INFLATION REPORT

(September 2017)

Ulaanbaatar

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EXECUTIVE SUMMARY

Inflation is projected to rise till the end of 2017 but remain within the target of 8 percent. This quarter, inflation forecast is adjusted downwards due to lower than expected price contributions of education, meat, and fuel products. As of August 2017, Ulaanbaatar city inflation was 1.3 percent monthly and 5.4 annually. These are consistent with its seasonal pattern to accelerate in the months of August. Increased economic activities are likely to lift demand-pull inflation, and it is further expected to be amplified by supply-side factors in the prices of vegetables and flour due to the harsh weather conditions. Furthermore, inflationary pressure caused by changes in consumer basket and tax rise in April and May of 2017 is expected to remain.

Positive developments in the external conditions have benefited the economy, pushing growth higher than expectations. In this regard, the forecasts are adjusted accordingly. Rising export prices and greater investments in the mining sector resulted in higher mining productions (except for copper). As a second-round effect, recovery in the mining sector boosted foreign trade and led to higher growth of trade, transportation, and manufacturing sectors, which buoyed the economic growth in the last 3 quarters.

Following economic recovery, employment in the agriculture and non-agricultural sectors such as trade, mining and transportation, has been increasing. Positive developments in the labor market supported domestic demand and household consumption. Moreover, in line with greater investments in the mining sector, growing coal exports and its transportations, investment in machinery, construction of mines, and inventories have increased significantly. Household consumption and investments have led to greater demand for both domestic and imported goods. The largest contribution to growth is driven by export revenues of mining companies which increased their production and exports, following higher commodity prices.

Trade and net taxes on products grew in line with greater mining production, contributing to positive output gap. The mining sector is expected to remain strong and further support employment in other sectors and household income. Furthermore, greater consumption and investments are projected to prop up economic recovery.

Global economic outlook, growth of main trading partners and rise in export prices have had positive impact on Mongolia's external demand. First, growth of China, Russia, Europe, and the USA, which determines our external demand, have surpassed expectations. Chinese economic growth is slowing down, yet it is expected to be higher than it was previously assumed. Similarly, Euro area growth outlook has improved. Due to current geopolitical situation and Chinese environmental policies, favorable conditions have risen at the Chinese coal market for Mongolia and is fueling coal exports. However, tightened economic sanctions and stagnant oil prices have led us to reduce Russia's economic growth outlook. Overall, the terms of trade improved as export prices accelerated faster than import prices. The export prices are expected to remain resilient in the last quarter of 2017, thus terms of trade is projected to improve compared to the previous year. However, in 2018 we expect worsening terms of trade due to higher import prices outweighing preserved export prices.

The balance of payments was in surplus in the second quarter of 2017. Although demand to import machinery, equipment, and vehicles grew, export volume increased in line with the rising commodity prices, thus fostered a surplus of trade balance. Shrinking deficits in services such as travel, tourism, and financial and professional advisory contributed positively to the balance of payments. Nevertheless, foreign currency outflows are elevated due to higher debt service and reinvested earnings, following the surge of external debt and foreign loans in recent years.

Government budget deficit is narrower, and fiscal stance is expected to remain tight. The government has been committed to its policy to diminish fiscal deficit and to preserve debt sustainability. Regardless of strong performance on the revenue side, results of fiscal impulse suggest fiscal stance to be tight, which is consistent with its policy is to reduce deficit. Following improved economic performance and greater trade turnover, income tax, value-added tax and excise taxes on imported goods are fueling fiscal revenue, thus reduced the need to finance fiscal deficit via borrowing. This year, to finance fiscal deficit and fill the financing gap, we expect the government to issue new debt, yet 8 percent lower than last year. It is a significant decline compared to a growth of 87 percent in the previous year.

While money supply is increasing, similar recovery is not observed in business loans so far. Growth of money supply was sustained since the second half of 2016. Consumer loan, mortgage loan, and net credit to the government from the banking system have boosted money supply growth. Recovery of commodity prices and mining production resulted in a surge of newly issued lending to the mining sector. Share of non-performing loans and past due loans in total loans decreased from the end of 2016 owing to recovery in mining and trade sectors, which were heavily indebted during the economic downturn and comprised most of the non-performing loans.

Following economic recovery, financial transactions have surged, and currency and deposits are multiplied through money multiplier. In addition, driven by stable exchange rates, improved market sentiment and positive market expectations, deposits and current accounts in domestic currency accelerated more than in foreign currency in the first 2 quarters.

Treasury bill rate and deposit rates declined. Both the reduction of the policy rate by 2 percentage points and banks' interest to hold highly liquid assets, have driven the treasury bill rate lower. Especially, rates of short-term treasury bill with maturities up to 1 year have declined about 7 percentage points. Rates on newly placed and newly extended deposits have declined, widening the loan and deposits interest rate spread.

The stock market is growing, and we observe recovery. Improved economic performance, greater consumption and larger trade turnover have a positive spill-over impact on market value of the companies listed at the Stock Exchange. Regardless of high volatility, Top 20 index improved from both the previous quarter and the previous year. In addition, the stock trades have become more active. Increased stock market activity and market valuation are mostly explained by vigorous exchange of stocks and higher market valuations of larger companies such as Darkhan Selenge, Tavan Tolgoi, APU, Gobi and Mongol Post.

I.1 Forecast used in the calculation of external demand[1]

Compared to previous projection/forecast, the projected external demand of the economy has increased due to the economy of China and Euro zone has grown while the Russian economy showed a decline during the reporting period. However, due to the increase in the prices of gold, iron ore and thermal coal, decrease in the copper prices and a very slight change in the oil prices to the compared to the previous forecast calculations contributed negatively to forecast/projection of terms of trade.

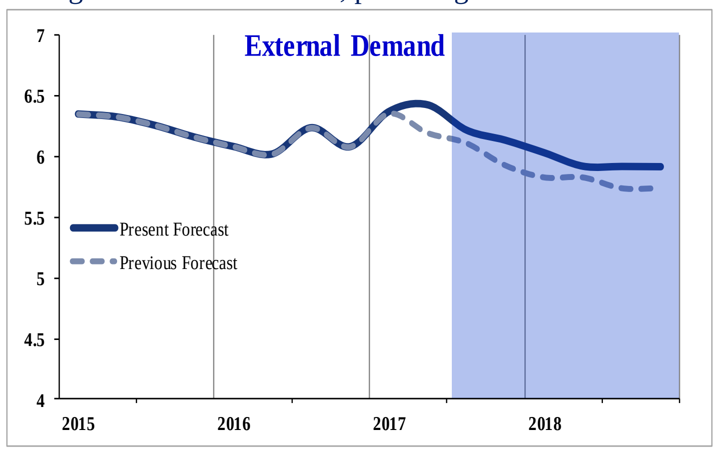
External Demand

During the forecast period the economic growth of China and Euro zone is expected to improve while the economy of Russian Federation will decline, therefore the outlook for the external demand of Mongolia for 2017 is expected to be higher than the previous estimation.

Though the debt amount in private sector has been rapidly increasing and the balance loss is high, the economic growth forecast of China for the second half of 2017 is expected to increase more than it was previously assumed. The Russian economy that has been shrinking for two consecutive years has grown due to 3.3 percent increase in personal consumption and 1.5 percent surge of investment in the first half of 2017. However, the factors that have influenced this growth will not be preserved further, therefore the economic growth forecast has been indicated as 1.5 instead of 1.6 percent. The activation in the American labor market during the reporting period and upsurge in personal consumption level have positively influenced the economic growth. According to analysts, these circumstances will continue further, therefore the mid-term real growth is estimated to be 2.1 percent. Decrease of political uncertainties has led to favorable terms of investment and the labor market improvement has set positive forecast for Euro zone economic growth. Hence, the projection for the external demand for 2017 has been estimated at 0.2 unit percent increase from the previous estimation.

Figure I.1.1

Change in External Demand, percentage



Source: Bloomberg, Roubini, IMF

[1]Economic growth of major trading partners, inflation forecast is from the Roubini Global Economics report of August, EIU August report, Median of forecasts estimated by the Bloomberg analysts, IMF-WEO July Update, relevant explanations were consolidated from these reports. These are not the conclusions and evaluations made by the Bank of Mongolia.

Having raised the infrastructure investment and the government expenses by following a soft/loose budget policy, the retail sales market has been activated, providing more investment and serving as the main factors for China's economic growth. Since the economic growth of China has been identified as higher than expected for the first half of 2017 at 6.9 percent, the analysts forecast the economic growth of China higher than expected by adding 0.2 unit percent and listing it as 6.8 percent. Some measures and policies to lower the high debt levels in the private sector throughout the mid-term are expected to be taken after the 19th National Congress of the Communist Party of China to be held by the end of 2017 as the rapidly rising debt amount of private sector has been attracting intense attention. Analysts mentioned the risks of economic growth slow down through mid and long term period, therefore the forecast for 2018 has been estimated by 0.2 unit percent lower than previously calculated and indicated at 6.0 percent.

On the contrary, the Euro zone economic growth is expected to be considerably stable, hence it is estimated to be at 1.8-2 percent. The improvement of conditions of key trading partner countries of Euro zone and decrease in uncertainties are leading to upsurge in the external demand forecast. The economic projection for 2017 is 0.2 unit percent higher and stated at 2 percent, and the economic forecast for 2018 is 0.1 unit percent higher and estimated at 1.7 percent.

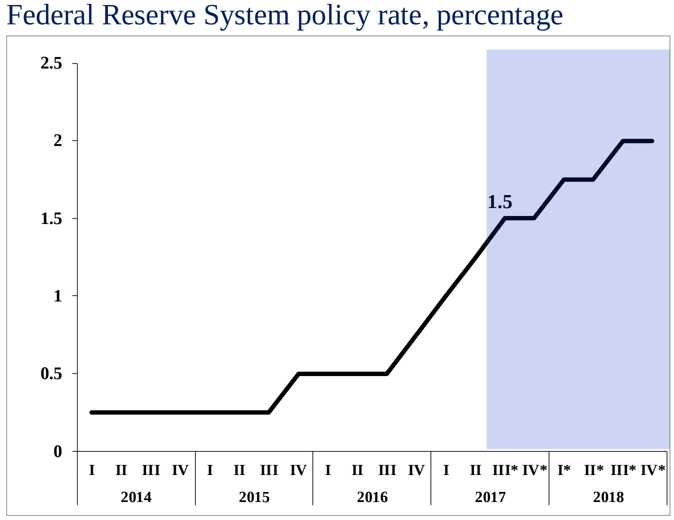
As of the first half of 2017, personal consumption has increased by 3.3 percent, the total investment has increased by 1.5 percent, marking the economic growth indicator of Russia at 2.5 percent which is higher than analysts' expectations. But, they consider that the factors that had an impact on this increase will not last throughout the mid-term period. Also, the fluctuations in crude oil prices greatly impact the economic growth forecast of Russia and analysts assume that the OPEC decision to reduce production until the end of the 1st quarter of 2018 shall have a positive effect on growth forecast. The plan to limit the infrastructure expenses and the government expenditures for the duration of 3 years between 2017 and 2019 in accordance with the framework of amendments made to the State Budget Law in order to reduce the state budget and the fact that USA made their tightened their sanctions against Russia in August of 2017, and the crude oil prices are not likely to rise, all these factors impact the Russian economic growth forecast of 2017 negatively by decreasing it 0.1 unit percent compared to the previous year, at 1.5 percent, and again decrease by 0.1 unit percent for 2018 at 1.4 percent.

Foreign Interest Rate

Due to the following events such as the unemployment rate of USA has decreased, the labor market has been activated, the inflation has increased, the real/nominal income of people has increased in line with personal consumption, the global financial market has been considerably stabilized, the Federal Reserve System of the United States has increased the policy rate by 0.25 unit percent in the 2nd quarter of 2017 and complying with a tight monetary policy through the mid-term providing conditions for an appreciation of the dollar (USD exchange rate). The Federal Reserve System is expected to increase the policy rate one more time in 2017 and 3 more times throughout the course of 2018 and it is highly

Figure I.1.2

Federal Reserve System policy rate, percentage



Source: Bloomberg

probable to expect a rate increase by December at the nearest future.

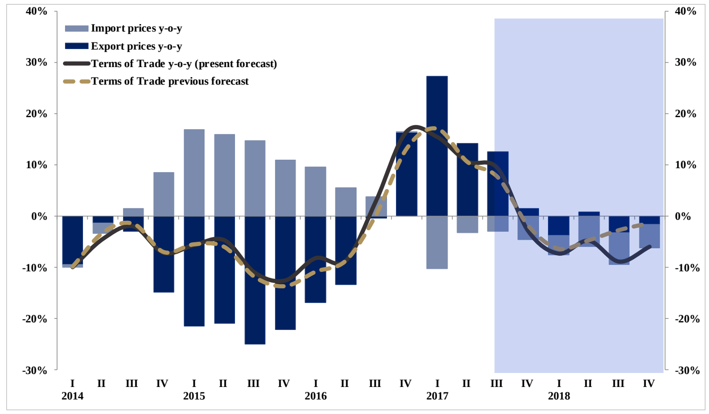
Terms of Trade (Trading terms and conditions)

While the trading terms and conditions have improved in the first half of year 2017 due to increase of copper and gold prices, the economic growth is projected to decrease again due to drop in prices of gold, iron ore and thermal coal in the second half of 2017 and 2018.

The copper price has rapidly risen by 1210 USD from October of 2016 to February of 2017 and reached the level of 5941 USD, but it has steadily decreased for the consecutive three months and the analysts consider that the increase in copper prices will not continue further. The reserves of copper in China's storage facilities are sufficient enough and compliance that some mining activities have been disturbed in 2017, decrease of copper supply is expected and may positively impact the copper prices increase during the mid-term. Also, due to opening of new mines in Latin America and Africa, the copper prices may decrease in the mid-term. It is expected that the manufacturing industry of China will slow down through the mid-term, decreasing amount of coking coal import, leading to expected drop in prices by 112 USD in 2017 and by 81 USD in 2018 at lower level than projected.

Figure I.1.3

Terms of Trade, export, import price difference y-o-y



Source: Bank of Mongolia

Within the framework of changes to supply structure, the Government of China is seeking measures to reduce the excess capacity of mines, specifically focusing on iron ore and coal sectors. Within the framework of those measures, the import has increased due to reduction of coal exploration, and the price of thermal coal exceeding the level of 82 USD at the beginning of 2017 has dropped to 77 USD in the reporting period. The power plants reserved their sources and it led to short term of thermal coal price increase and contributed to the maintenance of the price increase. The coal supply is expected to decrease due to the facts that China sanctioned the coal and iron ore trade with DPRK, the climate calamities in Indonesia, closure of the two biggest coal mines by the coal mining company "China Shenhua Energy" and so on. Therefore, the coal price forecast has been estimated at higher level than previous estimation for 2017 and 2018.

The gold price was at the peak highest at 1266 USD in April and the lowest at 1193 USD in January 2017. The political and geopolitical issues continue to impact the gold market price. Although the new policy programs adopted by Donald Trump, the President of USA and the uncertainty whether the United Kingdom will depart from the European Union and etc. played an additional impact on the increase of uncertainties, analysts emphasize that the gold price has been stable throughout the course of recent months. Furthermore, as the unemployment rate of USA is expected to decrease and the Federal Reserve System of the United States is planning to raise the policy rate, and the inflation rate of developing countries is expected to maintain stability, the forecast for gold prices is estimated to be 31 USD lower than the previous estimation for 2017 and 18 USD lower for 2018.

The price for Brent trademark oil that has reached the average of 55 USD per barrel in 2017 has declined and reached to 53 USD in average during the reporting period (last 3 months period) per barrel due to increase of oil production in USA and the excess storage of 100 million barrels more or 38 percent higher than the 5 year average indicator. The fact that the production of crude oil has increased in USA and the member countries of OPEC has reached a mutual agreement to reduce their oil production will lead to a sustainable course of crude oil prices until the end of the 1st quarter of 2018 and help maintain stable the crude oil prices. Therefore, the forecast for the crude oil price has been estimated at a slightly higher than the previous estimation for 2017-2018.

By the beginning of 2017, the prices of iron ore have suddenly increased reaching to 89.5 USD, but they have decreased again in the reporting quarter. With a strong emergence of the South Asian developing countries, the supply of steel is expected to increase. Within the framework measures taken by China's Government of the supply-side reforms and aiming to reduce the excess capacity in iron ore and coal sector, analysts note that the demand for steel may decrease by the end of 2017, but large-scaled mega projects shall activate the demand in the mid-term.

As about the foreign inflation, the inflation of Euro zone and USA is expected to decline compared to the previous forecast, while China's inflation is estimated to increase and Russia's inflation remain stable with no change. For instance, despite the loose monetary policy of China and non-traditional monetary expansion policy of the European Central Bank, the inflation rate of China and Euro zone will remain lower than the targeted rate. Notwithstanding, the inflation rate of Russia for the first half of 2017 was dependent on the price fluctuations of food products and was estimated at the rate of 4.4 percent year on year in the reporting period. The Central Bank of Russia is planning to continue the soft/loose monetary policy by reducing the policy rate to 8-8.5 percent. As the Federal Reserve System of the United States representing one of the main economies in the world is planning to increase the policy rate before the end of this year in order to enforce its monetary policy, the inflation for USA is estimated to be at 2 percent by the end of 2017 and at 2.2 percent in 2018.

I.2 Forecasts, and its uncertainties

Economic growth

Current forecasts are made with the assumption that the policy rate will be unchanged, monetary and fiscal policy will be consistent with the IMF's Extended Fund Facility (EFF) program and investment will increase following construction activities in the mining sector.

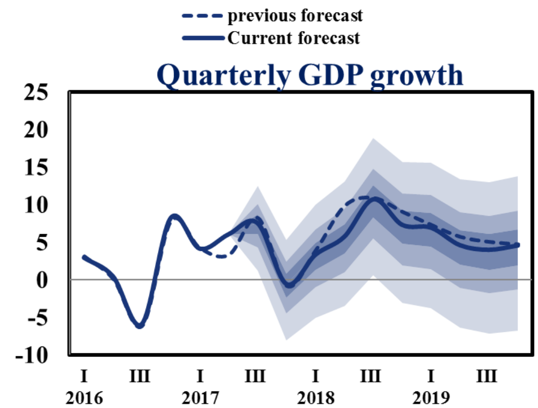
In this projection cycle, economic growth forecast is revised up due to improvements in the external conditions beyond expectations in second quarter. In particular, higher economic growth of trade partners and consequently higher prices for Mongolian export commodities led to greater improvements in terms of trade. For instance, in the second quarter of 2017 increased mining, export and transportation of coal were main factors that fueled economic growth beyond projections. Specifically, growth of mining sector excluding copper concentrate and non-mining sectors were greater than previously projected.

Economic growth is forecasted to pick up in the medium term. In 2017-2018, investments in mining sector is expected boost production in both mining and related non-mining sectors, consequently overall GDP growth. As for 2017, contributions of trade and net taxes on products are projected to be the greatest for overall economic growth. Moreover, the export price has been relatively stable and mining production excluding copper continues to increase. However, due to the declining concentration of copper, production in mining sector will be lower compared to previous year.

In 2018, investments in mining sector will continue to increase, leading to greater production in most of the mining sector and support mining related non-mining sectors as well. Furthermore, starting 2018, concentration of copper is expected to improve, and mining activities regarding crude oil and iron ore are likely to increase following rising commodity prices. In 2018, economic growth is projected to accelerate, and production is expected to be higher than its long-run trend, potentially fueling gradual increase of demand-pull inflation.

Figure I.2.1

GDP growth forecast (quarter-on-quarter)



Source: The BoM

Table I.2.1

Annual GDP growth and inflation forecasts (30 percent confidence interval)

	2016 *actual*	2017*	2018* *forecast*
GDP growth	1.2	1.7 – 5.2	3.5 – 8.6
Inflation, CPI[2]	0.1	6.0 – 9.0	6.0 – 11.0

Source: The BoM

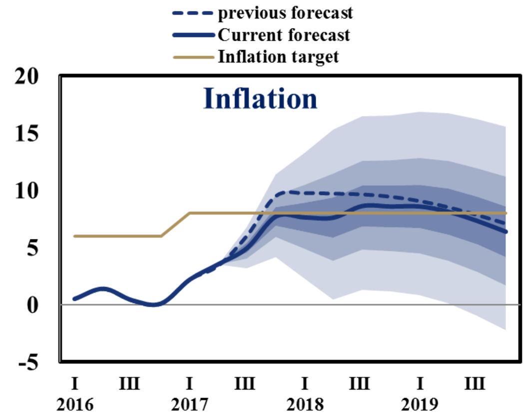
[2] Average inflation in last quarter of each year

Inflation

Inflation forecast is lower from the previous quarter due to changes in the following assumptions. First, in July price of meat declined more than projected and this trend is expected to remain in the upcoming months. Second, previously projected hike of the university tuition fees for the 2017-2018 academic year did not materialize. Third, to incorporate the impact of special tax hike on petroleum which was expected in July, domestic petroleum price was projected to increase in the end of July. However, tax hike was postponed to September and October.

Figure I.2.2

Inflation projection



Source: The BoM

In the upcoming quarters, rising prices of imported products, food items and petrol are expected contribute the most to inflation. Petroleum price is projected to increase following special tax hikes in October 2017. Due to seasonal effects meat price is forecasted to be lower in the second half of 2017. Due to rising tendency of food prices in the foreign market, price of food items excluding meat in domestic market is forecasted to increase.

In 2018, accelerating economic growth is expected to create inflationary pressures, yet household debt burden is most likely to curb inflation. Thus, inflation is forecasted to remain around the target rate. Exchange rate is forecasted to remain relatively stable.

Forecast uncertainties

Forecasts may differ from actual performance and may change in the upcoming quarters due to changes in economic policy, structural changes, shifts in the assumptions, and/or other unforeseeble circumstances in both external and domestic conditions. The following changes regarding the macroeconomic policy and external and domestic factors, may explain the potential difference between forecasts and actuals.

Uncertainties in the external sector

- The Chinese government may limit its construction activities thus lead to lower investment in the real estate sector. If construction sector declines, copper and iron ore productions are likely to decrease and so is iron ore import from Mongolia.
- Outlook for the Chinese economy remains an important source of uncertainty for Mongolian economy. Specifically, it remains uncertain how the Chinese government will respond to its debt issue in the medium term.
- Stable growth of Chinese manufacturing sector is likely to continue in 2017 and boost demand for copper. Yet it is uncertain whether such trend would persist in 2018. Chinese authorities are inclined to limit credit growth and support domestic consumption rather than manufacturing, which may negatively affect copper demand.

- Russian economic outlook is improving. However, impact of presidential election cycle and its outcome on the economic policy will be key source of uncertainty in 2018.
- In the USA, employment and economic conditions are improved, yet it is uncertain whether such trend would persist. In addition, geopolitical issues and sanctions in the international arena may create negative externalities for Mongolian economy.

Domestic economic uncertainties

- In line with the IMF program, short term measures and medium to long term structural policy changes are likely to boost investor sentiment and create a surge of short term capital inflow.[3] Unless the government remains committed to the Extended Fund Facility program requirements and properly manages the increased inflow of capital to build fiscal and foreign exchange reserves, in the medium to long term it will fail to build the economic resilience and further amplify its vulnerabilities. To prevent such risk is the main challenge for fiscal, monetary and financial policies.
- Details of foreign direct investment remains a source of uncertainty. In particular, under the framework of "Economic Recovery Plan" the start date and financing sources for large-scale projects such as Tavan Tolgoi are still uncertain. A sudden surge of investments related to megaprojects may cause the economy to overheat.
- Interruptions in the supply of goods may create inflationary pressures exceeding the forecasts. Due to weather-related risks, if the harvest of vegetables and wheat falls short, cost-push inflationary pressures may rise. Furthermore, any unplanned changes to administered prices may alter the inflation trajectory.
- The congestion of coal transportation at the Gashuunsukhait border port, Umnugovi province, has started to curb exports revenue and coal production. Persistence of this issue would augment its negative impact on foreign exchange inflow, the balance of payments and mining sector production.

[3] Assuming that the Government of Mongolia remains committed to the IMF program.

II. CURRENT ECONOMIC DEVELOPMENTS

II.1 Inflation

II.1.1 Inflation target, result

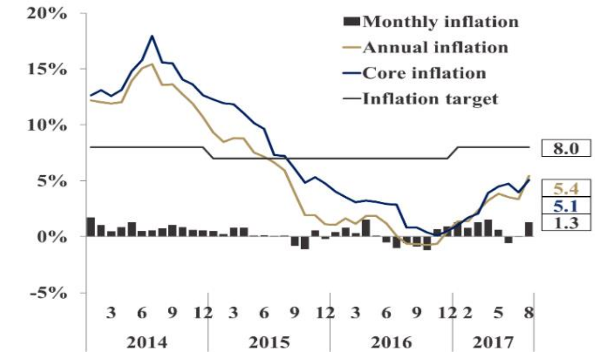
The Bank of Mongolia's main objective is to ensure price stability and maintain inflation at low and stable level. It has been stated in the Monetary Policy Guidelines for 2017 that inflation would be targeted at 8% in 2017-2019. In August 2017, annual inflation in UB and nationwide, measured by consumer price index, was below the inflation target (Figure II.1.1.1). Annual inflation reached 5.0% in nationwide and 5.4% in Ulaanbaatar in August 2017.

Annual inflation has been steadily growing since December 2016. Including 1) Meat prices increased by 8.4 percent in December 2016 and grew during the first quarter of 2017; 2) Annual inflation in April and May increased, dealing with CPI basket change and tax effects; 3) Due to drought conditions throughout the country, prices of vegetables and flour hiked; 4) Household income increased annually during the last two quarters, and depreciation has contributed to inflation last 4 quarters (Figure II.1.1.2).

Looking at the annual inflation by food and non-food items, the most of annual inflation is explained by the change in prices of non-food products. Most of domestic goods and services constitute winter clothing, solid fuel and administrated services. In the previous years, price of domestic goods had decreased in the first 8 months of the year and price of solid fuel had increased between September to November. But this year, price of domestic goods has not decreased and price of solid fuel increased early, by 6.2% in August. As a result, the effect of price of domestic goods on annual inflation was high. Also, in the second quarter, the price of imported goods has risen due to changes in the price of hybrid cars, its wheels and fuel prices. Food prices have started to have a positive effect on annual inflation since December 2016. From January to July, the main component of food inflation was the price changes of imported food. In August, domestic food inflation increased, dealing with changes in the price of vegetables and flour (Figure II.1.1.3).

Figure II.1.1.1

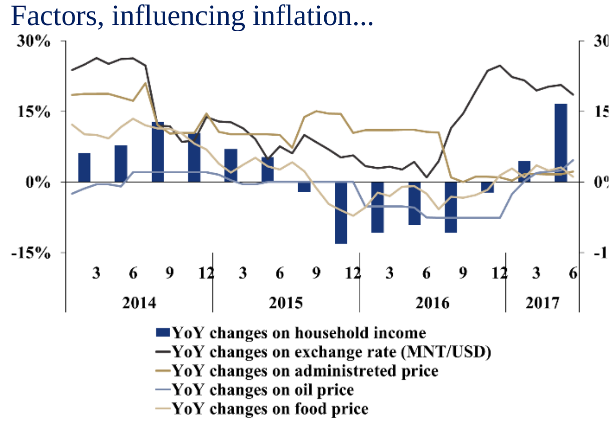
Annual and core inflation in UB increased last two quarters…



Source: NSO

Figure II.1.1.2

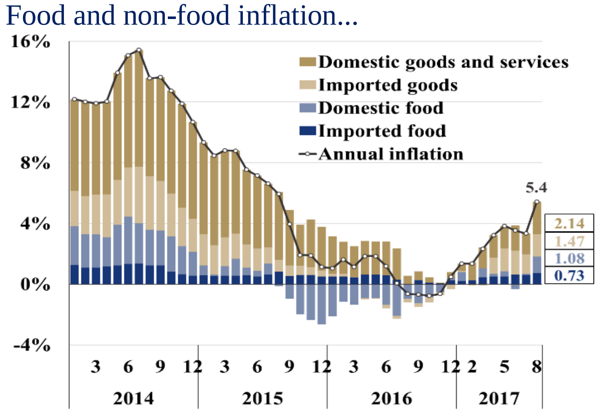
Factors, influencing inflation...



Source: NSO, BoM

Figure II.1.1.3

Food and non-food inflation...



Source: NSO, BoM

II.1.2 Inflation, its contribution

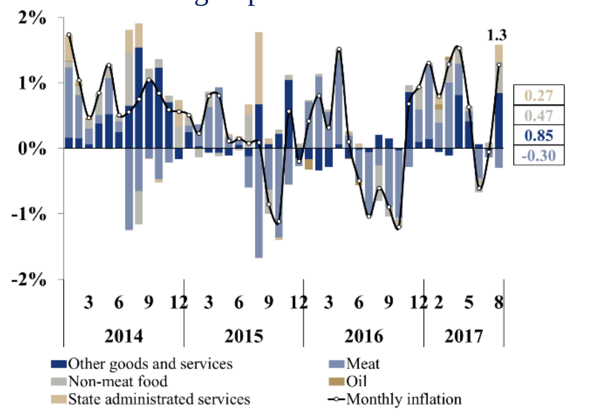
Consumer price index in Ulaanbaatar increased by 6.0 percent from the beginning of the year. Prices have steadily increased from November last year to May 2017, but decreased in June and July, as seasonal effect. During the second quarter, administrated services and oil price have not changed, and prices of other goods and services, including hybrid car, its wheels and imported clothing, have increased in April and May. In August, supply of vegetables and flour decreased, and prices increased rapidly. Moreover, payments for private primary schools, kindergartens, electricity and price of solid fuel have been increased (Fig. II.1.2.1).

The core inflation[4] in Ulaanbaatar has been climbing from beginning of 2017, reaching 5.1 percent in August 2017, the highest since November 2015. For most of the last two years, core inflation had surpassed overall inflation. In the first quarter of 2017, meat price has risen significantly, and gap between core and general inflation have diminished. Annually changes on meat prices became negative in the second quarter of 2017 so that core inflation started to exceed overall inflation. The 20% increase in vegetable prices caused general inflation to exceed basic inflation in August (Figure II.1.2.2).

Annual changes in the price of consumer goods and services in UB reached 5.4 percent in the August 2017. NSO revised the CPI basket in April 2017 and adjusted weight and methodology. New CPI basket picked up 44 new products having more price fluctuation compared to former CPI basket and pushed up inflation by about 0.35 percentage points. At the same time, the government has changed some types of taxes in April. Reducing exemption of the excise tax for electric motor, both motorized and liquefied gases cars by 50 percent raised price of "Prius 20" hybrid car by 22.4 percent totally from March to May, which increased inflation by 0.9 percentage points (Figure II.1.2.3).

Figure II.1.2.1

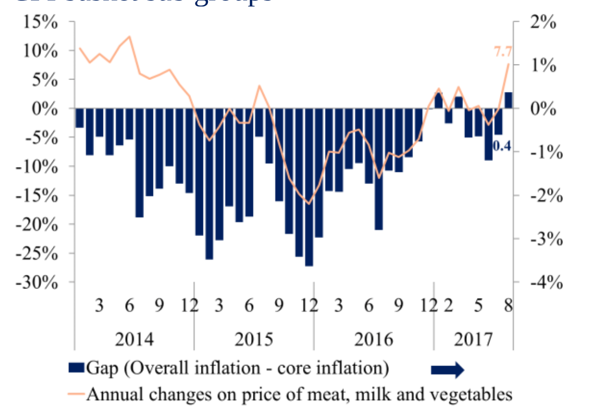
Components of annual inflation in UB, based on CPI basket sub groups



Source: NSO, BoM

Figure II.1.2.2

Components of annual inflation in UB, based on CPI basket sub groups



Source: NSO, BoM

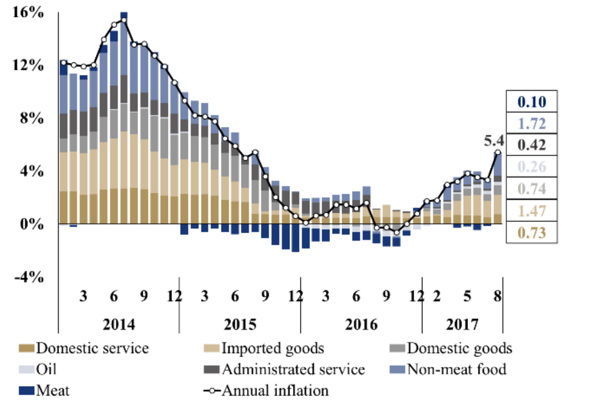
[4] Measuring core inflation by deducting year-on-year changes of 37 types of products' price, including meat, milk and vegetables, from CPI based overall inflation.

As seen in the component, the contribution of meat, meat related products (0.55 pp), non-meat food price (0.95 pp), price of oil (0.01 pp), state-administrated price (0.21 pp), domestic goods (0.17 pp) and domestic service (0.11 pp) increased from end of second quarter; but contribution of price of imported goods (-0.10 pp) decreased (Figure II.1.2.3).

In the first quarter of 2017, meat prices jumped by 38.2 percent from the beginning of the year, higher compared to the previous years' average. In the second quarter, the price of meat increased slowly, with the average annual growth rate of -4.5%, which led to the slowdown in food inflation. For instance, mutton price fell by 10.3% and horse meat by 10.4% in June. Starting from August 2017, meat price surpassed price level of that time last year. In other words, meat price fluctuation that remained over the last two years, is lowering in 2017. In case, price fluctuations remain low until the end of the year, meat prices is likely to have a positive impact on annual inflation (Figure II.1.2.4).

Figure II.1.2.3

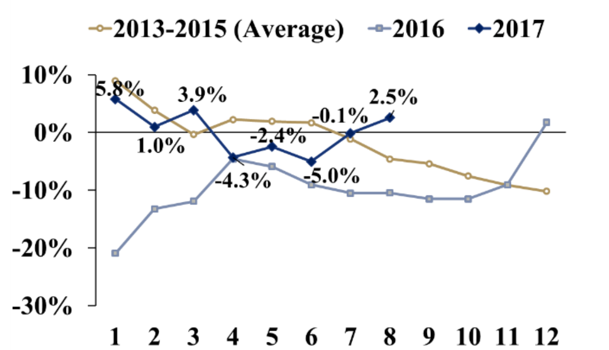
Components of annual inflation in UB, by major groups



Source: NSO, BoM

Figure II.1.2.4

Annual changes on meat price...



Source: NSO, BoM

II.2 Domestic economy

II.2.1 Current developments in the real sector

Economic growth continued to remain relatively strong at 6.1 percent y-o-y in 2017Q2; with the growth reaching 5.3 percent y-o-y as of 2017H1.

Total demand: From the demand side, household consumption and investment contributed positively to economic growth in the reporting quarter; while net exports and government consumption had negative contributions (Figure II.2.1.1).

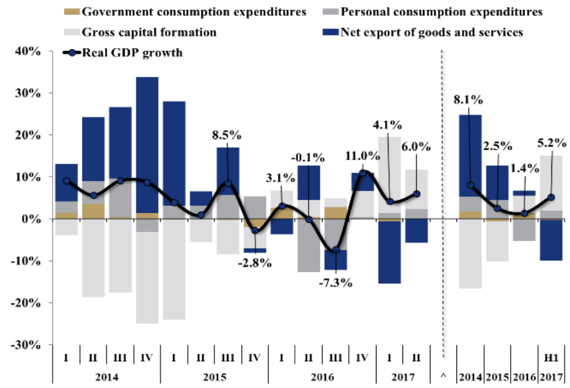
Domestic absorption[5] growth has picked up throughout the past 3 quarters, following a decline for 8 consecutive quarters. Investment or gross capital formation has been contributing positively to domestic absorption throughout the past 4 quarters; while household consumption had negative contributions (Figure II.2.1.2)[6].

Total supply: Net taxes on products and trade sector made the largest contributions to economic growth from the supply side in the reporting quarter. In addition to that, manufacturing, agriculture, transportation and other services' sectors contributed positively; while mining and construction sectors contributed negatively to economic growth.

Non-mining growth which had been slowing down in the recent years has revived in the past 3 quarters and reached 9.2 percent in the reporting quarter. On the other hand, mining growth which contributed significantly to economic growth in the recent years began to decline since 2016H2 and contracted by 6.1 percent in the reporting quarter (Figure II.2.1.3).

Figure II.2.1.1

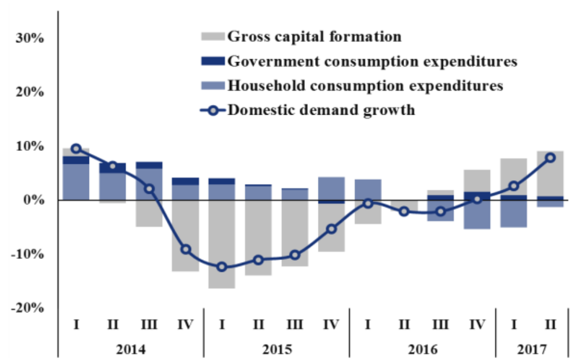
Investment has been mainly contributing to economic growth in the recent quarters.



Source: NSO

Figure II.2.1.2

Domestic absorption growth has been picking up throughout the past 3 quarters.



Source: NSO

[5] Refers to the total final demand of domestic agents namely, household, government and gross capital formation

[6] Calculated by the sum of the reporting quarter and the previous 3 quarters for each indicators

Labour market: Signs of recovery are being observed for the majority of labour market indicators. Specifically, labour force participation rate increased by 1.3 percentage point y-o-y in the reporting quarter, mainly due to the growth in economically active population of 8.4 percent, exceeding the growth in economically inactive population of 2.5 percent.

Employment grew by 9.4 percent y-o-y in the reporting quarter, with growth in majority of economic sectors except for health, science and water supply. Such growth in the number of employed, coupled with the number of unemployed remaining at the same level as previous year led to the decline in unemployment rate of around 0.8 percentage point y-o-y in the reporting quarter (Table II.2.1.1).

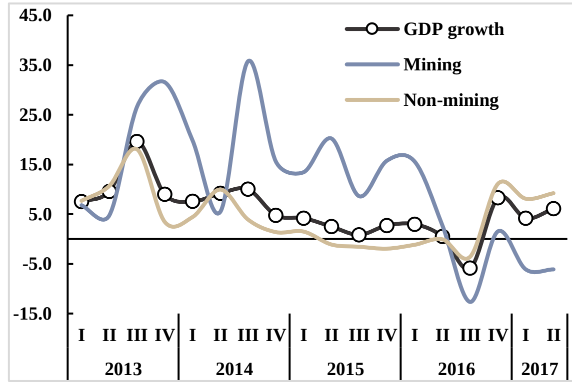
For the reporting quarter, employment growth exceeded economic growth causing/triggering total labour productivity[7] to decrease by 5.9 percent y-o-y and non-agriculture labour productivity to decline by 4.8 percent y-o-y. On the other hand/On the contrary, unit labour cost[8] increased by 12.2 percent y-o-y and non-agriculture unit labour cost rose by 9.7 percent y-o-y in the reporting quarter as a result of increased nominal wage and reduced labour productivity.

II.2.2 Household demand

Household income, wage: Real household income which had been declining throughout the previous 2 years has been growing during the past 2 consecutive quarters and subsequently, supported household expenditure growth. Moreover, increased labour force participation rate and employment is affecting household income growth positively. By looking at the components of household income, not only wages and salaries, pensions, allowances and compensation have increased, but also the contraction[9] in consumption from own businesses that had been observed since 2015 has recovered during the past 2 quarters (Figure II.2.2.1).

Figure II.2.1.3

Non-mining growth has been reviving throughout the past 3 quarters.



Source: NSO

Table II.2.1.1

Signs of recovery are being observed for the majority of labour market indicators.

	2015	2016	2016 Q2	2017 Q1	2017 Q2
Employment (thous. people)	1067.6	1132.8	1131.8	1147.0	1237.7
annual growth	*2.6%*	*6.1%*	*-1.2%*	*5.3%*	*9.4%*
Agriculture	335	352	314	319	357
Industry	207	209	233	209	251
Trade	154	173	171	205	199
Services	371	399	414	414	431
Unemployment (thous. people)	96.5	107.0	131.9	115	132
annual growth	*10.9%*	*10.9%*	*35.5%*	*-19.7%*	*-0.1%*
Labour force participation rate, %	60.5	60.4	60.2	59.5	61.6
annual growth	*0.2*	*-0.1*	*-2.6*	*-0.5*	*1.3*
Unemployment rate, %	8.3	8.6	10.4	9.1	9.6
annual growth	*0.6*	*0.3*	*2.6*	*-2.5*	*-0.8*

Source: NSO, Employment survey

[7] Calculated by dividing the sum of real GDP for the reporting quarter and the previous 3 quarters to the number of total employed

[8] Refers to the average labour cost required to produce a unit of good
(Unit labour cost = Employment*Nominal wage/Real GDP for the reporting quarter = Nominal wage/Labour productivity, in real terms)

[9] Compared with the previous year

Nominal average wage nationwide reached 966.6 million togrog in the reporting quarter – an increase of 8.9 percent y-o-y; while real average wage grew by 5.1 percent y-o-y (Figure II.2.2.3). Nominal average wage for majority of economic sectors grew in y-o-y terms. By looking at employment by their status, the number of paid employees did not change considerably in y-o-y terms, while the number of self-employed people increased by 49.1 percent.

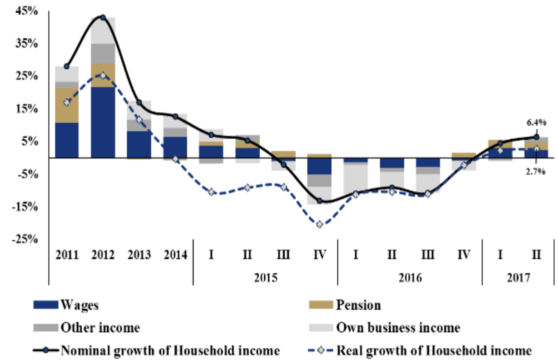
Household expenditure, consumption: Household consumption which contracted by 9.0 percent in previous year, grew by 4.3 percent y-o-y and contributed around 2.3 percentage point to economic growth in the reporting quarter, mostly owing to increased expenditure for leisure activities and medicine and hospital equipment.

In accordance with the growth in household income, real household expenditure increased by 2.4 percent y-o-y in the reporting quarter, facilitating growth in household consumption. By looking at the components of household expenditure, food, non-food as well as other expenditures grew by 3.5, 5.9 and 6.4 percent y-o-y in nominal terms, respectively (Figure II.2.2.2).

Though household income and expenditure have been growing in the recent quarters, real estate activities currently remain subdued due to the limited capability of households purchasing new housing. During the previous years, the boost in construction sector growth has been mainly supported by public investments financed by government along with theDevelopment bank of Mongolia and housing programs as well. However during the past 3 years, construction sector has been contracting due to reduction in the amount of such financing and high base effect (Figure II.2.4.2). Construction sector declined by 16.8 percent y-o-y and contributed around 0.7 negatively to economic growth, mainly due to reduced building works for residential, trade and services purposes, while autoroad construction for general engineering purposes exhibited increase in the reporting quarter. Number of employed in the construction sector grew by 1.7 percent y-o-y, while nominal average wage for the construction sector increased by 9.4 percent y-o-y (Figure II.2.2.4).

Figure II.2.2.1

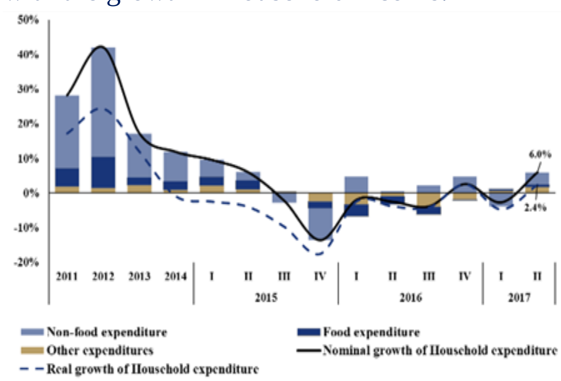
Real household income has been growing during the past 2 consecutive quarters.



Source: NSO

Figure II.2.2.2

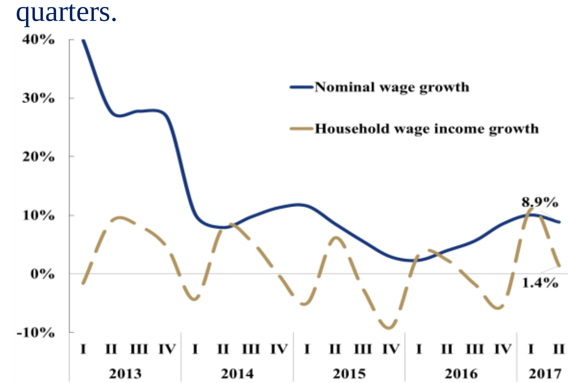
Household expenditure has increased in line with the growth in household income.



Source: NSO

Figure II.2.2.3

Nominal wage has been growing by approximately 10 percent during the recent quarters.



Source: NSO, analysts' estimations

By looking at labour market indicators in the agriculture sector which takes up around 10 percent[10] of average household income and 29 percent of total employment, number of employed grew by 13.8 percent y-o-y, out of which livestock herders grew by 11.4 percent y-o-y, while nominal average wage increased by 5.9 percent y-o-y. On the other hand, labour productivity for the agriculture sector dropped by 7.0 percent y-o-y, while its corresponding unit labour cost increased by 15.7 percent y-o-y. By looking at agriculture production, it grew consistently by around 4.2 percent y-o-y for the recent 2 quarters, contributing around 1.0 percentage point to economic growth. As of 2017H1, approximately 21.9 million new-born have been added to the livestock – an increase of 2.9 million heads y-o-y, and 0.6 million livestock losses due to natural causes have been registered – a two-fold decline y-o-y. Due to unfavorable weather conditions persisting during the summer months in most of the cultivated regions, the preliminary amount of crop production has been reduced to 259.2 thousand tons of wheat (-44.5 percent y-o-y), 102.3 thousand tons of potatoes (-38.1 percent y-o-y) and 75.7 thousand tons of vegetables (-19.8 percent y-o-y).

II.2.3 Government consumption

In accordance with the government policy aiming to ensure medium-term debt sustainability as well as economic growth sustainability by reducing fiscal deficits; current expenditures, specifically expenditures for goods and services are being cut. For instance, government consumption declined by 0.1 percent y-o-y and contributed to drag down the economic growth marginally (Figure II.2.3.1). For more detailed information on consolidated budget and public debt, refer to section II.3.

II.2.4 Investment

Driven by substantial pick-up in investments to the mining sector, total amount of investment rose by 32.4 percent y-o-y and contributed around 9.5 percentage points to economic growth in the reporting quarter. More specifically, gross fixed capital formation grew by 21.6 percent y-o-y owing to growth in maintenance works and machineries and equipment, while inventories increased by 58.9 percent y-o-y mainly to due to accumulation of spare parts, contributing to economic growth of around 4.5-5.0 percentage points, respectively (Figure II.2.4.1).

[10] Income from livestock production

Table II.2.2.1

Growth of sectors highly (dependent on)/related to mining has been picking up in the recent quarters.

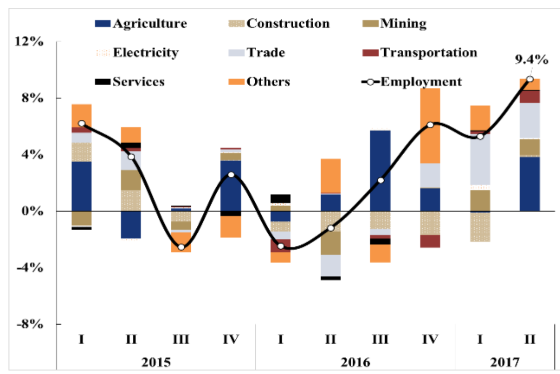
Sectors*	2016 YoY %	2017Q1 YoY %	2017Q2 YoY %	2017Q2 QoQ %**
GDP growth	**1.2**	**4.2**	**6.1**	**4.6**
Net taxes	0.5	18.4	24.0	-1.5
Trade	-2.3	23.9	14.7	-10.9
Manufacturing	-1.3	24.4	22.9	18.2
Agriculture	6.2	4.2	4.2	8.7
Transportation	11.4	8.1	18.8	45.9
Other services	1.1	0.2	4.1	16.2
Information	-1.7	1.2	9.7	32.6
Electricity	1.5	2.2	6.3	12.5
Construction	-6.3	-39.8	-16.8	15.1
Mining	0.2	-6.1	-6.1	-15.6

**ordered by contributions to economic growth in 2017Q2*
***seasonally adjusted*

Source: NSO

Figure II.2.2.4

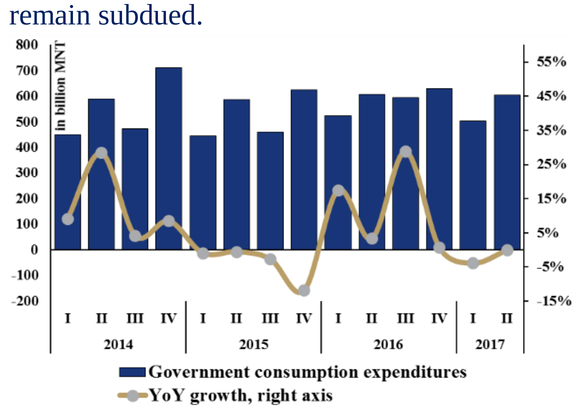
Employment has increased in most of economic sectors.



Source: NSO

Figure II.2.3.1

Government expenditure growth is expected to remain subdued.



Source: NSO

Furthermore, the ongoing development in the mining sector which had considerable impact on the sales of heavy machineries and equipment, coupled with increased sales of automobiles and fuel drove trade sector growth to 14.7 percent and contributed to economic growth of around 1.5 percentage points in the reporting quarter. Trade sector which had been declining since the end of 2014 owing to contraction in economic activities as well as household income, has been reviving in the recent quarters (Figure II.2.4.3). Recovery is being observed in labour market indicators for trade sector as well, with number of employed growing by 16.4 percent y-o-y and nominal average wage increasing by 9.9 percent y-o-y in the reporting quarter.

Manufacturing sector which had been slowing down since the latter half of 2015, has picked up in the recent 2-3 quarters, with its growth reaching 22.9 percent y-o-y and contributing around 1.1 percentage point to economic growth in the reporting quarter. Increased production of non-mining manufacturing goods such as, drinks, knitted goods and cement explain around 2/3 of this growth (Figure II.2.4.2). By looking at labour markets indicators in the manufacturing sector, employment grew by 8.1 percent y-o-y and nominal average wage increased by 32.3 percent y-o-y in the reporting quarter.

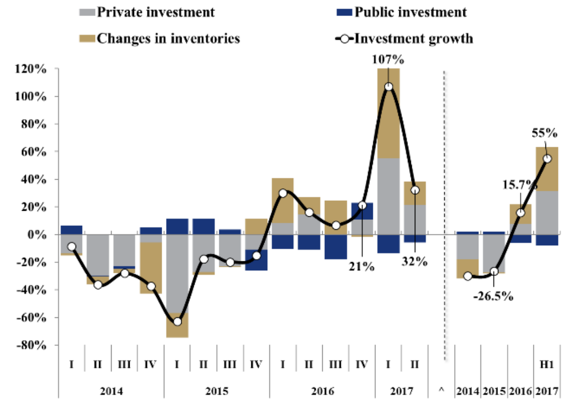
II.2.5 Foreign trade

With imports growing at a faster rate than exports, the decline in foreign trade surplus in y-o-y terms contributed to around 5.8 percentage points negatively to economic growth in the reporting quarter (Figure II.2.5.1).

Exports: Total exports ofgoods and services' grew by around 40.5 percent y-o-y in the reporting quarter. Due to the surge in commodity prices on the international markets, the amount of coal and iron ore exports has been increasing considerably since the latter half of 2016 and thus, supporting the growth in total exports. Specifically, the volume of coal exports rose by 70.3 percent or by 4.5 million tons y-o-y and reached 10.9 million tons in the reporting quarter. Moreover, increase in services' exports contributed positively to the total exports' growth. On the other hand, the decline of 30.7 percent y-o-y in non-monetary gold exports and 14.5 percent y-o-y in copper concentrates' exports, mainly owing to its lower metal content contributed negatively to the growth in total exports (Figure II.2.5.2).

Figure II.2.4.1

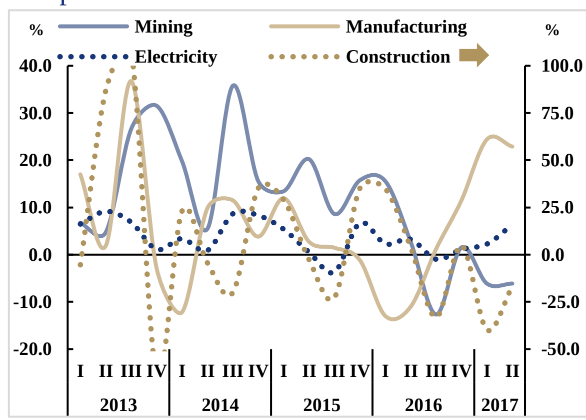
Gross capital formation has been substantially increasing due to investment in the mining sector.



Source: NSO

Figure II.2.4.2

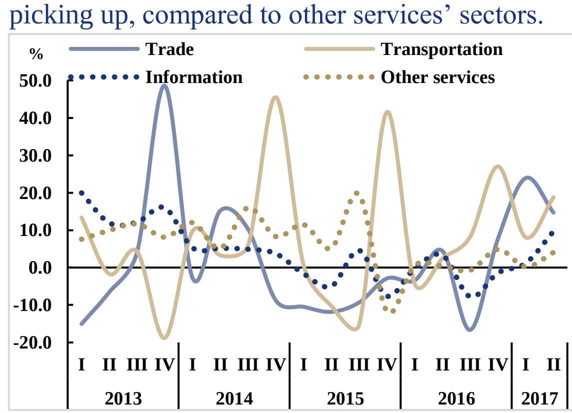
Manufacting sector growth has been strong, compared to other industrial sectors.



Source: NSO

Figure II.2.4.3

Trade and transportation sector growth have been picking up, compared to other services' sectors.



Source: NSO

In accordance with the surge in export prices on the international markets, mining sector production has picked up throughout the recent 3-4 quarters and has had spillover effects on non-mining sectors. However, mining sector growth slowing down and turning negative since the latter half of 2016, contracting by 6.1 percent y-o-y and contributing around -1.2 percentage point to economic growth in the reporting quarter is mostly explained by reduced production of copper concentrates and its metal content. In other words, mining sector production excluding copper concentrates and its metal content that has had negative contributions to the mining sector growth for the past 5 quarters, grew by approximately 6 percent y-o-y in the reporting quarter (Figure II.2.5.3). Labour market indicators in the mining sector have picked up as well, with employment growing by 34.2 percent y-o-y and nominal average wage increasing by 9.3 percent y-o-y in the reporting quarter.

Furthermore, increased coking coal exports have been contributing positively to manufacturing sector growth, explaining around 1/3 of 22.9 percent y-o-y growth in the reporting quarter.

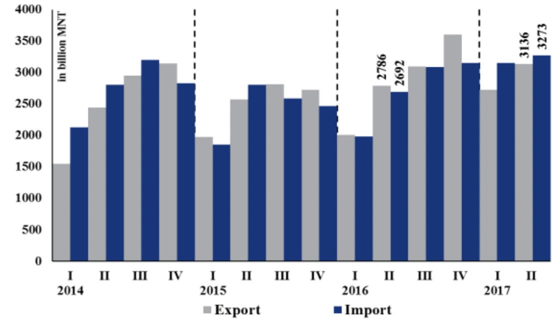
Alongside the pick-up in mining sector production, transportation sector has exhibited relatively high growth in the recent quarters as well, with its growth reaching 18.8 percent y-o-y and contributing around 0.9 percentage point to economic growth in the reporting quarter. The majority of this growth is explained by 60.6 percent y-o-y surge in autoroad freight turnover and 5.5 percent y-o-y increase in railroad exports freight turnover (Figure II.2.4.3). By looking at labour market conditions for the transportation sector, number of employed and nominal average wage grew by 14.6 and 5.4 percent y-o-y, respectively in the reporting quarter.

Imports: Total goods and services imports have been rising significantly since the beginning of 2017 and grew by 9.9 percent y-o-y in the reporting quarter. Most of growth in total imports is explained by increased imports of machineries, equipment and fuel due to the mega development ongoing in the mining sector and expectations of higher excise taxes. Besides these factors, imports of non-durable consumer goods and construction materials have exhibited growth as well.

In line with increased domestic production and tax base, coupled with rising imports, especially imports of machineries and equipment; net taxes on products which had been contracting since

Figure II.2.5.1

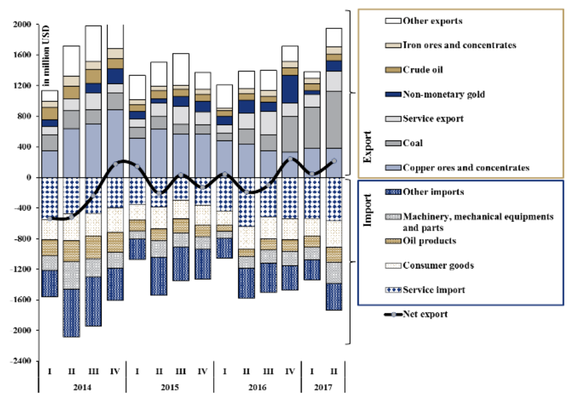
Though foreign trade is in surplus, imports have been growing at a faster rate than exports.



Source: Bank of Mongolia

Figure II.2.5.2

Exports growth has been mainly driven by coal exports, while imports of machinery, equipment and fuel has been mostly driving imports growth.



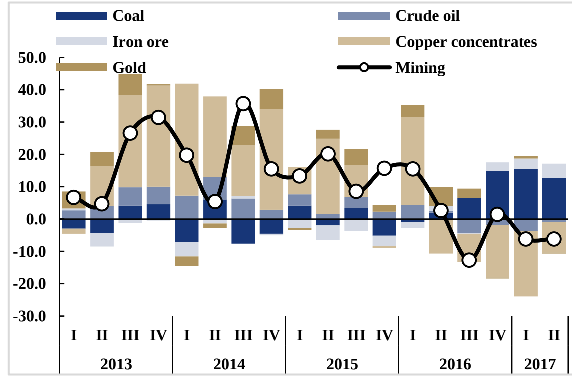
Source: Bank of Mongolia

the end of 2013 has picked up considerably in the recent 3 quarters, growing by around 24.0 percent y-o-y and contributing around 2.5 percentage point to economic growth in the reporting quarter. More specifically, the growth in net taxes on products mainly comes from VAT on domestic and imports goods and customs duties.

Furthermore, increased imports have had positive contributions to railroad imports freight turnover as well, with its growth reaching 37.1 percent y-o-y in the reporting quarter and further contributing to transportation sector growth.

Figure II.2.5.3

Coal and iron ore have been contributing positively to mining growth, while copper concentrates have had negative contributions.



Source: NSO, analysts' estimations

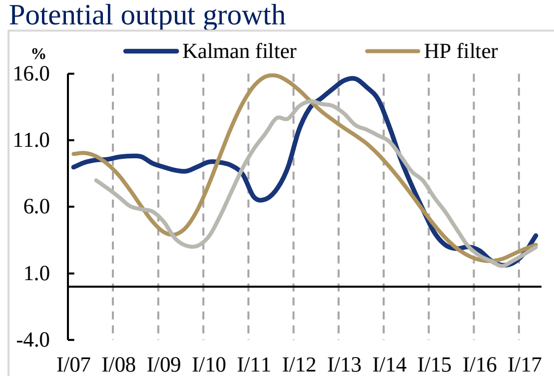
II.2.6 Potential output, output gap

Potential output[11] growth rate exceeded 10 percent during 2011-2013. However, since 2014 it has been on a rapidly declining trend due to decelerating foreign direct investments, reaching around 2-4 percent in recent quarters (Figure II.2.6.1).

Owing to recovery in the non-mining sector, total output exceeded its potential level during 2011-2013, thus output gap[12] was positive. Although it turned negative during 2014-2016 due to contraction of the non-mining sector, output gap in recent quarters has turned positive. Such positive gap was mainly driven by growth of trade and construction sectors and net tax on products, which were led by positive externalities of construction activities in the mining sector. Although mining output exceeded its potential starting late 2014, it turned negative in recent quarters as mining production fell below its potential level due to lower concentration of copper since mid-2016. (Figure II.2.6.2)

Figure II.2.6.1

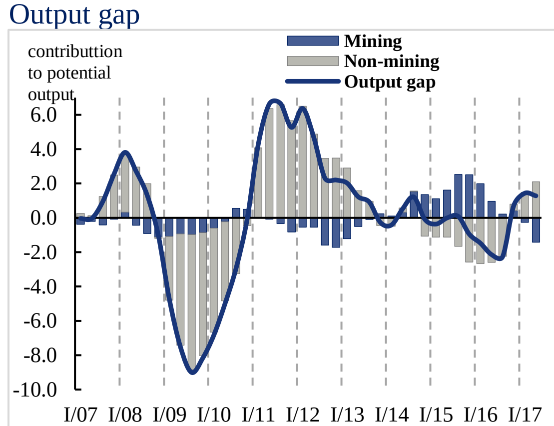
Potential output growth



Source: The BoM

Figure II.2.6.2

Output gap



Source: The BoM

[11] Was computed using the following methods: 1) Statistical method of HP filter, 2) Production function with factors of production and 3) Multi-variable Kalman filter based on macroeconomic indicators and their correlations.

[12] Was computed using Kalman Filter method.

II.3 Budget and government debt

Budget: As of 2017H1, actual equilibrated revenue overperformed by 4.7% and actual expenditure underperformed by 18.9% compared to the approved budget. Consequently, the budget deficit was MNT 677 billion and the primary balance deficit was MNT 153 billion. (Figure II.3.1).

Equilibrated revenue: The most components of revenue receipts/collection have performed more than 100%, except for grant revenue collection amounting 16% or MNT 78 billions down.), excise taxes collection on gasoline and diesel fuel reaching 44.1% (MNT 51.4 billions down) in the first half of 2017. Compared to the same period of the last year, equilibrated revenue scaled up by MNT 735.2 billions which include MNT 210.8 billions increase on ncome tax and MNT 235.5 billions increase on import-related taxes due to upbuilding in mining sector and exchange rate depreciation. (Figure II.3.2)

Total expenditure and net lending: Total spending performance was 81.1% in the reporting period. Interest payment on government debt expanded by 41.8%, subsidy increased by 27%, transfer increased by 4.3%, domestic net lending increased 4.4 times (MNT 65.4 billions) and capital expenditure decreased by 2.1% in the first half of 2017.

Budget deficit (including the Development Bank of Mongolia) stood aopproximately at MNT 2,000.0 billion on average during 2012-2015, while it increased/rose to MNT 4.1 trillion or 15.3% of GDP in 2016. Substantial amount of external and domestic debts were utilized to finance this deficit bringing sizeable pressure on the fiscal with interest payments for these loans and previously issued bonds. For instance, interest payment for 2017 is expected to reach MNT 1.2[13] trillion and 17.6% of budget revenue is projected to be spent on it (Figure II.3.3).

In recent years, high fiscal deficit has been financed by debts causing the high burden on fiscal financing to remain. Total fiscal financing needs were MNT 4.5 trillion in 2016, while it is projected to reach MNT 10.8 trillion in 2017 based on supplementary budget.

Figure II.3.1

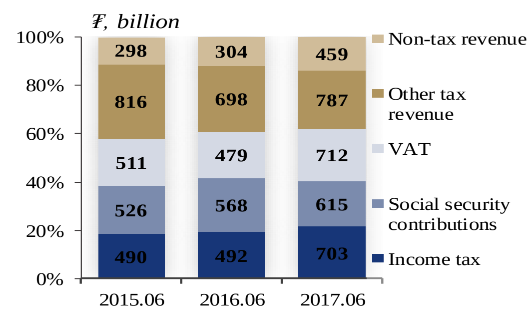
Fiscal indicators

₮, billion	2016 Perfor.	2017 Supp.bud.1	2017.06 Perfor.	Performance, %
Total revenue and grants	5852	6511	3587	104.3
Future heritage fund	-	267	197	105.1
Stabilization fund	-	209	113	94.7
Equilibrated revenue	5852	6036	3276	104.7
Tax revenue	4997	5050	2817	110.5
Import related revenue	1449	1559	782	104.5
Mineral related revenue	325	185	124	100.1
Other	3223	3306	1911	113.9
Non-tax revenue	855	986	459	79.0
Total expenditure and net lending	9520	8750	3953	81.1
Primary expenditure	8532	7539	3430	79.9
Interest payment	988	1211	523	89.8
Budget balance	-3668	-2714	-677	
percentage of GDP	-15.3	-10.4	-2.6	
Primary balance	-2680	-1503	-153	
percentage of GDP	-11.2	-5.8	-0.6	

Source: MoF

Figure II.3.2

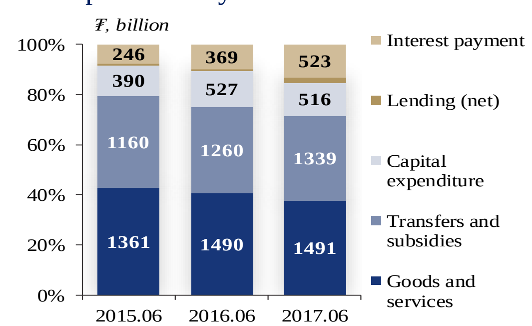
Equilibrated revenue by contributions



Source: MoF

Figure II.3.3

Total expenditure by contributions



Source: MoF

[13] It is 22.6 percent or MNT 223 billion y-o-y increase

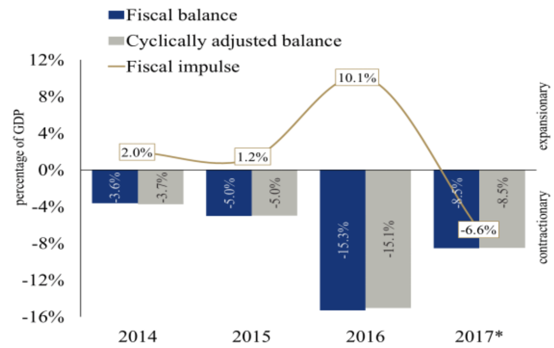
Fiscal stance and impulse: GDP growth and budget revenue collection depend mainly on commodit price fluctuations. Therefore, we adjusted budget balance using gdp gap to calculate fiscal stance .

Cyclical effects on budget deficit was -0.2 percentage point in 2016 and expected to vanish in this year due to decline in GDP gap. If we assume that budget revenue and expenditure follow its historical path, fiscal impulse will be -6.6 percentage point at end of 2017. This is indicating contractionary fiscal policy. (Figure II.3.4).

Nominal GDP growth increased by around 9% and budget equilibrated revenue increased by 23% compared to Q2 of the last year. Therefore, fiscal stance was -6.5 percent improved by 1.2 percentage point compared to the same period of the last year. (Figure II.3.5).

Figure II.3.4

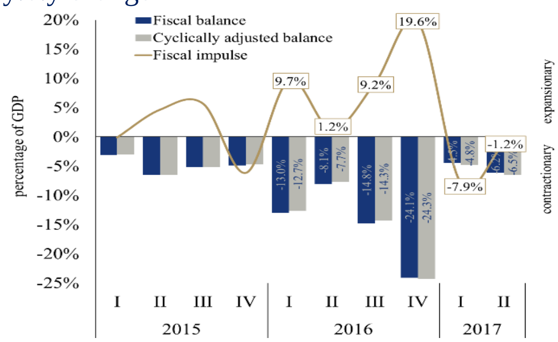
Cyclically adjusted balance and fiscal impulse, y.o.y change



Source: BoM

Figure II.3.5

Cyclically adjusted balance and fiscal impulse, y.o.y change



Source: BoM

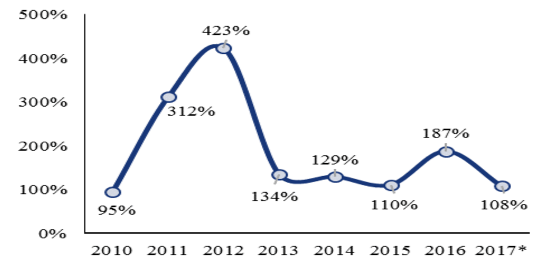
Debt repayment and debt roll-over ratio[14]:

In recent years, debt roll-over ratio has been exceeding 100 percent. The ratio was high in 2009 and 2012, due to the IMF Stand-By Arrangement program (co-implemented by the Government of Mongolia, the Bank of Mongolia and the IMF) and issuance of Chinggis bonds. In 2017, MNT 9705.3 billion is to be paid for principal payments (loans, bonds and securities) and interest payments, while MNT 10476.8 billion is expected to be issued in loans and securities. Consequently, the ratio is expected to be 108%. (Figure II.3.6). In the first half of 2017, the Government issued the loans and bonds of MNT 3890.1 billion and paid principal payments for bonds and loans, and interest payment of MNT 4329.1 billion.

Total government debt at present value: The amendments to the Fiscal Stability Law dated September 9, 2016 show that debt to GDP ratio shall be under 88 percent in 2016, under 85 percent in 2017, under 80 percent in 2018 and under 75 percent in the 2019 fiscal year. To meet those medium term fiscal targets, the Government of Mongolia is implementing policies to reduce the fiscal deficit. According to the Supplementary budget (1) of 2017, government debt to GDP ratios for 2017-2019 are approved to reach the ceilings specified in the law (Figure II.3.7).

Figure II.3.6

Debt roll-over ratio



Source: BoM

Figure II.3.7

Total government debt at present value

	2015	2016	2017*	2018*	2019*
₮, billion	perfor.	perfor.	sup.bud.	plan	plan
Total government debt	12124	18964	22144	22155	23547
percentage of GDP	52.4	79.4	85.0	80.0	75.0
of which: denominated in foreign currency	28.6	44.1	-	-	-
Debt rule/GDP	58.3	88.0	85.0	80.0	75.0

Source: MoF

[14] Debt roll-over ratio = (new loans, bonds) / (repayment of loans, bonds + interest payment)

II.4 Money and financial market

II.4.1 Money and loan indicators

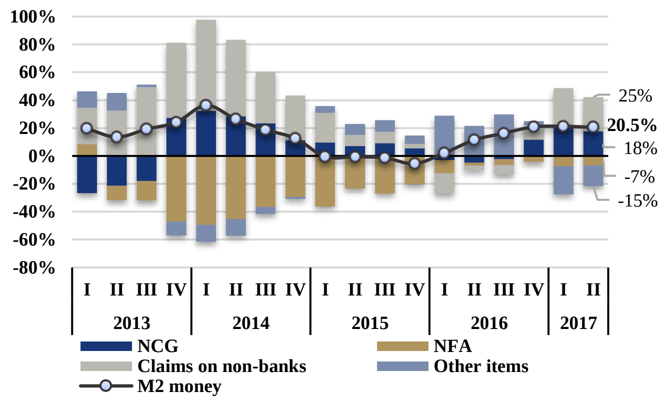
Growth of money and total loans outstanding accelerated in the second quarter of 2017, reaching 20.5 and 7.2 percent respectively. Fastest growing components were consumer loans and net credit to the government from the banking system.

Net domestic assets increased by 20.8 percent year-on-year in June, contributing the most to money supply growth. Due to huge fiscal deficit and weak investors' confidence, external funding shortened and domestic financing need for budget deficit increased dramatically in the second half of 2016. Hence, increased net credit to the government from the banking system explains a majority of money supply growth. In addition, acceleration of the discounted mortgage loan and consumer loan were among the main contributors of money supply growth.

From the liability side, growth of current account and deposits in domestic currency constituted significant portion of money supply growth. Outstanding levels of current account and deposits in domestic currency increased by 44 percent and 27 percent respectively, which was in total a 19.1 percentage point contribution to the money supply growth. Increased deposits and current accounts are mainly comprised of deposits of individuals and current accounts of corporates. Regarding the currency content of banks' liabilities, overall dollarization of liabilities has declined, mainly due to decreasing share of foreign exchange deposits and increasing share of domestic currency deposits. This implies a recovery of confidence in domestic currency.

Figure II.4.1.1

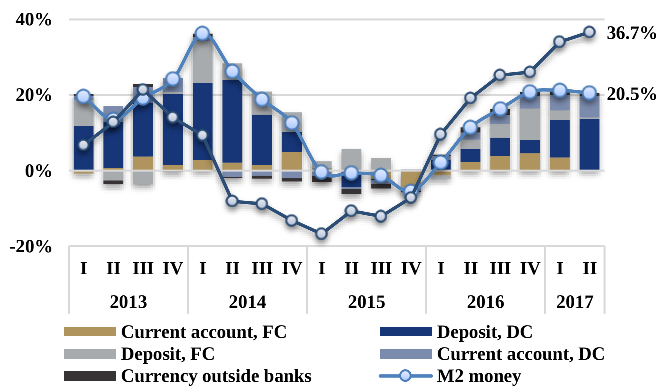
M2 money year-on-year growth by contributions, asset side



Source: The BoM

Figure II.4.1.2

M2 money year-on-year growth by contributions, liability side



Source: The BoM

Table II.4.1.3

Money supply: Asset and liability side

in billion MNT	2014	2015	2016	2017Q2
Net Foreign Assets	-2009	-4158	-4580	-4312
Net Domestic Assets	12643	14207	16723	17796
Broad money /M2/	10634	10049	12143	13484
M1 money	1816	1685	2125	2709
Currency outside banks	499	459	563	661
Current account, DC	1317	1227	1562	2048
Quasi-money	8818	8364	10018	10775
Deposit, DC	5410	5434	5791	7144
Deposit, FC	1969	1948	2790	2324
Current account, FC	1439	982	1438	1307

Source: The BoM

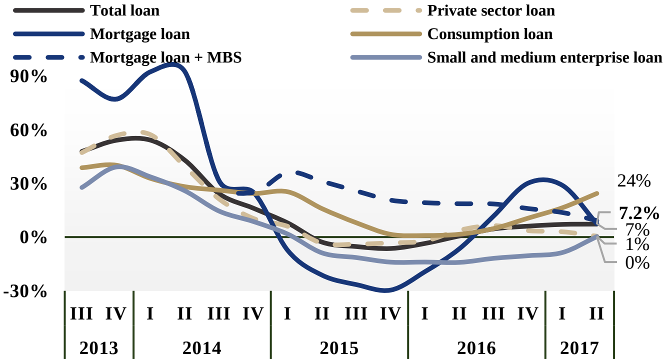
Outstanding loans by the depository corporations grew by 7.2 percent year-on-year. Increased lending is observed in all sectors except for the small and medium enterprises. Mortgage loan including the mortgage-backed securities increased by 9 percent. Growth of discounted mortgage loans contributed 2 percentage points to total loan growth. As for consumer loans, its growth accelerated to 24 percent in the second quarter and made the greatest contribution to total loan growth. Growth of pension and wage loans were the major drivers of consumer loans.

In the reporting quarter, comparison of loan growth by industrial sectors implies increased lending to the mining sector, which had been declining for the last 5 quarters. Though, its contribution to total loan growth is limited to 1 percentage point. Largest contribution to total lending was made in the real estate sector, mainly driven by increasing mortgage loans. While, lending to construction and trade sectors has shrunk.

Growth of new loan in the second quarter of 2017 reached 14.8 percent and it was mainly issued for consumption and mining sector. Growth of newly issued loans in the mining sector, which was mainly concentrated in the coal and gold sectors, is 7 times higher than same time last year and has contributed 8 percentage points to total newly issued loans. Growth of lending for consumption purposes explained 15 percentage point of total newly issued loans. Within the lending for consumption purposes, wage loan is 3.4 times greater than last year and other consumption lending excluding pension loan increased by 53 percent.

Figure II.4.1.4

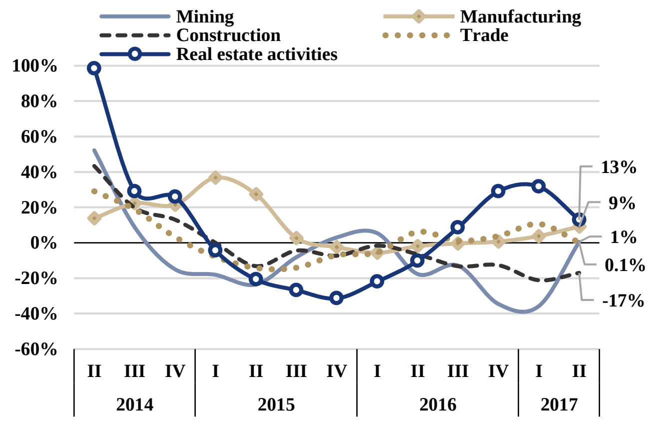
Growth of loans by the depository corporations, by sectors



Source: The BoM

Figure II.4.1.5

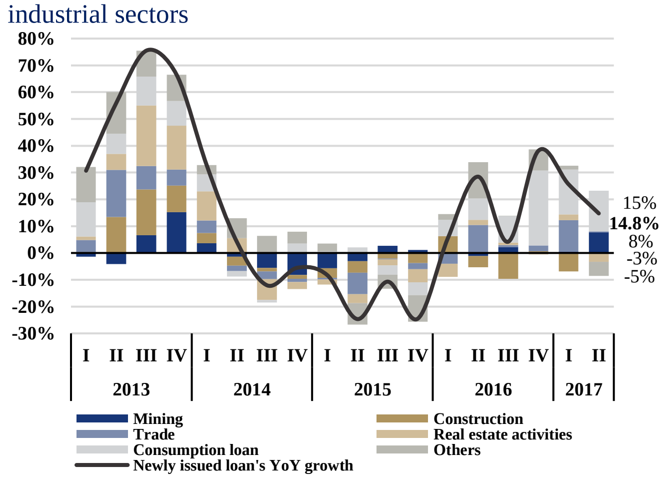
Growth of loans by the depository corporations, by industrial sectors



Source: The BoM

Figure II.4.1.6

Growth of newly issued loans in the banking system, by industrial sectors

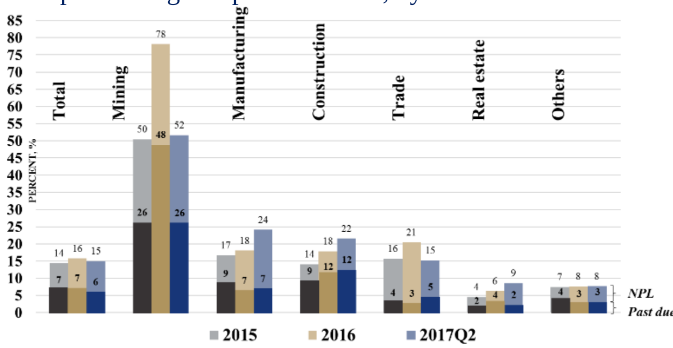


Source: The BoM

Compared to the end of 2016, share of the non-performing and past due loans to the total loan decreased by 1 percent, equivalent to 188 billion MNT. Majority of this decline is reported in the mining and trade sectors. In mining sector, non-performing loans and past due loans declined by 34 and 25 percent year-on-year respectively. As of second quarter, 36 percent of the total non-performing loan is reported in the mining and trade sectors, while 38 percent of the total past due loans was issued for the mining and construction sectors.

Figure II.4.1.7

Non-performing and past due loans, by industrial sectors



Source: The BoM

II.4.2 Interest rate

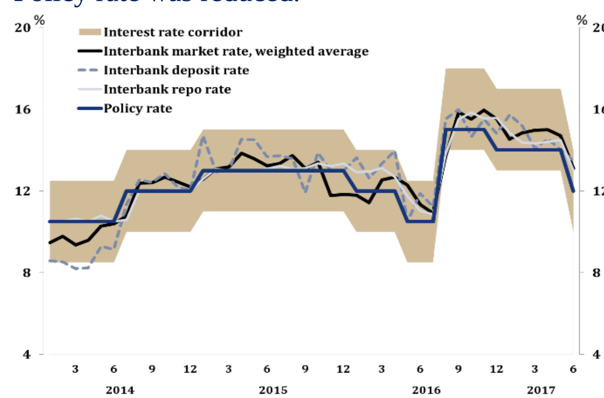
At its meeting in June 2017, the Monetary Policy Committee (MPC) of the Bank of Mongolia decided to reduce its policy rate by 2 percentage points to 12 percent. Monetary and fiscal policy actions taken in the second half of last year and the program jointly implemented with the IMF have reduced macroeconomic risks and uncertainties, and curbed pressure of short term foreign debt service, thus created room to reduce policy rate.

Following the policy rate cut, Treasury bill (T-bill) rate has been declining. For example, rate of three months T-bill issued in the primary market has declined by 5 percentage points quarter-on-quarter and reached 11.8 percent in June 2017. Similarly, rate of three months T-bill traded in the secondary market has declined by 1.82 percentage points quarter-on-quarter and reached 12.18 percent. In addition to policy rate reduction, recovery of investor sentiments and improved confidence in MNT among financial market participants were significant factors leading to lower government treasury bill rates.

In the second quarter of 2017, T-bill worth a total of 1.2 trillion MNT was traded through the Bank of Mongolia. Thus, outstanding level of T-bills reached 4.3 trillion MNT, which is a growth of 26 percent year-on-year.

Figure II.4.2.1

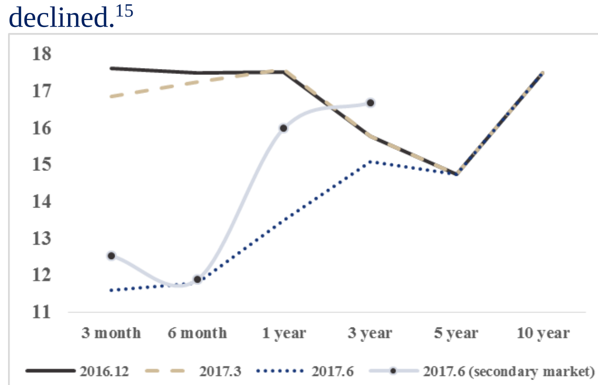
Policy rate was reduced.



Source: The BoM

Figure II.4.2.2

Short-term government treasury bill rate has declined.[15]

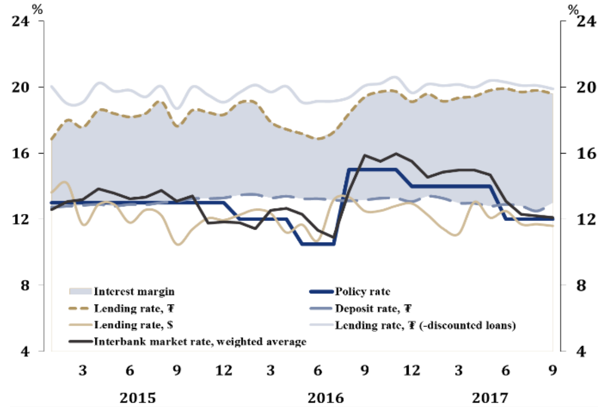


Source: The BoM

[15] Government treasury bills with maturities longer than 5 years were not issued on the primary market since 2014 and were never traded on the secondary market.

Figure II.4.2.3

interest rate margin is increased.



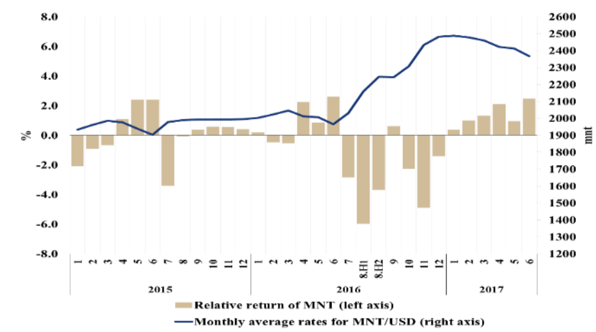
Source: The BoM

In the reporting quarter, bank interest rate on loans increased and deposit interest rate declined. In particular, interest rate on MNT loans[16] increased by 0.1 percentage points quarter-on-quarter reaching 20.3 percent, while interest rate on MNT deposits declined by 0.1 percentage points, reaching 12.9 percent. Due to higher lending rate and lower deposit rate, interest rate margin has increased to 7.4 percent.

The decision to implement the IMF program in May 2017 changed market expectations and resulted in nominal exchange rate appreciation. Consequently, relative return of MNT has remained positive since 2017. As of June 2017, relative return of MNT is at 2.4 percent, which is the highest rate since June 2016.

Figure II.4.2.4

Relative return of MNT has been positive since 2017.



Source: The BoM

II.4.3 Exchange rate

Exchange rate of MNT appreciated against US dollar starting mid-January till end of second quarter in 2017. For instance, exchange rate which stood at 2498.8[17] as of January 10, appreciated by 148.9 MNT or approximately 6 percent; reaching 2349.9 at the end of June. On average exchange rate of MNT to US dollar was at 2400.9 in the second quarter; which was an appreciation of 74.5 MNT or around 3.0 percent quarter-on-quarter and a depreciation of 406.7 MNT or 20.4 percent year-on-year /Figure II.4.3.1/.

Nominal effective exchange rate which had been depreciating throughout the past 4 consecutive quarters appreciated by 2.4 percent quarter-on-quarter[18]. Surplus of balance of payments in the reporting quarter as well as improvement in market expectations and sentiment were some of the factors leading to such appreciation. Specifically, exchange rate of MNT against US dollar, Chinese yuan, Japanese yen and Russian ruble appreciated approximately by 4.0, 2.4. 4.2 and 9.4 percent quarter-on-quarter[19] respectively.

Figure II.4.3.1

MNT to USD rate (2014.I-2017.II)

Source: The BoM

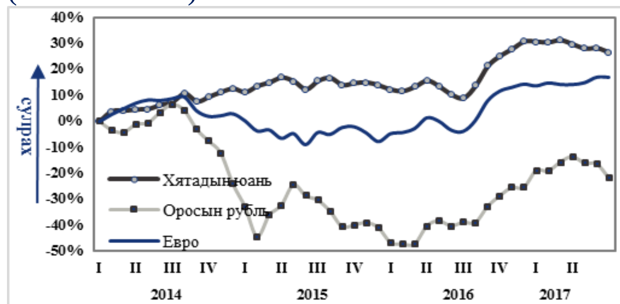
[16] Including discounted loans.
[17] Official exchange rate of MNT against US dollar
[18] Growth of quarterly average values
[19] As of the end of reporting period

Imports of goods and services[20] which had declined substantially throughout the past 3 years rebounded in the first half of 2017. Increased investment for megaprojects in the mining sector and acceleration of coal exports, increased demand for imports of investment goods and fuel. Canceling out such significant increases in imports, exports revenue was fueled by rising prices of major exporting commodities in the international market, thus resulted in a surplus of balance of payments in the second quarter. In addition, the authorities'commitment to the IMF program improved market expectations and further led to exchange rate appreciation.

Real effective exchange rate appreciated in the reporting quarter, mainly due to nominal exchange rate appreciation. In addition, average annual inflation reached 3.5 percent in the second quarter, thus rising domestic prices contributed to real appreciation. Although, real exchange rate appreciated by 3.0 percent quarter-on-quarter, it was still a depreciation of 16.6 percent year-on-year. Approximately 80 percent of quarter-on-quarter fluctuations and 90 percent of year-on-year changes in real exchange rate is driven by movements in nominal exchange rate.

Figure II.4.3.2

MNT rate fluctuation against main currencies (2014.I-2017.II)



Source: The BoM

Figure II.4.3.3

Changes of the REER (2013.I-2017.II)

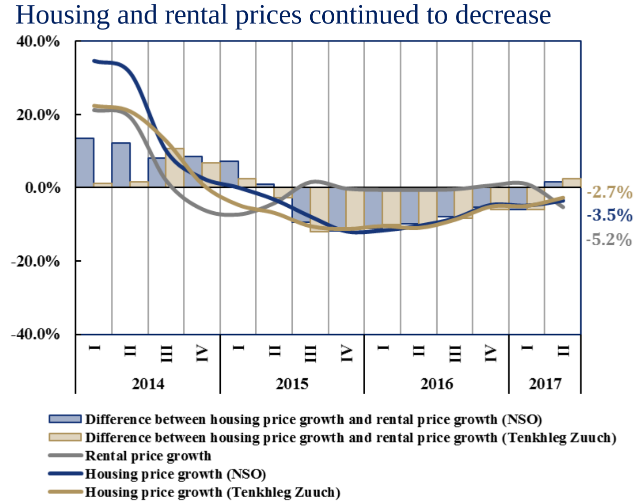
Source: The BoM

II.4.4 Real estate market

Housing and rental prices continued to decrease in the reporting quarter. The Housing price index estimated by the National Statistical Office in the second quarter of 2017 declined by 3.5 percent year-on-year and is 0.1 percent lower than the previous quarter. The housing price index estimated by "Tenkhleg Zuuch" company has also declined by 2.7 percent year-on-year in the same quarter. For instance, prices of old houses declined by 3.2 percent, while for new houses it is a 0.9 percent decline. Meanwhile, rental prices have been on a falling trend since the first quarter. Rental prices in the second quarter declined by 5.2 percent year-on-year, which is 6.2 percent lower than the previous quarter. (Figure II.4.4.1).

Figure II.4.4.1

Housing and rental prices continued to decrease



Source: NSO, Tenkhleg Zuuch

[20] Nominal imports expressed in c.i.f terms

Persistent low levels of housing price-to-income ratio and price-to-rent ratio suggest weak purchasing power of individuals and low demand for housing. In the reporting quarter, price-to-rent ratio slightly increased from the previous quarter as rental price declined more than housing price. In case of price-to-income ratio, growing household income lowered the ratio. Year-on-year household income expanded by 6.4 percent, which is a 5.2 percent growth from the previous quarter. (Figure II.4.4.2).

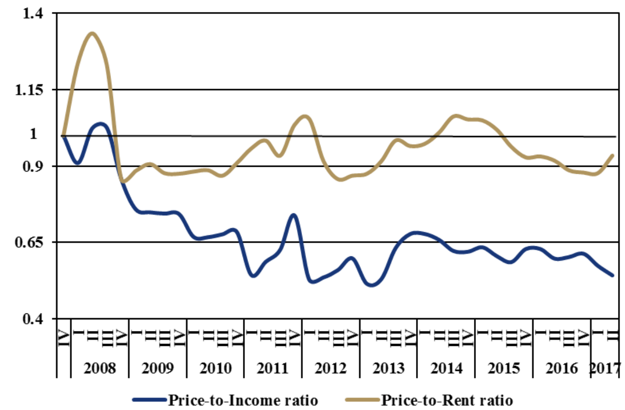
Price-to-rent ratio is an indicator of housing market yield and signals bubble in the housing market. Since the second quarter of 2015, it is the first time in which housing price reduction is lower than rental price reduction, thus leading to a slightly higher ratio.

Although price of housing is on a downward trend, according to the construction cost index, costs of construction materials have been increasing. As of second quarter of 2017, the construction cost index is 4.4 percent higher than a year ago, which is a 4.2 percent increase from the previous quarter (Figure II.4.4.3).

Housing purchases have been decreasing. According to the Property Rights Registration Agency (PRRA), 3626 new apartments were sold and issued certificates. It is 3.8 percent and 8.2 percent lower than last quarter and last year, respectively. In the second quarter, commercial banks issued new mortgage loans worth 197.3 billion MNT to 3139 individuals. Of the newly issued mortgage loans, 56.2 percent was financed under the Housing Mortgage Program, while 43.8 percent was financed by commercial banks' own capital.

Figure II.4.4.2

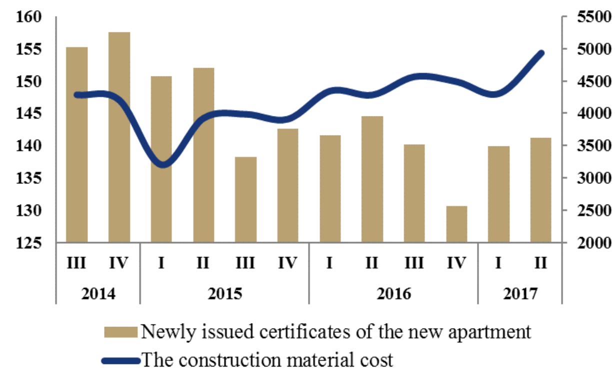
The housing purchasing power of individuals has been at low level



Source: NSO

Figure II.4.4.3

The construction material costs have been increased



Source: NSO, PRRA

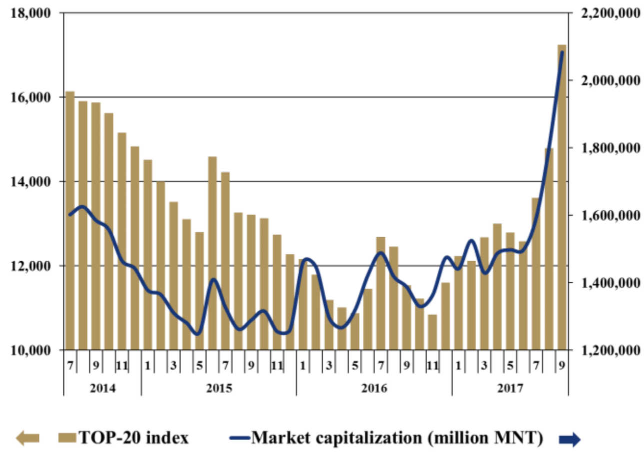
Stock market indicators have remained highly volatile in the last quarter but were on an upward trend, mainly due to increasing economic activity. For instance, the TOP-20 index reached 12790.5 unit in the second quarter, which was a growth of 15 percent year-on-year, and 3.6 percent quarter-on-quarter. Market capitalization reached 1.49 trillion MNT in the second quarter of 2017, which was an expansion of 11.8 percent year-on-year and 2 percent quarter-on-quarter. (Figure II.4.4.4).

In the reporting quarter shares worth a total of 76.2 billion MNT were traded. Out of which 63.6 percent was comprised of shares of Darkhan Selenge energy station, Tavan Tolgoi, APU, Gobi and Mongol. In addition, trades of these 5 company shares were the main factors behind the growth of TOP-20 index and market capitalization. Actively traded 20 stocks constituted 99.06 percent of the total number of shares traded and 93.37 percent of total traded value.

In the second quarter, government treasury bills worth a total of 1.2 trillion MNT were auctioned at the primary market managed by the Bank of Mongolia, with a weighted average interest rate of 14.3 percent per annum. It is 0.5 trillion MNT greater than in the previous quarter. At the secondary market managed by the Mongolian Stock Exchange, government treasury bills worth a total of 360.7 billion MNT were traded. It is 227.5 billion MNT or 1.7 times greater than in the previous quarter. Main factors leading to such increased trade of government treasury bills at both the primary and secondary market, are increased demand from the commercial banks due to exchange rate appreciation and reduction of policy rate by 2 percentage points in June 2017. (Figure II.4.4.5)

Figure II.4.4.4

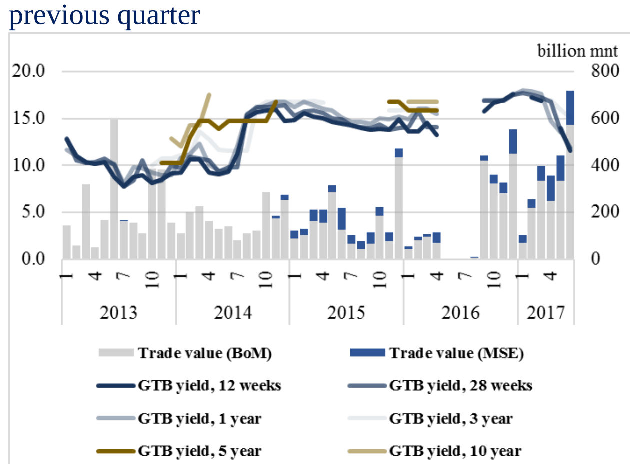
Stock market indicators have remained highly volatile across the last quarters



Source: MSE

Figure II.4.4.5

Government treasury bill auction increased from the previous quarter



Source: The BoM

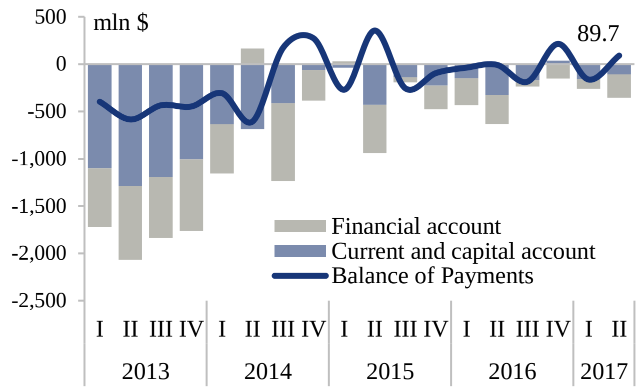
II.5 Balance of Payments

The balance of payment has improved for the reporting quarter. //Increased surplus in financial account driven by FDI and decreased current account deficit (triggered by soar in exports) caused the balance of payments to improve for the reporting quarter.// As of 2017 Q2, current and capital account had deficit of USD 89.7 million, while the financial account had surplus of USD 247.7 million causing the overall balance to see surplus of USD 89.7 million or 1.1% of GDP[21]. (Figure II.5).

Although the balance of payment has been in deficit constantly during 2013 Q1 and 2014 Q3, in recent years deficit has been narrowing eventually leading to surplus. The surplus observed in this quarter is explained substantially by surplus growth of financial account bolstered by FDI, while the surplus in the previous years (2015-2016) is explained by surplus increase in financial account triggered by bond issuance on the international market by both the government and the banks.

Figure II.5.1.1

Balance of Payments



Source: Bank of Mongolia

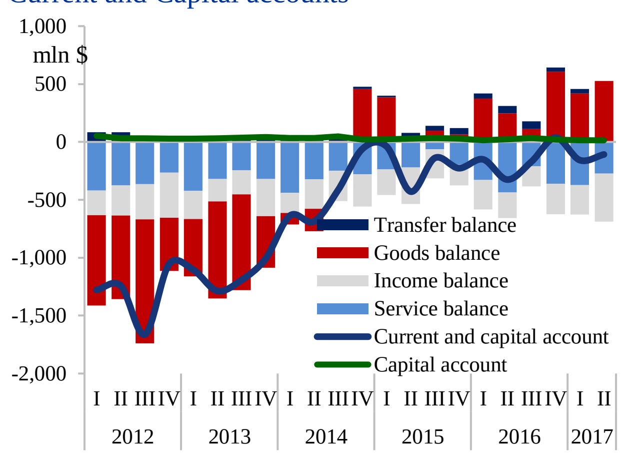
II.5.1 Current and Capital account

Current and Capital account deficit narrowed down to USD 108.2 million in the 2nd quarter of 2017. Better terms of trade, lifted Chinese steel performance and a boost in coal exports contributed to a surplus of trade balance and the current account improvement.

In addition to a surplus in goods balance, shrunk in services deficit helped to ease current account deficits. While a surge in transportation services in line with the emerged commodity exports worsened a deficit, the inflow of foreign tourism and reduction in outsourcing services such as financial and professional advisory helped to cancel it out.

Figure II.5.1.2

Current and Capital accounts



Source: Bank of Mongolia

Since Mongolia had large fiscal and current account deficit, low level of national savings and decline in its gross international reserve, the country started utilizing external loans and FDI to meet its financing needs more frequently. Although increased external loan and FDI support GDP growth in the short term, it is increasing the gross external

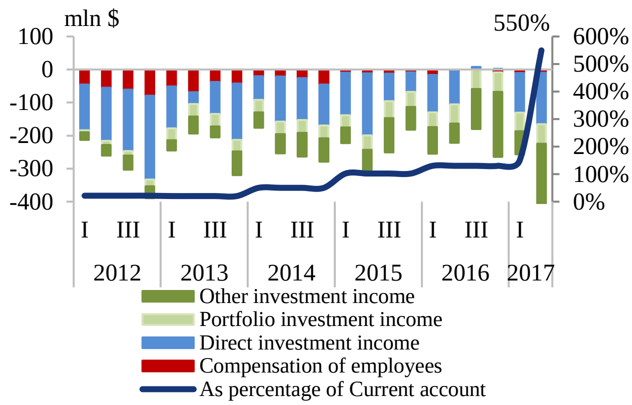
[21] Annual nominal GDP

debt of the country. As a result, the repayments for loan interests and investment dividends are surging. These surges are widening the income account deficit eventually leading to amply pressure on the overall balance. For example, primary income account deficit was 20% of GDP in 2012, while it increased to 102% in 2015, 130% in 2016 and 550% in 2017 Q2 (Figure II.5.1.3). By looking at the compositions of this increase, 67% of this increase is due to USD 132.2 million or 226% rise for enterprises' external loan interest repayments, while 27% of this increase is due to USD 52.9 million or 52% rise for FDI income repayments. Moreover, external loan interest repayments saw smooth surge throughout the years as listed below:

- USD 31.8 million or 2% of current account deficit in 2012 Q2,
- USD 72.5 million or 16% of current account deficit in 2015 Q2,
- USD 58.4 million or 17% of current account deficit in 2016 Q2,
- USD 190.6 million or 156% of current account deficit in 2017 Q2 (Figure II.5.1.4).

Figure II.5.1.3

Income account



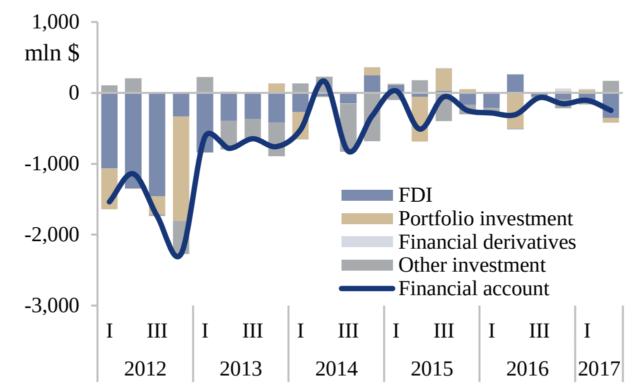
Source: Bank of Mongolia

II.5.2 Financial Account[22]

As of 2017 Q2, financial account surplus totaled to USD 247.7 million which is 19% or USD 59.0 million decrease compared to the same period of the last year. This decrease is explained by USD 563.5 million increase for FDI surplus, USD 440.4 million decrease in portfolio investment and USD 182.0 million decrease in other investment respectively (Figure II.5.2.1).

Figure II.5.2.1

Financial account



Source: Bank of Mongolia

For the reporting period, FDI surplus reached USD 354.9 million which is increase of USD 614.5 million compared to the same period of the last year. This rise is explained substantially due to increase in investment inflow for certain mining company's infrastructure development.

Despite large amount of external repayments have been made, the balance of payment saw surplus for this quarter. Consequently, at the end of June 2017, the gross international reserve reached to USD 1,319.4 million which is sufficient for 3.7 months of retained imports of goods payable in

[22] BOP for 2016Q2 took account for loan restructure for Oyu Tolgoi LLC.

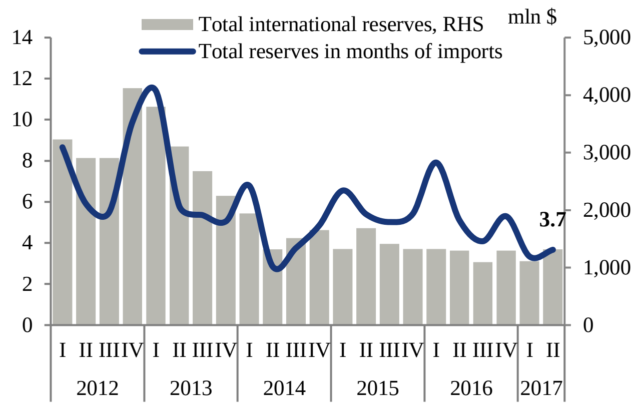
foreign currency that was measured as the average of last 3 months of imports (Figure II.5.3.1).

II.5.3 International Reserves

Gross official international reserve (GIR) built up by 201.4 million USD in the reporting quarter, USD 9.4 million increase from the beginning of the year, foreign currency liabilities of the BoM declined sharply. Furthermore, net international reserves improved by USD 558.4 million y-o-y and USD 708.3 million from the beginning of the year. Large external repayments have been made in the first half of the year, foreign currency liabilities to the government declined by USD 72.2 million, foreign currency liabilities to banks declined by USD 664.2 million. Loan disbursements of USD 34.1 million by the government, of USD 501.8 million by banks and of USD 581.4 million by the enterprises have been disbursed in the first half of 2017.

Figure II.5.3.1

International reserves



Source: Bank of Mongolia

II.5.4 Terms of Trade

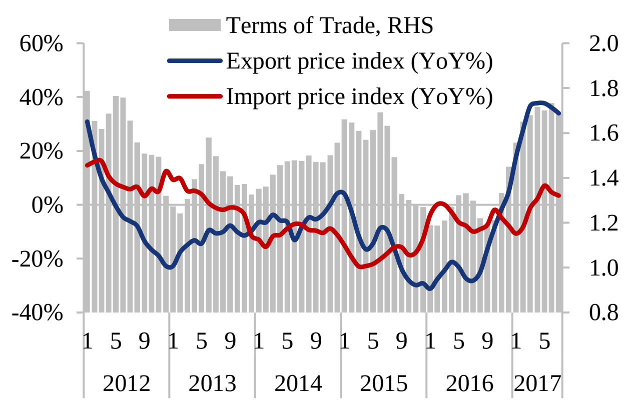
Terms of Trade improved by 30 percent y-o-y in the 2nd quarter of 2017.

The increase in prices of our main commodity exports on the world market benefited to our export revenues. For example, coal price increased by 117% y-oy copper price by 2.5% y-o-y, crude oil price 5.6% y-o-y iron ore price by 20% y-o-y and cashmere prices by 11% y-o-y

While import price of fuel declined slightly from the previous quarter, it is 25% higher y-o-y. Therefore, the increase in import price was mostly driven by higher fuel prices. The terms of trade improved in the first half of 2017 as the export prices accelerated faster than the import prices (Figure II.5.4.1).

Figure II.5.4.1

Terms of Trade Index



Source: Bank of Mongolia, General Department of Customs

II.6 Foreign Economic Environment

The economic growth of USA, Russia, and European zone has increased in the reporting period while the Chinese economy has maintained its stable growth level from the previous reporting quarter. Increase in infrastructure investment, activation of retail trade sector and growth in investment have played a key role in the flourishment of the Chinese economy. As for the Russian Federation, the upsurge in investment and growth in personal consumption were the main basis for supporting the economic growth. The Euro zone economic growth was raised by the external and internal demand, the non-traditional monetary expansion policies and the recovery in labor market underpinned the growth surge by far higher level than it was initially forecasted.

The intensification in China's construction sector, increase in import of iron ore and copper, the US dollar exchange rate staying weaker than expected during the reporting period have significantly influenced the increase in major metal prices between June and July of 2017. Decrease in the coal import of China and it's Government policy towards the reduction of air pollution had an impact on declining the coal prices.

II.6.1 The economic situation of the key trading partners

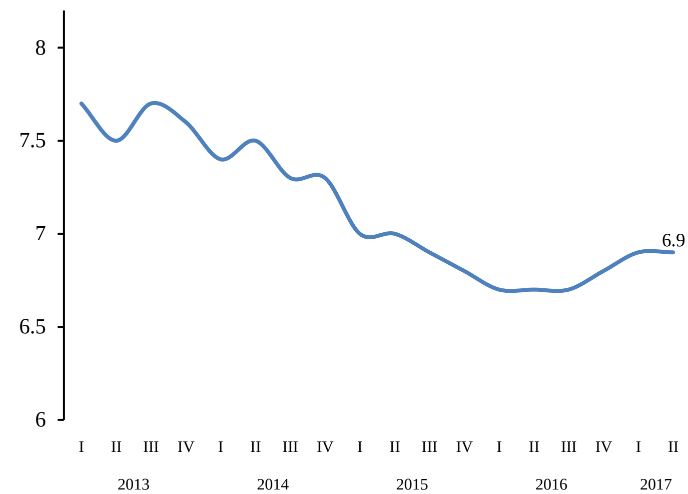
China's economy

The increase of China's Government investment in infrastructure, growth of consumption and development of industrial and service sector had a positive influence on China's economic surge. The economic surge has maintained its growth of the previous quarter and grew by 6.9 percent in the second quarter of 2017. Industrial sector growth increased from 6.0 percent in 2016 to 7.6 percent in the first half of 2017. Furthermore, the service sector that contributes 54.1 percent to the GDP has been activated and it has grown into 7.7 percent in the 2nd quarter of 2017. Also, the retail trade that has been growing at 10.4 percent rate has increased to 11 percent, and the increase of 8.6 percent in the real estate investment had a positive impact on the economic growth of China. Lastly, the household consumption growth that contribute 63.4 percent to the GDP has reached to 7.2 percent in the first 6 months of 2017.

People's Bank of China took measures for stricter/tighter monetary policies in order to protect the exchange rate of Renminbi, and have increased the interest rates for short and long-term loans several times this year. It is highly expected that the PBOC will increase the interest rate for one-year term savings and loans in the 4th quarter of 2017.

Figure II.6.1.1

China's economic growth, percentage /year on year/



Source: Bloomberg, Roubini

China's financial and economic situation is greatly dependent on debts and financial balance losses. Within the framework of the economy supporting policy of China's Government, the budget deficit was estimated to be not lower than 3.5-4 percent of GDP and the maintainance of the economic growth at the level not less than the targeted 6.5 percent and the Government had announced that it was going to increase the infrastructure investment in the following 2 years. Although this has a positive impact on the country's manufacturing industry, it may be lower in the short term due to the surplus in the mining sector and the industry's high surplus in resources and profitability. Though it has a positive impact in the industrial sector of the country, it is predicted that the profits to be gained from the short term investment growth in this sector may fall due to excess of resources/reserves in mining and manufacturing industry and poor effective activities/operations.

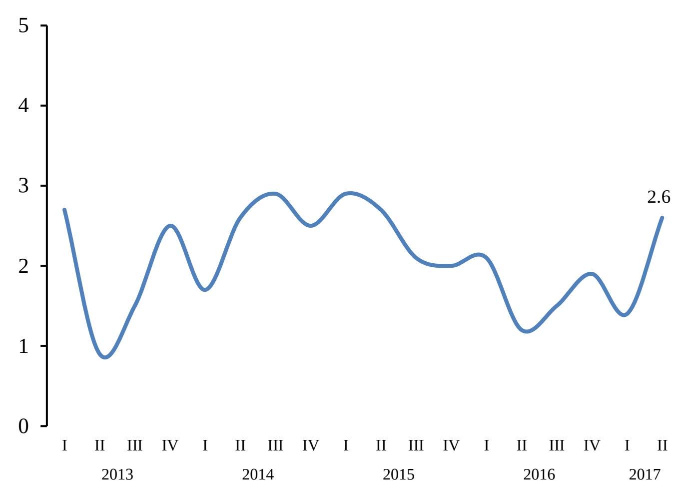
Notwithstanding the fact that China's authorities claim that high debt level will not have a negative impact on the economic growth, according to the analysis of international experts, the matter/issue of private sector debt over GDP ratio reaching over 250 percent shall result in creating risks of unstable conditions for business and banking sector of China and therefore raising flags for a necessity to take adequate measures of debt management (debt sustainability measures). The IMF released calculations that the household, company and Government loans shall reach 300 percent of GDP by year 2022. This is a warning that the circumstances will slow the mid term economic growth outlook and lead to potential risks. However, analysts emphasize the anticipation that a policy to lower loan growth and an economic strategy for mid term will be elaborated after the 19th National Congress of the Communist Party of China to be held by the end of 2017.

USA's economy

The unemployment rate of USA has decreased activating the labor market and personal consumption has increased as well with the growth of personal income and investment, and the beginning of stabilization of the world economy have mainly brought the economy to grow by 2.6 percent in the 2nd quarter of 2017 which is higher than it was initially predicted/forecasted. The personal consumption expenses that make up 2/3 of the country's economy have increased by 2.8 percent and business equipment investment increased by 8.2 percent, making it the the highest increase in the recent 2 years period. Personal consumption contributed by 1.93 unit percent, investment by 0.36 unit percent, Government investment by 0.12 unit percent and net export by 0.21 unit percent to the total growth of the economy.

Figure II.6.1.2

USA' economic growth, percentage /year on year/



Source: Bloomberg, Roubini

The unemployment level has maintained its 4.3 percent in the 2nd quarter of 2017 and 231.000 jobs were newly created leaving a promising labor market outlook. Furthermore, the manufacturing industry grew by 2.2 percent in July of 2017 compared to the same period of the previous year, specifically the mining sector grew by 10.21 percent. Although the plan of tax cuts and increase of infrastructure spending by the President of the United States of America Donald Trump will contribute positively to the economic growth, the analysts forecast that the aging population of USA and decrease in industial performance efficiency, and the political and economic uncertainties will have a negative impact on the economic growth as a whole.

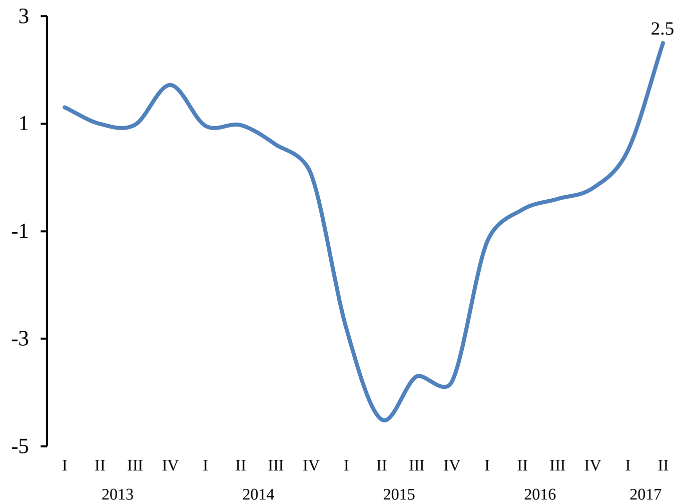
In line with the rising inflation and spur of economic activity, the Federal Reserve System has decided to increase its policy rate by 0.25 unit percent making the total of 1.25 percent during its meeting dated June 14, 2017.

Russian Federation's economy

Russia's economy, which has been shrinking over the course of the last consecutive 2 years period due to the European economic sanctions and the collapse of oil prices, has grown by 0.5 percent in the 1st quarter of 2017 reaching 2.5 percent by the first half of the year, making it the highest growth level since the 3rd quarter of 2012. Increase in investment and consumption have played a main role in the economic growth. Personal consumption has increased by 3.3 percent and gross investment have also increased by 1.5 percent in the first half of 2017. However, the manufacturing index has grown by 0.3 percent in the 1st quarter of 2017 and increased to 4.0 percent by the 2nd quarter of the same year. The fact that the wages were increased by 8.5 percent compared to the previous year and retail trade has expanded to 1.2 percent from the 0.7 percent growth in the previous quarter played a significant role in supporting economic growth of Russian Federation. Additionally, compared to the same period of the previous year, exports grew by 22.8 percent, imports grew by 30.2 percent in the first half of 2017, leading to improvement in the terms of trade and bringing a surplus of 8.7 billion USD in trade balance.

Figure II.6.1.3

Russia's economic growth, percentage /year on year/



Source: Bloomberg, Roubini

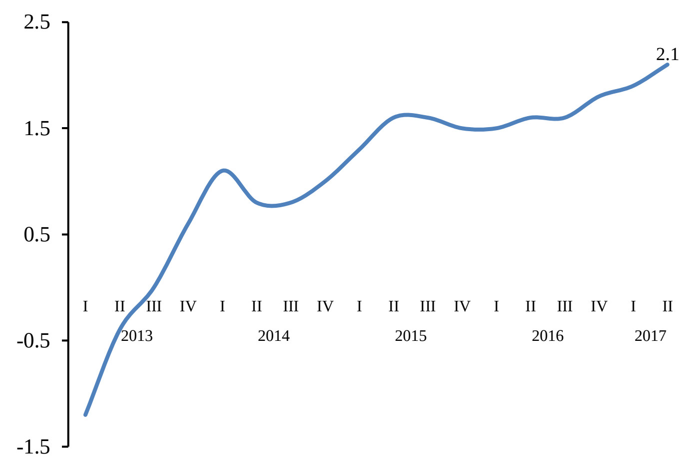
The depreciation of the Russian Ruble exchange rate was the highest in the reporting period since year 2015 due to oil price drops in the 2nd quarter of 2017 and the decision of USA government to ridify its sanctions against the Russian Federation. Also, the Ruble exchange rate depreciated against USD by 4.5 percent and it is expected to decline/depreciate even more. However, the inflation rate has been continuously decreasing to 3.9 percent by July of 2017 and the Central Bank of Russia expects to maintain the targeted 4.0 percent by the end of the year. In relation to this, the Central Bank of Russia has decreased its policy rate by 0.25 unit percent and made it to the total of 9 percent on the meeting of the 16th of June of 2017 and has made a decision to maintain the 9 percent rate on its meeting dated July 28 of 2017.

The Euro zone economy

The economy of Euro zone maintain its growth due to non-traditional monetary expansion policies and the external and internal demands and improvement in the labor market. The economic growth of 2.1 percent in the 2nd quarter of 2017 is a 0.2 unit percent increase from the previous quarter. The economic prognosis of key trading partner countries has improved in reliance with the stabilization of political uncertainties, leading to a favorable investment environment and supporting the regional economic growth. Furthermore, the PMI which indicates the activation of manufacturing industry was 56.7 in February of 2017 has reached to 57.4 by June of the same year, making it the highest level since the beginning of 2017 (January of 2017). Further increase of jobs and manufacturing is expected in accordance with the improvement of the manufacturing industry in Euro zone. However, the inflation rate shows no change compared to the previous month rate reaching 2 percent in February of 2017, making it the highest since January of 2013 and maintaining the 1.3 percent in July of 2017. The unemployment rate has reached 9.1 percent in June of 2017, making it the lowest level since February of 2009. Although the non-traditional monetary expansion policy supports the internal demand, analysts emphasize that the wage rate has not reached the satisfactory level yet which is the main obstacle in reaching the targetted inflation rate of 2 percent. Regardless of the non-traditional monetary policies of the Central Bank of Europe, the inflation rate is not expected to reach its targetted level by year 2018.

Figure II.6.1.4

The Euro zone growth, percentage /year on year/



Source: Bloomberg, Roubini

Although Spain's economy has rapidly been growing making 11 percent of the total GDP and supporting the Euro zone economy, the slow down in German Federation's economy that contributes 29 percent to the GDP of Euro zone has decreased by 0.1 percent in the reporting period has not affected the normal economic growth of France and Italy which contributes 21 percent and 16 percent each to the GDP of Euro zone.

II.6.2 The global market prices for the main export items of Mongolia

Copper: The copper prices have decreased to 5600 USD in May of 2017, and have reached 5985 USD in July, making it the highest level in the course of the last 2 concecutive years. Although the strike at the second largest copper mine has continued (Grasberg in Indonesia) and “Glencore” company has decreased its target production amount, the drop in price is associated with the excessive market supply of copper and a weak demand in the reporting period. Analysts point out that the copper price changes are conflicted with the basic fundamental factors and they have warned the investors that the price increase will not sustain in the medium term. Also, the decision to raise interest rates on Federal Reserve meeting in June 2017 resulted in the appreciation of the dollar, affecting the demand for industrial metals. However, the analysts think that the intensification in China’s real estate investment loans and increase in the sector demand may provide a short term support for the copper market.

Gold: Though gold prices rose to 1266 USD on April of 2017 and it reached its lowest price of 1218.8 USD after the meeting of the Federal Reserve System in May, it has increased back to 1293.6 USD in June of the same year. The geopolitical risks established in the world, specifically the sudden political and economical decisions made by the President of United States Donald Trump, poor relationship between USA and the DPRK have mainly influenced the gold prices since the beginning of 2017. Analysts note that the expected increase of policy rate by the Federal Reserve and the expectations from the new policy on taxes delivered by the President Donald Trump will have their impact on the gold market prices.

Thermal Coal: The average price for one ton of thermal coal that was 83 USD in the 1st quarter of 2017 has decreased to 78 USD in June of the same year and increased back to 82.3 USD, which is 32 USD higher compared to the prices of the same month of the previous year (year on year). The ongoing strikes at Indonesian and Australian mines and the tendency/expectation to increase the thermal coal resources by the power plants of China may lead to stable prices of thermal coal in the short term. However, within the frameworks of China’s Government policy to reduce air pollution, the Chinese Government announced that there will be added focus on the replacement of coal by natural gas within the coming 5 years and rely on more use of solar and wind energy.

Coking coal: The benchmark price for a good quality coking coal of the contract signed between Australia and Japan was maintained at the price of 285 USD in the 1st quarter of 2017, and it has decreased to 193 USD in the 2nd quarter of the same year. Due to typhoon “Debbie” passed over the east coast of Australia, the railway, sea ports and coal mines were stagnant and the reconstruction of the Queensland infrastructure have mainly affected the decrease in the prices in the reporting period. The Government of China has softened its excess capacity reducing policy (in accordance with supply-side reforms), the demand has decreased, providing conditions for the price drops, which has lead to the coking coal market prices of Australia drop to 149 USD/t in July of 2017.

Crude Oil: Though the average price for one barrel of crude oil was 55 USD in the 1st quarter of 2017, the prices of Brent trade mark oil have dropped to 53 USD per barrel in July of 2017. The fact that the production of crude oil has increased in USA and the member countries of OPEC has reached a mutual agreement to reduce their oil production will lead to a sustainable course of stable crude oil prices until the end of the 1st quarter of 2018.