

Mongolia – the next “gold rush”?

July, 2011 – Zhixin Shu, Senior Fund Manager



Zhixin Shu visited Mongolia in May this year and stayed at the Ivanhoe / Rio Tinto camp overnight. Photographs are taken by her on the trip.

Mongolia has a population of 2.7m people. About 30% of the population still live a nomadic life style, rearing 40m animals. 50% of the people live in the capital Ulaanbaatar (UB). The country has vast natural resources including rich deposit of coal, copper, gold, iron, uranium and other base metals. After the fall of the Soviet Union which provided 90% of the country’s financial support, Mongolia went through a period of economic hardship as the Soviet financial aids stopped. Neglected by the world for almost 20 years after the fall of the Iron Curtain, Mongolia is now back in the world spot light thanks to its rich natural resources that have attracted significant attention and foreign direct investment. South Gobi Resources (based in Ovoot Tolgoi, some 50km from the Chinese border) and Mongolia Mining Corporation (in Tavern Tolgoi, 250 km north of the Chinese border – a prolific coal resources area, where Mongolia Mining only has a small piece of the vast reserves) are already producing coals. Both companies are listed on the Hong Kong Stock Exchange.

South Gobi Resources’ coking coal mine in operation



Ariel view of transportation by road in Gobi Desert



In the nearby field of Oyu Tolgoi (translated to ‘Turquoise Hill’ – the result of copper oxide leaching at the surface), Ivanhoe/Rio Tinto are busy constructing a brand new copper/gold mine on perhaps the largest undeveloped copper reserves in the world. They are investing US\$6bn in the project and employ over 6000 workers. The first copper output is scheduled to be on stream in mid 2012. To put this investment into context, the GDP for Mongolia in 2010 was just US\$6.1bn (IMF). Once in production, Oyu Tolgoi will produce 1/3 of Mongolia’s GDP. The IMF estimates the GDP will grow to 15.6bn US\$ by 2016. Within a decade, the average income could triple to US\$10,000 a year.

Ivanhoe/Rio Tinto's copper mine camp



The construction of Oyu Tolgoi copper mine



A lack of infrastructure and financing in the country however, remains a key challenge to develop and monetise these resources and to modernise the country. Currently both South Gobi and Mongolia Mining are trucking their coal to Chinese borders. This is a very expensive method of transportation. The government has a plan to build a rail network within the country. The first phase involves building a 450km Russian gauge rail from the large Taver Tolgoi coal deposits to link with the cross-Mongolia line at Sainshand, where a large industrial complex is planned. A further 600km rail link is planned continuing north east to link into the trans-Siberian railway, which opens up the option for export via Russian ports on the east coast. The total estimated cost is US\$3bn for the railway and US\$13.9bn for the industrial park. The funding source for this has not been decided. The development may be listed to help raise financing combined with debt financing or funded via some form of private public partnership (PPP). Other investments have also been planned, e.g. building 7875km of new roads and highway (US\$4.8bn) and constructing 100000 housing units (US\$6.2bn).

Mongolia is a democratic country with an elected parliament. It has a relatively stable political system and tax regime. However, apart from a lack of infrastructure and the need to develop a robust legal environment, wide spread corruption also presents real challenges. The wealth divide between the rich and the poor is huge. One third of the population lives below the poverty line. In UB, 50% of the population still live in the Ger district without a connection to the national grid.

The UB Ger district



A university graduate is paid US\$350/month on a desk job, whilst luxury apartments in central UB are selling for 500kUS\$.

A development of luxury apartments in central UB



The government is looking at different development models from several countries, namely, Norway, Kazakhstan, Canada, Middle East, etc. to learn from their experience of turning national resources into national wealth.

Sandwiched between the two giants, China and Russia, Mongolia does not want to be too dependent on only one or two countries for its economic development. After over 200 years of Chinese rule until the collapse of Qing Dynasty in 1911, its relationship with China is largely a love-hate affair. Over the past 10 years, the Sino-Mongolia relationship has benefited both parties, the former can procure much sought after natural resources and the latter can enjoy much needed FDI and access to a significant end market. The relationship with Russia has traditionally been strong. Going back to the communist era, the Soviet Union was Mongolia's closest ally. After the dissolution of the Soviet Union in 1980, trade with Russia dropped from over 80% to just 19% now. Nevertheless, Mongolians still feel spiritually connected with Russia. Mongolia has an overwhelming desire to spread the risk and to maintain its national identity. The government has also adopted the third-neighbour policy, leveraging its enormous resources. Mongolia's third neighbours include the USA, Japan, India and Korea. To date, Mongolia has signed 41 bilateral investment agreements with various countries. This is evidenced by the recent appointment of the London Stock Exchange to help develop its stock exchange.

The Mongolia parliament has identified 15 strategic assets (including the copper/gold mine in Oyu Tolgoi) in which the state will take 1/3 of the stake and seek private financing (production contract, partnership, equity market or debt market) to develop these assets. For example, the government has divided Tavern Tolgoi coal fields into two parts, with the plan to IPO the western block of the mine in 2012 whilst inviting 6 private companies globally to bid for the development of the eastern block. What is clear is that to manage the new found resources effectively and to turn mining wealth into national wealth through investment in infrastructure, healthcare, education and improvement in living standard of the population, presents significant challenges for the government.

Whether the country turns resources into a blessing or a curse remain to be seen...