MOODY'S
INVESTORS SERVICE

Rating Action: Moody's changes Mongolia's outlook to stable from negative; affirms B3 rating

16 Mar 2021

Singapore, March 16, 2021 -- Moody's Investors Service ("Moody's") has today changed the outlook on the Government of Mongolia's issuer ratings to stable from negative and affirmed the long-term B3 issuer and foreign currency senior unsecured bond ratings and the (P)B3 senior unsecured MTN program rating. The short-term issuer ratings are affirmed at Not Prime.

The decision to change the rating outlook to stable reflects Moody's viewthat liquidity risks and external pressures have stabilized for the foreseeable future, albeit at somewhat higher levels than seen prior to the pandemic. Higher government borrowing requirements resulting from sizeable stimulus in 2020 were financed primarily through a combination of concessional sources and a drawdown on fiscal reserves, thus relieving liquidity pressures. Recent refinancing has also reduced upcoming maturities in 2021 and 2022. External vulnerabilities have declined, on the back of a faster than expected recovery in mining exports, that Moody's expects to continue.

The affirmation of the B3 rating reflects Mongolia's existing credit challenges, including long-standing external and liquidity risks, as well as fiscal weaknesses that have increased due to the pandemic. The economic impact of the coronavirus pandemic and the government's announced fiscal stimulus measures reversed gains from a broadly balanced government budget in years leading up to the pandemic. Moreover, weak governance continues to impede the government's capacity to shelter the economy and public finances from commodity price cycles that they are exposed to.

Mongolia's country ceilings remain unchanged: Mongolia's local-currency country ceilings remain at B1. The two notch gap to the sovereign rating reflects a strong government footprint in the economy, high commodity composition in overall revenues, and still-high external imbalances. The foreign-currency ceiling remains at B3, representing a two-notch gap to the local currency ceiling, to take into consideration our assessment of weak policy effectiveness and high external debt. All short-term foreign currency ceilings also remain unchanged at Not Prime.

Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL441766 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

RATINGS RATIONALE

RATIONALE FOR THE STABLE OUTLOOK

Donor support, access to market funding and narrower deficits mitigate government liquidity risks, albeit from relatively high levels.

Although wider fiscal deficits coupled with debt repayment obligations resulted in a spike in borrowing requirements to nearly 21% of GDP in 2020, the government was able to meet these requirements, primarily due to assistance from multilateral lenders. A debt refinancing exercise conducted in September last year also resulted in a substantial reduction of obligations due in 2021 and part of 2022. As a result, Moody's estimates gross borrowing requirements will reduce to 13.6% of GDP for 2021, from 16.5% estimated earlier, and stabilize between 15-16% until 2023, about 3ppt lower than Moody's earlier expectations.

Beside financing needs being somewhat lower than earlier assumed, financing sources are also more secure. Continued support from multilateral lenders will support budgetary expenditures in 2021. The government expects total financing from such sources to amount to upwards of $500 million in 2021. Apart from expenditure cuts arising from a reversal of some stimulus measures undertaken last year, other sources of budget financing will include savings from the Stabilization Fund and domestic bond issuance. Moody's expects that, given the excess liquidity prevailing in the domestic banking system, demand for government bond issuance will be strong.

With demonstrated access to market funding at reasonable costs, Moody's expects external market funding to support further refinancing. Apart from the $133 million remaining maturity in 2021 (post the debt-refinancing), Mongolia's upcoming refinancing needs include about $800 million due in 2022 and 2023 each, and $600 million in 2024. At these levels, Mongolia's debt maturities are not substantial compared with peers.

Apart from repayment obligations, improved fiscal performance will support lower overall borrowing requirements. Following a period of significant deficit reduction between 2016 and 2019, coronavirus-related fiscal stimulus measures resulted in the deficit widening to over 12% of GDP in 2020. While this is significantly wider than pre-pandemic deficits, Moody's expects Mongolia's fiscal deficit to narrow to 8% of GDP in 2021 and continue on a path of gradual consolidation thereafter. Deficit reduction will be driven by a gradual reversal of past spending measures, as well as revenue buoyancy, particularly on the back of a rebound in the mining sector, which will drive mineral revenue collections as well as an expansion in nominal GDP growth.

The stable outlook is also underpinned by receding external vulnerability risks albeit from relatively high levels.

A narrower current account coupled with financial assistance from official lenders has led to a faster accumulation of foreign reserves than anticipated at the start of the pandemic. In particular, after posting a sharp contraction due to border closures with China, coal exports recovered in the second half of 2020, while copper and gold exports also posted year-on-year increases, limiting the export contraction.

In 2021, stronger growth in both exports and imports will result in wider current account deficits relative to 2020, although Moody's estimates deficits in the next four years will narrow to nearly half of pre-pandemic averages. A steady recovery in China, Mongolia's largest export market, will continue to support overall demand for commodities. A rebound would be further boosted by the operationalization of a railway connecting the Tavan Tolgoi coking coal mine to the Chinese border, scheduled to be completed by the end of 2021, easing transportation bottlenecks.

For 2021, Moody's expects foreign exchange reserves to increase to $4.6 billion, from just under $4.0 billion at the end of 2020. Coupled with the extended repayment schedule, this will result in the Moody's External Vulnerability Indicator, the ratio of maturing external debt to reserves, moderating to 116% in 2021 from 237% in 2020. Moody's expects this ratio to hover around 150-180% over 2022-23 indicating that although reserve adequacy has improved and stabilized, it will remain a credit constraint.

RATIONALE FOR THE B3 RATING

The B3 rating balances prevailing liquidity pressures and external and fiscal vulnerabilities, against improvements made over recent years in the debt financing strategy.

Moody's expects government debt to rise to nearly 75% of GDP in 2021, and debt affordability to weaken somewhat, acting as a setback to improvements in fiscal strength that had occurred in the three years preceding the pandemic. A more pronounced increase in the debt burden will be prevented by a resumption in strong nominal GDP growth and a recovery in mining revenues. Instead, the debt burden will fall gradually in the next few years, to just over 70% of GDP by 2024, supported by deficit reduction and steady economic growth.

Mongolia's potential growth continues to represent an underlying credit strength, although dependent on large projects proceeding as planned beyond 2020. Moody's assumes no major changes to the planned production schedule for Oyu Tolgoi -- the country's largest copper mine -- notwithstanding ongoing negotiations to amend the investment agreement. In spite of the 5.4% contraction in growth over 2020, growth prospects in 2021 and beyond remain bright. Moody's expects growth in 2021 to expand at 6.0% year-on-year.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

Mongolia's ESG Credit Impact Score is highly negative (CIS-4), driven by a high exposure to environmental risks, a moderately negative social risk issuer profile score, and a weak governance profile.

Mongolia's exposure to environmental risks is highly negative (E-4 issuer profile score), related to an economy that is highly dependent on the production and exports of hydrocarbons, with implications for waste and pollution levels. Mongolia is also vulnerable to water scarcity driven by mineral extraction, deforestation, and desertification.

Exposure to social risks is moderately negative (S-3 issuer profile score). The uneven distribution of incomes, is balanced by a young population coupled with a strong social safety net that has enhanced the provision of health and education benefits.

Mongolia has a highly negative governance profile score (G-4 issuer profile) reflecting weak executive institutions and policy effectiveness against ongoing structural reforms. A high government debt burden and other immediate liquidity pressures constrain the sovereign's financial capacity to respond to environmental and social risks

GDP per capita (PPP basis, US$): 12,551 (2019 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 5.1% (2019 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 5.2% (2019 Actual)

Gen. Gov. Financial Balance/GDP: -0.6% (2019 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: -15.4% (2019 Actual) (also known as External Balance)

External debt/GDP: 218.7% (2019 Actual)

Economic resiliency: b1

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 11 March 2021, a rating committee was called to discuss the rating of the Mongolia, Government of. The main points raised during the discussion were: The issuer has become less susceptible to event risks, with receding government liquidity and external vulnerability risks.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

FACTORS THAT COULD LEAD TO AN UPGRADE

A consistently falling debt burden accompanied by steady improvements in debt affordability would alleviate fiscal constraints and drive upward rating momentum. These indications would likely relate to improvements in the management of domestic public finances, containing the government's funding requirements and the economy's external financing needs. Efforts towards gradually diversifying the economy away from its reliance on commodities that reduce growth volatility and susceptibility to boom-bust economic cycles would also likely be a trigger for upward rating action.

FACTORS THAT COULD LEAD TO A DOWNGRADE

A rating downgrade could transpire from widening gross borrowing requirements significantly above our baseline assumptions, and/or rising government liquidity risks that point to difficulties in meeting these borrowing needs. Persistent external financing gaps that threaten macroeconomic stability would also exert downward rating pressures. A sustained shock to growth, for instance through the derailment of large mining projects, would also be a trigger for downward rating action.

The principal methodology used in these ratings was Sovereign Ratings Methodology published in November 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1158631 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

The List of Affected Credit Ratings announced here are a mix of solicited and unsolicited credit ratings. Additionally, the List of Affected Credit Ratings includes additional disclosures that vary with regard to some of the ratings. Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL441766 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and provides, for each of the credit ratings covered, Moody's disclosures on the following items:

• Rating Solicitation

• Issuer Participation

• Participation: Access to Management

• Participation: Access to Internal Documents

• Disclosure to Rated Entity

• Endorsement

• Lead Analyst

• Releasing Office

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1243406 .

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Anushka Shah
Vice President - Senior Analyst
Sovereign Risk Group
Moody's Investors Service Singapore Pte. Ltd.
50 Raffles Place #23-06
Singapore Land Tower
Singapore 48623
Singapore
JOURNALISTS: 852 3758 1350
Client Service: 852 3551 3077

Marie Diron
MD - Sovereign Risk
Sovereign Risk Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Singapore Pte. Ltd.
50 Raffles Place #23-06
Singapore Land Tower
Singapore 48623
Singapore
JOURNALISTS: 852 3758 1350
Client Service: 852 3551 3077

under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any credit rating, agreed to pay to MJKK or MSFJ (as applicable) for credit ratings opinions and services rendered by it fees ranging from JPY125,000 to approximately JPY550,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.