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BALANCING FINANCES AND SENSIBILITIES IN THE MINING SECTOR



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Mongolia

Economy

The World Bank projected Mongolia's economy to grow by 13 percent by the end of this year. However, foreign investment and other uncertainties are bringing instability to the country's economy. There has been a slowdown in its export growth and a sharp decline in foreign direct investment inflow towards Mongolia. This was mainly due to a



slowdown in China's economic growth in the first quarter of this year.

Inflation

Mongolia's inflation fell to 9.8 percent last March compared with

double-digit inflation last year. Last July the National Statistical Office reported inflation of 8.3 percent. Whether this decline is to remain until the end of this year is uncertain, especially with monetary policy by the Bank of Mongolia to reduce the short-term loan interest rates and an expanded state budget.

Investment

According to the Ministry of Economic Development and the Bank of Mongolia, registered foreign direct investment (FDI) in Mongolia totalled USD 961 million in the first half of 2013, declining 43 percent from the



previous year. FDI in the mining industry declined 32 percent with other sectors



falling below 50 percent or more.

Crisis

Mongolia exported eight million tonnes of coal in the first seven months of this year, earning revenue of USD 582 million for coal export. Export revenue declined by more than 20 percent compared with the previous year.

On the world market, the price of coal declined two times. According to an estimate by officials at the Ministry of Mining, measures that include changes to inland

customs need to be taken in order to reduce the cost of mining exploration. Exploration costs are expected fall by 24 percent to USD 19.

Mining

State-owned Erdenes Tavan Tolgoi produced 2.6 million tonnes of coal during the first eight months of this year. The company is expected to mine 4.5 million tonnes of coal from the East Tsankhi deposit and three million tonnes from the West Tsankhi this year, which would mean a three-fold increase from 2012. The company expects that the export of coal from West Tsankhi would fulfil a debt of USD 170 million to Aluminum Corp. of China Ltd. (Chalco), earning as much as USD 200 million for 2013.

Production and tax revenue of mining products (H1 2013)

	Production	Tax revenue (billion/s of MNT)	Estimate 2013
Copper (thousand/s of tonnes)	1.568	1.568	0.6%
Coal (million/s of tonnes)	35	28	-21.1%
Molybdenum (tonne)	8.859	7.643	-13.7%
Gold (kilogram)	2.199	1.956	-11.1%
Spar (thousand/s of tonnes)	2.400	2.192	-8.7%
Iron (thousand/s of tonnes)	26.183	22.943	-12.4%
Zinc (thousand/s of tonnes)	31.157	24.740	-28.2%
Total	59.350	51.512	-13.2%

Average global prices of minerals (USD)

Type of minerals	Production	Tax revenue (billion/s of MNT)	Estimate 2013
Gold (ounce)	1.568	1.568	0.6%
Silver (ounce)	35	28	-21.1%
Copper (tonne)	8.859	7.643	-13.7%
Zinc (tonne)	2.199	1.956	-11.1%
Lead (tonne)	2.400	2.192	-8.7%
Tin (tonne)	26.183	22.943	-12.4%
Molybdenum (tonne)	31.157	24.740	-28.2%
Tungsten (tonne)	59.350	51.512	-13.2%
Iron ore (tonne)	168	146	-13.1%
Coal (tonne)	209	127	-39.1%

World



Global health

New Zealand said that Fonterra products that are at the centre of a global contamination scare did not contain botulism-causing bacteria. The scare had triggered a recall and import bans from some countries. However, the Ministry for Primary Industries said that tests indicated the presence of a different type of bacteria that does not cause botulism. Fonterra is the biggest dairy firm in New Zealand, which is the world's largest exporter of dairy products.

Europe



The euro zone has emerged from recession after a record 18 months of economic contraction. The bloc's GDP grew by 0.3 percent in the second quarter of 2013, slightly ahead of forecasts, the Eurostat agency said. The growth was widely expected after the German economy rose 0.7 percent between April and June. Germany and France both posted stronger-than-expected growth, expanding 0.7 percent and 0.5 percent respectively. Portugal, among the smallest and the weakest eurozone economies, showed the fastest growth, at 1.1 percent.

United States

Growth in US house prices remained strong in June, according to a closely watched survey. The Standard & Poor's/Case Shiller index showed that prices were 12.1 percent higher in June compared with a year earlier. The index measures single-family home prices across 20 cities, and found price rises in all of them. But the pace of growth was slightly below the 12.2 percent annual growth rate measured for May. House prices in Las Vegas and San Francisco saw the biggest increases, rising nearly 25 percent over the year.

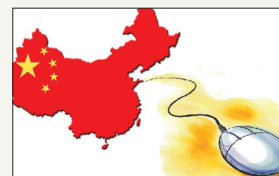


Precious stones

The world's biggest round blue diamond is estimated to sell for more than USD 19 million at an auction in Hong Kong in October, Bloomberg reported. Sotheby's will auction the brilliant-cut flawless stone, weighing 7.59 carats, on October 7 as part of the company's 40th anniversary sales in Asia. "The Premier Blue" is the largest round fancy vivid stone of that color to have been graded by the Gemological Institute of America. It was sourced from the Premier mine near Pretoria, South Africa.

China

China is poised to surpass the United States to become the world's largest e-commerce market this year, according to consultancy Bain & Co. With forecast 32 percent average annual growth, online shopping expenditures in China are set to reach 3.3 trillion yuan (USD 539 billion) by 2015, the consultancy said in a report. The study was based on a survey of more than 1,300 shoppers in China across a range of cities, ages, educational backgrounds and income levels.



A. Amarsaikhan's column



Шог зургийг А.Амарсайхан

FUTURE TOPIC

THE VIBRANT ECONOMY

I. OTGONJARGAL

To compare the economy to human medical conditions, one might say the economy has a concussion.

A concussion is a serious effect from injury that can result in permanent damage if the proper procedures are not immediately applied. And in the first half of this year, Mongolia lost some of the momentum that drove rapid economic growth over the last few years, largely because of a decline in export coal prices. There are some external factors and a dispute over Oyu Tolgoi also affecting investment.

Revenue earned thus far has fallen 30 percent short of projections. By the end of this year, the shortfall may reach MNT 1.5 trillion, according to Bank of Mongolia Governor N. Zoljargal. It is no surprise that this year's revenue is facing a huge budget shortfall. This is due to overly optimistic projections made when drafting the budget. For example, the budget predicted coal export of 30 million tonnes and an alteration to the tax rates agreed upon in the Oyu Tolgoi investment agreement for an additional MNT 445.8 billion. None of these predictions have come true.

Another point of contention is the Financial Stability Law, which took effect at the beginning of this year. The law mandates that the deficit not exceed 2 percent of GDP, and that looks to certainly not be the case this year. This non-compliance with the law ignores a main concern of economists for the growing deficits in the country.

There are definitely concerns for growth to think about. We here at *Mongolian Economy* would describe today's economy in Mongolia as vibrant. But there is a real possibility for a budget crisis. Foreign direct investment (FDI) in 2011, when not counting investment to Oyu Tolgoi, grew to USD 2.5 billion. Today, however, FDI is a fifth of that level. It seems as if a fiscal crisis is knocking on the door unless government quickly takes up extreme measures.

Recently almost 2,000 jobs were cut by Oyu Tolgoi, and small mining companies are shutting down. The

number of flights running between Ulaanbaatar and Umnugobi has fallen from 10 to five times a week. The number of passengers travelling between Tavan Tolgoi and Tsogtsetsii has also fallen significantly, according to the Ministry of Mining.

The currency rate is heading ever-more uphill. Savings Bank failed and was absorbed by State Bank. Daily price growth for goods such as rice and sugar is on the rise. Taxi prices, too, are on the rise, with O. Magnai, head of the Agency for Fair Competition and Consumer Protection, recently stating that taxi fares would rise to MNT 1,000 per kilometre with an initial fee of MNT 1,500.

Yet, there have been some bright points in the economy, including the government-backed 8 percent mortgage programme, positive results from the Price Stabilisation Programme, and inflation keeping to the single digits for the first time since 2010. But there is scepticism about how long these positive indicators can last. The scepticism is reasonable. These programmes that should have been paid for by the government directly are instead being financed by the Bank of Mongolia. Economists are sceptical that these programmes will not be implemented without exhausting the reserves held by the central bank. If they are right, the situation would be much worse than it is today. Economists once again are calling for greater independence for the central bank.

Now a question is being raised: What to do when the economy needs medical attention? Should politicians tirelessly debate on whether the economy is in crisis and if there is sufficient evidence available for an answer?

In this edition, *Mongolian Economy* has directed its focus on what measures could be taken to overcome these economic difficulties without exacerbating an already bad situation. *Mongolian Economy* aims to raise issues surrounding the mining industry and the vibrant economy from every aspect. This issue looks closely at the legal and tax environments, occupational safety and health, and corporate social responsibility. ■



BUDGET

THE FISCAL CRISIS

B. BAYARTOGTOKH

Central Bank governor N. Zoljargal said that government revenue will likely to fall MNT 1.5 trillion short of projections made in the 2013 budget. If correct it means the country would have violated the Fiscal Stability Law in the first year it took effect.

The law specifies that the budget deficit should not exceed a ceiling of two percent of GDP. Comparatively, the central bank governor is warning of an 11 percent deficit by the end of this year. And it is not only the Bank of Mongolia; the World Bank and Open Society Forum, too, have warned of this eventual failure.

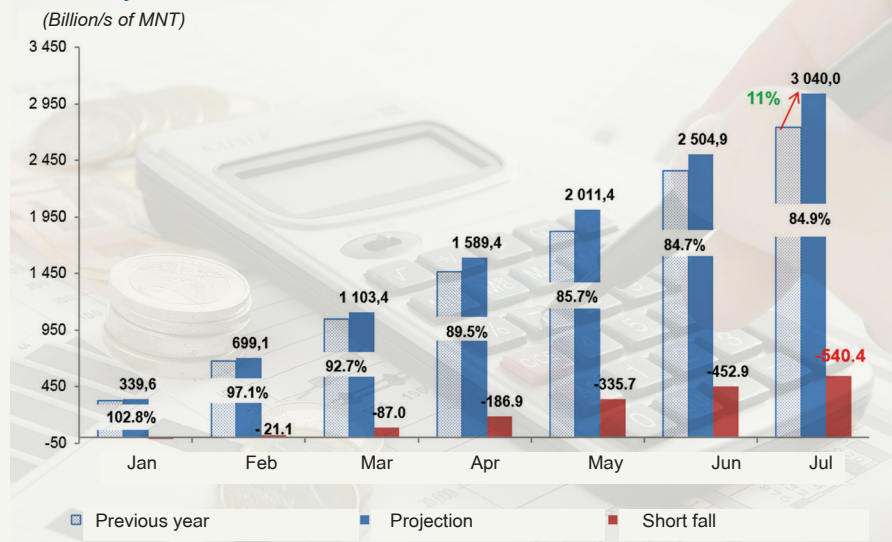
The deficit grew to MNT 1 trillion between January and August this year. That contrasts against the government's projection of MNT 360.9 billion, which would have been within the 2 percent budgetary ceiling.

Clearly, the law is not being enforced as its drafter had hoped.

Falling Short on Promises

According to a Mongolia Quarterly Economic Update by the World Bank, the budget has been out of balance since 2010, when spending was merely 0.5 percent of GDP. Government expenditure expanded to 4.8 percent of GDP in 2011 and 7 percent last year—the worst results from the last 13 years. Ironically this year, as legislation takes effect that is meant to rein in spending, government expenditure is likely to

Total Projected revenue



break the 2012 record.

Some socio-economic investments are likely to be transferred to the 2014 budget, but that is only pushing the burden to next year. As priorities are ranked, it is likely that some necessary programs will be cut out entirely.

“Rather than amending the budget, it would be better to learn ways to reduce costs”, said L. Oyun, a lecturer at the School of Economic Science of the National University of Mongolia. “The budget is a law which was approved, so it shouldn’t be a habit to constantly be amending laws. Therefore, we need to seek out investments to recover the deficit”.

Any amendments to the budget will likely be discussed when the State Great Khural reconvenes for its fall session. Although no discussion

on the matter has yet been discussed, the budget is now struggling as state agencies are being told to cut their costs.

Too-optimistic Budget

According to parliamentarian Rinchinnyamyn Amarjargal, the 2013 budget is a “budget with no estimation”. In the past two years, budgetary spending has grown 41 percent while revenue grew just 27 percent. The state budget has expanded along with Mongolia’s mining-driven economy. This made lawmakers a bit over confident, resulting in a budget with overly optimistic projections for revenue.

Both the Oyu Tolgoi and Tavan Tolgoi mines are falling short of expectations. The 2013 budget ▶▶

▶ projected that Erdenes Tavan Tolgoi's coal revenue would double 2012 figures. Due to poor demand from China and weak economic conditions, export from the coal industry is likely to only reach a third of the projected 30 million tonnes of washed coal. All together, the budget is likely fall MNT 540.4 billion short of its original projection.

"Budget revenue is not likely to reach its target due to the negative impact from external economic factors", said J. Ganbat, head of the fiscal policy department at the Ministry of Finance. "Mongolia's economy is strongly dependent on China's economy, but China's economy is still slowing down as it relies on its main markets, which includes Europe and the USA, where there is also sluggish economic growth".

"All this drives a decline in the budget revenue of Mongolia".

The 2013 budget projected more than MNT 300 billion from the export of coal. But in the first half of this year, a mere 6.3 million tonnes of coal has been exported compared with the expectation of 30 million tonnes for the year. Another problem is that the price of coal has declined 35 percent on average from a year ago. To the budget that means a loss of MNT 50 billion.

"This is not a budget crisis, but it is a crisis of state responsibility", said A. Jargalsaikhan, a head of the Economic Policy Institute.

Earn More or Spend Less

Tax revenue is expected to comprise 91 percent of total budget revenue this year and 9 percent of other sources of revenue. The percentage of budgetary spending to GDP varies every year, ranging from 33 to 48.5 percent. But there has been growth since 2009, with budget deficits spurred on by a decline in the prices of mining products.

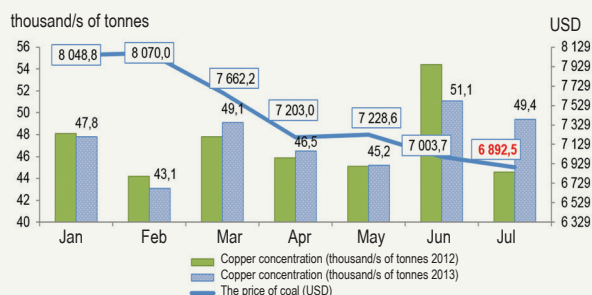
"In 2013 Mongolia's budget revenue will fall short, which will cause the need for the difficult tasks of cutting spending, and in return it will shrink the country's economy much more", wrote the World Bank in its quarterly report. Operating expenses make up 65.4 percent of total government expenses, which looks high compared with 33.4 percent capital expenditure. Also 29 percent of total budgetary expenses will be spending for 23 special government funds, including funds for human development, training centres, tourism, environmental conservation, immunisations, small and medium enterprise development, social welfare, and social insurance.

For the year until August, revenue generated from the export of coal and copper has declined 55 and 40 percent, respectively. Without including Oyu Tolgoi, foreign direct investment declined 49 percent compared with the year before. In 2011, FDI reached USD 2.5 billion, also when excluding investment for Oyu Tolgoi's. But today it has shrunk as much as five times to USD 500 million.

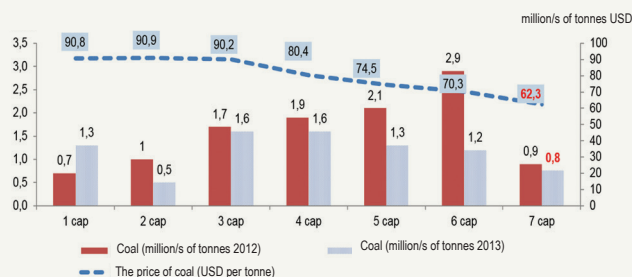
Mongolia's deficit would be much less if it could only buckle down and make the hard choices for budgetary cuts where necessary. That is not easy, but is not terrible when considering the alternative of a possible fiscal crisis. ■



Decline in export and the price of copper



Decline in export and the price of coal



Slowdown in China's economy



FOREIGN INVESTMENT

AN ECONOMY WITHOUT TROUSERS

BY E. ZORIGT

Mongolia has seen a minor crisis and some decline in investment due to poor state policy on foreign direct investment (FDI). The investment environment for the country is deteriorating, and, if it continues like this, Mongolia's economy may find itself without trousers.

"Decline means tightening one's belt while crisis means losing your trousers", once said the renowned Russian economist Boris Pankinii.

The degradation of the investment environment has threatened Mongolia's economy since the passage of the Strategic Entities Foreign Investment Law (SEFIL) last year. Investors had no choice but to abandon Mongolia because of this sort of unexpected surprises in the legal sphere. FDI for Mongolia declined by 31 percent to USD 868.1 million in the first quarter of this year compared to the previous year. Also, the government's unsuccessful attempt to amend the investment agreement for Oyu Tolgoi and an ongoing discussion over approval of a new Minerals Law have scared off investors. Although some officials from the Ministry of Mining and the Ministry of Economic Development say that FDI has not come to a halt, some entrepreneurs in Mongolia's mining sector are voicing unanimously that it has.

"As I am in a hotspot for the mining business, foreign direct investment has already come to

a halt", said D. Jargalsaikhan, a chief executive at MIH Group. "For example, one of Mongolia's mining companies has been shut down and two have had their operations suspended. These are a direct effect from the recent decline in foreign direct investment".

There are at least two ways to go about development. One is to borrow money, which means issuing bonds. Another way is to attract foreign investment. In Mongolia, USD 45 billion to USD 68 billion of investment is needed, according a study by Trade and Development Bank of Mongolia (see Table 1). The

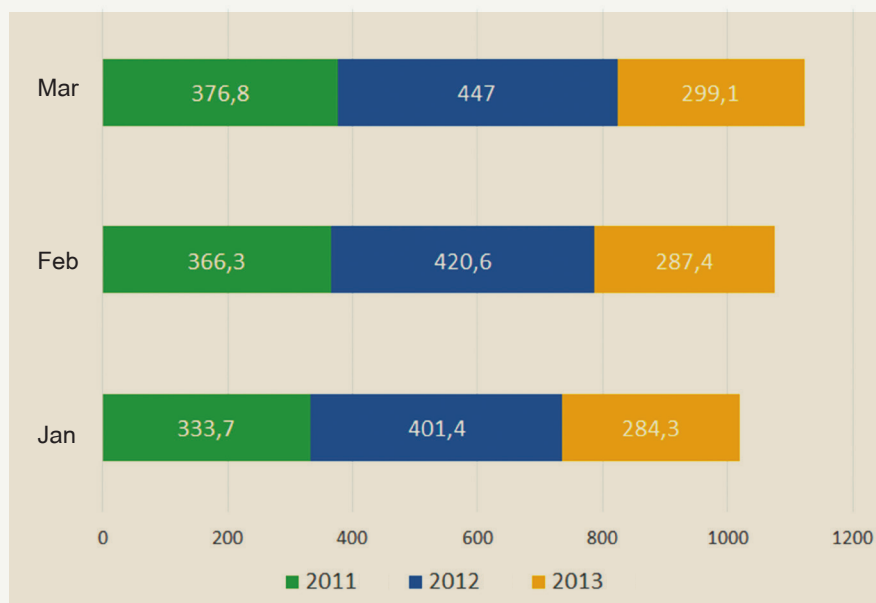
government and domestic investors alone could not fulfil that need.

"If the state policy on the mining sector remains unstable, Mongolia will no longer be able to attract foreign investors," said T. Lkagvadorj, chief executive of Hunnu Coal. "Only long-term stability in the legal setting could lead foreign investors to return their trusts back to invest in Mongolia."

However, said Lkagvadorj, it is possible Mongolia could introduce even more restrictive policies to dissuade foreign investors.

"As a result, no room is left for investors, and when they leave the country Mongolians say, 'What's

Table 1. Foreign direct Investment



► the matter? Can't you take a joke or something? Come back and now we can make it better for you", he said. "Investors are not toys".

Already the doubt in the Mongolian economy has hampered economic growth to just 7.2 percent

for the first quarter this year. If circumstances still continue like this, the funding for large projects in Mongolia may come to a complete halt. The experience from the initial investments to projects in Mongolia may be costing it its reputation in

the world. How are Mongolians supposed to achieve economic development if the government refuses to rectify the situation?

For Mongolia, there may be no fireplace to set a fire and no kettle to make tea. ■

Table2. Foreign direct investment (bysector)

(Million/s of USD)

Sector	2012 06 30	2013 06 30	Margin
Exploration, exploitation & oil industry	1.271.025.318.1	863.384.068.0	-32.07%
Trade and public catering	339.702.150.7	87.376.854.4	-74.28
Banking and finance	16.858.502.1	970.000.0	-94.25
Construction and building materials	23.097.168.4	1.736.631.6	-92.48
Transport	9.493.190.1	3.614.066.8	-61.93
Tourism	11.698.038.8	175.351.0	-98.50
Culture, education, science and media	330.426.8	123.000.0	-62.78
Health and beauty services	745.241.8	60.500.0	-91.88
Agriculture	229.925.0	40.000.0	-82.60
Other	14.496.844.4	2.590.300.0	-82.13
Total foreign direct investment	1.688.133.071.2	960.917.120.7	-43.08

Table3. Investment projects

(billion/s USD)

Sector	Amount
Mining	12-20
Infrastructure	8-12
Urban development	6-8
Agriculture	1-2
Manufacturing	15-20
Environment	1-2
Society	1-2
Finance	1-2
Total	45-68

Table4. Foreign direct investment in Mongolia

(million/s of USD)

Country	2013 Q1	2013/2012
	Amount	Margin (percent)
China	65.2	-47%
South Korea	13.9	-20%
Canada	25.7	-17%
Hong Kong	564.0	+4 %
Japan	10.7	-64%
Russia	7.1	
UK	4.8	-93%
US	83.0	-53%
Europe (except UK and Germany)	4.4	
Australia	32.2	40%
Germany	3.6	
Singapore	28.4	-20%
Other	27.9	-87%
Total	870.8	-315

Table4. Finance sheet

(million/s of USD)

Indicator	Q1		Margin	
	2012	2013	Amount	Percent
Finance sheet	1.862.9	475.3	-1.387.6	-74%
A. Assets account	42.2	24.7	-17.5	-42%
B. Financial account	1,820.6	450.6	-1,370.1	-75%
a. Direct investment	1.263.3	868.1	-395.2	-31%
Outward	-5.7	-2.7	3.0	-52%
Inward	1,269.0	870.8	-398.2	-31%
b. Investment package	582.2	8.0	-574.3	-99%
c. Derivative	0.0	0.0	0.0	
d. Other investments	-24.9	-425.5	-400.6	1612%
Of this: Trade loans	44.7	61.6	16.9	38%
Cash transactions	-527.5	-521.7	5.8	-1%

OUTLOOK

HOW WILL MONGOLIA PERFORM IN 2013?

(SEMI-ANNUAL UPDATE)

The first half of 2013 passed with a great deal of change and optimism toward the market. However, these were not always justified, well reasoned or realistic. Unless serious measures are taken, fundamental indicators to the economy may end up in quite poor shape. Having said that, it should be noted that Mongolia was able in the past to steer itself out of troublesome situations quite quickly.

Global environment in H1 2013

As it was generally predicted, the world hasn't seen a steep reversal in economic growth. As of the first half of 2013, financial institutions have slightly lowered year-end growth forecasts, averaging at 2.6 percent for the world, 2 percent for United States, -0.1 percent for the euro zone and 7.6 percent for China.

First, growth was lower than expected in major emerging market economies, reflecting, to varying degrees, infrastructure bottlenecks and other capacity constraints, slower external demand growth, lower commodity prices, financial stability concerns, and, in some cases, weaker policy support. Second, the recession in the euro area was deeper than expected, as low demand, depressed confidence, and weak balance sheets interacted to exacerbate the effects on growth and the impact of tight fiscal and financial conditions. Third, despite some positive signals the US economy expanded at a weaker pace (IMF).

Mongolia in H1 2013

Mongolia on the surface seems to perform fairly well despite unfavorable external conditions. However, fundamental structural weaknesses exist in the economy.

The chart on the right shows a snapshot of the macroeconomic health by major six indicators on a scale

of seven points (seven being the best and one being the worst score with break even at four) for two quarters of 2013.

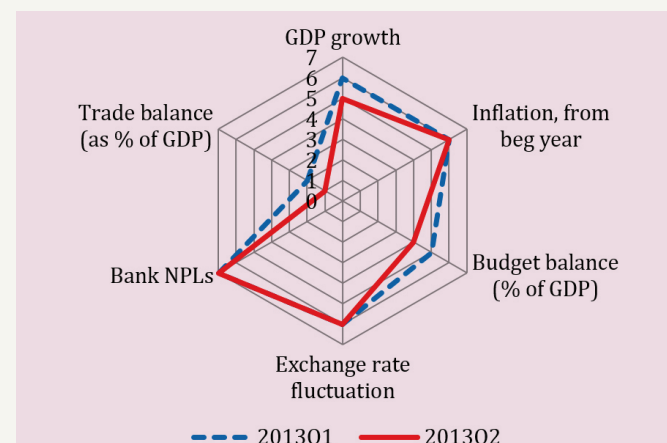
According to second quarter 2013 results, the health score stands at 4.8 points which indicates performance a ▶

2013 GDP growth forecast

	World		US		Eurozone		China	
	2013	2014	2013	2014	2013	2014	2013	2014
Fitch	2.40	3.40	2.80	3	0.90	1.50	7.50	7
Goldman Sachs	3.3	4.10	2	2.90	-0.10	0.90	7.50	7.70
Standard Chartered	2.30	3.40	2.10	2.50	0.40	0.60	7.70	8.20
Citibank	2.60	3.20	1.80	1.70	1.10	0.70	7.40	7.10
World bank	2.20	3	2.00	2.80	-0.60	0.90	7.78	7.74
ADB			2.00	2.60	-0.50	1.20	7.70	7.50
IMF	3.10	3.80	1.70	2.70	-0.60	0.90	7.80	7.70

Source: cited institutions as of Jun-Jul 2013

Macro-economic health matrix



▶ little over break even. A score of 4.8 is better performance compared to the same period of last year (higher by 1.3 points), but lower than the first quarter of 2013 (a decline by 0.7 points).

Subsiding inflation, stable exchange and low non-performing loans rates have contributed to positive results. Downward moves were a result of a sliding GDP

What were main movements that shaped the economy in H1 2013?

As predicted, there were a few major factors that would influence the economy in 2013 such as political stability, Oyu Tolgoi and foreign investment-related moves. As we go through past the half-year mark, many uncertainties started to clear, and what we see is not reassuring.

Presidential elections went peacefully without consequential changes in the power balance. However, fragility remains with regard to the ability of the government to implement its platform continuously.

Unfortunately, issues were not profoundly settled on the Oyu Tolgoi mine and its operations. This creates a drag on the performance of the overall economy as well as on investor sentiment. As a result, some improvements made in the investment-related legal environment could not restore investor confidence, virtually erasing the spillover effect the mining sector previously had on the private sector.

As expected, the role of the government in the economy is growing as the government pursues a policy to increase the size of public investments from the state budget funds, and government eurobond proceeds. We see even stronger involvement of the government in the economy through policy programmes from the Bank of Mongolia.

On monetary policy and inflation targeting the central bank has taken some bold actions and was able to reach concrete results (annual inflation rate is down to the single digits), however sustainability of this raises doubts with loosening policy as money supply grows and policy rates are lowered.

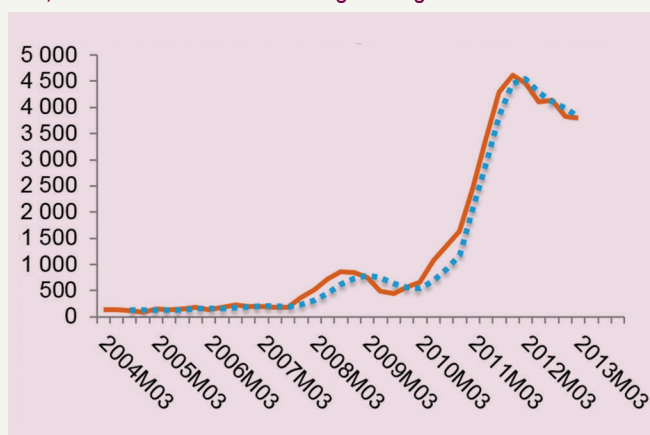
The ever-increasing trade deficit did not have a steep reversal in the first half of 2013. Trade turnover decreased by around 9 percent year-on-year, and trade deficit now stands at around USD 1 billion.

Decreasing foreign direct investment (FDI) and reduced inflow of export revenues led to a weakening of the national currency. Hopes that government bond proceeds of USD 1.5 billion would have a reverse effect were not justified, as the tugruqs were supplied into the economy.

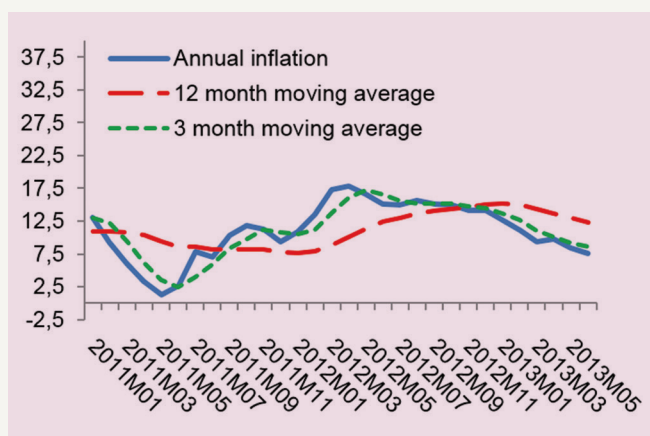
Expected 2013 year end results

We update our GDP growth forecast in 2013 from

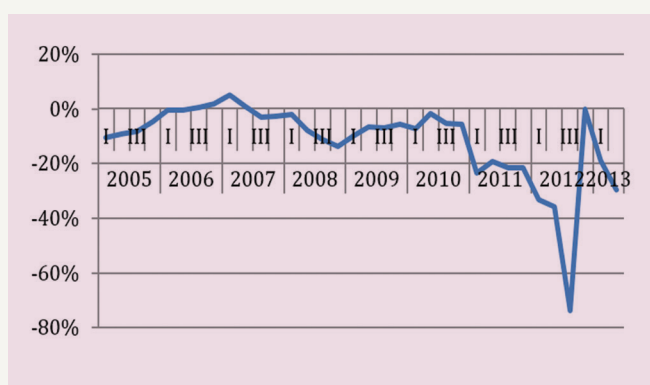
FDI, mln USD and 12mo moving average



Inflation, %

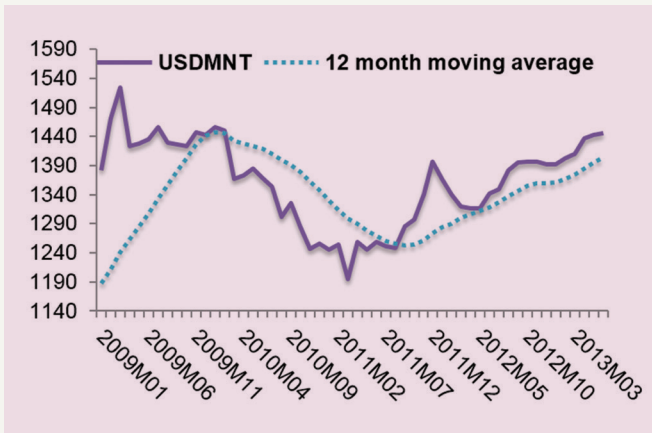


Foreign trade balance, as percentage of GDP



10 percent to around 8 percent. While OT production will contribute to GDP, other mining, especially junior mining and exploration projects, will continue to shrink. 2013 carries on to reveal structural weaknesses of the economy, such as overdependence of mining and FDI. However, political factors seems to have an even higher impact on the economy. Substantial shifts will continue to occur in 2013, from the private sector to an increased public sector role, from mining sector growth to a larger ▶

Exchange rate, USD/MNT



Mandal forecast for key indicators in 2013

Indicator	2013 (forecast at end 2012)	2013 (forecast at Jul 2013)
GDP growth, percent	10*	8
Inflation, percent	10	10
Loan interest rates, percent	18	18
USD/MNT exchange rate, end year	1250	1700
NPL rate, percent	8	8

► share for infrastructure, logistics and construction, from a predominantly FDI and international financial institution-financed economy to a commercial bond-funded economy. Sustainability of fundamentals remains a key issue.

Progress made in lowering inflation is likely to reverse in the second half. We think that growing housing prices (driven by subsidised mortgage loans), a weakening national currency and perceived instability in the economy will take a toll, and it would be difficult to keep it at single-digit levels. It is estimated to be around 10 percent or higher. Fiscal stability becomes the main concern for the second half of the year, as revenue collection falters. The government will need to stop some investment project financing, and also cut down on current expenditures.

Commercial loan interest rates have fallen during the first half of the year by 1.2 basis points to 17.9 percent

at a weighted average. Loan growth rates are rising, but the fact that bank liquidity is short term, room for further growth is limited. Loan interest rates are projected to stay at around 18 percent.

Exchange rates reflect not only on foreign currency demand supply balance, but also on overall risk perception. Given current weaknesses in the economy, it is likely for people to hold to dollars, supporting further weakening of the local currency. We forecast that exchange rate against the dollar will reach MNT 1,700 by the end of the year.

The banking sector is not immune to sudden shocks. Failure of one of the large banks would have an impact on systemic health. All banks are required to become compliant with higher capital adequacy ratios. Non-performing loan rates, although remaining low, has high concentration risk. ■

Negative consequences	High	<ul style="list-style-type: none"> Rising inflation 	<ul style="list-style-type: none"> Distress in some segments of the construction sector High fiscal deficit, leading to fiscal instability 	<ul style="list-style-type: none"> Heavy involvement of the government in private sector Deterioration of investor environment leading to shrinking of mining sector
	Medium	<ul style="list-style-type: none"> New Chinese government policies not favorable for Mongolia 	<ul style="list-style-type: none"> Worsening liquidity of banks Scarcity of loans, reducing turnover of the economy Increased NPLs, banking sector instability 	<ul style="list-style-type: none"> Plunging global commodity prices Increase foreign trade deficit Increased FX fluctuation
	Low	<ul style="list-style-type: none"> Epidemics and pandemics in neighboring countries Natural disasters 	<ul style="list-style-type: none"> Increasing prices of imported fuel from Russia 	<ul style="list-style-type: none"> Slow recovery of the global economy
		Low	Medium	High
		Probability of occurrence		

EXPORTS

ADVICE ON EXPORT

B. TOGTOKH

An economy without export is without legs. Any country dependent on the huge consumption of imports always sees price growth for imported goods. Mongolians, too, have experienced this phenomenon.

Despite promises made, there has been no drastic change to these circumstances in Mongolia. There has been a lot of talk of supporting export production and propping up domestic industry to substitute the import of goods, including a recent statement by Prime Minister Norovyn Altankhuyag that the government would make support for export production a top priority. Mongolia is also getting a loud reminder of the value of diverse export trade with the recent economic slump spurred on by the fall in mineral prices and weak demand from China for coal.

A workshop was held in August on how to improve export capacity, organised by an EU initiative to support small business in Mongolia and the European Bank for Reconstruction and Development (EBRD). The main goal was to help Mongolian firms meet international standards for export and help them identify their target markets.

Some 25 firms providing advisory services in Mongolia attended the training, which is being



offered worldwide to 25 countries. The three-day workshop helped these firms advise their clients on establishing domestic production for export and improving their competitiveness over the course of three months.

“It is important to produce products that could replace a portion of the imported goods, outside of mining”, said Ch. Naranchimeg, head of applied mathematics and statistics at the Institute of Finance and Economics.

Naranchimeg said Mongolia should focus on establishing the production of value-added and finished products to combat the negative effects of Dutch disease, a phenomenon witnessed in resource-based economies where

other sectors of the economy grow less competitive.

Mongolian business can also benefit from the weakness of the local currency against the US dollar, as goods made here become more affordable abroad. The government can help by providing tax breaks on the import of spare parts and low-interest loans for small-business development. But production alone is not enough, said workshop participants. Mongolia is also in need of wise management to run these businesses.

“Mongolia seems very interesting to me, as its industries aside from mining try to find their shapes”, said Robert Fonteijn, one of the trainers from the EBRD. ■

CALENDAR

THE SEASON OF CONFERENCES IN ULAANBAATAR

MASA IGATA, CHIEF EXECUTIVE OF FRONTIER SECURITIES

In September, several important conferences will be held in Ulaanbaatar.

Those includes "Invest Mongolia" (Sep2-3), the Discover Mongolia Forum (Sep5-7), the Asian Bankers Association conference (Sep12-13), the World Economic Forum (Sep14-15), and the NAMBC Investors Conference (Sep24-26).

Those conferences are all important especially because those will be the first gatherings of government officials, the private sector and the investment communities since the presidential election in June.

Below highlights each conference in terms of focus and topics and guides readers how they can gather the information they need through those conferences.

2. Downgrade of the banking sector by credit agencies and its implications to future funding costs for bonds issued out of Mongolia

3. The green economy and its business opportunities

4. Abenomics and strong supports from financial markets in Japan

5. Business opportunities in non-mining sectors (Real Estate, Infrastructure, Agriculture, equipment, and etcetera.)

Given the importance of two-way communications, the conference has traditionally consisted of various panel discussions. Therefore, the number of speakers has been one of the largest. Also, the organiser has selected speakers very carefully, securing a high quality for debates. The conference will also be supported by the Ministry of Mining, the Ministry of Environment & Green Development and the Ministry of Economic Development, and attendance of high-level officials from each ministry can be expected.

Major sponsors will be Quam Group, PricewaterhouseCoopers Audit LLC and Moody's Investor Services.

Concurrently with the conference, booths are prepared for companies who seek business relations in capital markets, fund raisings and financial services.

Registration is free of charge for a conference badge. However, to attend the fun networking events, Green, White or Blue badges can be purchased.



Invest Mongolia (Sep2-3)

Invest Mongolia has been the biggest event in Mongolia for foreign investment communities who are involved in capital markets (stocks and bonds). The conference will be held at Chinggis Khan Hotel on September 2 to 3 with 60 to 70 distinguished speakers from all over the world. This year, their focus will be on following:

1. How can Mongolia restore the investors' confidence it has lost since May 2012?

Discover Mongolia (Sep5-7)

Throughout its history, the Discover Mongolia Forum has become a hallmark event for Mongolia's minerals exploration and development sector. The primary mission of the forum is to support the development of the Mongolian mining sector by connecting people, providing information, building networks, and realising the importance of mining exploration and the legal environment surrounding it. »



▶ The conference will be held at the Children's Palace from September 5 to 6, and shall organise a mine site visit on September 7, 2013.

This year, the forum has decided to slightly change the traditional format of the conference. The conference shall be comprised of panels to address core issues that are essential for the development of a robust and effective minerals industry. These are:

- A Stable Legal Environment for the Minerals Sector
- Optimal Infrastructure Solutions for Mining Development Needs
- Environmentally Sound Mining
- Human Resources for Mining: Demand and Supply
- Stakeholders Engagement at the Local Level

Besides these five panels, the mining conference shall organize an ambassadors' panel with the ambassadors of Japan, South Korea, Russia and China to discuss regional cooperation in the minerals industry.

Also, the Conference shall contain an international exchange session presenting the views of Australia, Kyrgyz and North Korea on their perspectives of cooperation with Mongolia in the minerals industry.

Concurrently with the mining conference, the forum hosts an exhibition of geological and mining companies and dozens of companies which provide various services to the minerals industry.

The registration fee is USD 500 for a white badge and USD 900 for a green badge (full access).

Asian Bankers Association Conference (Sep12-13)

The Mongolian Bankers Association (MBA) will host the 30th Asian Bankers Association (ABA) general meeting and a conference in Ulaanbaatar on September 12 and

13 at The Blue Sky Tower and Hotel, according to a news agency.

Chaired by ABA Chairman Lorenzo V. Tan, the Planning Committee focuses on the theme "Asia: Growth Engine of the Global Economy".

Intended to provide a platform for ABA members, the upcoming conference has invited experts to discuss how major developments in the global and regional markets will impact the Asian banking sector and to exchange views on measures the Asian banking sector can undertake to help sustain growth. Also, they wish to enable the Asia-Pacific region to play a catalytic role in the global economic growth and recovery.

Eminent speakers from both government and the private sector will share their views and insights on topics such as "Global Macroeconomics: Key Factors for Asian Banks", "Investment Opportunities and Challenges in Emerging Asian Markets", and "Electronic Channels: Reshaping the Financial Services Industry".

The CEO Forum will provide a high-level field for top bank executives and leaders to share the best practices and experience, debate current strategic issues in banking, and discuss winning business approaches.

The "Discover ABA" session presentations, on the other hand, will be made by select ABA member banks on their respective financial markets.

The arrival of this conference is very timely, given that the banking system in Mongolia is being questioned after the bailout of Savings Bank and the downgrading of credit



rating agencies on Mongolian banks.

However, we do not know how much in depth the debates will be conducted as the topics cited are too general. We hope MBA will get some suggestions from ABA on how monitoring systems for financial institutions are introduced in other Asian countries to ensure the credibility of the system.

World Economic Forum (Sep14-15)

According to the organiser of the event, the country is now at a crucial turning point. Also, Mongolia's future prosperity is affected by a range of highly uncertain drivers of change, including the reliability of foreign investments, fluctuating commodity prices and the future of geopolitical ▶



▶ relations with neighboring Russia and China.

The World Economic Forum Strategic Dialogue on the Future of Mongolia will bring together the Mongolian government and World Economic Forum strategic and industry partners, select foundation members, global growth companies, and Young Global Leaders and Global Shapers to explore future economic pathways for the country.

This meeting forms an essential part of the World Economic Forum's Scenarios for Mongolia project, the outcomes of which will be presented at the 2014 World Economic Forum annual meeting in Davos-Klosters.

This forum may impact the future direction of Mongolia and include the attendance of known international speakers and high level government officials.

Also, it is important to note that some portion of the forum will be done completely off the record, which implies that more concrete solutions might be expected out of the forum later on.

The forum will be held at IkhTenger and Blue Sky Tower and Hotel from Sep14 to 15.

NAMBC Investors Conference (Sep24-26)

The Chairman of the North America-Mongolia Business Council (NAMBC) has recently announced that Sanjaa-



surengyn Oyun, minister of environment, and UB Mayor Erdenyn Bat-Uul will be featured speakers at NAMBC's 16th Annual Investors Conference, from September 24 to 26, 2013, at the Kempinski Khan Palace Hotel. Oyun will be the lead speaker in the segment on "Green Development is Profitable Development" and Bat-Uul will kick off the segment on "Urbanisation in Mongolia and the Transformation of Ulaanbaatar." Other conference panels will address "The Future of Mining in Mongolia" and "Investment and the Mongolian Economy."

The Investors Conference will also celebrate the 40th anniversary of Mongolia-Canada diplomatic relations this year.

The 16th Annual Investors Conference convenes in Ulaanbaatar just a few days before the State Great Khural (parliament) opens its fall session. Parliament's crowded agenda—and the agenda for their conference—includes a new minerals law, a revised investment law and other legislative and policy developments affecting both foreign and domestic investors in all sectors, including mining.

The registration fee is USD 1,600 for non-members.

This conference is particularly useful for US and Canadian Investors who are interested in both the mining and non-mining sectors. However, investors from other regions are welcomed to attend as well. As the registration fee is rather expensive, the number of attendees is less than other major conferences. But, the quality of the delegates is high. Therefore, listening to the series of free discussions and question-answer sessions will be a stimulating experience.

Conclusion

First of all, these conferences are very important for foreign investment communities to understand the policies that have been taken by government officials going forward. We believe that the politicians are aware that the current situation is critical. But, we are still not sure what kind of measures are to be taken in the near future.

Secondly, for investment communities, understanding the most up-to-date business opportunities and risks will be rewarding.

Thirdly, for Mongolian companies, networking with foreign visitors will be a valuable opportunity because many foreign visitors from overseas have found themselves in a tough environment this year. Generally, they are very seriously thinking about their business in Mongolia and with a cautious outlook.

In any case, we hope these conferences will be an opportunity for government officials to understand the demands of foreign and private companies and the need for quick implementation of those measures after getting consensus within government. ■



B. Medree, chief executive of Trade and Development Bank of Mongolia and vice president of the Mongolians Bankers Association

BANKING AND FINANCE

BANKERS CARRYING THE WEIGHT OF THE ECONOMY

In light of the Asian Bankers Association's general meeting to be held in Mongolia, Mongolian Economy spoke with B. Medree, chief executive of Trade and Development Bank of Mongolia and vice president of the Mongolians Bankers Association.

What is the importance of the Asian Bankers Association (ABA) meeting to Mongolia?

It has been some time since the Mongolian Bankers Association (MBA) established its cooperation with the Asian Bankers Association (ABA), and we have been learning from its experience. This time we are giving

high priority to the 30th ABA General Meeting and Conference because it is being held in Mongolia.

This is a clear indication that Mongolia's banking sector has reached the international level. Today Mongolia's financial market embraces the latest financial products and services, advanced technology and ca-

pable personnel in its banking sector. It means that Mongolia's banks are playing the most important role in the country's economic development. During the conference, the leading representatives from financial and banking sectors in the Asia-Pacific region will gather together in the city of Ulaanbaatar and exchange their experiences and achievements, which will further provide opportunity for expansion of the international relations of Mongolia's banking sector and its gain in popularity worldwide.

MBA is honoured to have the po- ▶

▶ tential to host this renowned conference in Mongolia with the support of Mongolian commercial banks.

What are the main points in the agenda?

The conference will take place between the 12th and 13th of September, consisting of several sessions. The main theme for the conference is "Asia: Growth Engine of the Global Economy".

Also numerous speakers from the public and private sectors will share their views and insights on topics including "Global Macroeconomics: Key Factors for Asian Banks", "Investment Opportunities and Challenges in Emerging Asian Markets", and "Electronic Channels: Reshaping the Financial Services Industry". Its representatives are not the ones who are from the financial and banking sectors, but from regional investors and entrepreneurs, Mongolian commercial banks and financial institutes, and the state policy makers. Thus, we are optimistic about the expected results from the 30th ABA General Meeting and Conference. This is obviously a big event which will introduce the Mongolian banking sector to the international arena.

As an experienced banker, what would you say about the current standing of the Mongolian banking sector compared with other nations?

Compared with the other banks, Mongolian commercial banks are smaller in terms of their assets. But in the recent two decades, our banking sector has been booming. In Mongolia, the commercial banks first issued IPOs [initial public offerings] and bonds on international markets. The banking products and services that are common in Asia and Europe are all here in Mongolia, too.

Mongolian commercial banks have relatively good indicators because the banks carry a huge economic burden for Mongolia. The total assets of Mongolian banks comprise 85 percent of GDP.

What has MBA done to encour-

age collaboration between banks?

Please note that MBA is not a business organisation. It is a professional association in which bankers gather together to discuss policy in the banking sector and address the related issues.

MBA is playing a very important role in the close cooperation and development of the commercial banks. For example, there are some professional councils including risk management, human resource, special assets management and IT management. These councils enable the banks to identify issues together, to determine their collaborative stance and to seek the right solution.

Also the commercial banks have discussed how to further implement the mortgage programme sponsored by the government of Mongolia as well as its conditions and the deliverance of their proposals to the relevant authorities.

So, I would say that MBA's operations are as good as its hosting of the

30th ABA General Meeting and Conference, with the support of Mongolian commercial banks.

Regarding the 8 percent mortgage loan programme, has it been successful in reaching its target population and what successes have been made as a result of it?

The commercial banks have managed to successfully conduct the mortgage programme, which is now being provided for clients on a normal basis. There are enough sources for the mortgages, and the banks are striving to provide good services for their clients who have fulfilled all the requirements for the mortgages.

TDB [Trade and Development Bank] issues loan for citizens with middle income, who are the targeted group. Borrowers of TDB constituted more than 25 percent of overall loans 42 days after the commencement of the programme, according to figures from the Bank of Mongolia. ■

MONGOLIAN ECONOMY'S QUESTION

HOW CAN MONGOLIA AVERT CRISIS?

Mongolia's rapidly growing economy is in sharp decline, mainly due to the falling export of mining products. Mongolian Economy asked public officials and professionals on their opinion of how Mongolia can pull itself by the bootstraps and return to world-beating growth.



D. Zorigt, Member of the State Great Khural

Most importantly, the investment environment needs to be clear in order to bring the confidence of foreign investors back. I have been working on a draft Investment Law for a while. Thus, this law should be approved first. The bill sets out to stabilise the tax environment, without increasing the volume of the main taxes.

Because this law is entirely dedicated to the foreign investors who lost their confidences in Mongolia, it would be a great stimulus to revive their confidences. After this, the government of Mongolia will have to make a special plan for the mining industry. The State Great Khural has been taking precautions against any possible risks, which it will have to work on with its legislation while creating policy. ▶▶



O. Chuluunbat,
Vice Minister of
Economic Development

► Improvements need to be made in the legal and investment environments. Today's weakness in Mongolia's economy is due to the deterioration of its legal environment. Also one thing that the Mongolian state should focus on is the succession from a previous government to a new one.

The government of Mongolia is not doing well on the succession [of governments]. If an agreement was made by a previous government, there is no way the next government should be able to deny it. Now Mongolia is called a country lacking legal improvements on the global market.

In order to improve its legality, Mongolians need legal education. Otherwise, there will be nobody to talk to and a lack of respect for Mongolians on the market. Indeed, there was a good tradition for Mongolians respecting their business partners, even if their businesses were unsuccessful.

The previous government made agreements with Rio Tinto and China's Chalco. These agreements need to be complied with by the current government. If there is any problem with the agreement, it is better to ask former Prime Minister S. Batbold, former Finance Minister S. Bayartsogt and former minerals and energy minister S. Zorig on what were the principles in which the agreements were made.

As we did not have discussion internally, we must not blame foreign investors on the agreement. In this case foreign investors cannot understand us. Thus, we need a particular policy in which Mongolia's succession, tradition and ethics can be included.



Namgar Alгаа, chief
executive at the
Mongolian National
Mining Association

The solution will be short- and long-term policies. It is good that the long-term policy has just begun today. This would be a good standard if we could establish fundamentals with a new Investment Law, which would stabilise the mining industry in Mongolia.

There is no need for an updated version of the Minerals Law, which has already been amended three times before. I think that summing up the successes and mistakes with a little amendment would be fine, as it was already last amended in 2006. In this way, we could save our time.

According to the Constitution of Mongolia, any private properties shall be deemed public property. But in reality, the rights of private properties cannot be protected properly. At least, its rights should be protected at any judicial stage. Today, the state properties are protected, but the private ones are not.



B. Lkhagvajav, an
Economist and Lawyer

A policy should be as soft as possible and loan forgiveness needs to be granted. By doing so, accounting and payment issues will be put in order and undisclosed financial statements will be tackled. Additionally, the state needs to support not only foreign investors but it also needs to support domestic entities. In doing so, some tax incentives could be proposed for entities based on their salary funds, which will prevent job cuts. Unreasonable tax incentives should be discontinued. Leaving the market free in this way would be a great contribution by the government of Mongolia.

If the Minerals Law cannot be amended with compromise, there should be an official announcement that the same rules will be enforced during the next five years. I want the government of Mongolia to make its minerals policy clear and to go to China to make more agreements on the export of coal.

It is important for the government to come up with a solution on further cooperation with China, the main coal supplier, especially at the time when there is a sharp decline in the price of coal, which makes up the majority of Mongolia's state budget. ►►



Chuluuntseren Otgochuluu, Director of the Department for Strategic Policy and Planning at the Ministry of Mining

► Mongolia has been included in the top five countries in the world for its export of mining products in only five years. Export will hopefully expand in the future. It takes so much time to learn to manage and regulate any changes that happen during very rapid growth. It makes us understand that the Chinese economy cannot maintain its growth forever and that it cannot purchase mining products from Mongolia all the time.

Thus, there is a lot to do to decide how to export coal to the third-market countries (which includes Japan and South Korea), how to process coal, whether to be dependent on the export of coal and copper, and whether to diversify gold, iron, spar, oil and rare earth elements. The Ministry of Mining is carrying out research on these minerals.

With the financing of MNT 7 billion from the state budget, geological research is being conducted in order to identify what is underneath the territory of Mongolia. This is not exploration, but it is a research study that precedes exploration. For exploration, we have no choice now but to trust the private sector. For this case, they ask us to show a general layout of minerals in the territory of Mongolia. Thus, now the ministry is doing a lot to prepare such a layout.

For legal purposes, one change in a law cannot improve the investment environment. The authorities are working on making an integrated policy to regulate the issues ranging from issues mentioned to issues that are regulated by the Minerals Law as well as some issues regulated by the Petroleum Law and the Budget Law; and making regulations to remove ambiguity or conflict between the laws. ■

TAXES

CIRCLING THE DRAIN

BY B. TUYA

Mongolia's mining sector is in dire need of help.

The irony is the sector that should be carrying the entire economy is in need of a helping hand. The reason is simple: the loss of foreign investment and legal instability have put development on hold. There is also the matter of exorbitant taxation, making it difficult for companies to operate profitably.

While the situation is obvious, ►



policy makers are still claiming that the economy is doing fine.

According to a recent study by the Mineral Resources Authority, mining firms contribute 32.9 percent of all taxes. That is relatively low compared to, for example, Uzbekistan, where 62.9 percent of taxes originate from the mining industry. Although the government has sold mining firms on the idea that its tax scheme is extremely flexible, mining companies are feeling the onerous pains from tax collection as they fall on hard times.

The Real Picture

In addition to the slump in mineral prices, foreign investment has come to a trickle due to perceived instability in the legal environment. However, there is another factor affecting the sector: "It is incomprehensible that the mining sector is seen as a vending machine that you can take money from. Plus, under the name of tax revision the government tends to deduct invalid taxations", said Namgaryn Alгаа, the executive director of the Mongolian National Mining Association (MNMA).

When mining companies find it hard to be profitable, custom fees become a greater burden, say domestic companies. But according to N. Erdenemyadag, a tax official specialising in mineral resources at the General Department of Taxation, the burden is relatively light.

"Compared to other countries like the Scandinavian countries", said Erdenemyadag, "taxation in Mongolia is quite low. However, the unsustainable legal environment seems to be the main issue".

It is the structure of the tax system, argue miners, that is actually working against them. They say they are forced to pay taxes for a quoted price that is actually higher than what commodities are selling for on the market.

Erdenemyadag defends the practice: "Using a market quote to set the price is not only done in Mongolia. Other countries, such as Kazakhstan or Indonesia have the same policy as well. If global trends change, it is possible for the quoted prices for mineral resources to change. However, domestic companies have different sales prices. Thus, we can only calculate an average and calculate a quote".

But in practice this does not work so well. For example, Energy Resource sells raw coal for USD 46 a tonne while paying taxes for a quoted price of USD 76 a tonne. Diversified miner Mongolyn Alt (MAK) sells processed coal at USD 80 while paying taxes on a government quote of USD 96 a tonne.

"Taxation is putting pressure on Mongolia's mining sector in every possible way", said Alгаа.

Unwise Policy

A foreign relations minister for the Netherlands once said, "Good taxation plays an important role in strengthening the legitimacy of the recipient government". But in Mongolia's case, the tax regime seems to only serve itself.

"The tax policy must be improved", said MNMA's Alгаа. He added, "The government can't just demand that taxes be paid when there is no profit to be made".

Mongolia's handling of double tax agreements is another example of how misguided Mongolia can be when it comes to tax collection. When Mongolia was eager for foreign investment it made tax agreements with over 30 countries. Under normal circumstances, Mongolia would levy a 20 percent withholding tax on dividends paid by mining companies. But the dual taxation agreement allowed Dutch-registered firms to channel income from dividends, royalties and interest earned in Mon-

golia through their shell company in the Netherlands, allowing them to avoid paying withholding tax to Mongolia, explained Reuters in an article published last July.

When Mongolia grew tired of the lost revenue and felt less need for foreign investment it attempted to negotiate for better terms. The International Monetary Fund encouraged the move, saying Mongolia should consider "selectively re-negotiating" more than 30 tax treaties which were potentially harmful to tax revenue. Although the Fund recommended terminating the agreement as a last resort, Mongolia opted to do so just when the negotiations did not go quickly enough. Mongolia then hastily cancelled its treaties with Luxembourg, the Netherlands, the United Arab Emirates, and Kuwait.

The Next Step

Political instability will not do any favours for Mongolia in its development. However, creating that stability has proven a difficult task for Mongolia, a young democracy in the midst of some growing pains.

"The department holds regular meetings and gatherings with mining sector representatives. We try to reflect their ideas and opinions on the policies we make. We totally agree on the fact that improvements should be made. Step by step we are trying to bring innovations and work closely with tax payers", said tax authority Erdenemyadag.

Private sector associates are praising President Tsakhiagyn Elbegdorj's initiative to bring order to all the chaos in the political sphere. However, they are skeptical about the outcome promised. Mining companies are hoping the government will make progress in supporting the sector, instead of pressing business for more tax money. ■



FORUMS AND EXHIBITIONS

WITHOUT FOREIGN INVESTORS

It has been several centuries since the world's nations first began using their natural resources. According to ABS and MinEx Consulting, there have been 485 medium-size deposits discovered, in addition to 245 deposits the size of Erdenet and 47 deposits like Oyu Tolgoi. Clearly, Mongolia is not the only country with mineral wealth. But how reasonable is it for Mongolia to act as if the world would starve without Mongolia's resources?

Worldwide, approximately 40 billion tonnes of mineral resources and oil are mined a year. Mongolia exported 3.4 tonnes of gold and eight million tonnes of coal in the first seven months of this year compared with 18,940 tonnes from Kyrgyzstan in 2011. Of course, it exports some other mining products, but their volumes are not significant. With 2.6 million tonnes of gold produced worldwide in 2011, clearly Mongolia's contribution is merely a drop in the ocean.

In the first quarter of this year, Mongolia's GDP grew by 7.2 percent from the previous year, the worst in the past

three years. This is not the only area of declined growth, either. According to the mining minister, the economy has also seen a decline in the price of coal and reduced demand from China.

Mongolia's Fortune

"We have to accept that Mongolia's economy is returning to its normal level, by gradually cooling off after overheating during the boom years", said Mining Minister Davaajav Gankhuyag.

The minister's words have awoken Mongolia from its dream. In 2011 Australia suffered from a huge flood, severely hampering its coal production and, as an effect, boosting coal prices. This helped Mongolia expand its export to reach economic growth of 17.3 percent for the year. In 2011 Mongolia's coal export increased by 27.5 percent to reach 21.3 million tonnes.

Startled by the competition, the Australian Associated Press published an article in August 2010 titled: "Mongolia can undercut Aussie coal export". The

current leading suppliers of coal to China are Australia, Mozambique and Russia, with Mongolia lagging far behind. And now the coal industry in Australia, the lead competitor, is fully revived and once again sits at its top position.

Can Mongolia ever compete with Australia, Canada and Mozambique? And will coal prices ever return to the levels of before the decline? Although it has the good fortune of bordering China, it does not have the economic advantage one might expect. Transport of sea-borne coal to China costs between USD 15 and USD 25 per tonne of coal, depending on the distance travelled. That compares with USD 20 a tonne for coal from Mongolia. There is the argument that Mongolia needs to find new markets for its coal, such as South Korea and Japan, and that it must refine its minerals for added value. Meanwhile China has agreements with a number of countries for coal trade and its own production. In short, China does not have to ever rely too heavily on Mongolia for its minerals.

The declining economic figures in- ▶▶

► dicating that Mongolia cannot scorn foreign investors without risking losses in the minerals sector, which comprises 20 percent of GDP and 90 percent of exports. Foreign direct investment declined 43 percent in the first half of 2013 compared to the previous year. This prompted the mining minister to state that Mongolia has to accept that the previous projection for 30 million tonnes of exports in 2013 was too optimistic. Another projection predicting 20 million tonnes of exports has been made, but the current outlook indicates that anything above 10 million tonnes this year is unlikely.

In 1997 Mongolians dreamt of attracting a mere 1 percent of the world's investment for exploration. But in 2004 Mongolia attracted about four percent of total investment, according to Metals Economics Group. Breaking it down, 2011 figures show Canada representing 18 percent of total investment for coal exploration in Mongolia; the USA was 8 percent; Chile was 5 percent; Australia was 13 percent; and South Africa was 6 percent.

It's Me or Nobody at All

In an economic lecture on resource nationalism delivered at Johns Hopkins University in California, Mongolia was included in a list amongst Russia, Venezuela and Kazakhstan; a list of countries where the resource nationalism disease had infected and weakened the economy. Russia is one of the world's most powerful nations while Venezuela has many years of experience in mining, with great technology at its disposal. But Mongolia has no defence against resource nationalism. Mongolia may become a clear example of resource nationalism, just like it is for Dutch disease.

Currently Mongolia lacks the investment, equipment, technology and experience to utilise its natural resources. A one-meter drill hole costs between USD 100 and USD 120. That may justify Mongolia in taking its foreign investors in the mining industry for granted, but they carry the burdens of high risk and high cost. The quick approval of the Foreign Entities Strategic Investment Law (SEFIL) has proven that Mongolia already suffers

from the resource nationalism disease.

At this moment, when there is not much foreign investment left in the mining industry, every Mongolian boasts that it is me or nobody at all. The two world-class miners BHP Billiton and Vale have already left Mongolia. It is no big deal for mining companies of that scale to come and go from Mongolia. But it is important

for Mongolia to secure foreign investment.

If Mongolia continues with the misguided policies that have driven foreign investors to abandon it, they will never return. Mongolia is not the only nation with natural resources in the world.

Source: "Unuudur" newspaper ■

HEALTH

OCCUPATIONAL SAFETY AND HEALTH IN MONGOLIA



E. ZORIGT

Each morning urban residents wake up to the sounds of their alarm clocks and larks tweeting in the cool air. Some people prefer to get up early in the morning and go to work, while others commute via public transport with sleepy eyes, trying to get to work on time. Most

people spend at least eight hours at work. It means most of our time awake is spent at work. Thus, it makes sense to expect the relations between employer and employee should be civil and the workplace be safe and secure.

Many centuries ago, employers' rights prevailed over employees'. But today protecting employees' rights has ►

► become a main responsibility for employers. In countries where the occupation safety and health system is well developed, employees are happy with their daily tasks and their performance is often more productive. Needless to say, their employment lasts longer, too.

As rapidly as Mongolia's mining sector develops its labour market, it is also developing a growing sector of suppliers and small industry. But unless Mongolia develops its own occupational safety and health standards, employees will not be able to place their trusts in the labour market.

Vital Issue in Important Industry

Much of the Mongolian workforce is employed in the mining and construction industries. However, these industries carry some of the highest risks of injury and death, which is why they can ask for higher salaries. According to Chart 1, the most number of accidents at the workplace occurred within the mining sector.

But it is also for that reason that mining operations have what many miners call exemplary occupational safety and health standards.

"According to Mongolia's Law on Occupational Safety and Health, approved in 2008, all organisations must follow occupational safety and health standards at the workplace", said Z. Monkhsul, a senior state inspector on occupational safety and health at the State Professional Inspection Agency. "As large foreign firms operate in the mining industry, they bring their own experiences. For example, Rio Tinto is adopting the British occupational safety and health standards at Oyu Tolgoi".

But that certainly does not fit the public perception, which sees mining as dangerous, dirty, and often times not worth the risks involved.

"Mongolians have a poor understanding of occupational safety and health standards", said Namgaryn Alгаа, head of the Mongolian National Mining Association (MNMA).

Saying that domestic companies are doing nothing would be unfair. Support from Germany's Federal Ministry

of Economics and Technology and the German Society for International Cooperation's (GIZ's) Integrated Mineral Resource's Initiative, have allowed MNMA and Mongolian gold miner Mongolyn Alt (MAK) to launch a host of occupational safety and health standards in Mongolia and go beyond the minimum standards set by Mongolian law by following international standards.

"Occupational health and safety improves the competitiveness of any company", said Ch. Erdenebayar, head of MAK's health, safety and environmental division. "Thus, health and safety is not necessarily looked at from a cost perspective." He noted that at MAK employees follow the standards from the international regulatory body Occupational Health and Safety Advisory Services (OHSAS).

An update for the Mongolian Law on the Occupational Safety and Health is under way to clarify some of the ambiguities in the law as it currently reads. It will be important for the new law to offer clear definitions of terms and expectations. Also training will be crucial to ensure that employees understand what is expected of them.

"I would agree that mining experts in charge of occupational safety and health need to gather together for discussion on making our procedures clear", said Erdenebayar. He added, "Miners cannot

act on their own accords. If they did so, there would be no accountability".

Tragedy

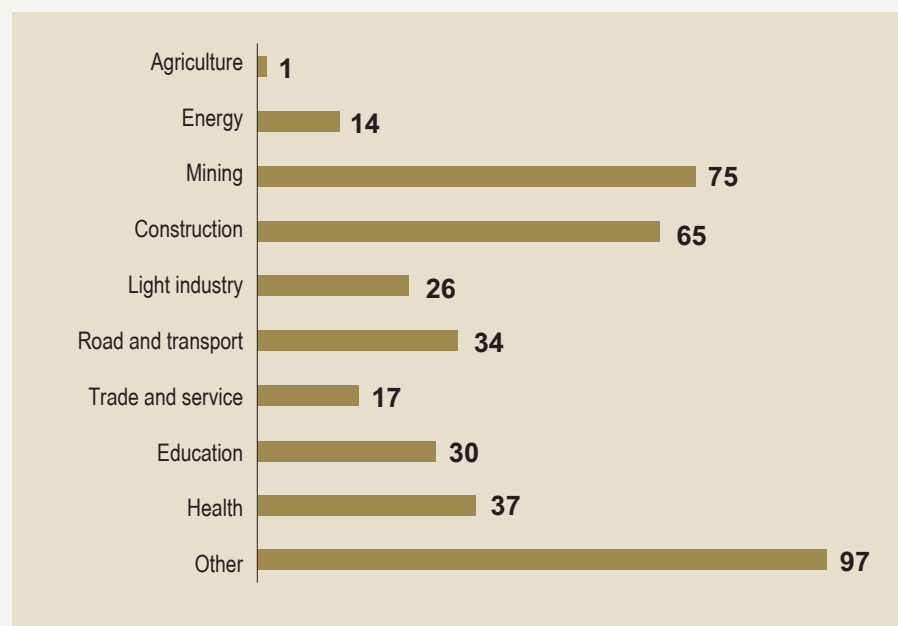
"We should understand that occupational safety and health is an integrated and complex system", said MNMA's Alгаа. "The whole system cannot be changed by addressing only one issue."

Erdenebayar takes it a step further, saying these concepts should be taught from grade school through to university. He said that this idea was already mandated by the law, but was largely ignored. He said if every citizen had the right education training, they could do more when they come across emergencies.

"There have been several cases of death near construction sites due to irresponsibility", Erdenebayar said. "When a young man was heavily injured on the head and lying on the ground until death, the people around him only took pictures instead of providing first aid to him. They could have provided him with the first aid, but none of them did. This is because they had no idea what to do about it".

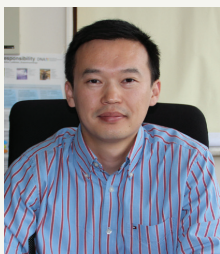
This is a tragedy. It could have been prevented. If only everyone took part in building a concrete foundation for safety; they could help create a safer society for us all. ■

Chart1. Industrial accident (2012)



CSR

CORPORATE SOCIAL RESPONSIBILITY IN THE MINING INDUSTRY



OTGONBAYARYN BATBOLD is a component coordinator at the German Agency for International Cooperation (GIZ).

The mining industry is at the centre of the attention of communities and state organisations, not only in Mongolia but also internationally. There were a number of cases where mining companies wasted millions of dollars due to the absence of policies for sustainable development before commencing their exploration activities. But it cannot be said that in Mongolia there is no good example of corporate social responsibility (CSR), where there are some companies which are doing very well.

There is a lot to be done to make others understand what has already been accomplished and how they can learn from those accomplishments. There is a question that remains unanswered in Mongolia: how do mining companies understand CSR?

To reach an answer to this question, the German Agency for International Cooperation (GIZ)'s Integrated Mineral Resources Initiative (IMRI) carried out a study in 2011 on the mining industry in Mongolia. The study found the greatest response surrounding two concepts: wildlife conservation and restoration of closed mines and relations with localities that are directly affected by the operations of mining companies.

The second issue includes support

to local socio-economic development, public awareness among locals on the impacts of mines and the measures to be taken while involving locals in the resolution of important issues. Involving stakeholders in decision-making related to mining would be a fundamental basis for transparency and responsibility in the mining industry.

Other components of CSR relevant to the mining industry include the economic contribution to society from mining via payment of taxes owed, transparency regarding tax payments and licence issuance, and occupational safety and health standards for employees. Additionally, mining companies need to follow the International Council on Mining and Metals (ICMM) principles, ISO 26000 standard and Paul Collier's Manifesto of Natural Resources.

According to study results compiled by GIZ, although stakeholders and decision makers had some ideas or knowledge about CSR in the mining industry their knowledge was incomplete. Their understanding has the potential for further expansion. However, it was not yet a basis for implementing policy and economic concepts.

In summary, we need to understand that CSR is something that includes environmental, economic and

social issues, and these three themes are interconnected, which should not be separate from one another. If Mongolian mining companies implement CSR, they will be accepted internationally and they would be able to acquire what the international community calls the "social licence".

Western mining companies have systematically adopted CSR in their management systems by making policies in the past twenty years, and they have voluntarily used the standards for environmental conservation, human rights protection and occupational safety and health. Thus, Western companies operating in Mongolia are on the leading position in terms of CSR compared to their Mongolian, Russian and Chinese counterparts.

Recently, large Mongolian mining companies have also commenced the implementation of CSR. According to mining company representatives, CSR improves their competitiveness. Therefore, the leading Mongolian mining companies have initiated capabilities to systematically implement CSR. These companies are aiming at becoming the leaders in terms of CSR and support to small and medium enterprises for its implementation.

Large Western and Mongolian mining companies are especially in- ▶

► terested in the implementation of CSR. Some of the companies participating in the GIZ study said the main issues in their strategies on CSR were occupational safety and the health of employees, environmental conservation, cooperation with locals and the involvement of locals in decision-making. The relations between mining companies and locals were often connected with the topics of local development. The companies often provided the local governments with the financial support to be used in developing the local infrastructure and improving the public service qualities of kindergartens, schools and hospitals.

Mining companies are also greatly interested in the improvement of specialised professionals in Mongolia, as the country lacks them. That is why some companies have already commenced the organisa-

tion of some mining-related refresher courses and training in local areas.

As such, there are some advanced-progressing activities in Mongolia. But all of the CSR programmes among the Western and Mongolian mining companies seem to fall short of their full potential because of a lack of economic support. Also the policy and legal environment is not comprehensive enough.

For instance, legislation is often unclear and its implementation at the administration level is inadequate. Also, there is the absence of a comprehensive socio-economic development policy in which mining companies can use for guidance.

All stakeholders involved in the study unanimously agreed that there should be a formal document that includes the main elements of CSR for the mining industry and a particular mechanism for economic support to implement those concepts. ■

with a PMA awarded on 18 January, had resolved the key aspect of the investment dispute filed on 11 July. The PMAs relate to three mineral exploration licenses held by SouthGobi Sands, being licenses 9449X, 5267X and 13779X. License 9449X relates to certain areas associated with the Soumber deposit outside the existing mining license and the PMA previously granted. Licenses 5267X and 13779X relate to the Zag Suuj deposit.

SouthGobi owns the Ovoot Tolgoi mine, which produces and sells coal to customers in China.

Source: *Mining Weekly*

PROPHECY SIGNS MULTIPLE COAL OFFTAKE AGREEMENTS

Prophecy Coal Corp. announced that it has entered into a binding coal sales contracts with a number of buyers which will involve the sale of over 30,000 tonnes of coal per month from the company's Ulaan Ovoo mine.

The buyers include cement plants, a metallurgical plant, a heat plant, chemical plants and Russian traders. The off-take quantity and a variety of customers reflect the company's significant efforts to drive higher margin sales while satisfying government power plant needs, which are excluded from the 30,000 tonnes per month forecast. All sales require pre-payments, as has been the company's practice since January 2013. The orders reflect strong demand in Mongolian and Russian markets, whereby economies are growing at double-digit rates, and local thermal coal mine production are declining.

The company cautioned that mining operations at the Ulaan Ovoo mine has been curtailed since July 2012. Some orders will be delivered in August and September from existing coal stockpile. Fulfilling all the offtake agreements is contingent on a mine restart, which requires time and capital expenditures. The company has installed significant water-pumping capacity at the mine site and will soon start pit-dewatering aiming to start mining fresh coal by November 2013 and thereafter on a continued basis.

Source: *Prophecy Coal Corp.* ►►



NEWSWIRE HIGHLIGHTS

NewsWire is a weekly news aggregate sponsored by the Business Council of Mongolia. Each week NewsWire delivers breaking and significant news from local and international news sources for a Mongolian and foreign audience alike. The following are news highlights from the month of August:

BUSINESS

MONGOLIA GRANTS SOUTHGobi PRE-MINING AGREEMENTS

Toronto- and Hong Kong-listed SouthGobi Resources Ltd. has withdrawn its "notice of investment dispute", which it filed with the Mongolian gov-

ernment in July last year, after it was granted three pre-mining agreements (PMAs).

The PMAs now pave the way for the company to progress to the mining license application stage. SouthGobi, in which TSX-listed Turquoise Hill owns a majority stake, said on Thursday that the granting of the three PMAs, together

▶ ECONOMY

EPCRC'S MONTHLY MACROECONOMIC OVERVIEW

Economic growth rebounded in the second quarter of 2013. Real gross domestic product (GDP) grew by 14.3 percent in the year to June, a strong improvement on the 7.1 percent growth recorded for the twelve months to March 2013. Expansion in the first half was 11.3 percent, a slow-down from the 13.1 percent growth recorded for the same period one year prior.

Mongolia's government finances worsened slightly in July. The accumulative 2013 budget for the central and local governments is now recording a deficit of MNT 146 billion, up from MNT 133 billion in June. The deficit is an improvement from this time last year, when combined government finances were in deficit of MNT 600 billion. Revenue also remained 10.8 percent higher while expenditure was 4.7 percent down.

The trade balance was in deficit USD 1.3 billion for the seven months to July. This is deterioration since June, but represents a modest improvement compared to the USD \$1.4 billion trade deficit for the same period last year.

The Mongolian tugrug depreciated sharply in July. The monthly average exchange rate fell 2.5 percent to MNT 1,474 against the U.S. dollar. This was the biggest monthly fall in the value of the tugrug since December 2011. The value of the tugrug fell 9.7 percent over the past year to July.

Inflation continued to moderate in July to 8.3 percent. Compared to July 2012 this is a big fall in inflation since it decreased by 6.2 units. The year to date inflation rate was 4.9 percent, while inflation for the month of July was a modest 0.1 percent.

The money supply (M2) increased only slightly in July. M2 rose 1.1 percent from the previous month reaching MNT 8.1 trillion or USD 5.4 billion. M2 is 16.3 percent higher than the same period in July 2012.

Bank deposits rose by 4 percent in July to MNT 5.2 billion. Deposits are now 18.6 percent higher than a year ago despite recent problems in the banking sector. Deposits in foreign currency

grew quickly in July, rising by 11.5 percent to MNT 1.2 billion, while tugrug deposits grew by 1.9 percent.

Non-performing loans rose 43 percent in July.

Source: Economic Policy and Competitiveness Research Center

PREMIER ATTEMPTS TO COOL FEARS SURROUNDING THE ECONOMY

Prime Minister Norov Altankhuyag attempted to assuage concerns for the economy during his 30-minute weekly press conference on 24 August.

The prime minister was quick to point out the positives in the economy, with 11.3 percent growth for the first half of 2013 compared with 12.4 percent for the same period in 2012. He also noted the drastic fall in inflation.

"The inflation rate was 14 percent last year, now it is 8.3 percent this year, meaning that the government's policy on lessening the price soar of consumer products is successful", said the premier.

He went on to say that unemployment had also fallen, thanks to the creation of 37,000 jobs, largely spurred on by the government program "Let's Live in Our Motherland." He said his Cabinet was paying great attention to the loss in foreign investment and the decline to the currency exchange rate for the tugrug to the U.S. dollar. In addition to the close of phase one development at the Oyu Tolgoi copper mine, the prime minister noted that gold mining firms had been receiving less investment due to legislation prohibiting exploration for gold near certain forestry and water sources. The prime minister noted that falls in the tugrug were normal for this time of the year, while Mongolia could expect more investment with the development of an underground mine at Oyu Tolgoi.

The prime minister said the government had no plans to increase taxes, and that the fuel price would not increase. He also noted that the 8 percent government-backed mortgage program would continue normally.

Source: Montsame

POLITICS MONGOLIA TO SCRAP CONTRO-

VERSIAL FOREIGN INVESTMENT LAW -OFFICIAL

Mongolia plans to scrap a controversial law designed to curb foreign ownership in what it considers to be strategic sectors, such as mining, a government official said, as the country seeks to kickstart its stalled economy.

The new measure, if passed, will replace the 2012 Strategic Entities Foreign Investment Law (SEFIL), which analysts say has been partly responsible for a slump of 43 percent in overseas investment in the first half of 2013, on an annual basis. Sereeter Javkhlanbaatar, director of foreign investment at the Economic Development Ministry, said the new law would seek to allay concerns about limits in sectors such as mining.

"We won't separate the market between strategic and non-strategic", he told an audience of investors during a meeting of the Business Council of Mongolia on Monday, 29 August.

Sectors identified as strategic by the 2012 law include telecommunications, banking and finance, besides mining. At the moment, companies looking to buy 33 percent or more of any company deemed to belong to a "strategic" sector must secure government approval. State-owned firms require government approval for any interest in a strategic asset, and parliamentary approval for a stake of more than 49 percent.

But it was unclear if a new law could reverse the slide, he said. Javkhlanbaatar said the new law alone would not be enough to bring foreign investment back to levels in 2011, when Mongolia racked up world-beating economic growth of 17.3 percent. He also noted that existing licensing systems governing sectors like mining and banking could be tightened to guarantee national security, which could raise concerns among investors.

Nick Plummer, an analyst at the Economic Policy and Research Competitiveness Center, said tougher licensing terms could actually increase uncertainty and extend delays whether or not the distinction between "strategic" and "non-strategic" was removed.

"Until we see the draft legislation, we can only guess at what changes the government intends to make", he said.

Source: Reuters ■