

**KEYNOTE ADDRESS BY MR. O. CHULUUNBAT,
GOVERNOR OF THE BANK OF MONGOLIA ON THE MONGOLIA
INVESTMENT FORUM
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Distinguished Guests,

Ladies and Gentlemen,

PROSPECTS FOR FDI (GLOBAL VIEW)

The continued need of firms to improve their competitiveness by expanding into new markets, reducing costs and accessing natural resources and strategic assets abroad, ongoing liberalization and growth of TNC's from emerging markets provides strong incentives for further FDI in developing countries in particular.

There is some variation in the FDI prospects of individual regions. In view of the improved economic situation in Asia and Oceania, its important role as a global production centre, its improved policy environment and significant regional integration efforts, the prospects of FDI flows to that region are strongly positive. According to the TNC's, experts and IPA's surveyed by UNCTAD, the region's outlook for FDI is bright.

FDI inflows in to CIS are expected to grow further in the near future, based on expectation that their competitive wages, in particular in South East Europe, could attract an increasing number of efficiency-seeking or export-oriented projects, while the natural resource-rich CIS countries could benefit from continued high oil, gas and minerals prices.

Intense competitive pressures in many industries are leading firms to explore new ways of improving their competitiveness. Some of these ways are by expanding operations in the fast-growing markets of emerging economies to boost sales, and by rationalizing production activities with a view to reaping economies of scale and lowering production costs. Higher prices for many commodities have further stimulated FDI to countries that are rich in natural resources such as oil and minerals. In some developed as well developing countries increased inflows in 2004 were linked to an upturn in cross-border merger and acquisition (M&A) activity. Greenfield FDI continued to rise for the third consecutive year in 2004. Provided economic growth is maintained, the prospects for a further increase in global FDI flows in next few years are promising.

INGREDIENTS FOR A GOOD INVESTMENT CLIMATE

A perusal of international business surveys, moreover shows that the list of what the multinational investment community considers the ingredients for a good investment climate is long and demanding: low inflation; correct exchange rates; steady economic growth; privatized infrastructure services; high literacy rates; extensive access to the Internet; liberalized trade; stable and transparent political institutions and procedures.

WHAT HAS BEEN DONE RECENTLY IN MONGOLIA TO IMPROVE FDI CLIMATE

Recognizing the importance of foreign investment in building up a solid private sector, in enhancing of the domestic growth and in achieving of country's sustainable development goal's the Government of Mongolia from the outset paid special attention to the attraction of foreign investments and took wide range of promotional activities on various levels to create favourable FDI friendly environment in the country.

The Foreign Investment Law of Mongolia provides for liberal investment regime, supported by fiscal incentives and protection of investment. The regime accords non-discriminatory national treatment to foreign investors and set no conditions under which it could be withdrawn. It allows foreign investors to invest in any sectors, unless specially prohibited by law, and to establish wholly owned or joint venture companies. The amendments included in the 2002 law relate to the types and forms of foreign investment, and served to further ensure companies could work in a stable taxation environment.

Mongolia ranks number one among Asian countries in terms of procedural time lag for starting business and along with Thailand prescribes the lowest number of requisite procedures for startig business.

In order to support the economic growth and activity and to create more business friendly environment latest tax reforms lowered the general tax levels including corporate income taxes and value added tax by 5 percent and broadened tax-deductible base.

Since 1991 Mongolia has conducted DTT's with 35 countries and BIT's with 39 countries. Trade agreements concluded by the Government especially with the US and EU, which gave to Mongolia the status of the Most Favourable Nation, played and are playing a big role in attracting FDI to Mongolia.

Mongolia has joined the “Washington Convention” on the Settlement of Investment disputes between the State and nationals of another State and the “Seoul Convention on Investment Insurance”.

As a result a more favorable external and internal legal environment was established to provide a freer and more open regime for business such as tax exemptions, deductions and export encouraging policies are provided under the FDI and other related laws. An improved enabling environment has resulted in increased FDI across a broader range of sectors.

MAIN MONGOLIAN MACROECONOMIC INDICATORS

Mongolia being a member of the main International Organizations such as World Bank, WTO is now an active member of the global community and its economy has been converted into one of most open economies in the region and Mongolia has achieved most of the performance targets set by IMF.

The Mongolian Government through successfully implemented policy initiatives, has made steady progress toward achieving its goal of sustained economic growth.

The measures and activities have started to bear fruition and Mongolia has been recently experiencing a constant increase in GDP for recent years.

GDP growth

The Mongolian economy performed well in 2005. The GDP reached 2,266,0 billion MNTG. It' growth was 6.2 percent higher than the 5.3% median among many Asian economies. According to the estimations, the GDP growth will reach 7.5 percent by the end of 2006. Fitch forecasts Mongolia's GDP to register growth rates of 5-6% in 2006 and 2007.

Industrial production which increased by 15% in 2004 mainly led by raise in the mining sector, grew by 10.6% in 2005 and it is etimated to have a growth rate of 6.6 percent by the end 2006.

Service sector accounts for over 50 percent of GDP and remains one of the strongest growing sector. The growth of the service sector is estimated to be 8.9 percent by the end of the year.

Recent development of financial intermediation and costruction have made a noticeable contribution to economic growth. The growth rates in 2005 were 16.7 percent and 11.9 percent respectively.

Inflation

Based on the rising cost of imported fuel in the second half of 2004, partly owing to disruptions of supply from the Russian supplier Yukos, the annual

inflation rate accelerated from 4.7% in 2003 to 11% in 2004. Since January 2005 the oil supply from Yukos have been relatively stable and the global oil price have also eased slightly and the annual inflation fell at 9.5 percent in 2005.

In July 2006 the consumer price index increased by 1.8 percent from the corresponding period of the previous year, by 5.9 percent from the end of the previous year and decreased by 0.2 percent in comparison to the previous month.

Within the frame work of consolidation of economic and financial stabilization and ensuring economic growth the Mongolbank remains committed to the objective of maintaing inflation whithin single digit rate. The annual inflation rate in 2006 is estimated to be at 6.3 percent.

Current account

Current account surplus was 104.3 Mio USD for 2005, an increase of 40.9 Mio USD on the previous year and equal to 5.6 percent of estimated GDP. The positive movement in the current account balance since 2004 was mainly driven by following:

- Upward movement in country terms of trade due to the high increase in world market prices of gold and copper inspite of increase in oil prices
- Depreciation of MNTG
- Increase of worker remittances from abroad

The current account surplus by the end of the 2nd Quarter 2006 reached 73.2 Mio USD. The current account position is forecast to stay above 4 percent of GDP for the end of 2006.

The capital and financial account

The capital and financial account had a surplus of 43.4 Mio in 2005 which is 2.8 fold more than the state in 2004. In 2005 FDI was equal to 9.8 percent of GDP. There was a financial account surplus due to FDI of 182.3 USD which increased 96.2 percent on the previous year.

FDI in the mining sector is expected to grow in the near future as exploration results have exceeded expectations in ceratin areas. Also development of transport and other infrastructure will also aid the integrtion of Mongolia's growing mining industry with the growing chinese market.

Foreign exchange reserves

External liquidity remains strong as reflected by stable and relatively high foreign exchange reserves. Official foreign reserves increased substantially

from 163.6 Mio USD at the end of 2004, to 298.6 Mio USD in 2005. It is estimated to reach a record high of 415.5 Mio USD by the end of 2006. It will mean an achievement of one of policy measures initiated by the government to consolidate economic and stabilisation and ensuring economic growth of at least 6 percent.

Exchange rate

The exchange rate was decontrolled in January 2003 and since we have fully liberalized foreign exchange regime. Increased demand for imports following robust economic growth has depreciated the exchange rate for recent years.

Tugrik rate against USD in real terms appreciated by 1.2 percent by the end of June 2006 on the year's begin and by about 12 percent on base year 2000 due to the increases in supply of foreign exchanges.

Central bank bills

In view of increasing inflationary pressure in 2004 Bank of Mongolia tightened its Monetary policy. BoM increased interest rate on 28 day CBB from 14% to 15% in order to absorb excess money supply in the economy. Central Bank Bills (CBB) weighted average interest rate as at the end of 2004 was 15.8%. In 2005 the daily weighted average on CBB's moderated to 8.58%, a drop of 4.1 points on the previous year.

Banking sector overview

Mongolia has achieved significant progress in restructuring the nation's banking system, a critical precondition for sustainable economic recovery. A stable banking system is also one of important ingredients of a good investment climate.

The sector has performed phenomenally over the last 4-5 years. Mongolia's banking system is healthy and largely privatized now. Only 1 bank of the 16 banks is state owned and 2 banks have state participation while remaining 13 banks are in private sector. Of the 13 privately owned banks, 6 had participation of foreign ownership (of which, the controlling interest of 5 banks is owned by foreign investors).

Banking sector indicators expanded: namely, total assets grew by 42.9 percent, total credit by 41.8 percent and capital by 23.9 percent while non-performing loans declined by 0.6 percent on the previous year in 2005.

Banking capital is likely to grow considerably following the raise of capital reserve requirements to 8.0 billion MNTG for banks in March, 2006. Increasing minimum capital requirement in banks should increase resilience to various risks, improve public confidence in the banking system, bring greater exposure to individual borrowers and the scope of financial intermediation should be broadened.

In 2005, money supply (M2) increased by 38.1 percent and its share in GDP has grown by 7.3 units to 51.6 percent. Due to increase in nominal GDP, the share of equity in the banking system to GDP climbed up by 0.4 units to 9.1 percent.

Deposits

Mongolian banking system continues to develop, significant progress has been made in restoring public confidence as reflected in the flow of deposits into banking system. Deposits with banks have increased 9.9 fold to 692.8 billion MNTG since 1999. **Deposits to GDP ratio** stood at 39.8 percent in 2005 compared to 13.7% in 1999. The improving Deposits to GDP ratio is an indicator of improved financial intermediation efficiency of the commercial banks.

Loans

BoM's policy has been aimed toward intensifying loan activity, reducing interest rates and supporting investment. As a result of continued efforts total loans outstanding by July 2006 increased by 47.8 percent from the corresponding period of the previous year, by 3.4 percent from the previous month and reached 1.1 trillion MNTG. Since 1996 -1999 lending by banks has increased 11 fold. **Loans to GDP ratio** stood at 36% in 2004 compared to 8.9% in 1999.

As of July 2006, private sector accounts for 57% of total loans outstanding. The share of Non-performing loans (NPL) in total loans was 23.5% in 2000. During the recent years the share of NPL in total loans dropped significantly It made in 5.7% in 2005 and 6.2% by July 2006 of total loans.

Tremendous growth in lending was fueled by increase in deposit base of banks and has led to increased economic activity.

Pre-tax profits at banks grew by 23.6 percent to 20.3 billion MNTG as a result of a dramatic increase in total revenue (27.9 percent).

International standards in supervision

Bank supervision has improved, regulations have been amended to improve prudential banking practises in line with international standards. Amendments fit cover fit and proper tests, exit policy, legal lending limit, credit restructuring and assessment of productive assets, short-term financing and bond portfolio trading.

In collaboration with the ADB BoM issued Corporate Governance Guidelines for banks to improve their structure and the efficiency of their internal audit and control systems.

Continuing efforts to develop the banking system

- To develop the financial markets and the full range of financial intermediation
- To issue government bonds on the international markets
- To create a legal framework to create financial offshore zones
- To intensify actions to introduce long-term loans and mortgages for housing sector
- To strengthen the protection of privacy of accounts of individuals through special highly protective measures stipulated by law

RESULTS OF FDI POLICY

Ranking of Mongolia

Mongolia's ranking based on **UNCTAD's Inward FDI Performance Index**³ rose from 82nd place in 1995-1997 to 15th place in 2001-2003. Mongolia's **UNCTAD's Inward FDI Potential Index**⁴ has risen from the 95th place in 1993-1997 to the 69th in 1996-1997 and to the 63rd in 2001-2003.

Affirmation of B+ by Fitch on 1 September, 2006

Fitch Ratings, the international rating agency, has on 1st September affirmed Mongolia's Long term foreign currency Issuer Default Rating (IDR) of B+ and Long term local currency rating IDR of B+. At the same time the agency affirmed the country's short term rating of B and Country ceiling rating of B+.

Country of operations of the EBRD

Mongolia was accepted as an EBRD country of operations in July 2006. T Accepting Mongolia as an EBRD country of operations in July 2006 the EBRD has shifted the borders of its activities further east for the first time.

I'm confident that accepting Mongolia as an EBRD country of operations will contribute to the further development of the investment climate in the country.

FDI inflows

As a result of policy measures taken by the Government of Mongolia to attract FDI the total amount of FDI has increased significantly. In 1995-1996 around 30-40 Mio USD of FDI was registered annually.

In recent years, however, FDI has increased more than 200 Mio USD each year. In 2004 FDI was 237 Mio USD and in 2005 311 Mio USD. This brought total FDI to more than 1.4 billion USD by 4800 foreign companies from 88 countries since 1990. Around 80 percent of total FDI was undertaken in the period 2000-2005.

³ Calculated as the ratio of the country's share in global FDI inflows to its share in global GDP.

⁴ Measuring the potential based on a set of structural variables of countries in attracting FDI.

To date foreign companies have created 80 000 jobs. They account for around half of the country's total exports and more than 10 percent of the total tax revenue in recent years.

More than 40 percent of FDI as in the mining and geological prospecting sectors.

FDI in banking sector

FDI in the banking and financial services sector increased to above 5 percent of total FDI in 2005. The highest FDI flow – 19.7 Mio occurred in 2001.

Privatization efforts and activities to attract FDI in various economic sectors of the Government of Mongolia has led to greater presence of foreign capital in the banking sector. In 2003 the Agricultural Bank, the last commercial bank to be privatized, was sold to HS Securities, Japan.

Since the banking has been an important sector for FDI because of privatization process and liberalization in the banking system.

Ladies and Gentlemen,

I am sure that the Mongolia Investor Forum 2006 will provide you with the latest and first hand information on what Mongolia has done to create a better climate for business and on the investment opportunities in Mongolia.

I firmly believe that Investor Forum will offer foreign and domestic investors and decision makers the opportunity to exchange views and ideas and develop new contacts which will enable you to team up with Mongolian business people based on mutual benefits.

Thank You.