3.5 Components of annual growth in total deposits and indicators of deposit interest rates



Source: Estimation of MED, Bank of Mongolia statistics.
Notes: Effective interest rate=(1+nominal annual interest rate/number of compounding periods per year))^(Number of compounding periods per year)-1

50. The weighted average interbank rate declined reflecting the policy rate cuts. Following the policy rate cuts, and the weighted average interbank interest rate decreased to 10.2 percent in the third quarter of 2024, down 2.8 percentage points from the same period last year and 0.7 percentage points from the previous quarter. Despite the reduction in interbank rates, the weighted average interest rate on new deposits rose to 11.5 percent, marking an increase of 0.5 percentage points compared to the same period last year.

51. The difference between the effective interest rates on loans and deposits widened compared to the previous quarter. In the third quarter of 2024, the effective interest rate of commercial banks reached 17.7 percent, reflecting an increase of 0.4 percentage points from the same period last year. Similarly, the effective interest rate on deposits rose to 12 percent, marking an increase of 0.6 percentage points year-on-year. As a result, the difference between the effective rates on loans and deposits widened by 1.0 percentage points compared to the previous quarter, reaching 5.7 percent. This represents a decrease of 0.1 percentage points from the same period last year. Despite a policy rate cut, the gap between interest rates on loans and deposits widened compared to the previous quarter.

52. The growth in the outstanding loans of non-bank financial institutions remained high. In the third quarter of 2024, the total outstanding loans of 555 non-bank financial institutions (NBFIs) reached MNT 5.2 trillion, reflecting a 53.9 percent increase compared to the same period last year. Of the total outstanding loan, 89.7 percent were issued to individuals, while 10.3 percent were issued to legal entities. Notably, consumer loans made up 68 percent of the total outstanding loan. In terms of fintech loan services, NBFIs extended fintech loans amounting to MNT 1.2 trillion to 1.6 million borrowers during the third quarter of 2024. The weighted average monthly interest rate on loans issued by NBFIs stood at 3.4 percent, marking a modest increase of 0.1 percentage points from a year earlier.

53. Stock market value growth reached 17.6 percent. In the third quarter of 2024, the stock market capitalization reached MNT 12.1 trillion, an increase of 17.6 percent from the same period last year. The market capitalization reached 17.2 percent of GDP, and trading activity has seen significant improvements in recent years, largely driven by the banks' IPOs. Total securities trading reached MNT 1.1 trillion in the third quarter of 2024, marking an increase of 61.7 percent from the same period last year. Trades related to corporate bonds accounted for 58.4 percent, stocks for 23.1 percent, asset-backed securities for 12.4 percent, and investment funds for 6.1 percent.

54. Stock market indices rose, and liquidity improved. In the third quarter of 2024, a total of 895.4 million shares valued at MNT 242.5 billion were traded in the stock market across 187 transactions. Of this, MNT 24.1 billion was traded in the primary market and MNT 217.7 billion was traded in the secondary market. Corporate bond trading also reached MNT 618.7 billion, marking a 6.4-fold increase compared to the same period last year. Debt securities issued under the "Mayor's Program" in the second quarter of 2024 accounted for 80.8 percent of total bond trading, and new bond issuances by two companies were recorded. In the third quarter of 2024, the TOP-20 index increased by 35.1 percent compared to the same period last year. The MSE A and MSE B indices also increased by 20.4 and 26.3 percent, respectively, from the same period last year. The liquidity ratio of the securities market improved by 0.5 percentage points from the same period last year to 1.8 percent.