BANKING SYSTEM IN MONGOLIA

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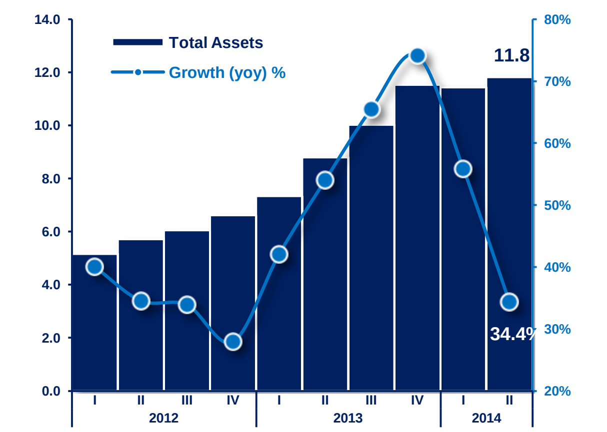
I. Current banking system situation

Mongolia is an emerging country in Asia with Gross Domestic Product of \$10.6 billion[1] as in 2013. The banking system has overall assets in amount of \$11.8 billion as June, 2014 increased by 34.4% (yoy) compared to that of previous year, which is so high growth compared to other countries as Moody's stated in its report (Report, 2013).

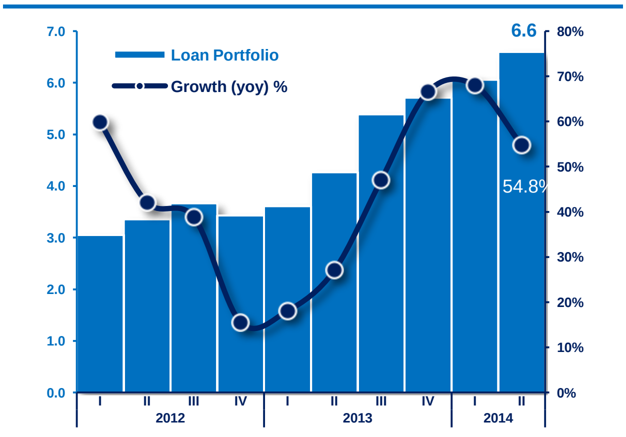
Figure I-1: Overall asset in USD billions



Source: www.mongolbank.mn

Loan portfolio has increased by 54.8% (yoy) and reached at \$6.6 billion, of which 75.7% is loan disbursed in MNT, the rest is in other currencies.

Figure I-2: Loan Portfolio in USD billions

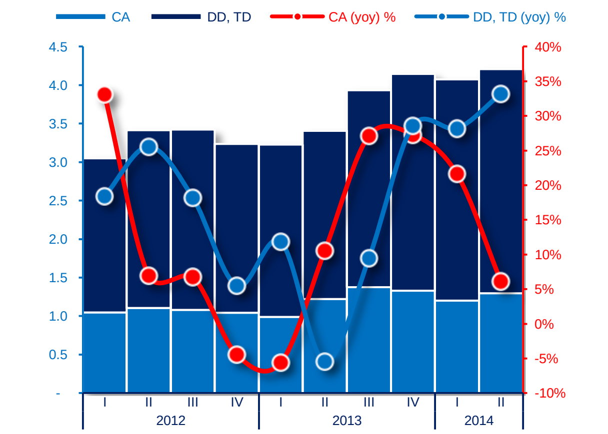


[1] The GDP is in nominal basis

Source: www.mongolbank.mn

For the liability side, current account, demand and time deposit are increasing with high speed as well but not so fast as asset and loan portfolio grow. For instance, overall current account amounted to \$1.3 billion increasing by 6.1% (yoy), while demand and time deposit reached at \$2.9 billion at the end of June, 2014 increased by 33.2% (yoy).

Figure I-3: Current account, Deposits in USD billion



Source: www.mongolbank.mn

The overall equity of the banking system has reached at \$1.1 billion with increasing speed of 52.6% (yoy) at the end of June, 2014.

I.1 The relationship between macro economy and banking system

The factor, which made the banking system grow so fast in short time was obviously macro economic situation in that time and expansionary monetary policy impact. During 2010-2011 (after the Financial Crisis), Mongolian economy was appreciating very much from the increase in main mining products' price like copper and coal. For instance, real economic growth for 2011 reached at 17.5% (yoy), which is the fastest growth in the world thanks to foreign direct investment inflow and government spending for some projects. As Mongolia is in a progress of two large mining deposits such as Oyu-Tolgoi

(OT)[2] and Tavan tolgoi (TT), the cash flow into banking system (into the economy) is increasing so fast recently, generating high economic performance. Besides economic impact on banking system, expansionary policy played key role in banking system strong growth, which we will see in following part of the essay.

I.2 Banking system structure

Who plays the key roles in the banking system to generate high performance is of course central bank. Bank of Mongolia (BoM) is the only institution, which governs and implements monetary policy throughout the economy independently. Moreover, there are 14 commercial banks having their over operations:

The biggest five commercial banks are here:

Table I-1: Commercial banks in Mongolia

Banks' name	Asset ($ billion)	Websites
TDB	2.7	www.tdb.mn
Khan bank	2.6	www.khanbank.mn
Golomt	2.3	www.golomt.mn
XacBank	1.0	www.xacbank.mn
State bank	1.0	www.statebank.mn

Source: banks' official websites

The biggest 5 commercial banks are Trade and Development bank, Khan bank, Golomt bank, Xacbank and State bank (State bank is owned by the government, all other banks are jointly funded by foreign and domestic companies).

II. Brief history of the banking system

BoM was established in 1924, having 90 years of history from now and the national currency MNT (Tugrik) was issued in 1925. One level banking system was dominant until 1990 and new two level of system introduced, separating central bank and commercial banks.

III. Monetary policies of central bank

Bank of Mongolia (BoM) is the only institution implementing "Monetary Policy" to the whole economy passing through banking system. Bank of Mongolia's main aim is to maintain the stability of MNT. Maintaining the stability of national currency has several aspects in terms of its definition. As, maintaining the stability of national currency somehow means that keeping the inflation as low as possible, but it also means that keeping exchange rate stable at the same time. Thus, BoM aims to keep inflation rate as low as possible, while keeping exchange rate in certain range. Historically, BoM has been implementing several policies, which were targeting to monetary aggregates, however, recently it has changed its monetary policy way into targeting inflation to keep the national currency stable.

III.1 Central bank activities

In order to keep the national currency stable, BoM's has been implementing several classical instruments like changing policy rates each times influencing the interbank activities and banking system, the whole economy at the end. In addition to this traditional monetary ways, BoM is recently introducing a new counter-cyclical (Making some capital buffer during economic prosperous times and using the capital buffer in recession times) policy named "Macro-Prudential Policy" (IMF, Key Aspects of Macroprudencial Policy , 2013). In the policy, the prudential ratios such as TIER 1 ratio, concentration ratios for single borrowers, ratios for foreign asset and liabilities, CAR% (Capital Adequacy Ratio %) and liquidity ratios are included to be managed. Addition these, BoM has introduced brand new (non-traditional) monetary policy in cooperation with the government, which were projects named "Price Stability for medium term[3]" and "Project for Mortgage[4]" to ease the problem that the economy has faced in 2013, while keeping inflation low as possible.

III.2 The "Price Stability for medium term" and "Project for Mortgage"

The projects are designed to decrease the inflation, which is resulted from supply shortage, however, eventually the projects' purpose changed to ease the impact of external shocks on the economy, save the employment and keep the economic growth at double digits. In 2013, inflation rate was relatively lower at 8.3% compared to other years due to weak economic performance and this economic condition gave an opportunity to the central bank to ease its monetary policy. Thus, BoM printed out MNT3.8 trillion ($2.1 billion) and injected it into the economy conveying by the banking system for several projects following:

[2] Link is available here: http://ot.mn/en

[3] Link is available here: http://www.mongolbank.mn/pricestability.aspx

[4] link is available here: http://www.mongolbank.mn/ipotek_statistic.aspx

Table III-1: The projects implemented by BoM

Price Stability for medium term	$0.8 billion
Government deposit	$0.5 billion
Mortgage loan	$0.8 billion

Source: www.mongolbank.mn

Thanks to the money printing, the real economic growth for 2013 was kept at 11.7% (yoy) still in double digits. However, the policy had very bad effect on currency market and made MNT depreciate against other currencies hugely. As in 2013, the currency market had been already contracted due to sharp fall in foreign investment, however, the printing of MNT and injecting it into the economy simulated MNT depreciate more against other currencies dramatically. The expansionary monetary policy also had negative impacts on banking system in direct and indirect ways, generating much risk for the banking system.

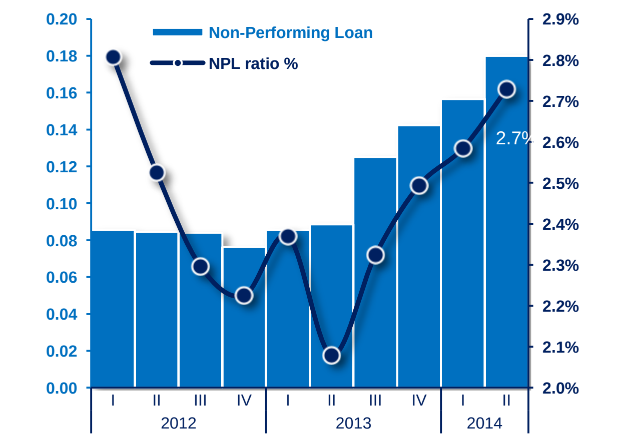
IV. Banking system risks

Moody's assessed Mongolian banking system remains negative for five main aspects like operating environment, asset quality, funding and liquidity, profitability and efficiency as well as systemic support (Report, 2013).

IV.1 Credit risk (Asset quality)

Thanks to the projects pursuing by BoM, the asset quality has been deteriorating recently because amount of disbursed loan for 2013 and 2014 was so enormous compared to previous years, however, the macroeconomic situation in Mongolia is getting worse due to shortage of foreign cash flow. As there is strong correlation between the economy and the system, loan repayment burden is getting bigger and bigger, making great credit risks in near future.

Figure IV-1: Non-performing loan (USD billion) and NPL%



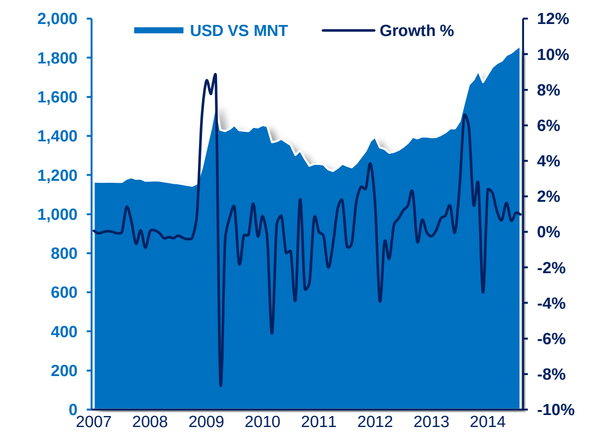
Source: www.mongolbank.mn

Furthermore, concentration on single borrower and counterparty risks are the main risks for the system. It is easily shown from the Figure IV-1: Non-performing loan (USD billion) and NPL% that NPL ratio (Non-performing loan ratio) has increasing trend currently. The Non-performing loan portfolio has reached $0.2 billion, which is 2.73% of overall LP as June of 2014.

IV.2 Market risk: Exchange rate risk

Macroeconomic condition in Mongolia is slowing down due to sharp fall in foreign direct investment as mentioned before so that the exchange rate (MNT against USD) is fluctuating dramatically. Besides that, the impact of printing much money (the impact of BoM's project named "Price Stability") and injected it into the economy intensified the currency votalities throughout the currency market. The high vulnerability can be easily shown from figure named Figure IV-2: Exchange rate and fluctuation. The official MNT rate has depreciated against USD by 18.65% (yoy) compared to that of 2013 and reached 1,862.2 at the end of August, 2014. The high depreciation is making much burden for the commercial banks, which has short positions in direct ways. For Mongolia, liability for banks is not only coming from deposit but it is also consisted of borrowed funds from foreign institutions, meaning that some banks usually have short positions on their liability side. Therefore, high currency votalities had a big negative effect on the banks, which have short positions.

Figure IV-2: Exchange rate and fluctuation (mom %)



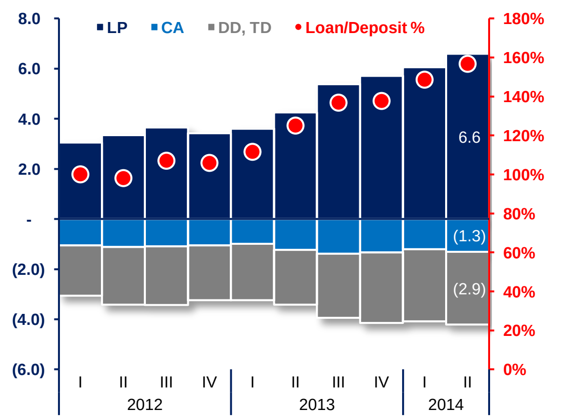
Source: www.mongolbank.mn

Furthermore, the MNT depreciation influenced loans' repayments, which were borrowed in foreign currencies in negative ways, making credit risks as well (IMF, 2011). This kind of impact of exchange rate fluctuation on loan repayment is called indirect way to affect banking activity.

IV.3 Liquidity risk

Liquidity risk could be risen in near future due to high speed of loan growth, a result of money easing process (printing money), since public (specially, term deposit) deposit is not increasing as fast as loan portfolio increases recently on the other side.

Figure IV-3: LP, CA, DD and TD (USD billion)



Source: www.mongolbank.mn

It is seen from the above picture of Loan to deposit ratios (Current Account + Demand + Term Deposit), the ratio is increasing recently and reached to 156.8% (20.9% higher than the peak point during the Financial Crisis (2008-2009)).

V. The results from the projects

The projects introduced by BoM were successful in keeping the real economic growth at higher level and saving employment, however, we paid much just for keeping economic growth at higher level. We sacrificed MNT's independencies, which led to high inflation again. As Mongolia is hugely dependent on imports from other countries, strong fluctuation of MNT made the import goods more expensive, which led to high inflation again. For this reason, BoM has increased the policy rate from 10.5% to 12.0% in August, 2014 to tight up the economy and catch the inflation at lower level. Moreover, the trade off for keeping economic growth stable is that making the whole banking system at risks like credit, market and liquidity. However, It was a good lesson and good exercise for monetary policy implementation as an observer's view.

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VI. Bibliography

1. IMF. (2011, May). Mongolia: Financial System Stability Assessment . Washington, D.C.: IMF.
2. Mongolia, B. o. (2014 , July). Monetary Policy Implementation for 2014 . Ulaanbaatar, Mongolia : Bank of Mongolia .
3. Report, M. (2013, April 11). Banking System Outlook. Moody's Rating Agency.

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