
A new Bank of Mongolia

Bank of Mongolia has assumed a pivotal role in transforming the former planned economy, reports Blair Baker in Ulaanbaatar.

The name Mongolia typically conjures up images of the warrior Genghis Khan, nomadic wanderers living in yurts, and a sizeable barren outpost of Soviet domain. While these associations are reflective of the Mongolian experience, the country has sought to reinvent itself within the context of an open-market, capitalist society. The country's central bank, Bank of Mongolia,, has been the catalyst behind much of the progress being effected.

The collapse of the Soviet empire more than one decade ago found Mongolia in a profound struggle after 75 years of Soviet patronage. The end of financial support from Moscow created quite an external shock in Ulaanbaatar and elsewhere throughout the former planned economy much as it did in other Soviet dependencies. The Mongolian People's Revolutionary Party (MPRP), the socialist-minded former communists, reassumed power in 2000 from the Mongolian National Democratic Party (MNDP), putatively a more market-oriented political party. The MPRP championed the MNDP's failed measures to introduce market-style economic reform and acquired a dominating majority of seats in the Great *Hural*, or state parliament, feeding on Mongolians' disillusionment with the former free-market experiment. Perhaps ironically, the most far-reaching economic progress made in Mongolia's brief post-Soviet history has been on the MPRP's watch.

The MPRP named Ochirbat Chuluunbat as governor of Bank of Mongolia (BoM) in August 2000, shortly after winning the general election. The 44 year-old Chuluunbat has been involved in the Mongolian banking sector since 1981, having served as deputy governor of BoM in the MPRP's previous government. Educated at Moscow's Institute of International Relations and known affectionately as "Chook" to his western counterparts, Chuluunbat was saddled with immense problems stemming from the MNDP's failed bid to retain power in 2000 by loosening the government's fiscal purse strings. Politicians played a decisive role as the heads of banks during the previous opposition government and this precipitated an appreciable accumulation of debt in the final months of the MNDP's grasp on power.

Market reforms from the socialist minded



Blair Baker

Kick-starting credit As the newly-minted governor, Chuluunbat realised one of his first tasks had to be to shore up confidence in the troubled banking sector. Worried international investors, upon whom the Mongolian economy is now dependent, were starting to unwind their foreign direct investments. Rife political cronyism had resulted in a non-performing outstanding loan ratio that exceeded 40%. Speaking in October 2000 about the situation, Chuluunbat said “Foreign investors have already begun to doubt our ability to keep a sustainable economic growth environment...Very large damage has been done to the banks. Now the public has no confidence in the banking sector and everybody hides his money under the pillow.”



Ochirbat Chuluunbat

Chuluunbat responded by more clearly defining the BoM's legal mandate. Recognising the need to raise standards of financial sector accountability, the BoM instituted policies to take collateral in the event of non-payment of outstanding loans; Chuluunbat famously said this included “socks”. A culmination of the BoM's efforts was the Mongolian Asset Recovery Agency (MARA) – an entity that legally enhanced the central bank's powers to reclaim assets. Results came quickly. Individual savings in the banking system increased by Tg45 billion (togrogs) in early 2001 and the non-performing outstanding loan ratio has now been more than halved. Chuluunbat is not complacent, however. “A non-performing loan ratio of less than 10% is progress,” he said, adding “but we must strengthen our financial credit sector even further.”

Return to financial intermediation A natural by-product of an increase in banking sector accountability has been a re-emergence of financial intermediation. In November 2000, the BoM first formulated a plan to provide a comprehensive deposit guarantee programme *à la* western banking practices and this legislation is now being drafted. This initiative coincided with a plan to privatise the Trade and Development Bank, the country's largest financial institution – a privatisation that took place in May 2002 in exchange for \$13.5m in equity capital. Western bank management is going to be brought in to improve the bank's solvency ratios and return the institution to profitability – an achievement that Chuluunbat lauds. Similarly, Agricultural Bank has become profitable after more than one year of restructuring under receivership of the BoM. Still, Chuluunbat says public sector involvement in the banking sector remains too high at 25% – a level he hopes to reduce further.

After enduring three banking crises in 1994, 1996, and 1998, financial-sector data suggest confidence is recovering. Shortly before Chuluunbat assumed the top role, net deposits in the banking sector totalled Tg111.6 billion. That figure increased to Tg158.8 billion in June 2001 and was reported at Tg241.3 billion as of August 2002. Likewise, outstanding loans increased from Tg58.3 billion in June 2000 to Tg107.1 billion in June 2001 and Tg195.9 billion as of August 2002. The non-performing loan ratio has moved inversely with the improvement in the deposit and loan data and was reported around some Tg11.4 billion as of August 2002 – less than 10% of outstanding loans.

Moreover, the effects of stricter regulatory oversight by the BoM and expanded financial intermediation can be evidenced in an appreciable increase in the money supply without the standard increase in inflation. The broad money supply aggregate measured Tg255.3 billion in June 2000 and increased to Tg313.9 billion and Tg430.7 billion in June 2001 and July 2002, respectively. Likewise, the reserve money supply aggregate grew from Tg144.7 billion to Tg155.7 billion and Tg179.7 billion during the same period. Inflation, on the other hand, had fallen. The annual year-on-year increase in consumer prices fell from 13.2% in June 2000 to 4.7% one year later and was a mere 0.2% as of June 2002. Another indicator of the improvement in financial intermediation is the ratio of broad money to gross domestic product which increased from 4.5% in 2000 to 29.3% in 2001.

Stricter regulatory oversight

Another encouraging development in the banking sector has been the growth of non-bank financial institutions (NBFIs). Only seven NBFIs were in operation in 1999 and this increased to 23 in 2000, 28 NBFIs in 2001 and 60 in 2002. The assets of these NBFIs now exceed Tg23 billion of which 64% are financed by foreign direct investment – another sign that foreign banking expertise has an interest in developing Mongolian operations. These institutions have sought to create a market niche that was not being entirely fulfilled by the larger commercial banking sector. Typical activities include small and mid-size commercial lending, financial leasing, forfeiting, factoring, foreign exchange trading, etc. Chuluunbat welcomes NBFIs as they have diversified the usual credit channels and “expanded the effectiveness of the (BoM’s) monetary transmission mechanism,” in other words, the central bank’s ability to regulate the growth of credit.

Non-bank growth

Bank of Mongolia’s legal mandate is to ensure the stability of Mongolia’s currency, the togrog, and to implement monetary policy on behalf of the government. Prior to 1991, Mongolia was devoid of a modernised central banking system, much less a western-oriented commercial banking sector. In 1991, the government instituted a Banking Law that created a two-tiered banking system comprising of the (central) Bank of Mongolia and commercial banks. The BoM’s legal remit was further developed in 1996 when the Law on the Central Bank invested far-reaching responsibilities of financial oversight in the central bank. These functions include the management of interest rates and exchange rates, the oversight of government borrowing, the supervision of interbank settlements and lending, the printing and issuance of bank notes and coins, the management of Mongolia’s foreign currency reserves, and the financial supervision of commercial banks. Additionally, the BoM is responsible for reviewing applications for the establishment of new commercial banking entities and branches of existing financial institutions.

Legal development

In October 2000, Chuluunbat announced the BoM would pursue policies to keep the togrog “quite stable” and predicted it would trade between 1060 and 1100 against the US dollar. The currency is now trading around 1,116 against the US dollar having depreciated slightly from a rate of 1098 in June 2001 and has behaved consistently against the euro, British pound, Japanese yen, and Chinese renminbi. In 2001, BoM intervened steadily in

The togrog rides high

the market having bought and sold an aggregate \$115.3m and \$ 181.3m respectively in the domestic foreign exchange market. The togrog's real trade-weighted exchange rate index appreciated to 139.59 index points – an increase of 7.2 index points from the previous year. Mongolia's net foreign reserves have also grown during this period, reaching Tg176.29 billion in August 2002 from Tg162.01 billion in June 2001 and Tg135.98 billion in June 2000. Aside from bettering Mongolia's ability to service its debt, which Chuluunbat characterises as "very serviceable," he says the growth in foreign reserves is important to "show the world that Mongolia is open for business." The foreign exchange reserves are now equivalent to more than fifteen weeks of import cover and were principally generated from gold trading and interest income on deposits.

Financial supervision BoM has also strengthened the domestic banking sector by improving its supervision of commercial banks and NBFIs. Bank of Mongolia ratified the government's "Long and Medium-Term Development Strategy" of 2000 and added its weight to the "Financial Sector Restructuring Medium-Term Plan" that was approved by parliament in 2001. One initiative undertaken by the BoM was an increase in its minimum equity capital requirement to Tg2 billion in June 2001, thereby strengthening the underlying capital base of financial institutions. A more recent endeavour on the supervisory front was the introduction of a CAMELS expanded bank ratings system – a framework that institutes remedial supervisory actions whenever standards fall below a certain threshold. As a result of these and related measures, the average capital adequacy ratio of banks was 24.6% at the end of 2001 – appreciably above the 10% minimum required by the BoM. Chuluunbat emphatically notes the central bank will continue "to raise provisioning standards and strengthen asset classification" as part of its ongoing process of banking system reform. It is no coincidence that Standard & Poors upgraded its assessment of Mongolia last year".

Part of the international club March 2001 marked the tenth anniversary of Mongolia joining the World Bank – a milestone Chuluunbat takes great pride in when he remembers the BoM's efforts to increase the country's multilateral accountability following the dissolution of the Soviet empire. Chuluunbat currently spearheads the country's negotiations with the International Monetary Fund and World Bank. The Asian Development Bank established a resident mission in Ulaanbaatar in August 2001 and has assumed a key role in several key public-sector development initiatives. Additionally, Mongolia is poised to become a full member of the European Bank for Reconstruction and Development at the next annual meeting in Tashkent in May 2003 – thereby enabling Mongolia to receive loans and equity investments.

Chuluunbat's stewardship of the Ban of Mongolia is yielding tangible results. It is transforming the Mongolian economy, one togrog at a time. □

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