

Country Report Mongolia

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Mongolia's foreign exchanges reserves have decreased rapidly, as FDI in the mining sector has plunged, while import demand has remained high on the back of loose macroeconomic policies.

Strengths (+) and weaknesses (-)

(+) Very strong growth prospects

A vast endowment of a range of mineral resources, of which most are untapped, and ample room for further economic development make that Mongolia's growth potential is large.

(-) Underdeveloped and resource-dependent economy

Mongolia's economy is underdeveloped (HDI rank 108 out of 187) and the country's economy depends heavily on the extraction and export of natural resources.

(-) Unstable policy environment

Mongolia's democracy is young and its institutions are weak. Policies change frequently, which creates uncertainty for investors.

(-) High external vulnerability

Mongolia's current account balance shows large deficits. Furthermore, as exports consist of commodities, while strategic goods, such as food and fuel, need to be imported, the country is vulnerable to commodity price fluctuations. Moreover, roughly 90% of exports are bought by China, which makes Mongolia vulnerable to adverse developments in its big neighbour.

Key developments

1. Balance of payments risk has increased significantly

In recent months, Mongolia's stock of foreign exchange reserves has fallen significantly. According to Mongolia's

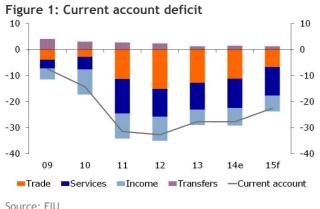
central bank, gross foreign exchange reserves fell to USD 1.3bn in June 2014, down from USD 2.2bn in December 2013 and USD 4.1bn in December 2012. This has been related to a number of factors. First, the inflow of foreign direct investment (FDI) has fallen strongly. In recent years, Mongolia received large amounts of mining related FDI. However, due to a souring of the relations between mining companies and the government (see key development 2) net FDI has fallen from USD 1,260m in the first months of 2013 to just USD 380m in the first six months of 2014. Second, the trade deficit remained high. While higher copper exports and a fall of imports of investment goods led to an improvement of the trade balance, expansionary fiscal and monetary policies have continued to boost import demand (see also key development 3). As a result, the current account deficit is likely to remain high and is no longer fully covered by high net FDI inflows. Third, access to other sources of finance has also remained limited, after the country successfully issued a USD 1.5bn sovereign bond in late 2012. Mongolian officials have indicated that there might be a possibility to double the existing RMB 10bn (USD 1.6bn) swap facility with the Chinese central bank, but this has failed to materialise so far. The same applies to a rumoured USD 1bn samurai bond issue in Japan. Overall, as Mongolia's foreign exchange reserves have fallen to slightly more than 2 months of (the 2013) imports of goods and services, balance of payment risk has increased significantly.

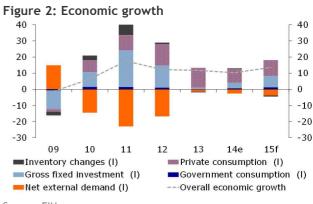
2. Relations between mining companies and government remain difficult

In recent years, mining investment has decreased. This was to a large extent related to a deterioration of the relations between mining companies and the government. A tax dispute between Rio Tinto and the government has made it unsure whether a planned further expansion of Mongolia's large Oyu Tolgoi copper and gold mine will start anytime soon. The uncertain regulatory environment has also in general acted as a break on mining investment. Mongolia's parliament has recently approved some amendments to the country's mineral law, which should facilitate investment in mining, but it is yet to be seen to what extent these amendments will result in more investment in the near future.

3. Loose monetary and fiscal policies result in macroeconomic vulnerabilities

Partially in response to limit the impact of the fall in mining investment on economic growth, Mongolia has adopted rather loose macroeconomic policies. The central bank reduced its policy rate in several steps from 13.25% to 10.5% in 2013. Meanwhile, the government launched a subsidised mortgage program in June 2013, which has resulted in a very rapid growth of credit and construction activity. While the non-performing loan ratio has remained very low, and the credit-to-GDP ratio is also still fairly modest, this could nevertheless result in future vulnerabilities. The government has also continued to conduct other types of off-budget spending. These loose macroeconomic policies have contributed to inflation, which increased to 14.6% in June 2014, and also fuelled the large current account deficit. The central bank increased its policy rate to from 10.5% to 12% in late July 2014, but more action is probable needed to ensure macroeconomic stability.





Source: EIU

Factsheet of Mongolia

National facts	acts			Social and governance indicators			
Type of government	Parliament	ary democracy	Human Develop	108 / 187			
Capital	Ulaanbaata	F	Ease of doing bu	76 / 185			
Surface area (thousand sq km)	1,564		Economic freedo	107 / 148			
Population (millions)	2.8		Corruption perc	83 / 177			
Main religions	Buddhist (53%)		Press freedom i	88 / 179			
	Muslim (3%	6)	Gini index (incor	36.5			
Main ethnic groups	Khalkh (81%)		Population below	n.a.			
	Kazakh (4º	%)	The second state of the contract of the second second				
	Dorvod (39	%)	Foreign trade			2012	
Head of State (president)	Tsakhia Elbegdorj		Main export partners (%)		Main import partners (%)		
Head of Gov (prime-minister)	Norov Altankhuyag		China	82	China	49	
Monetary unit	Tughrik (MNT)		Canada	4	Russia	34	
			Russia	1	US	12	
conomy		2013	South Korea	1	South Korea	8	
conomic size	bn USD	% world total	Main export produ	cts (%)			
Nominal GDP	11	0.02	Copper			n.a.	
Nominal GDP at PPP	16	0.02	Apparel			n.a.	
Export value of goods and services	5	0.02	Livestock			n.a.	
IMF quotum (in mln SDR)	51	0.02	Animal products			n.a.	
conomic structure	2013	5-year av.	Main import produ	cts (%)			
Real GDP growth	11.7	8.8	Machinery and equipment			n.a.	
Agriculture (% of GDP)	17	18	Fuel			n.a.	
Industry (% of GDP)	33	35	Cars			n.a.	
Services (% of GDP)	50	47	Food products			n.a.	
Standards of living	USD	% world av.	Openness of the e	conomy		2013	
Nominal GDP per head	4,037	36	Export value of	f GDP)	44		
Nominal GDP per head at PPP	5,544	37	Import value of	67			
Real GDP per head	1,796	21	Inward FDI (% o	of GDP)		19.9	

Source: EIU, CIA World Factbook, UN, World Economic Forum, Transparency International, Reporters Without Borders, World Bank.

Background information

Traditionally, Mongolia's economy was dominated by herding and agriculture. Mongolia is endowed with large reserves of a wide range of mineral resources and the development of these resources has become the main growth driver in the past decade. The Oyu Tolgoi mine, for instance, which is situated on one of the world's largest untapped copper reserves, is estimated to produce 500,000 tonnes of copper and 500,000 ounces of gold a year for the next 35 years. As a result, if the country succeeds to manage this natural resource wealth well, Mongolia's economic medium-to-long term outlook is bright. In spite of these good growth outlook, Mongolia's economic structure remains weak. The Mongolian economy is highly dependent on the production and export of commodities and thus at the mercy of international commodity price fluctuations. Moreover, Mongolia is enclosed by Russia and China and is highly dependent on trade with these countries; Russia supplies nearly all of its fuel and energy needs, while China buys roughly 90% of the country's total exports. Mongolia is thus particularly vulnerable to adverse developments in China. Furthermore, Mongolia's benign economic outlook would be adversely affected by any adverse change in investor sentiment, as the country will need substantial amounts of foreign direct investment (FDI) to reap the benefits of its massive natural resource endowments. Given Mongolia's large current account deficit, its weak export structure and its dependence on FDI inflows and donor aid, external liquidity risk is high. Mongolia's democracy is still young and, as a result, its institutions are immature. Corruption, also among high-ranking officials, remains a problem.

Economic indicators of Mongolia

Mongolia							
Selection of economic indicators	2009	2010	2011	2012	2013	2014e	2015f
Key country risk indicators							
GDP (% real change pa)	-1.3	6.4	17.5	12.3	11.7	10.3	13.6
Consumer prices (average % change pa)	6.3	10.2	9.5	15.0	9.6	11.3	8.3
Current account balance (% of GDP)	-7.5	-14.3	-31.5	-32.7	-27.7	-27.7	-22.6
Total foreign exchange reserves (mln USD)	1,294	2,197	2,275	3,930	2,096	2,150	3,360
Economic growth							
GDP (% real change pa)	-1.3	6.4	17.5	12.3	11.7	10.3	13.6
Gross fixed investment (% real change pa)	-29.8	33.0	65.5	28.2	2.0	6.6	14.3
Private consumption (real % change pa)	-2.5	11.0	13.6	19.6	16.9	11.1	12.9
Government consumption (% real change pa)	-5.5	13.4	12.4	9.4	-2.5	7.0	13.0
Exports of G&S (% real change pa)	19.7	6.8	28.1	-0.2	6.2	17.9	19.1
Imports of G&S (% real change pa)	-4.7	24.1	45.8	14.5	4.9	12.7	14.9
Economic policy							
Budget balance (% of GDP)	-4.2	2.8	-2.6	-8.5	-2.0	-2.8	-1.2
Public debt (% of GDP)*	n.a.	n.a.	n.a.	61	60	63	n.a.
Money market interest rate (%)	10.0	11.0	12.3	13.3	10.5	11.5	12.2
M2 growth (% change pa)	24	62	37	19	24	15	19
Consumer prices (average % change pa)	6.3	10.2	9.5	15.0	9.6	11.3	8.3
Exchange rate LCU to USD (average)	1,438	1,357	1,266	1,358	1,524	1,784	1,822
Recorded unemployment (%)	5.9	6.5	4.8	n.a.	n.a.	n.a.	n.a.
Balance of payments (mln USD)							
Current account balance	-342	-886	-2,760	-3,362	-3,177	-3,270	-3,3
Trade balance	-178	-172	-990	-1,552	-1,467	-1,320	-9
Export value of goods	1,881	2,908	4,816	4,382	4,075	4,690	6,0
Import value of goods	2,059	3,080	5,807	5,934	5,542	6,010	7,0
Services balance	-154	-303	-1,163	-1,102	-1,182	-1,330	-1,6
Income balance	-195	-598	-845	-948	-671	-800	-8
Transfer balance	186	187	238	239	143	170	1
Net direct investment flows	570	1,630	4,620	4,408	2,235	2,220	3,0
Net portfolio investment flows	-82	969	77	-74	20	430	-5
Net debt flows	292	273	49	2,566	313	160	2,4
Other capital flows (negative is flight)	232	-1,026	-1,823	-1,862	-1,269	460	-3
Change in international reserves	670	961	163	1,675	-1,878	-10	1,2
external position (mln USD)							
Total foreign debt	2,216	2,506	2,564	5,081	5,371	5,530	7,8
Short-term debt	72	230	239	297	247	310	3
Total debt service due, incl. short-term debt	242	255	349	497	1,039	1,160	9
Total foreign exchange reserves	1,294	2,197	2,275	3,930	2,096	2,150	3,3
International investment position	n.a.	-1,678	-8,229	-14,376	n.a.	n.a.	n
Total assets	n.a.	6,549	5,421	6,380	n.a.	n.a.	n
Total liabilities	n.a.	8,227	13,649	20,755	n.a.	n.a.	n.
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Trade balance (% of GDP)	-3.9	-2.8	-11.3	-15.1	-12.8	-11.2	-6.7
Current account balance (% of GDP)	-7.5	-14.3	-31.5	-32.7	-27.7	-27.7	-22.6
Inward FDI (% of GDP)	13.6	27.3	53.8	43.3	19.9	19.4	21.4
Foreign debt (% of GDP)	48	40	29	49	47	47	54
Foreign debt (% of XGSIT)	86	67	43	86	99	90	103
International investment position (% of GDP)	n.a.	-27.1	-93.9	-140.0	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	9	7	6	8	19	19	13
Interest service ratio incl. arrears (% of XGSIT)	1	1	0	1	2	2	1
FX-reserves import cover (months)	5.9	6.8	3.6	5.9	3.3	3.1	4.2
FX-reserves debt service cover (%)	535	863	652	790	202	186	341
Liquidity ratio	134	133	97	108	85	84	98

Source: EIU, *Moody's

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