

Frontier's Strategy Note: 02/13/2015



"Foreign Direct Investment to Mongolia"

Today we would like to discuss about FDI inflow to Mongolia, but from different angle. We all aware, that FDI inflow to Mongolia has been decreasing significantly for last few years. This time we tried to analyze the FDI data since 1991, and the structure of FDI inflow, brief comparison with the global data and other developing countries in Asia to see the bigger picture.

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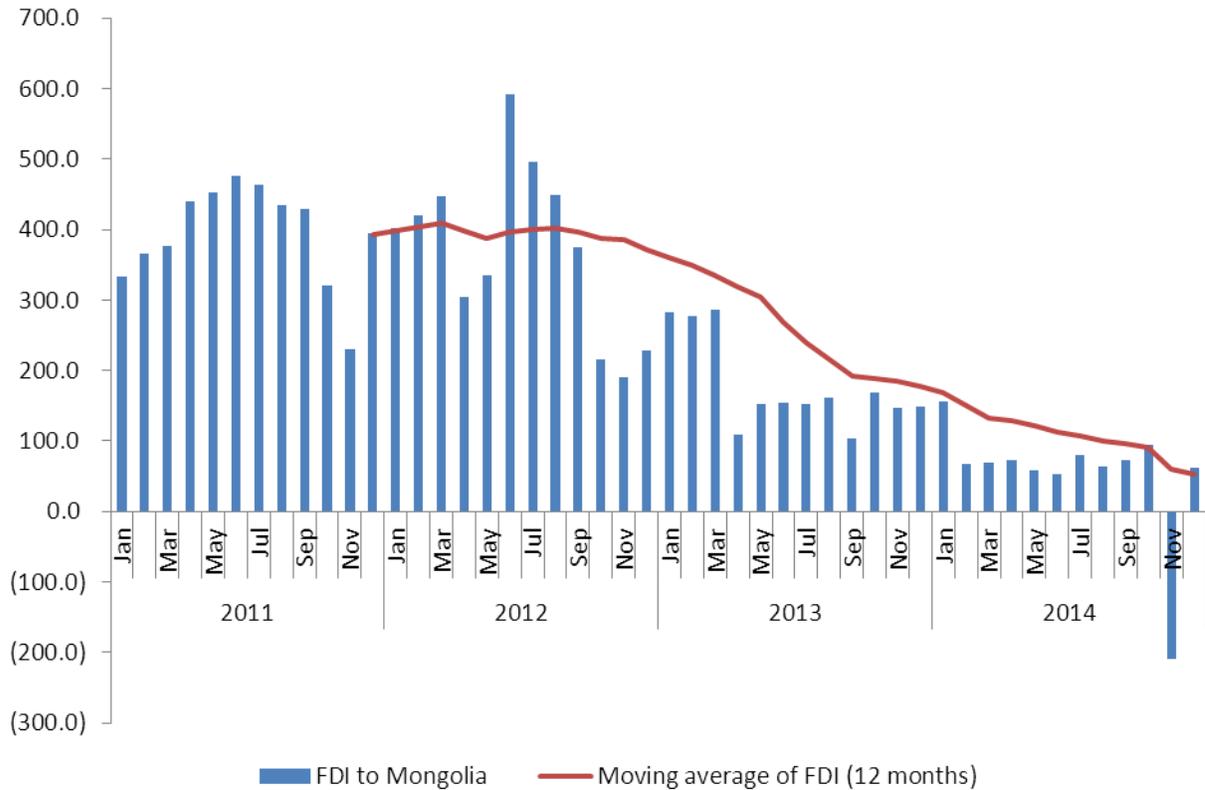
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As of December 2014, annual FDI inflow to Mongolia has decreased to 644 million USD in 2014, from 2.1 billion USD in 2013, according to the statistics by the Bank of Mongolia. Annual decrease of inward FDI has reached the peak of 68 percent in 2014, 17 percentage units higher than 2013.

If we look closer to data in 2014, divestment of 208 million USD occurred in November. Profit reinvestment as a component of FDI once reached to 361 million USD, almost 10% of total inward FDI in 2011. However this performance has been negative since 2013: -300 million USD in 2013 and -156.1 million USD in 2014. This might be reflection of the sentiment of existing foreign investors in Mongolia, that their interest to invest in Mongolia is decreasing and investors are pulling back their capital much faster in last two years.

Figure 1. Monthly FDI inflow to Mongolia, 2011-2014



Data source: Bank of Mongolia

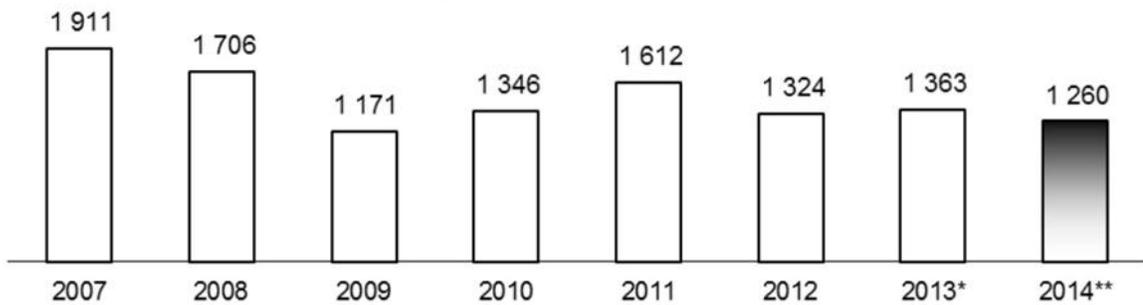


Global FDI trend

Some local sources were saying the FDI inflow has fallen globally, so we wanted to verify the newest global data and compare the performance of Mongolia with other developing nations in Asia. (Please note that some data may be different due to the different sources. We therefore used them as stated in the sources)

The UNCTAD has recently released its 18th issue of Global Investment Trend Monitoring report. In 2014, global FDI inflows declined by 8% to an estimated US\$1.26 trillion (Figure 2) due to fragility of the global economy, policy uncertainty and geopolitical risks. At the regional level, flows to developing Asia were up; those to Africa remained flat, while FDI to Latin America declined.

Figure 2. Estimated global FDI inflows, 2007-2014
 (Billions of US dollars)



Source: ©UNCTAD.

* Revised; ** Preliminary estimates.

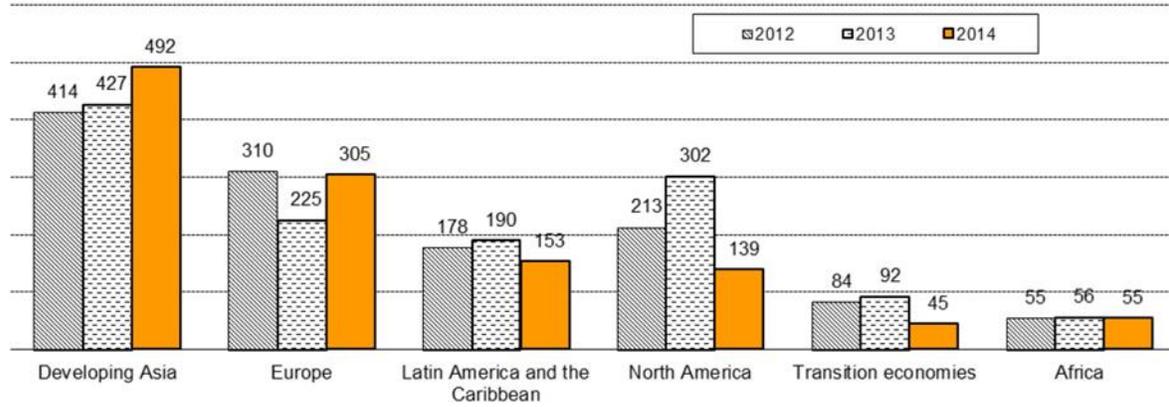
Note: Excluding Caribbean offshore financial centres.

FDI flows in developing economies remained resilient in 2014, despite the slowing economic growth rate. Developing economies saw their FDI reaching a new high of more than US\$700 billion, 4% higher than 2013, with a global share of 56%.

The increase was mainly driven by developing Asia – the world's largest recipient region. Preliminary estimates demonstrate that combined inflows to 40 economies in the region grew by an estimated 15% to a historical level of around US\$492 billion in 2014. Among the sub-regions East Asia, South-East Asia and South Asia experienced rapid increases in inflows, while those to West Asia dropped. With inflows to China at an estimated \$128 billion – including both financial and non-financial sectors – the country became the largest FDI recipient in the world in 2014.

This was mainly driven by an increase in FDI in the service sector, while FDI to the manufacturing sector fell, particularly from Japan, and especially in industries that are sensitive to rising labour costs (UNCTAD).

Figure 3. Estimated FDI inflows, by region, 2012-2014
 (Billions of US dollars)



Source: ©UNCTAD.

Note: Latin America and the Caribbean excludes Caribbean offshore financial centers.

So here we can see that although the global inward FDI has slightly decreased in 2014, trend of FDI inflow to the developing Asian countries stayed positive for last 3 years.

FDI inflow trend in Mongolia

We compared FDI inflow of Mongolia with some countries in Asia and selected mineral resource rich countries. In 2009, FDI inflows contracted globally as can be seen from table 1. After global financial crisis hit in 2008, global FDI inflow has decreased by 33% in 2009 and it recovered quickly the next year. Also following during the mineral boom in 2011, global inward FDI increased by 20% and mineral rich countries realized the highest increase in FDI inflow. However since 2012, FDI inflow has been moderated and showed different trend for each country.

After global financial crisis in 2008, inward FDI to Mongolia has also recovered rapidly in 2010, before it loses the momentum from 2012 and the decline has been deepening since. During the mining boom years, Mongolia was one of the countries that experienced the highest increase in FDI inflow. Around 80% of the FDI inflow was in the mining sector.

The differences in annual changes of FDI inflow of the countries in 2012 and 2013 suggest that the recent changes in FDI inflow are most likely depending on the country specific factors, rather than the global factors.

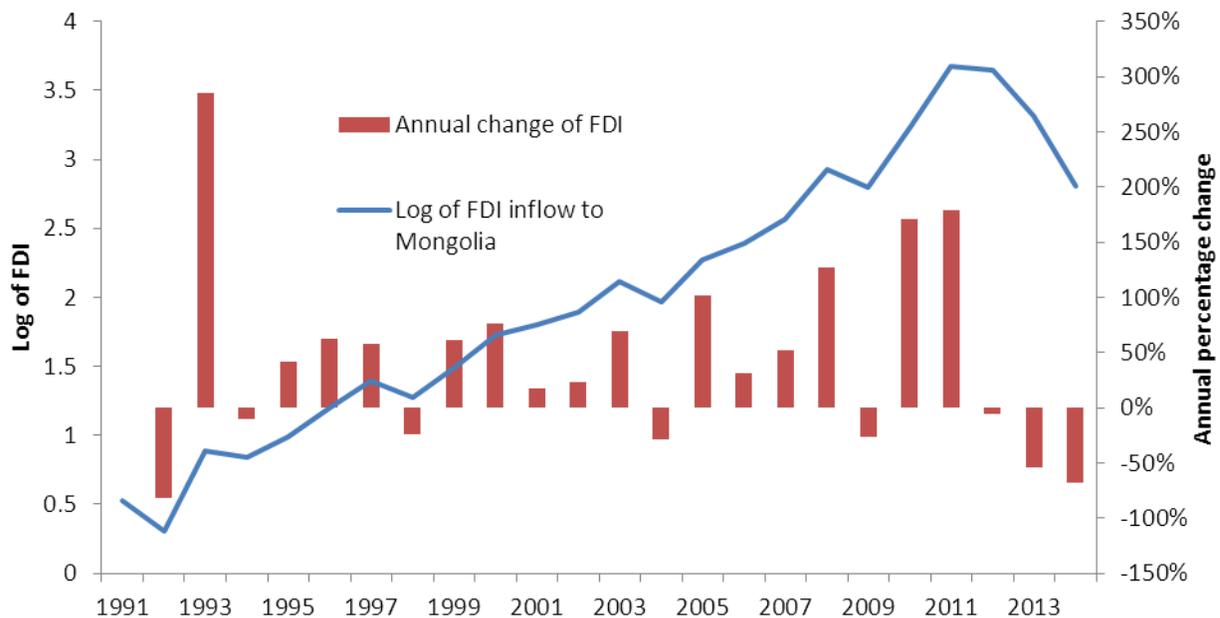
Table 1. Change in FDI inflow in selected countries

	2009	2010	2011	2012	2013
<u>World</u>	-33%	16%	20%	-22%	9%
Developing economies: Asia	-18%	26%	5%	-4%	3%
China	-12%	21%	8%	-2%	2%
Indonesia	-48%	182%	40%	-1%	-4%
Kazakhstan	-15%	-48%	85%	0%	-29%
Lao People's Dem. Rep.	-17%	47%	8%	-2%	1%
Malaysia	-80%	524%	35%	-17%	22%
Mongolia	-26%	171%	179%	-6%	-54%
Viet Nam	-21%	5%	-6%	11%	6%
Selected mineral resource rich countries					
Australia	-42%	32%	82%	-15%	-10%
Brazil	-42%	87%	37%	-2%	-2%
Canada	-63%	25%	40%	8%	45%
Chile	-17%	22%	49%	22%	-29%
Russian Federation	-51%	18%	28%	-8%	57%

Data source: UNCTAD

If we look back whole picture of FDI inflow to Mongolia, FDI inflow has decreased time to time, approximately once in every 4 to 5 years, since 1991. However the nature of current situation of FDI inflow is different in comparison to the previous drops in various aspects, as explained below.

Figure 4. Annual change of FDI inflow to Mongolia and log of annual FDI inflow



Data source: Bank of Mongolia



1. *Duration and scale of the fall.* As described in the figure 4, during previous drops of FDI to Mongolia, inward FDI has quickly recovered the next year after fall. But this time, decrease of inward FDI is continuing for consecutive 3 years, with the peak of 68% in 2014. Despite the fact that Mongolian authorities are making positive changes in the legal environment in the recent years, decline in FDI inflow is deepening.

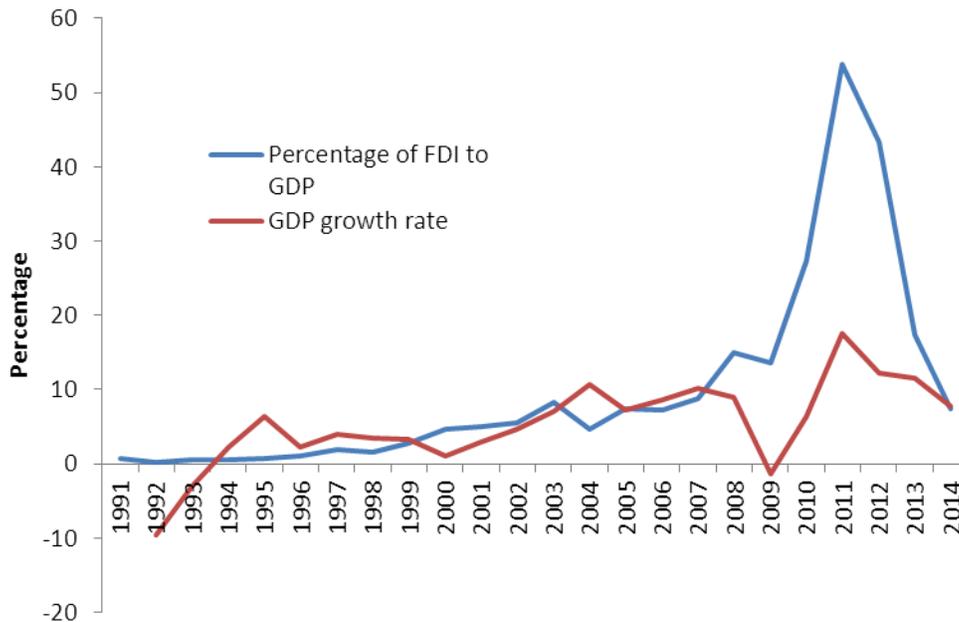
2. *Scale of the FDI and its contribution to the economy.* FDI inflow to Mongolia has increased enormously in last 5 years. Although there were some setbacks, the general trend was increasing (Figure 4).

The amount FDI inflow in 2011 reached to 4.7 billion USD, which is 19 times greater than the FDI inflow in 2001 and 74 times greater than it was 10 years ago. This was an impressive progress. But by the end of 2014, annual FDI inflow has decreased to 644.3 million USD, to the post crisis level of 2009, when the economy has actually contracted.

GDP growth and growth of FDI inflow have been moving together since 2008, but with much higher volatility for FDI inflow (Figure 5).

Percentage of FDI inflow to the country’s GDP has increased sharply during last 5 years too. In 2011, FDI inflow to Mongolia has reached to 53% of its GDP.

Figure 5. GDP growth rate of Mongolia and percentage of FDI inflow to annual GDP of Mongolia



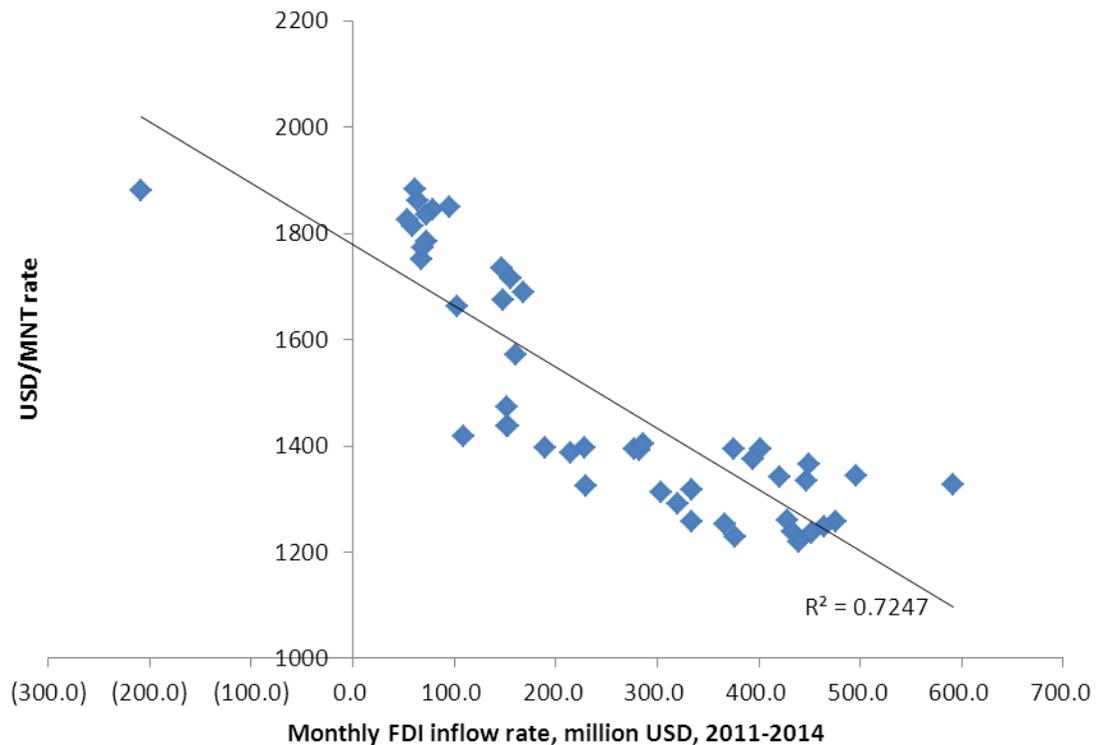
Data source: Bank of Mongolia



As the contribution of inward FDI to the country’s economy increases, its impact is also becoming more noticeable.

We calculated the correlation between FDI inflow and currency rate performance, using monthly FDI inflow and monthly average currency rate for the period from January 2011 to December 2014, as announced by Bank of Mongolia. Correlation between monthly FDI inflow and monthly USD/MNT and CNY/MNT rates, were -0.9 and -0.85, respectively. Although this cannot express the causal relationship between variables, it reveals the trend that when FDI inflow decreases, value of Mongolian tugriks against USD and Chinese yuan also decreases. On the other hand, monthly FDI inflow has shown strong positive correlations against the monthly NEER (nominal effective exchange rate), 0.85, which means that when FDI inflow increases, the value of Mongolian tugriks increased.

Figure 6. Monthly FDI and USD/MNT rate



Data source: Bank of Mongolia

3. *Structure of the FDI.* Despite the sharp decrease in general FDI inflow in 2013, UNCTAD reported that the Greenfield FDI projects in Mongolia have increased dramatically the same year.

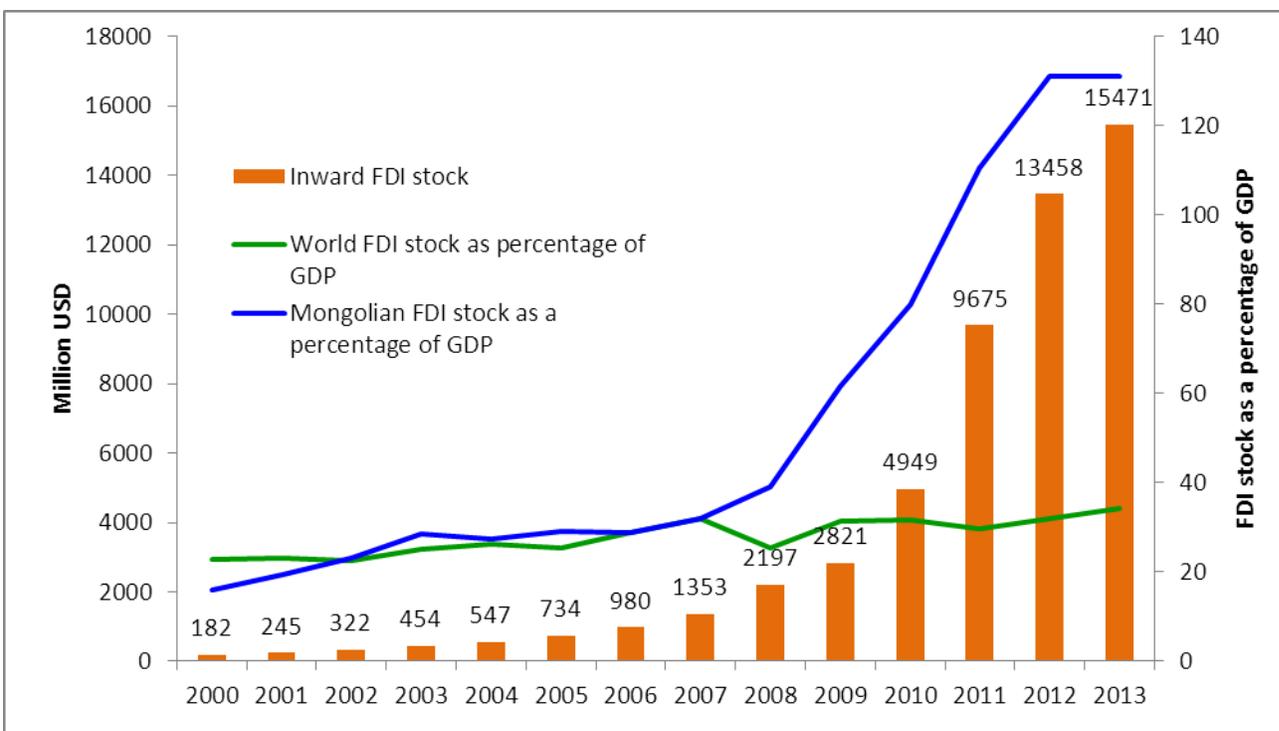
Table 2. Greenfield FDI projects in Mongolia

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Value of greenfield FDI projects (million USD)	829	10	1 500	216	448	330	302	1 608	183	122	595
Project numbers	6	2	8	3	8	8	3	9	5	5	11
Average value of the project	138.17	4.95	187.55	72.00	56.04	41.23	100.63	178.69	36.66	24.44	54.13

Data source: UNCTAD

As a whole, inward FDI stock of Mongolia has increased continuously, reaching to over 15 billion USD in 2013. It is likely to reach to 16 billion USD in 2014. Inward FDI stock has over passed the annual GDP of Mongolia since 2012. FDI stock has been accounted for 130% of GDP in 2013 for Mongolia, one of the highest in the world. (Only a few Caribbean countries have reached 170%).

Figure 7. Stock of FDI inflow to Mongolia and its percentage to the economy



Data source: UNCTAD



Summary.

According to our analysis, as the inward FDI to Mongolia has increased dramatically since 2010, its impacts on the economy have also becoming more noticeable. The fact that 80% of the FDI inflow for last 5 years was invested to the mining sector, prove that the surge of FDI inflow to the country mainly driven by the investment to the mining sector.

Correlation between monthly FDI inflow and monthly NEER has shown strong positive relations, revealing the trend that when FDI inflow increases, the value of Mongolian tugriks also has increased for last 4 years. The facts that inward Greenfield FDI project has increased in 2013 might be showing that Mongolia is still attracting some interest from foreign investors.

The fact that current total stock of inward FDI stock has surpassed the GDP of Mongolia since 2012, are highlighting the importance of the existing foreign investments in the country. We also assume that sharp decline of the reinvestment of the profit of FDI might be reflecting the sentiment of the existing foreign investors. Therefore as we suggested before, while striving to attract new foreign investment, Mongolia needs to improve current business environment in order to keep the accumulated foreign investment in Mongolia. Frontier believes that FDI inflow to Mongolia will improve in the near future, but the scale might not be substantial enough to reverse the currency rate or the macro economy fundamentals of the country.

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