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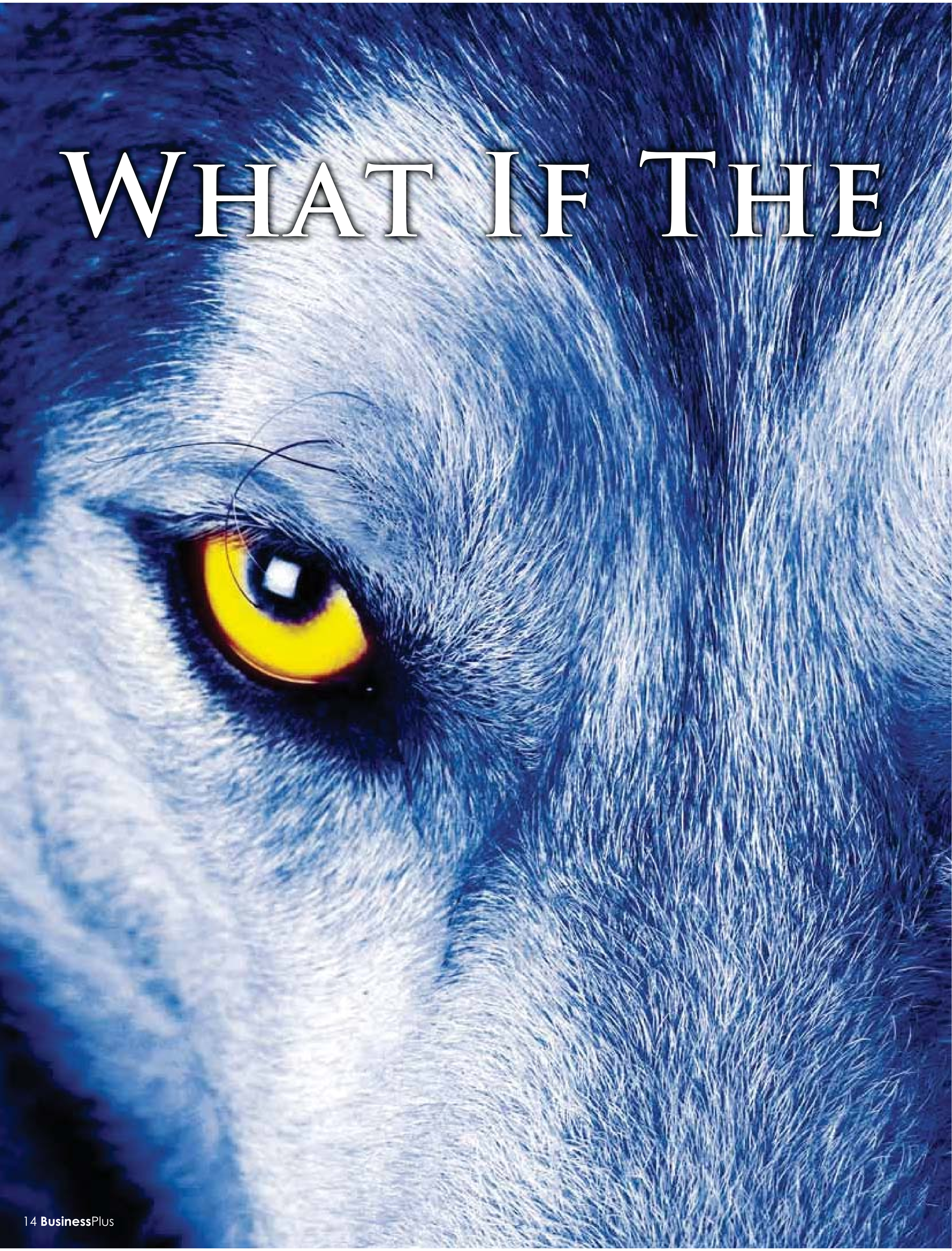

EMERGING ASIA

WOLF SNARLS?

Emerging economies all have risks. But what about virtually unknown Mongolia, whose GDP is set to grow at 30% a year by 2013?

By Chris Devonshire-Ellis, Dezan Shira & Associates

Attending the Mongolian Economic Forum this year was not just a welcome occasional foray into an interesting, yet relatively small and obscure Asian country, it was an insight into two main issues. Firstly, for me, it provided a snapshot back in time of a country just emerging from years of depression – much as I found China when I first began working in the country 25 years ago. But secondly, and more importantly, it provided the recognition that what is happening in Mongolia is going to change the way the world sources its most in-demand raw commodities.

Mongolia possesses the world's largest copper reserves, the second-largest coal reserves, significant onshore oil and gas fields, the world's second-largest deposits of rare earths, massive gold and iron ore reserves, and many other hugely significant deposits of minerals ranging from uranium to tungsten and zinc. Put simply, Mongolia's minerals will provide the world with supplies of many of its most valuable raw minerals for the rest of this century. That's why the country is suddenly gaining attention, and that is why the Mongolia issue is important.

Opportunities, therefore, are huge for businesses in Mongolia, for mining companies and their supporting industries, as well as for those who will need to create a supply chain that gets both raw and processed products from some relatively inaccessible areas to the global markets. Yet the question always keeps cropping up – what about the risk? A whole host of risk assessment expertise was assembled at the forum, and I can relate their opinions in this article. Chaired by Dun & Bradstreet's country manager, the session quoted Mongolia's President Tsakhia Elbegdorj who said: "Our country is in great danger. Precisely because we have a wealth of natural resources."

President of Mongolia Tsakhia Elbegdorj

The Mongolian parliament building

It is that perspective – that comes from the nation's highest office – that makes Mongolia somewhat unique. Where some nations have reaped massive bonanzas, others have become troubled. Mongolia appears to recognise that the wealth within can lead to two paths – that towards a Norway, Qatar or South Africa, or socially divisive paths down which nations such as Nigeria and Venezuela have trodden. Risk element number one then – treating mineral wealth as a license to print money – appears to have abated as the Mongolians themselves understand the risk.

Additionally, when an economy becomes so dependent upon natural resources as a source of wealth, a specific set of risk criteria then come into play as definable issues.

The main ones are:

- Fluctuations in global commodity prices
- Changes in foreign trade and political patterns
- Appreciation of the domestic currency

Concerning the currency matter, Mongolia already has one of the fastest growing currencies in the world, and this is an area of concern.

Other countries have struggled to adapt when their currency appreciates as it makes exports more expensive. Some serious damage to a number of international economies has occurred when changing from a manufacturing to a commodities-based economy, with Holland being the most recent example. In what is still referred to as "the Dutch disease" the nation lost its entire manufacturing industry after its huge gas reserves impacted on its economy. It took nearly three decades to sort out the mess, by which time the nation lost its shipbuilding and auto industries. Already, Mongolia's cashmere industry is suffering similar problems as a result of currency appreciation. China, it goes without saying, faces similar problems.

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In terms of the fluctuation of global commodity prices, this is a little out of Mongolian hands. However, it is an issue that can be understood. Mongolia, it was stressed, needs to establish and implement a stabilisation fund in order to avoid cases like Nigeria, where wealth management is a serious problem. The expansion of the Mongolian financial sector and services industry also needs to take a role in this, and to this end the government has appointed both Goldman Sachs and the Deutsche Bank to advice. For example, the participation in hedging can play a role in protecting fiscal budgets against commodity price shifts.

Mexico, as an example of another nation largely dependent upon mineral wealth, took out contracts to hedge against the value of commodities it

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was producing in order to protect its fiscal annual budget, to be funded by those same revenues. Sure enough, the commodities dropped in value – but the effective "insurance fund" from the paying out of returns from the hedging contracts allowed the country to maintain the integrity of its fiscal expenditure. Such are the structures that Mongolia intends to put into place.

Mongolia's Deputy Finance Minister Ganhhuyag Hutagt went so far as to say that the government will implement a national level policy and strategy unit to determine and assess risk, and that he will examine the creation of a "risk management officer" under the office of the prime minister. Clearly, the perils of macro-economic risk are not being ignored by the nation's leaders. It was also mentioned that a policy think-tank and research unit will need to be established in order to study issues such as the impact of inflation in China upon Mongolia's economy, and how price fluctuations in commodities would impact.

Regarding hot money, the head of the Mongol Bank L.Purevdorj stated that this was an issue, with an estimated 40% of the country's total foreign reserves "capable of being withdrawn at any time." Mongolia's foreign currency reserves have increased by 250% over the past 12 months, and while certain elements within the government wish to spend this, the bank's position will be more cautious until the longer term sustainability of these reserves can be better understood and managed. In building up reserves, rather than spending them, the bank's policy will see Mongolia's credit rating increase and enable it to borrow at preferential rates.

Barclays Capital observed that the Mongolian GDP growth in 2010 reached 10%, the same as China, and is projected to reach 30% by 2013, making the economy one of the fastest growing in the world. Stating that investors want "economic, political and social stability, coupled with transparency," it was also suggested that there is a need to better understand stability issues; especially those pertaining to the mining industry and the management and laws related to this.

The establishing of secondary industries will depend upon the transparency of how Mongolia treats the main economic driver which is mining. Noting that the sovereign wealth fund idea was close to being implemented, it was additionally stressed that how this fund was managed will be keenly observed for clues about the transparency and stability of the Mongolian economy.

Meanwhile, the London Stock Exchange (LSE) recently announced that it has won a tender issued by the Mongolian Stock Exchange (MSE) to

The Mongolian Stock Exchange occupies a former Soviet era Children's Cinema in downtown Ulaan Baatar

The main office and residential quarters of the Ukhaa Khudag coal mine in the South Gobi desert

commence with restructuring of the MSE. The new head of the MSE will be the current Chairman of the LSE, with a team of some 60 London-based managers, analysts and researchers relocating to the capital Ulaan Baatar to assist. The Mongolian government intends to disperse of many of its state -owned enterprises, in addition to creating new markets in Mongolia for the trading of Mongolian commodities and the companies involved with these. BP

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