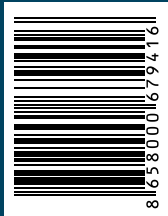


*For green development*

# MONGOLIAN ECONOMY

JANUARY, 2015, ISSUE №01 (080)



www.mongolianeconomy.mn



# BILEGENOMICS

- ▶ Support FDI and raise funds internationally
- ▶ Cut budget and downsize government
- ▶ Raise debt ceiling and pay off current debts with new debts
- ▶ Efficient distribution of social welfare



## REAGANOMICS

- ▶ Reduce the growth of government spending
- ▶ Reduce the federal income tax and capital gains tax
- ▶ Reduce government regulation
- ▶ Tighten the money supply in order to reduce inflation



## ABENOMICS

- ▶ Fiscal stimulus
- ▶ Monetary easing
- ▶ Structural reforms



## OBAMANOMICS

- ▶ Affordable Care Act (aka ObamaCare)
- ▶ Redistribution of wealth (tax hikes on the riches)
- ▶ The Dodd-Frank overhaul of the financial regulatory system
- ▶ Energy regulation



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## EDITOR'S NOTE

**H**appy New Year to all our readers. The New Year holiday was a time for the team at Mongolian Economy to reflect on our past achievements and give thanks to you, our readers. For that reason, our last issue of 2014 was dedicated to sharing a collection of our most important and interesting articles, interviews and opinions over the past three years in a special edition entitled 'Challenge, Solution, Development'.

2015 will be a great year filled with great goals. Besides delivering research and analysis-based articles, we at Mongolian Economy will do our best to present you with interviews and opinions from both prominent national and international leaders and experts.

The year's very first edition presents an outlook on Mongolia's economic development for 2015, as well as prospects for the world economy throughout the coming months.

Recently elected Prime Minister Ch.Saikhanbileg has introduced his plans to combat Mongolia's slowing economic growth, which include decreasing inefficient expenditures to achieve long term development and progress. He called on citizens to tighten their belts for the year, to help prevent a crisis and foster a better future. As Mongolia enters saving's mode, long-term success will require a clear vision and strong leadership—we at Mongolian Economy call this 'Bilegenomics', and herein offer details on the Prime Minister's initial plans for recovery.

Mongolia's development hinges on its ongoing megaprojects in mining. The Tavan Tolgoi project, with the government's recent selection of an investor group, is heading towards firm realization. The article 'Tavan Tolgoi: the giant awakens' presents you a comprehensive outlook.

For 2015, we will continue to provide readers with the country's most important stories and reports on business and the economy, in articles and analysis that can only be found within the pages of Mongolian Economy magazine.

**B.Uuriintuya**

**Editor**



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Please add the red characters after [MongolianEconomy.mn/](http://MongolianEconomy.mn/) to read full versions of the articles found below.



### Housing construction to increase in the foreseeable future

Everywhere across the city in recent years, Central Bank backed housing construction projects have been sprouting up, as the government continues a supply side supportive policy. Since last year, MNT 582.8 billion in mortgage loans have been issued - [en/i/7008](#)

## ECONOMISTS' COLUMNS



**L. Byambaa**

### Bank expansion strategies for the new banking market

Mongolia's current banking sector has been fundamentally cemented to the point where it now plays the main role in the financial sector. Banks currently supply the majority of private sector, business, and citizen demand - [en/p/6669](#)



**Stefan Hanselmann**

### Innovation in Mongolia – many small steps make a big leap

It is common place that the only constant thing in life is the permanence of change - and change harbours opportunities. And what could be better proof of this than this very country? - [en/b/4257](#)



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## MONGOLIA

## Industry



The Derst Tokhoi fuel factory has launched operations at Sergelen soum, Tuv province. It has the capacity to produce 300,000 tonnes of its patented fuel per year, which would provide half the fuel consumption of Ulaanbaatar. Every 2.5 tonnes of the patented fuel produced will burn just as much energy as four tonnes of coal. In terms of price, a tonne of the patented fuel costs approximately MNT 125,000, which is a bit cheaper than raw coal. The factory was built at a cost of MNT 2.8 billion.

## Commodity Prices



The volume of exports has grown while commodity prices declined last year. For example, as of November 2014, coal exports had increased by 5.1 percent, while gold exports by 14.1 percent, crude oil by 39.7 percent and copper concentrate rose by 2 percent, the Ministry of Mining reported. These exports brought in MNT 1.07 trillion in state revenue. Experts say they don't expect a swing in copper prices in the next two to three years. The state budget has a projection of MNT 1,126 billion in state revenue from mining in 2015. That includes MNT 324.3 billion from Oyu Tolgoi, MNT 447.5 billion from Erdenet Mining, and MNT 60.8 billion from Erdenes

Tavan Tolgoi.

## Housing

A ger district redevelopment plan will launch next year. The government will roll out a no-money-down mortgage loan scheme that will cover collateral costs for lending. The 30 percent down payment will be covered by the Ulaanbaatar Housing Fund, which is set to provide MNT 13.5 billion to mortgage borrowers. Kesemar marketing association will conduct market research on housing in Ulaanbaatar. In the past year, most of the apartments sold



were 40 to 50 square meters. All 168 apartments built were part of the re-planning initiative for Ulaanbaatar's ger districts. Funding for an additional 204,000 units in the city is needed, where 65,000 will require 30 percent down payments. Resolving issues with the down payment will be a key objective.

## Roads



Mongolia has a total of 5,000 kilometers of paved road, including the more than 1,800 kilometers built in 2014. That total is expected to expand to 5,700 kilometers in 2015, with roads connecting every province to Ulaanbaatar. Experts say that a lack of routine maintenance has resulted in heavy damage to the roads. The Cabinet Secretariat is planning to restructure the state-owned Ulaanbaatar Road

Maintenance company and permit state-owned holding companies to create their own companies that would focus on specific localities such as Byaynchandmani Soum, Tuv province or the Nailakh District of Ulaanbaatar. Also, provincial governors will select contractors for repairs and maintenance in Dundgobi, Umnugobi, Bayan-Ulgii and Zamiin-Uud Soum, Dornogobi.

## WORLD NEWS

## Indian defense assistance

A Mongolian delegation led by Brigadier General Lkhachinjav, of the General Authority on Border Protection, visited Indian home minister Rajnath Singh in New Delhi in December, to discuss increasing defense cooperation between the two countries. India, like Mongolia, shares a border with China, and seeks to increase its development assistance in Asia to counter-balance China's dominance. Both President Elbegdorj and new Prime Minister Narendra Modi are committed to expanding relations and strengthening ties with other Asian countries, commitments that include military cooperation. During the visit, India offered assistance in developing Mongolia's capabilities in special operations, weapons and tactics, and cybersecurity.

## Oil downtrend



At the close of 2014, a year when resource commodity prices trended downward, oil sunk to a five-year low. Oil prices plummeted 50 percent since June, as per barrel prices went from over

USD 100 to almost USD 50 per barrel. The price decline is a result of an increased supply from ramped-up production in the United States and a decreased demand from China's slowed manufacturing economy. The price of oil will stay low and may even continue to decline well into 2015, according to industry experts.

## Russia's economic crisis



Russia's petro-based economy is slipping into a recession due to diving oil and gas prices and Western sanctions stemming from the Kremlin's role in the Ukraine crisis. As Russia's main exports, oil and gas fund around half of the country's budget, which for balancing needs crude to be twice the current level of under USD 60 a barrel. With the Western sanctions, foreign investment is down dramatically, capital flight is up, and Russian companies and banks are denied access to international capital markets. Meanwhile, the Russian ruble has plunged with the price of oil, and a December central bank extraordinary interest rate hike had the concurrent effect of spiking exchange rates, which peaked at almost 80 rubles to the US dollar. Russian citizens and banks alike have been hit hard. At the end of December, the central bank was forced to save failed lender Trust Bank, a bailout upwards of USD 2.5 billion. More bailouts are expected to follow. As for 2015's prospects, the best-case scenario comes from President Vladimir Putin during his 2014 year-end news conference—economic recovery in two years. The

nightmare scenario is a fall in the oil price to near USD 40, a drop that would force Russia to take drastic capital controls to prevent bank runs.

### Mitsubishi copper contract



Oyu Tolgoi has signed a contract with Mitsubishi Materials Corp to export 5,000 tonnes of copper concentrate to the Japanese company on a trial basis. Mitsubishi imports about 1 million tonnes a year, while after years of delayed expansion, in 2015 the Oyu Tolgoi mine is expected to produce nearly 200,000 tonnes of copper concentrate.

### Eurozone growth stalls



The eurozone economy saw anaemic growth in December and suffered its worst quarter for more than a year, a survey has indicated. The closely watched Markit/CIPS composite purchasing managers' index (PMI) for December fell to 51.4 from an earlier estimate of 51.7. But that was better than the previous month's reading of 51.1, which had marked a 16-month low. The eurozone economy has seen 18 months of continuous, albeit weak growth. Markit said its latest PMI survey, which combines the results of individual surveys of the construction, services and manufacturing industries, suggested the eurozone economy grew by just 0.1% in the last three months of 2014. ■



## # MONGOLIA

### THE LATEST ON TWITTER

**UHRSN @uhrsn** Nov 29

[#Mongolia](#) Under UN Human Rights Investigation For Executive Detention <http://ow.ly/F0HSB>

*Mongolia is able to detain foreigners indefinitely without appeal under its current exit visa ban policy. Three former employees of SouthGobi Resources—Justin Kapla, Hilarion Cajucom Jr. and Crisotbal David—have been detained for over two years without being criminally charged. The travel ban prohibiting visitors from leaving the country continues to scare many foreign investors from coming to Mongolia. Per the US State Department: “since 2010, Mongolian public and private entities continue to abuse the exit visa system to pressure foreign investors to settle civil and commercial disputes.” The United Nations is currently investigating the detention of American Justin Kapla as a violation of international human rights treaties that Mongolia has signed.*

**Jargalsaikhan @SJJargalsaikhan** Dec 22

Development Dialogue 10: Women's Political Empowerment in #Mongolia 23 December, 2014 Ulaanbaatar [www.mn.undp.org/content/mongolia/en/home/presscenter/development-dialogues-/DevelopmentDialogue10WomanPoliticalEmpowermentInMongolia.html#GenderEquality](http://www.mn.undp.org/content/mongolia/en/home/presscenter/development-dialogues-/DevelopmentDialogue10WomanPoliticalEmpowermentInMongolia.html#GenderEquality)

*The United Nations Development Programme and the National Committee on Gender Equality held a dialogue that discussed the challenges Mongolian women face in political participation, and solutions and laws that could increase gender equality in government. As per the UNDP in Mongolia: “Women's representation in the parliament increased to 14.5 percent as a result of the 2012 general elections. However, Mongolia still ranks below the world average of 21.9 percent.”*

**Katherine Johnston @Katherine\_A\_J** Dec 29

ODI's Good News Story of 2014 [#education in #Mongolia](http://www.developmentprogress.org/decline-recovery-post-primary-education-mongolia) [www.developmentprogress.org/decline-recovery-post-primary-education-mongolia](http://www.developmentprogress.org/decline-recovery-post-primary-education-mongolia)

*Since lows in the early 1990s, the accessibility of and enrollment in Mongolian post-primary education has increased to current high levels, near to the average of high-income countries. According to a new report by Development Progress, a project conducted by UK-based international development think tank ODI, post-primary education in both rural and urban areas throughout Mongolia has rapidly expanded to near-universal access for secondary education and high enrollment in tertiary education.*

**Otgonbaatar.A @AOtgonbaatar** Jan 7

Your purchases support small and medium sized businesses better than the state's promotion. [#NationalProduction](#)

*The standard practice of trade organisations in developed counties is to ensure that national goods never have less than equal footing with imported goods. Customer awareness can make a big difference in bolstering local production.*

**Baika Puntsag @baikap** Jan 5

The Shangri La Hotel will be opened and two cinemas will be opened. A year-round ice skating rink will be opened at Khunnu Mall. [#Thisyear](#)

*The majority of development projects that add to the progress and prosperity of Mongolia are being built with the capital of private enterprises.*

**Otgonbayar.Ye@OtgonbayarY** Jan 4

I was introduced to the Monbeliyar breed of cow farm. Mongolians have done something really big here. [#Development](#)

*Monbeliyar cattle, originally a French breed, was recently introduced to Mongolia because of its higher meat and milk production than native cattle. The cow farm in Arkhust soum, Tuv province, began operation last year with five bulls and 300 cows, with the intention of raising a new hybrid breed that can better survive the Mongolian cold.*



PHOTO BY B. BYAMBA-OCHIR

*Mongolia's 28th Prime Minister Chimed Saikhanbileg, elected to head the Solution government*

## GOVERNANCE

# Bilegenomics



**BY B. UURIINTUYA**  
*Magazine Editor*

**F**acing a crumbling economy, Russian President Vladimir Putin defiantly stated in his recent year-end press conference: “No one will ever make Russia feel alone.” Meanwhile, Chinese President Xi Jinping seeks to boost his country’s slowing economy by fostering closer relations with growing economies around the world, already in 2015 pledging USD 250 billion to Latin America in a power move of economic expansion. As the new year unfolds, the world’s economic health is faring less well than could be desired. For Mongolia, as the novelty of its new government wears off, Mongolians look to the new Prime Minister for action to combat their current stagnating economy.

According to economists, Mongolia is not beset by an economic crisis; rather it is struggling with economic difficulties. The major problem is that if it does not address these challenges, the country—with half its population poor—may easily slip into a crisis. Many blame the situation on continued social welfare programmes or

inefficient expenditures of the government. Some even say attempts to buy voters in the 2012 and 2013 elections, by promising and distributing cash, caused the current mess. In a recent speech before parliament, new Prime Minister Ch.Saikhanbileg stated: “We, Mongolians, are the cause of the economic failure. Income from big project investments and mining product price increases were distributed carelessly, while shortcomings were financed by commercial loans, which do not often bring the results we want.” He added: “It is not easy to say words like ‘reduction’ and ‘deduction’. However, it is the medicine Mongolia needs. Although it is difficult for me, as Prime Minister, to cut all expenditures, there is no other choice than that.”

It is the Prime Minister’s duty to save money whenever and wherever he can. It is high time that Mongolia stopped squandering money and treating the State Budget like a wish list. The tradition of politicians making empty promises to stay in politics must end, if Mongolia is to avoid a crisis. »

► The Prime Minister has revealed the general guidelines that will lead policy implementation throughout his term. He notes the importance of increasing credit limits, saying loans should be long term (up to 40 years), and with low interest. This would support the private sector by offering loans with governmental guarantees. He also intends to impose property taxes and decrease state workers by 15 percent. Although he seeks strict policies to limit budget expenditures, he would do so without neglecting the social groups—the poor, old, unemployable, and single mothers—that need state care the most. Generally, however, the vast majority of Mongolians will not be spoon-fed by others, and must learn to feed themselves. Mongolian Economy magazine calls his action plan ‘Bilegenomics’, a catch-all name—in the tradition of Abenomics, Obamanomics, and Reaganomics—for the measures Ch.Saikhanbileg will undertake to restore prosperity to Mongolia’s economy.

According to the Prime Minister, the Mongolian government knows its citizens well, ever since it conducted a detailed survey on population and family living standards. Thus, he said, the government is now able to reach out to those who really need the help. Yet the proposed saving’s mode salvo seems to be aimed at Mongolia’s upright citizens rather than at those sitting in government. For example, there is a procurement budget for parliament members that includes salaries for advisors and secretaries, and allowances for car fuel and mobile phones, that sums up to MNT 90 million a year. Most in parliament are unwilling to give up such amenities. With few significant voices supporting the idea, it is far from being realized. During an interview with a local broadcaster, parliament member G.Bayarsaikhan spoke out by saying: “There is a budget for every parliament member. I, personally, am willing to just go on with my salary as a member of parliament. And if the government can make 15 percent of the state employees redundant, it can start saving from its expenditures.” Although carving off chunks from the State’s own expenditures are routinely discussed, the idea of exactly how the savings will proceed remains undercooked. Meanwhile, politicians are full of ways to cut holes in citizen’s pockets; one of which is by reducing monetary subsidies given as social welfare.

There have been few occasions

since 2006 where underprivileged Mongolians were unable to receive distributed cash from the government. A sudden subsidy reduction would seem harsh for citizens. Although many in government stipulate that uncontrolled cash distribution caused many of the poor to prefer laziness over the drive to work—a fact that can be traced from recent data on unemployment rates and vacancy announcements—the situation is rather the fault of the government, which unleashed its social welfare so carelessly. While the government tries to fix its mistake, it should not dictate to mothers, children or the elderly to tighten their belts and take on the added burden of a suffering country. At least, not at this starting point, say many. Only MNT 28.6 billion is believed to be saved, if child and elderly social welfare subsidies are reduced. But MNT 300 billion was spent in the past three years on monthly stipends

for university students. A large portion of the population, even students, agrees that this sort of scholarship has now become a form of unnecessary fostering.

Another example of the government’s funding of needless expenditures through its approved budget involves financing musical theatre renovation and construction throughout the country. According to a recent data report, it would cost the government up to MNT 9 billion to renovate or build one new theatre in each province’s soum. This year’s budget allocated up to MNT 2 billion for the nationwide project. Is the newly formed government really trying to save as much as it can to help the economy avoid a crisis?

Entering a saving’s mode would require a lot of courage and clarity from the government. Bilegenomics must not leave citizens behind, but lead the country out of tough times and back to prosperity. ■





FORECAST

# Mongolia's economic outlook for 2015

L. BYAMBAA

## Global economic outlook

The global economy sputtered to 2014's end with slightly less economic growth than predicted at the year's outset. Though the US economy has revived and continues its trending rise, developing countries, Russia, China, and Europe had an unexpectedly low performing year. Expectations for 2015 remain positive, however, with world economic growth projected at 2.2 percent; at 3 percent for the US, 1.4 percent for the Eurozone, and 7 percent for China. While worldwide economic performance forecasts for 2015 are now lower than projections done in early 2014, according to the World Bank, the IMF, and other prognosticators, the current sharp price fall of petroleum products may end up having a generally positive effect on the global economic situation in 2015.

## Mongolia's economy in 2014

Throughout 2014, the government continued to delay negotiations regarding the costly underground expansion financing of Oyu Tolgoi—a multi-billion dollar megaproject and Mongolia's most important economic contributor for the foreseeable future—deepening the country's economic vulnerability. The year ended with a combined GDP growth forecasted to be a relatively disappointing 6.5 percent.

The US dollar closed at the highest level of appreciation at the end of 2014. The internal flow of dollars were unable to rise decent levels due to flat export prices on the world market, and the continuing fall in foreign direct investment. Nevertheless, increased copper exports and declining imports offers the foreign trade balance an opportunity to achieve a positive balance.

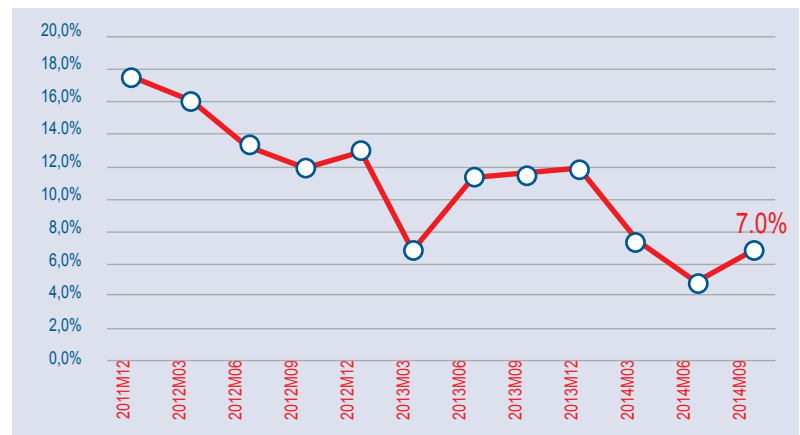
Inflation, accelerating off and on throughout 2014, is forecasted to have reached 12 percent for the year, due to drops in business activities and market demand, and compounded by a tightened Mongol Bank monetary policy that began in the second quarter in order to curb inflation and stabilize the currency. ▶▶

Table 1. GDP growth forecast for 2014 and 2015, by percentage

	World		USA		Eurozone		China	
	2014	2015	2014	2015	2014	2015	2014	2015
Fitch	2.5	2.9	2.4	3.1	0.8	1.1	7.3	6.8
CitiBank	2.7	3.1	2.3	3.0	0.8	1.1	7.3	6.9
World Bank	2.8	3.4	2.1	3	1.1	1.8	7.6	7.5
IMF	3.4	4	1.7	3	1.1	1.5	7.4	7.1

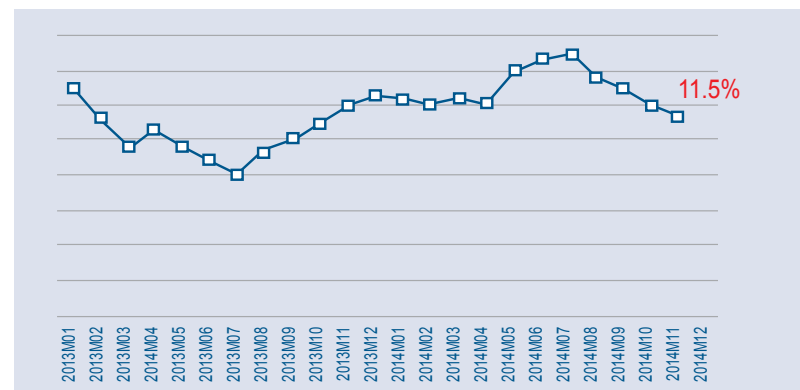
Source: economic reports of above mentioned organizations; outlook from last half of 2014

Chart 1. GDP quarterly growth, 2010 comparing price



Source: National Statistical Office of Mongolia

Chart 2. Inflation rate, 2013 through 2014



Source: National Statistical Office of Mongolia

## Main factors influential to economic trends in 2015

There are several factors affecting Mongolia's economic outlook throughout the coming year.

- Political stability
- Oyu Tolgoi's underground expansion financing dispute
- Condition of the financial sector
- External environment

► Political instability in 2014 placed a heavy burden on the business sector, by wasting time, delaying decision making on key issues, and postponing financing. This year’s economic performance depends on how consistently Prime Minister Ch.Saikhnbileg’s newly established ‘Solution’ government can function, and on what decisive measures they will take to tackle the current economic difficulties. So far, the current market and the confidence of investors seem only to have weakened. Meanwhile, Oyu Tolgoi’s underground expansion funding is still on hold, resulting in innumerable direct and indirect economic consequences that prevent any rise in investor confidence. Despite the emergence of positive change, such as in the legal environment and tax regime, investors still wait for an Oyu Tolgoi solution and continue to invest their money elsewhere. In the financial sector, the quality of loans and liquidity injection measures of banks and financial institutions may face complications, which if allowed to linger would have a longer-term negative effect on the economy. Any potential challenges or problems would be compounded by the continuing decline of global commodity prices, from a worldwide slackening demand that can be mostly traced back to China. In addition, Russian, regional and international geopolitical instability might pose major risks.

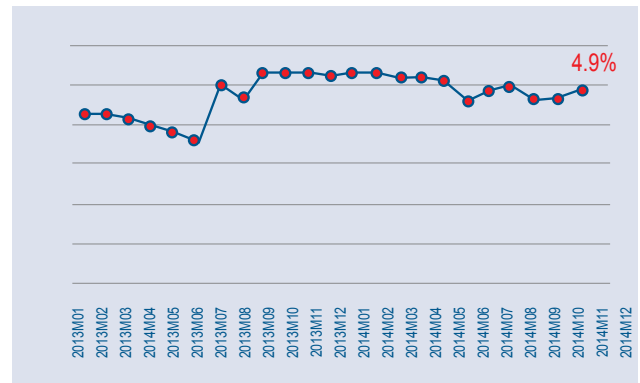
### 2015 economic performance outlook

An examination of the basic situational and political factors that influence Mongolia’s economy shows that performance is likely to be bad in 2015. Current economic indicators appear weak, and the opportunity to change is barely visible through the country’s murky and bogged-down reality. The states of the current account deficit, liquidity injection and budget gathering, financial sector environment and currency are expected to remain on the negative side. Whereas economic growth in 2013 and 2014 was fuelled by government bonds, that type of financial resource and money flow won’t even provide a spark in 2015. In addition, all government investment orientated money was cut from the state budget for this year. The cumulative effect reduces GDP growth forecasts to 5 percent in 2015, the lowest figure since 2009. And that’s if the issues holding up the Oyu Tolgoi and Tavan Tolgoi megaprojects are solved. If not, growth drops to the world average, somewhere between 2 and 3 percent.

Inflation will rise, affected on the supply side, driven in particular by factors related to currency depreciation, while demand side factors are expected to have a minimal influence. In other words, investment and purchase demands will drop in an environment where the unemployment rate is rising high and consumers’ expectations remain negative, business activation is weakening, and wages and revenues cannot rise. If Mongol Bank undertakes quantitative easing—buying financial assets, lowering their yield, while increasing the monetary base—and supplies the market with money, the inflation rate will rapidly escalate. In any case, the inflation rate will likely exceed Mongol Bank’s targeted rate of no more than 7 percent.

In terms of foreign trade, although Mongolia’s exports are expected to grow, particularly copper, it is still hard for revenue to rise, as export prices are unlikely to increase in the world market. This may not be such a dire problem, as import levels should drop slightly and remain stable, from weakened business and consumption demand. There should be enough room to keep the USD exchange rate from sharp rises. But bad loans, particularly home loans and loans in USD, are of such a poor quality and quantity that they will have an increasingly negative effect. ■

Chart 3. Bad loans, 2013 through 2014, by percentage



Source: Mongolbank

Table 2. 2014 forecast of basic indicators

Indicators	2014 preliminary performance forecast	2015
GDP growth, percentage	6.5%	5%
Inflation, percentage	12%	12%
Loan rate, percentage	18%	19%
USD-MNT, at the end of the year	1,900	2000
Bad loan, percentage	5%	6%

Source: Analyst’s calculation

Table 3. Macroeconomic risks in 2015

Negative consequences	High	Investment negative flow	Construction sector’s deadlock; particularly office segment halt	Political instability
		<ul style="list-style-type: none"> <li>• Foreign trade deficit rise and growth of systemic risk of banks</li> </ul>	<ul style="list-style-type: none"> <li>• Shortage of payment capacity</li> <li>• Continued foreign investment fall</li> <li>• Appreciation of foreign currency</li> <li>• Mongol Bank’s quantitative easing measures; Inflation rise</li> <li>• Bad loan increase</li> </ul>	
Mid	Regional instability	Shrink of loan availability, economic circulation slow-down	Big number of bankruptcies for businesses	Fall in the price of mining products on the world market
	<ul style="list-style-type: none"> <li>• Rise in the price of petrol products; importing from Russia</li> </ul>	<ul style="list-style-type: none"> <li>• Rise in the price of petrol products; importing from Russia</li> </ul>		
Low	Infectious disease and epidemic breakout in neighboring countries and in Mongolia	Raise in budget deficit and in budget instability	World’s economic recovery struggle lingers	Russia falls into economic crisis
	<ul style="list-style-type: none"> <li>• Natural disaster</li> </ul>	<ul style="list-style-type: none"> <li>• Russia falls into economic crisis</li> </ul>		
		Low	Mid	High
Possibility of occurring				

Source: Analyst’s calculation

## REAL ESTATE

# Hitches in housing construction sector

BY S.BATZAYA

**T**owering cranes are everywhere in Ulaanbaatar during construction season, raising masses of concrete buildings into the sky. Housing construction is booming—supposedly to provide apartment homes for the roughly 200,000 families still living in the amenity-less ger districts that surround the city. Yet property development remains largely unregulated. In the midst of Mongolia's shaky economy, unchecked construction could result in a housing market collapse.

Since 2012, despite a steady decline in Mongolia's economic growth, housing construction has increased to levels higher than ever. Companies continue to invest in construction while other sectors of the economy underperform. The race to build has continued alongside climbing prices. But with so much new space available to live, those high prices may not last.

"Companies building domestically are in such a hurry to make their short-term gains. As a result, the whole sector has come off the wheels," says recently appointed Construction and Urban Development Minister, D.Tsogtbaatar.

## Mortgage loan mess

Mongolia's poor infrastructure makes the inability to deliver heating, electricity and water to many ger district homes a chronic problem. While falling commodity prices have left their mark on the economy, the government has eased the economic downfall with programmes such as the Bank of Mongolia's-backed 8 percent mortgage initiative, to aid families in their move out of the unsupported ger districts and into apartments on the existing infrastructure grid. However, such government intervention isn't sustainable in its current form. "It is not wrong to issue the loans; but first significant changes must be made to the financial markets. It is not just a problem of the real estate or construction industries," says D.Tsogtbaatar.

Mongolia has seen 40,000 apartments commissioned since 2011, with 20,000 built last year alone. Yet the 8 percent mortgage programme, first launched under the S.Batbold government, has achieved such widespread popularity that the volume of credit issued by banks has been deliberately reduced in recent years. And according to Director of UMC Alpha, N.Monsor, the favorable bank loans service many if not more affluent people than the needful poor.

Market research from real estate specialist M.A.D. Investment Solutions signals alarm over the growing problem of housing supply, concluding: "We have to support the banking sector well. Increases in the housing supply must be stopped immediately. By doing so, the banking sector will avoid a collapse."

Despite growing unease, the government stubbornly continues to support the 8 percent loan programme, ignoring caution and supporting the myriad interests in the construction sector, to the jeopardy of the banking and real estate sectors.

## Poor support and infrastructure

There are many problems in the construction sector. Mongolia produces few raw construction materials and lacks a professional labor force, having to import both to fuel its industry. Imports further undermine the sector, raising the dollar exchange rate and increasing the difficulty of making loan payments. As housing sales throughout the city decline, and developers build at higher costs, purchase and rental prices grow. The best situation developers can hope for is to rent below cost; however, this can quickly spiral into collapse with low demand and the accumulating effects of debt.

Ts.Uyanga at M.A.D highlights the lack of comprehensive urban planning and infrastructure support for buildings under construction. "Even if current construction on all buildings were to stop, ►



PHOTO BY B. BYAMBA-OCHIR



► there is still no infrastructure for many buildings only just completed.” These new apartment buildings are faced with the ridiculous prospect of being unable to supply heat. Urban planning should guide housing development, however in Ulaanbaatar the tail continues to wag the dog.

In this sector, foreign investment is very small. Minister of Construction and Urban Development D. Tsogtbaatar hopes this will change, saying: “It is important to attract foreign investment to develop the real estate market. Therefore, a policy

attracting capital will be followed. Foreign investment has been very beneficial for the development of Dubai, London and Hong Kong. Citizens of these cities encourage such investment. I hope that our citizens will approach the field the same way.” Director N. Monsor said that a more favorable investment environment is important to attracting investors from outside Mongolia. Meanwhile, domestic investment in the construction sector has increased 2.3 times from 2013 to 2014, with loan debt up nearly 60 percent.

The legal environment of the real estate sector remains as weak as the tax environment is illogical. Residential and office buildings do not pay taxes. If taxes were to be applied, the income alone would fix the city’s lack of infrastructure for the power grid and sewage system for the new construction, and finally give the underprivileged on the fringes a realistic shot at a livable home. If construction continues unregulated, however, the more realistic outcome is a housing market collapse. ■

## MEGAPROJECT

# Tavan Tolgoi: the giant awakens

BY B.BAYARTOGTOKH

The Tavan Tolgoi coal deposit has returned to the global spotlight and is back at the negotiating table. With 7.4 billion tons of coal in reserve, the deposit is one of the largest coal basins in the world, an untapped mine with the potential to contribute billions to Mongolia's economy. The Tavan Tolgoi development megaproject officially adopted a strategic investor group last month on 25 December, 2014. The winner is a consortium of entities from three countries, a move that hopefully marks the return of foreign investment and development activity for Mongolia.

The Tavan Tolgoi deposit, situated in the Ulaan River Valley of Tsogtsetsii county, Umnugobi province, is a top megaproject designed to lift the Mongolian economy. Any project that costs more than USD 1 billion and that is of significant economic importance to a country is considered a megaproject, according to global criteria. That's why the commencement of the Tavan Tolgoi project bears the highest development responsibilities and, more importantly, time pressure. Back in 2011 when the coal price was many times higher than it is today, Tavan Tolgoi's invitation bid attracted 16 contenders from five continents. Amongst the finalists was a union of companies headed by South Korea's Kores Group, Australia's Hstrata Coal, Brazil's Vale, Luxembourg's ArcelorMittal, China's Shenhua Energy, and the United States' Peabody Energy. Before a strategic investor was finalised, however, the government deemed the terms of the bid controversial and scrapped the bid, forcing any potential investors to wait indefinitely. Almost four years passed without a clear path to help development move forward.

Now that Tavan Tolgoi has acquired a strategic investor, according to the December announcement, let's look at the current situation; today the price of coal has plummeted, demand is low, and inflation has weakened the MNT rate by 25 percent. Much of Mongolia's worsened situation has to do with China's slumping manufacturing economy, which has less of a demand for coal yet simultaneously

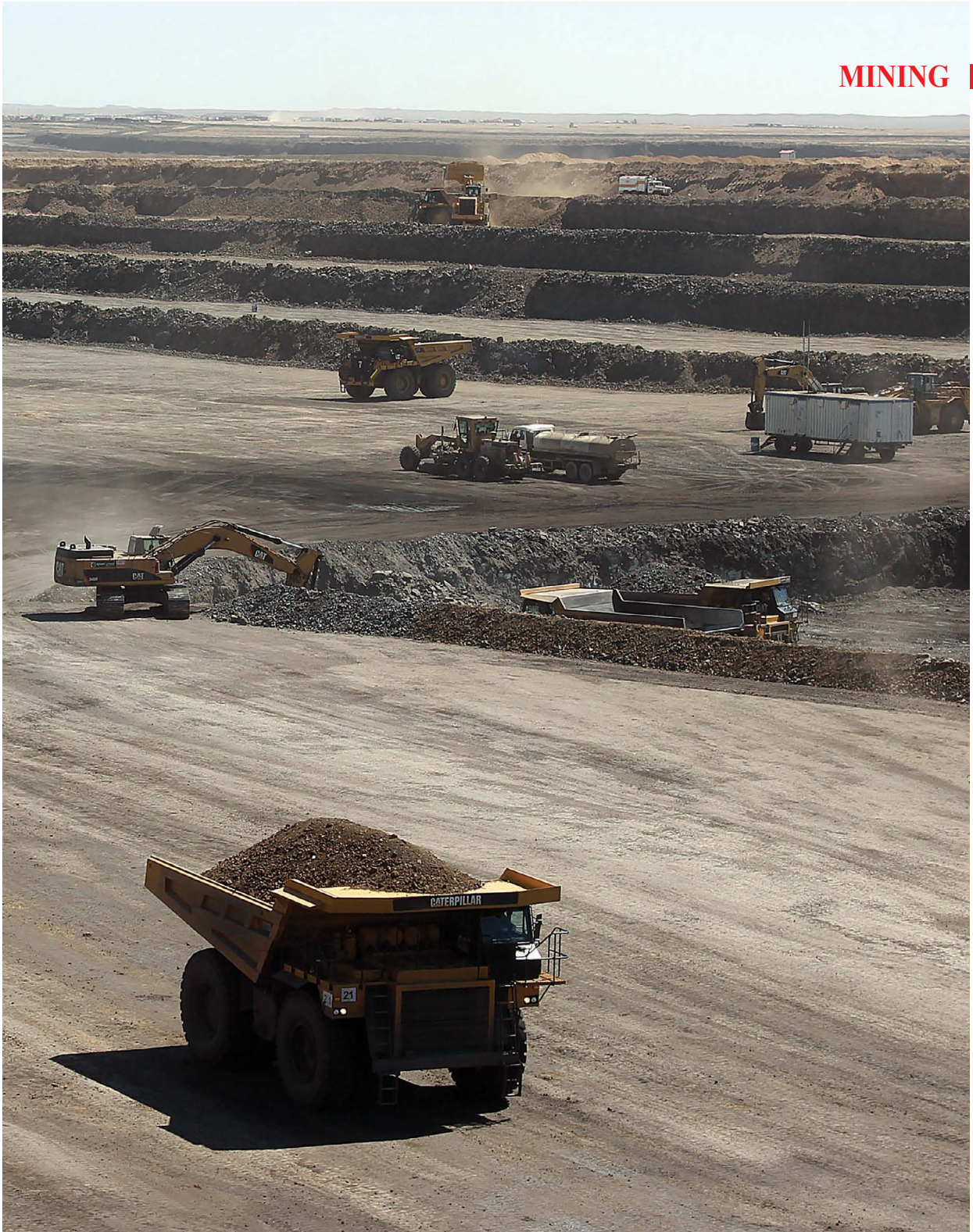
receives over 90 percent of Mongolia's coal export.

During the most recent round of bidding, Mongolia was forced to practically beg the contenders to bid again. After the government of Mongolia sent an invitation to investors last year, only six companies bothered to submit proposals. Despite the low price of coal in the Chinese market, the fact that companies from China, Japan and the US sent proposals shows how much value the Tavan Tolgoi deposit still possesses. The winning bid is a consortium of domestic giant Energy Resources, China's Shenhua Energy, and Japan's Sumitomo Corp. A surprise to some, US mining company Peabody Energy lost its bid; Peabody has mining experience in Mongolia, and is a known entity amongst the public. When asked why Peabody couldn't make the cut, M.Enkhsaikhan, head of the bidding evaluation committee on Tavan Tolgoi, explained: "The Shenhua-led consortium not only met the requirements made by the Government of Mongolia, but also proposed several specific things in return. Also, the fact that they had become a consortium with a domestic company onboard played to their advantage. The Government of Mongolia upheld its preference of supporting a national investor."

Minister of Mining R.Jigjid said: "Peabody Energy is a world-renowned big company. It's been operating in Mongolia since several years ago and has made excellent preparations. So even though they didn't win the bidding, they are open to collaborate on Tavan Tolgoi in the future. Because this is a global-scale large mine, we will work to adopt as many of the best practices as possible."

In any case, after years of inactivity, Tavan Tolgoi has finally found an investor for 2015 and beyond. The investment agreement between the investors and the government commenced on January 5th, with project implementation to start this spring. Minister M.Enkhsaikhan said: "We think the agreement will be finished by the Lunar New Year, or mid-February." The winning consortium is to be responsible for the following:

- To use the Tavan Tolgoi deposit fully as per the 'Investment and Cooperation Agreement' without transferring ownership to the investors (Tavan Tolgoi will remain the property of the State);
- To mine coal in the West and East Tsankh mineral usage special license areas of Tavan Tolgoi, to conduct additional exploration activities, and to increase the known reserve;
- To establish capacity to mine at least 30 million tonnes of coal in the Tavan Tolgoi area, and supply the processed product to at least two countries' markets, within a period of 2.5 years;
- To be responsible for ensuring Erdenes Tavan Tolgoi LLC pays off the remainder of its debts to China's Chalco company, and allow it to become accountable for the contract with Chalco;
- To build the Tavantolgoi-Gashuunsukhait railroad in the near future out of its own expense. The investors will receive the construct-own-use-transfer rights of the railroad, 30 years after the railroad is created, with 51% in government ownership free of charge, according to the Law of Concession.
- The Tavan Tolgoi megaproject is in need of a massive amount of funding for it to proceed on time and target. For this reason, the winning consortium has promised to invest USD 4 billion as a start, with half going to finance the railroad construction. The following is the market value and assets of the companies in the consortium:
  - China's Shenhua Energy has a current market value of USD 60 billion. Their advantage is in their ownership stakes in railway, refinery and coal-exchange markets.
  - Japan's Sumitomo Corporation has a current market value of USD 13 billion. Sumitomo is a coal and mineral seller in the Asia-Pacific region. Mr. Hiroto Fujiwara, director ►►



- of the corporation's Mongolian branch, said: "Our company has been operating in Mongolia since 1992. Our involvement in this project will focus on making coal sales on the third markets [beyond Mongolia's two neighbors]."
- Mongolia's Energy Resources LLC is a 100 percent-owned daughter company of the Mongolian Mining Corporation, which is registered on the Hong Kong Stock Exchange. Its market value is 500 million USD. This company is known for its Corporate Social Responsibility policies and has a refinery that processes 15 million tonnes of coal annually. It also recently established a power plant.

There are several advantages to be gained from the pending final agreement. First, as the 'Investment and Collaboration Agreement between the Government of Mongolia and the Consortium' is currently penned, Energy Resources LLC can use its 15 million tonne coal producing refinery in full blast and lower its coal processing expenses. Second, mining from West and East Tsankh is easier than today's mining at Ukhaa-Khudag, thus decreasing cost. Third, once the railroad is constructed, the transportation cost will decrease by USD 2 to USD 7 per tonne. Fourth, supplying coal to secondary markets will be possible. These advances would result in a general rise in efficiency, improving Mongolian Mining Corporation stock in return. The three partnering companies are registered on international stock exchanges, which means they speak the same business language.

Finally, Tavan Tolgoi, which dragged on as a tragedy for years, has awakened. With the right support, the megaproject should lift more than its share of weight in a revitalised Mongolian economy. ■

## OIL

# Oil refinery must only be the beginning

By B.BAYARTOGTOKH

Mongolia meets its oil demand entirely by imports. According to the Ministry of Mining, 90.8 percent of oil comes from Russia. The government has announced that it will halt the Price Stabilization Program, which helped control oil prices over the last two years.

However, according to the chairman of the Petroleum Authority, G.Ulziiburen, oil prices are unlikely to swing in the next four to five months. The price of oil has started to fall worldwide since the third quarter of last year, which will provide some cover for the country once the program is phased out—but that will only provide short-term relief. A longer-term solution will be a petroleum refinery of Mongolia's own.

Mongolia's petroleum consumption rose to one million tonnes in 2011, and 1.4 million tonnes in 2014. Oil consumption has grown annually, and the depreciation of the currency is exacerbating price growth. An oil refinery would be a strong defense against growth in fuel prices.

Former Prime Minister N.Altankhuyag's government made construction of an oil refinery a priority, but there has been no word if this commitment has been transferred over to the new government led by Ch.Saikhanbileg. Oil is not only a strategically crucial resource, but also proof of national security. An oil refinery could also be the catalyst for the launch of a chemicals industry.

Mining Minister R.Jigjid said that the the proposed Darkhan Petroleum Plant could start production as soon as this year. But that promise was made while he was state secretary of mining in the Altankhuyag government. The most promising project proposed for oil refinement in Mongolia, the plant would have the capacity to produce two million tonnes of refined fuels a year. A preliminary feasibility study is already complete, and the International bank of Japan is committed to financing 85 percent of the USD 600 million needed for its construction.

Unfortunately, a dispute over the site location has also complicated matters. If resolved, however, Mongolia would have a refinery able to produce 44,000 tonnes of fuels a day, and bring



an additional MNT 340 billion to government revenue by 2018, at the earliest.

There are three sites where oil is exploited by companies Donshen and Petro China Daichin Tamsag. Over 10 licenses have been issued for the construction of an oil refinery, but only six remain valid.

The Mongolian government is entitled to 26.5 percent of all oil production, according to the production dividend agreement signed with resource owners. This year, Chinese companies can buy 700,000 to 800,000 tonnes of oil from Mongolia for refinement. Insiders say there will be economic benefits once Mongolia can refine between three million and five million tonnes of oil a year. But that would require even more crude oil extraction.

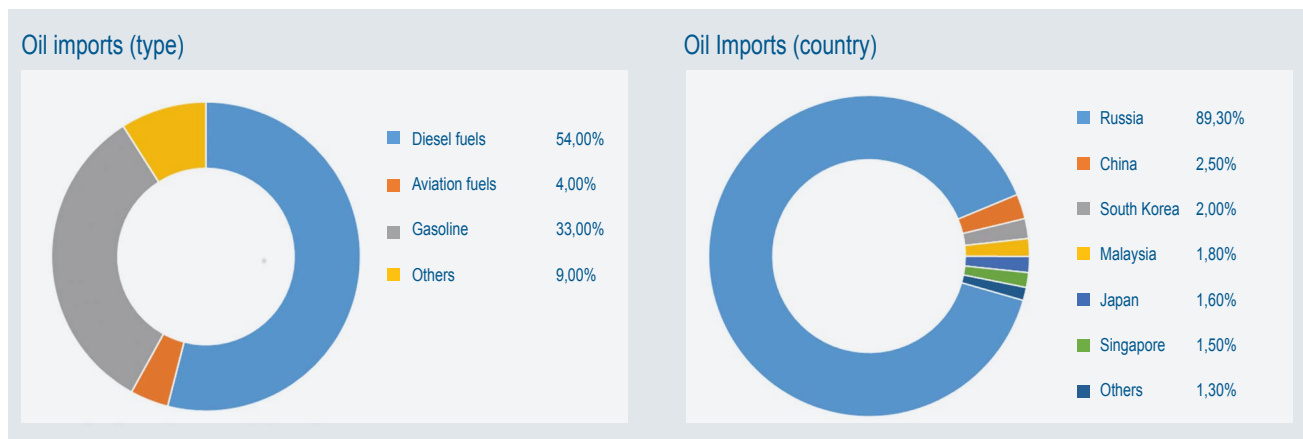
Mongolia's oil reserves could grow with further exploration, according to MonGeoPhysic Chief Executive Officer B.Dendevchuluun. "There is lots of room for further development," said Dendevchuluun, who also has worked as a geologist.

Parliament passed two significant policies for the oil industry in 2014: the State Mineral's Policy and a new Petroleum Law. "These steps have started to send positive messages" said, T.Amarzul, executive director of the oil explorer Petro Matad. Petro Matad has three oil exploration sites, including two in Western Mongolia.

Last year saw USD 600 millions in investment into global oil. But Mongolia is a new player that has not been fully introduced to the world oil market. It extracts 2,810 tonnes of oil a day and exports a similar number of oil to China.

Still, investment in the oil sector has seen rapid growth since the passage of the Petroleum Law. Twenty-seven companies have put in requests to commence exploration, of which 80 percent will invest in oil. The oil industry here brought in MNT 245.3 billion in government revenue last year.

"We should be more active in this new and friendly legal environment," said oil explorer Wolf Petroleum's chairman, T.Lkhagvadorj. "Work has already started on compiling a resource estimate. To do that, we need new investments... which will be key for the independent development of the country." ■



## MARKET

# Mining sector's brighter 2015?

By S.ZAYA

Politicians have been sticking their noses in the business of the mining sector long enough to put a dent in the industry. Some investors have low expectations for the Mongolian mining sector in 2015. Meanwhile the mining cycle, which sees periodic rises and falls in commodity prices, continues to sour the economy.

But it's not all bad news for the new year. Although 2014 saw prices fall, next year is forecasted for a welcome rise. And parliament spent last year setting up a return of investors' affection with new, more investment-friendly legislation. Parliament passed an amendment to the country's mining law that makes investment more transparent. It also passed a Minerals Policy to give investors an idea of what plans they have for the industry down the road, and relaxed the royalty rate for gold. One issue for mining investors to watch out for in 2015 is how the government placates investors who lost their claims to deposits in recent years, and how it compensates their losses. Another is the direction the country's largest mining projects take.

## Earning a good reputation

Mongolia has seen the suspension of 200 licenses because of the Law on Prohibiting Mineral Exploration and Extraction Near Water Sources, Protected Areas and Forests – also known as the “Long Name Law.” Another group holding some 106 licenses lost theirs in 2013. A judge annulled the licenses after ruling that the former Mineral Resources Authority head who approved them was guilty of corruption.

Parliament passed a solution to the 106 license holders' dilemma last July with the decision to hold public tenders for the licenses each month, until January 9. The bidding started at 30 percent of a deposit's value and was only granted to bidders without any outstanding tax debt and who were in good standing with the law. The Ministry of Mining brokered the auction of 23 licenses in September and October, 11 of which were retaken by the original license holders. Three licenses received no bids, however, and five only saw one bidder, so their auctions will continue into the new year. There are a total of 18 sites – six located in Umnugobi province and four in Dornogobi province.

The minimum bid is meant to offer a return for the original license holders, said B.Batkhuu, head of the policy coordination department at the Ministry of Mining. Original license holders are exempt from paying the minimum if they wish to bid again for their licenses.

The next determining factor of the mining sector is how Mongolia moves forward with its largest mining projects. Oyu Tolgoi still has its major underground expansion project on delay, while investors have been culled to manage and operate the deposits held by state-owned miner Erdenes Tavan Tolgoi.

Erdenes Tavan Tolgoi has two coal blocks, known as East and West Tsankhi. West Tsankhi is still relatively untapped, with only a small portion extracted in 2014 by a local contractor. Mining the east and west blocks will now be the responsibility of a consortium that includes China's Shenhua Energy, Japanese company Sumitomo Corporation, and the locally operated Energy Resources.

## Recovery in the gold sector

The cut to gold royalties from up to 10 percent to a flat 2.5 percent has tripled gold buying by the Bank of Mongolia. The central bank in turn sold 70 percent more gold in 2014 from the year before. The development of gold mines has stimulated some economic activity.

Mongolia has about 4,000 tonnes of known gold reserves – 1,000 tonnes of which is held at Oyu Tolgoi. It has about 200 active gold miners, with 120 miners who sell to the central bank. In 2013, 62 companies sold six tonnes of gold to the Bank of Mongolia, or nearly double that of the year before, and beat out the targeted 11,000 tons for 2014.

Mongolia can solve much of its economic ills if the disputes that hold back the expansion project at Oyu Tolgoi are resolved.

Mining Association President N.Alгаа said he is certain that foreign investment will return if mega projects like Oyu Tolgoi move forward. The “legal environment is beginning to be enough,” he said. “Now, attitudes have to be changed.”

He noted that copper prices have been relatively stable while coal prices floundered. But he said he expects coal prices to buoy by 2017.

In the end, long-term economic success will mean expanding the number of markets the country depends on. But Mongolia needs its mining sector today to invest in other industries for tomorrow. ■





PHOTO BY B. BYAMBA-OCHIR

**BANKER**

# Mongolia should focus on what must be done, and act quickly

*Norihiko Kato, Chief Executive Officer of Khan Bank, has extensive banking experience in corporate banking and strategic corporate planning. He held the position of Regional Head for the Middle East and General Manager of Bahrain Branch, BTMU (Bank of Tokyo-Mitsubishi UFJ) from 2006 to 2009. Norihiko Kato, the Chief Executive Officer of Khan Bank, started living and working in Mongolia in 2009.*

**Khan Bank must have many novelties to offer to both its international and national customers. What is the latest news from Khan Bank? We heard that the bank has maintained its rating by Moody's.**

At the moment, the Mongolian economy is facing a difficult situation and critical views of global investors and rating agencies, and the Mongolian banks are vigilant. Lately, Moody's downgraded its ratings on some Mongolian banks but Khan Bank has maintained the same rating as the sovereign rating. I think that it has mainly come from Khan Bank's well-diversified business portfolio including relatively stable retail business and retail loan portfolio.

I believe that Khan Bank's strong effort to maintain transparency and good corporate governance brought positive effect when the rating agency reviewed our performance. Still the economic environment hasn't recovered, and the macroeconomic situation is difficult as ever. So we have to be very vigilant and move quickly to fix the pending macroeconomic issues. I'm sure each bank is working hard to minimize and manage risks under this difficult circumstance.

**The bank is applying for a custodian service license. Could you provide us with more details on this subject?**

Custody business has a good potential, and it is a very important business that Mongolia should have. With strong sub-custodians in the country, we can attract more investment from around the world into Mongolia in government and corporate bonds and Mongolian companies' stocks, etc. This sub-custodian capability is essential for the Mongolian economy. However custodian business requires strong system and operational capacity with solid and detailed procedures. Accordingly, it's a good fit for the banks, but we still need significant amount of investment and effort. It may take at least a few years or even more time for this business to become profitable. In the mid to long-term, it could be a great business opportunity for the banks. Recently, two other commercial banks have received custodian service license. We are also preparing license application to the authorities. There are several things that we have to complete prior to submitting the application to the regulators. Once we receive the license, we would like to move quickly to make this service available in this country. We are closely contacting global investors and global custodians. Those global custodians work for many kinds of global investors including those who are potentially interested in investing in Mongolia. Global custodians collaborate with local sub-custodians to provide good custodian services to their clients, so they are very careful in arranging cooperation with the sub-custodians. Mongolian banks need to work hard to provide good level of custody business services with effective and solid operations and controls, so that we can meet the global custodians' expectations.

**How do you see the future of custodian services in Mongolia? Do you think that all commercial banks should be involved in this business?**

Entering into sub-custodian business is subject to each bank's strategy but it needs a large amount of system investment, in addition to building strong operational capacity. We will need to do many things registrations, dividend payment, tax payment, correct reporting and these must be automated and no mistakes are allowed. Due to nature of this business, the number of banks that can carry out such operations could be small. Also, there is constraint caused by size of the market and size of the economy. Yet, there should be at least a few sub-custodians to operate, so that global custodians feel comfortable. Having only one sub-custodian in one country could be risky.

**How do investors see this potential opportunity? Are they excited or hesitant?**

There are global investors who are interested in Mongolia. Unfortunately, Mongolia's current economic situation and image of the country to the world are less appealing than before. However there are number of foreign investments already made, and in the mid to long term, Mongolia has great potential. That's why the big global custodian banks are interested in the progress of development of Mongolia's capital markets including custodian business and other areas—they stay tuned for updates on the development of investment environment in Mongolia. They are cautious as they don't want to upset their global clients. Large institutional investors generally don't invest in a country without custodian services. There are smaller and independent investors who come and invest in stocks on Mongolian Stock Exchange and Government bonds through brokerage firms.

“

We have to manage the liquidity and problem loan situation, and to improve quality of customer services to meet their financial needs.

”

**How would you describe the current banking sector of Mongolia and its future?**

The immediate challenges of the bank are assets quality and liquidity. After two years of credit-driven monetary policy, the policy interest rate was finally increased at the end of July, 2014. The Bank of Mongolia and Government policy shifted to unwind those policy credit programs gradually though they still have such programs but on a smaller scale. The policy makers are now tightening money supply to avoid hyperinflation and credit bubbles to burst. Consequently, the liquidity of the market is now much tighter than before and the growth of the economy is much slower. For ordinary customers, getting loans from banks could be a bit more difficult and costly. Of course, Khan Bank operates very carefully to maintain appropriate level of liquidity, so that we are always liquid enough to meet our customers' needs. Those issues-liquidity and assets quality-are the Mongolian banks' immediate challenges, I would say.

In 2009, we suffered negative GDP growth and at that time, the banks' non-performing loan ratios were much higher than those of today. We learned our lesson, and now all banks are paying extra attention to manage their asset's quality.

**Mongolians trust Khan Bank. How does the bank maintain its trust amongst the people? And what is the »**

► **bank's plan to expand its customer base in the future?**

I really appreciate our valued customers' trust in Khan Bank. We have the largest branch network across the country to serve retail customers, SME customers and growing number of corporate customers as well. It is our utmost priority to meet the customers' expectations and trust. The bank must be financially solid, so that it can provide efficient financial services at all times. Also, disclosure is very important. In Mongolia, currently, no banks are listed. If the companies are listed in the stock exchange, there should be rigorous disclosure requirements. The banks are currently following the Bank of Mongolia's disclosure requirements and guidelines. In a way, it is the minimum requirement. All banks are trying to be more open and transparent as you can see from the banks website. In return, the banks would be able to earn confidence of investors, customers and depositors. More proactive disclosure beyond the minimum requirement should be one of the important efforts of the bank.

**How do you see the potential of the Mongolian economy? Can we go beyond the expectations of global investors and bankers?**

“ Mongolian banks need to work hard to provide good level of custody business services with effective and solid operations and controls ”

Mongolia is rich in natural resources and with a relatively small number of populations who are generally well-educated, intelligent and hard-working; the country has a bright future and interesting potential. It should not only explore mining resources but also should work on diversifying the economy; it's called inclusive development. Policymakers should keep this in mind. Mining will probably bring wealth sooner if we can move right. Then we can use this wealth to develop other parts of the economy.

**Regarding diversification, do you think instead of defining the mining sector as a leading economic contributor, the banking sector should play a bigger role in helping the economy to grow?**

The country's banking sector functions to raise funds and provide the funds to other sectors for growth like blood vessels. Today we are importing foreign capital as we need foreign direct investment for the development but in the future, Mongolia might become a capital-exporter country. In order to do that, we need to introduce a variety of financial services; managing fund investment like oil-producing countries, for example. Investing in other capital markets will require more sophisticated services from the financial institutions. But this is a bit far away issue. It's okay to dream a bit, but Mongolia should focus on what must be done now and act quickly.

**What must the banking sector really do now?**

We have to manage the liquidity and problem loan situation, and to improve quality of customer services to meet their financial needs. There's no miracle or easy way to do this but solid efforts and continuous improvements will move us forward.

**The bank has earned a certification for achieving international standards in information security. How does it benefit your customers?**

Information security is one of the most important elements for banks as well as for other industries. Khan Bank has recently obtained ISO/IEC 27001:2013 standard certification. It certifies that we have a global standard level of information security management system in place. By establishing Information Security Management System in accordance with the requirements of ISO/IEC 27001:2013 standard, the bank receives many benefits including protection of customer information and the bank's information assets from external and internal threats, prevention and mitigation of risks related with information security for ensuring its sustainable operation. The process of establishing Information Security Management System took us about a year and a half. Then we received a certification audit from the certified global institution. Getting the certificate was not the utmost goal but to adhere to international requirements in our daily operations was the priority. We will go through surveillance audit every year, so this is not a one shot achievement but something we must continue and maintain at all the time. ISO/IEC 27001:2013 is the latest version of the international standard for information security. I'm pleased that we are the first institution to receive such a certificate in Mongolia.

**What is the bank's core ideology?**

Khan Bank is a Mongolian bank. We have both foreign and Mongolian shareholders, and we are regulated by the Mongolian laws and regulations and we provide services to Mongolian customers throughout the country. I want Khan Bank to continue supporting the sustainable development of the Mongolian economy, keeping our customers' trust in us. We always strive to demonstrate the best practices and improve what we're doing now.

**How long have you been in this position? What changes have you witnessed during your time?**

I have been in this position for almost three years now. I first came to Mongolia in 2009 as an advisor to Khan Bank and then I took the position of Chief Executive Officer in 2011 first as acting. So far, the country's development is impressive. Generally, the living standard has been improved, and the private sector has become much stronger than before. Even though we have many issues to deal with, the rapid economic growth of the recent years has brought significant development to the country so far. But again, there is much we need to do quickly in order to sustain the healthy growth.

**What would you personally advise the banking sector?**

Not only the banks but also financial institutions should work hard to improve their management skills and services to grow in a sustainable manner. Short-term opportunistic growth is not sustainable. The correct policies, correct regulations and correct practices are the key to the long-term sustainable growth. ■

## STOCK EXCHANGE

# Milestones of 2014, and what to expect in 2015



G.MUNKH-ERDENE, *Investment Analyst, Gauli Investment Securities*

## Two years on, and only one IPO

In recent years, as the economy has slowed, the Mongolian Stock Exchange (MSE) has had only one initial public offering: Mereks Co., which went public last year at MNT 100 per share and capitalised MNT 2.6 billion in total. The company used the attracted capital to construct a concrete factory with a 150 cubic meters output per hour. The pilot factory, now up and running, has received its concrete-producing license and reached an agreement with Standard Properties LLC to supply 80,000 cubic meters of concrete. Starting this spring, Mereks Co. is working to stabilise its output rate.

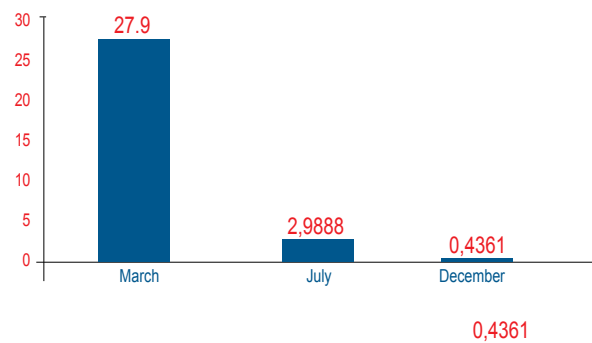
## Government bonds return to the MSE

Government bonds offered on the Mongolian Stock Exchange picked up speed once again in 2014 after two years of inactivity. Traders bought 31.3 billion in the first two months of availability, out of a total of MNT 100 billion valued stock scheduled to be sold. Because of the no-risk, high-liquidity, relatively high-interest aspect of government stocks, bond trading has greatly attracted the attention of small investors. A government bond means there's no risk, the bond's annual interest of 16 percent is competitive with bank savings' interests, and the maturity dates of three, seven, or twelve months makes its liquidity high. The high interest rate is due to the economic downturn—as the economy recovers, the interest rate is bound to go down. Thus the current bond on the MSE is a great opportunity for investors to make a safe and high-yield investment.

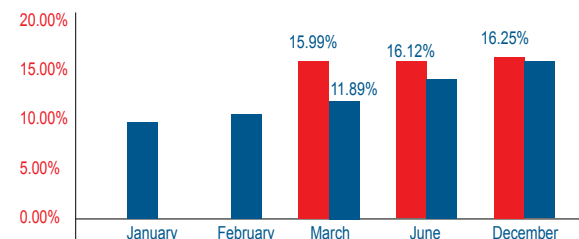
## New laws and investment funds

The government has ratified both the Law on Investment Funds and the Law on Securities Markets. The two laws are expected to establish a firm foundation for investment funds, increase the size of the trading market, and improve transparency. Unofficial records reveal that two or three companies looking to found an investment fund have already submitted their application to the Financial Regulatory Commission (FRC). Because regulations were approved in December of last year, the first investment funds will begin to appear in 2015. The Law on Investment Funds only regulates mutual funds and equity funds, independent of the Law on Pension Funds. As long as

Government stock rates



Yield curve (annually)

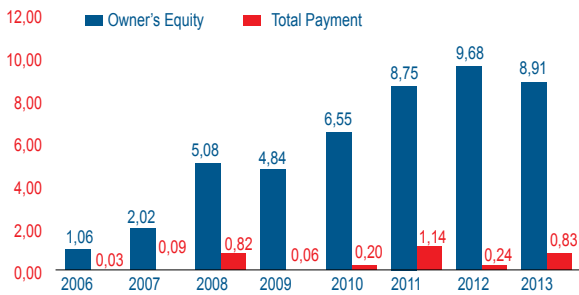


transparency continues to be a major challenge, there remains a clear need to enforce the implementation of these laws. Well-adopted laws and regulations will require strong partnerships with the FRC and professionals in the industry, in informing companies what opportunities and responsibilities are necessary for their operation. Increased promotion will be needed to inform potential investors on the improved safety of the legal environment.

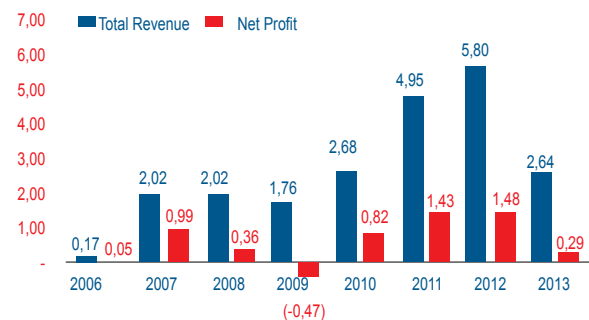
## Positive change in oversight

The Ministry of Finance acquired the Mongolian Stock Exchange last year, detaching the MSE from the State Property Committee. The Ministry is better able to help improve the financial reporting of companies and create more investors in the market. The MSE was lost in the shuffle under its previous administration by the State Property Committee, which owns many companies in different sectors and lacks the expertise to focus on the stock exchange. The Ministry's acquisition of the MSE will see the development of institutional memory throughout the stock market sector, a major step, but there needs to be more sustainable policy work done in the long term. ▶▶

Source (billion MNT)



Revenue &amp; profit (billion MNT)



## What to expect in 2015

### Tavan Tolgoi likely an active economic contributor

The winning bid for the development of the Erdenes Tavan Tolgoi deposit, one of the world's largest untapped coking and thermal coal deposits, was announced just before New Year's—a consortium of Chinese, Japanese and Mongolian companies, as announced by Deputy Minister M.Enkhsaikhan, will develop the mine. According to the Deputy Minister, the consortium and the Government of Mongolia are working to finalise a 'Collaboration and Investment Agreement' before the Lunar New Year. A signed contract would mean more than USD 4 billion invested into the Tavan Tolgoi mine project over the next three years to build:

- A Coal Preparation Plant with a 30 million tonne output per year, and
- A railway connection from Tavantolgoi to Gashuunsukhait.

The agreement stipulates the consortium produce an output of 30 million tonnes of coked coal each year to supply at least two export markets. Such investment ensures that the cost of coal extraction, processing and transportation would decrease by at least USD 20 per tonne—a cost-savings of as much as USD 600 million annually and an increase in profit margins for the companies. In the short run, this means a foreign currency inflow increase that lowers the USD exchange rate, and a rise in coal export profits soon to follow; in the long run, expect an increase in the stock value of Erdenes Tavan Tolgoi, a portion of which is owned by each and every Mongolian citizen. A higher valued Tavan Tolgoi stock means more buzz and activity in the stock market.

### BDSec to end trading additional stocks

BDSec Co. issued additional shares equal to 35.29 percent of its existing shares, and offered investors the opportunity to buy at a premium cheaper than market value. As a result,

32.61 percent of the 1,956,625 additional stocks were bought, attracting MNT 3,778,242,875. A remaining 4,043,375 stocks are to be sold for no less than MNT 2,146 per in 2015. About 94 percent of the accumulated capital will be used for underwriting and investment activities, while six percent will be for human resource development and employee stock ownership plan (ESOP) programs. As part of the expanded underwriting and investment activities, the company is planning to make private investments in other companies—especially those in construction, mining, finance and industry—through trading in the Stock Exchange. BDSec is one of the biggest broker, dealer and underwriter companies in Mongolia, accounting for 73 percent of all trading in the MSE in 2013. BDSec has helped 14 companies accumulate MNT 18.1 billion from going public, while performing 10 IPOs.

### Two or three IPOs imminent

Although the economy is in bad shape, two or three companies are boldly making preparations to go public, according to unofficial sources. While the exact companies, their sector, and the total value of their IPOs remain unknown, any IPO means new products that should have a positive effect on the stock market. Companies performing an IPO for the first time trade at least 20 percent of their equity, creating many owners with less equity, better governance and more transparency, while the value of publicly offered companies is more likely to increase than government privatised companies.

### Government privatisation coming soon

Parliament Speaker Z.Enkhbold received a recent draft order to privatise and reform 22 state properties and state-owned companies from 2014 to 2016. As of today, the order is still pending; but with approval in 2015, 13 companies would be privatised in their entirety, while nine would seek to downgrade their government equity. Unfortunately, only seven out of the 22 companies have plans for privatisation through the Stock Exchange. The remaining 15 companies would be privatised through a closed or open Call for Bidding, according to the draft order.

We at Gaudi Investment Securities think the most ideal privatisation of all companies is through the stock market. Investment for any state company comes from personal and company taxes, and import and export tariffs. When a state company is in loss, more taxpayers' money gets allocated to the company. Thus, the tax-paying companies and individuals are the real investors of the state owned companies. This is why we propose the idea to privatise through the stock market, to give the investors a chance to receive benefits from their perpetually unfaltering investment.

### Government support needs to be sustained

In recent years, many experts and politicians have emphasised the importance of developing the stock market. On many occasions the government has reaffirmed its willingness to provide support. Starting from 2015, if companies go public, then their financial funding benefits should increase, as long as the current state policy stays bent on creating financial supports for companies going public by ensuring a pleasant legal environment. ■

## OPINION

# General knowledge about Mongolia's current affairs



**NAOKI HISADA**

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Bank of Tokyo-Mitsubishi UFJ, Ltd.*

Granted with the right to open a representative office by the Bank of Mongolia on December 20, 2013, the Bank of Tokyo-Mitsubishi UFJ officially opened its representative office in Ulaanbaatar, Mongolia. The economic growth of Mongolia has been on a stable path since it started producing and exporting its minerals.

There is immense potential for Mongolia to export minerals such as coal and copper from Umnugobi province (under the spotlight of the whole world) to the Asia-Pacific region. Many mining-oriented projects and programmes must be developed in order to attract foreign direct investment, not to mention the need to prioritise the importance of strengthening the domestic production and infrastructure industries. Japan and Mongolia have agreed to put an emphasis on the outlook of their strategic cooperation between the two countries and therefore have put into place two framework policies: creating an attractive investment environment and further strengthening economic cooperation. Both parties hope to advance the industrial sector by giving a significant boost to the economy.

Bank of Tokyo-Mitsubishi UFJ has been a consistent financier and supporter of the Japanese industrial production through its outreach to the Mongolian market via trade financing and project financing. The purpose of opening a representative office in Ulaanbaatar was to collect abundant information and meet the needs of our clients. This article will provide information about the success stories of Japanese companies, business opportunities in Mongolia and foreign relations.

First of all, let's cover the entrepreneurial paths of Japanese companies and the potential business opportunities in the Mongolian market. Of all the companies with Japanese investment, Mobicom Corporation—the largest representative of the telecommunications industry—has been at the forefront in achieving huge success. As of today, more than half of the cellphone owners in Mongolia receive their services from Mobicom alone.

A year before Mobicom was established in 1994, a tender bid was announced by the government of Mongolia for a permit to start a business in the telecommunications sector. At the time, Japan had only a 3 percent penetration rate in the cellphone carrier market, and increasing that was considered a challenge for Japan. Nevertheless, Mobicom was established as a joint venture between Japan and Mongolia during a challenging time.

It must have been difficult to justify this investment idea for Mongolia's telecommunications market to the Japanese company. There were many businesses with no real leadership; there was no apparent winner in the telecommunications sector to speak of at the time as well. However, many successful business stories have been made in Mongolia as one of the representatives of burgeoning economies.

Additionally, a Japanese company has been contracted by the Civil Aviation Authority of Mongolia to lead construction of a new international airport. The total cost for construction is estimated at 50 billion yen, and one of the loan requirements will be that Japanese technology represent over 90 percent of

all applicable technology at the airport. The new airport will have a 3,600 meter runway, receive 2 million passengers annually and have 33,000 square meters available for its terminal. The total size of the airport will be equivalent to the size of the Komatsu Airport in Japan.

There are four business arenas which are attractive to Japanese companies in Mongolia.

The foremost attractive area is agriculture. The agriculture sector is considered a sector of strategic importance, and Mongolia has demonstrated a desire to ease off dependence on food and agricultural goods produced in China. In spite of the vast terrains across the country, Mongolia lacks the technological capability to manage agricultural goods, and hence, storing vegetables and fruits by acceptable standards is deemed an attractive business opportunity.

One of the most recent examples of this was a Japanese company's introduction of green house production. It is impossible to plant greens and other vegetables outdoors during the wintertime. Moreover, imported vegetables don't ensure food security. Therefore, the all year round production of rare vegetables and greens has been initiated and the produce is currently available in the market.

Japanese technology for water treatment and artificial lighting has been applied to the production of fresh vegetables and greens in greenhouses. The moisture, carbon dioxide and calorific value are controlled by a remote system.

An over 100,000 square area at close proximity to Ulaanbaatar has been



▶ devoted to greenhouses that will produce a variety of fruits and vegetables, such as strawberries, cucumbers and salad greens. Recently, modern technology has allowed shrimp farms in dry places. Some Mongolian entrepreneurs have shown interest in shrimp farms and some projects that will utilise Japanese technology are well underway.

Mutton and beef are widely used in Mongolia, whereas fish consumption had for a long time been next to none. However, Mongolians have been consuming seafood for a decade, which is considered a relatively young business opportunity.

The second most attractive sector is the construction sector. Major infrastructure work and development are on the rise, and more residential apartments, bridges, roads, canals and water pipes are needed for further growth. These infrastructure development initiatives cannot be sourced locally, hence the reliance on Japanese technical capacity and investment. Experts from Mongolia have been continually sent to the construction factory of Hokkaido in order to learn about the leading Japanese technology with resistance to the cold. Many Japanese companies have stepped forward to take part in the construction of apartments and houses in Mongolia. Looking at the fact that the Japanese style of kitchen and its user friendly

electronic goods are widely respected for their ease of application in modern households, Japanese technology has great market potential in Mongolia.

The third attractive sector is the autotrading business. One phenomenon that puzzles everyone is that more than half of the automobiles in Mongolia are from Japan. Gasoline in Mongolia is very expensive because it is mostly imported from Russia. Moreover, road conditions are not so great, and the temperature reaches -30 degrees Celsius due to the harsh climate. Japanese cars are high in demand because of their safety, durability and better gas mileage, especially the SUV and hybrid cars. If the tax on car exports from Japan was reduced, the market for car sales and automobile services would expand significantly. Other services related to cars include repairs to motors and electrical damage incurred because of repairs made by inexperienced auto repair workers and a lack of spare parts found locally. Accordingly, there will be a new market if Japanese companies with a high technological capacity fill in the services gap for automobiles.

The fourth attractive sector for Japanese companies is improving air pollution. Ulaanbaatar, the capital city of Mongolia, becomes the most polluted city in the world during its peak cold period in winter. Over 500,000 city residents

consume coal and wood logs in order to fend off the cold weather. Residential apartments and accommodations built 20 years ago are heated by coal, which emits a significant amount of air pollution. Additionally, Ulaanbaatar is surrounded by four mountains, which leaves the level of air pollution at dangerous levels.

Recently, a Japanese waste disposal company opened negotiations for the installation of an air pollution filter that would filter out pollution emitted from a coal-fired boiler at a school construction site. The Mongolian government has pledged to improve the environment, which I think is a significant step in itself in fighting against air pollution.

The next significant point of importance is to discuss cooperation between Mongolia with Japan, China and Russia. Strategically located between China and Russia, Mongolia is able to balance relations with both its neighbours, in addition to the “Third Neighbour” nations such as Japan, America, Europe, and Middle Eastern countries.

Between July and September of 2014, the Mongolian government signed agreements with Japan, China and Russia. On July 22, President of Mongolian Ts. Elbegdorj visited Japan and met with Shinzo Abe, the prime minister of Japan, where they collectively agreed on an economic partnership agreement. ▶▶



PHOTO BY B. BYAMBA-OCHIR

► The Mongolian president proposed cancelling the existing 5 percent customs tax on Japanese car exports in the next 10 years.

Miso, soy sauce, Japanese alcohol and vodka are also proposed to become customs duty tax-free so that Japanese food products will have a better opportunity to spread through the market. Concurrently, Mongolia has canceled an 11 percent customs duty tax on Mongolian cashmere products to Japan. This is the fine result of the 15th Japanese-Mongolian Economic Partnership Agreement. The first bilateral economic partnership agreement was aimed for offsetting the dependency on China and Russia. The Ministry of Education and Science of Mongolia in partnership with JICA announced that they would send 1,000 outstanding students to Japan for physics and other technical training initiatives under the umbrella framework of supporting the education system of Mongolia.

This educational program will produce professionals who are experts in the field of engineering across air transport, roads and buildings which meet international standards. In addition, the Trade and Development Bank of Mongolia (TDB) opened a representative office in Tokyo on July 22. TDB shall be responsible for providing information about the Mongolia market economy to

Japan in order to increase foreign direct investment, obtain capital and bring investors.

Let's focus on China again. Xi Jinping, China's president, paid an official visit to Mongolia on August 21 and 22. This visit of the president of the People's Republic of China was the first high-level visit of a Chinese official to Mongolia after 11 years. Over 26 cooperation agreements have been signed across various fields such as China-Mongolia diplomatic relations, economy, trade, transportation, banking and finance, culture, and minerals and mining.

Foreign trade between the two countries by 2020 is expected to reach a target of USD 10 billion. The additional agreement stipulates that in three years' time, foreign trade will reach as much as USD 2.44 billion, or about 1.5 times today's total trade. That would have a large impact on increasing Mongolia's foreign exchange reserves. Within the framework of the foreign exchange trade, China will additionally supply more currency, equivalent to USD 810 million. Foreign currency reserve risk will be minimized with further financial support from China.

On September 3, Vladimir Putin, the Russian president, paid an official visit to Mongolia. Russia currently owns 51 percent of the Ulaanbaatar Railway

Joint Stock Company, and 49 percent of Erdenet Mining Corporation. On the back of rail transportation for minerals, the trade turnover between the two countries by 2020 is targeted to reach USD 10 billion, from USD 1.6 billion in 2013. Mongolia intends to build a dual-gauge railway line by 2020 with routes from Sukhbaatar, Ulaanbaatar, Sainshand to Zamyn-Uud, and the capacity for 100 million tonnes of freight annually. Thus, it will be the nearest railway link to connect Asia with Russia and Europe.

Russia has announced its support for meeting the demand for beef, mutton and meat products from Mongolia. Russia and Mongolia have reached an agreement that Mongolian passengers will travel to Russia visa-free. In general, Vladimir Putin's visit to Mongolia lasted only five hours, which did not imply much significant support compared to the presidential visit to Mongolia by China.

Hereby, we have intended to give a clear picture of the current situation and the general overview of Mongolia.

**There are three concerns we must consider with importance:**

First, the underground mine development for the second phase of the Oyu Tolgoi mine is still uncertain.

Second, macro-economic trends are worthy of discussion. It is crucial to pay attention to foreign exchange reserves as it is not easy to control and strengthen economic stability. There is no optimal level of foreign exchange reserves as clearly defined in textbooks, but there are benchmarks. The "foreign exchange reserves/import" ratio should be more than three months of imports while "the foreign exchange reserves/short-term debt" ratio should be the equivalent of one year's payments.

Third, foreign direct investment towards the mining sector is once again becoming active, and China seems to be taking the lead. In other words, it is important to carefully watch direct investment from China. As a developing country, Mongolia has medium and long-term growth potentials on the back of copper, coal and other mineral resources despite some management issues. Thus, keeping the above-mentioned three concerns in mind, we will carefully watch future development trends of the Mongolian economy. The Bank of Tokyo-Mitsubishi UFJ Representative Office will do its best in assisting with the potential economic growth. ■