Foresight

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New mine expansion could kick-start the Mongolian economy

By Mark Eberst, KPMG in Mongolia

The imminent 5.4 billion dollar (US$) development of Mongolia's Oyu Tolgoi mine not only provides a major boost to the country's economic fortunes, but also demonstrates renewed efforts to welcome foreign investors.

For the last 2 years, it feels as if the fate of an entire country has rested on a windswept piece of land in the South Gobi Desert. The planned underground expansion of the Oyu Tolgoi copper and gold mine had stalled following disagreements over tax, revenue and cost sharing between the Mongolian government and joint owner Rio Tinto.

This deadlock, combined with falling commodity prices, has had a devastating impact on Mongolia's economy, with GDP growth plunging from a record 17 percent in 2011 to a predicted 3 percent for 2015, and foreign investment falling from US$4.5 billion in 2012 to US$400 million in 2014.[1]

When the dispute was finally settled in mid-2015, the sighs of relief were palpable, with Prime Minister Saikhanbileg Chimed saying that the deal opens "a new page in history" for his country. Once it is fully operational, the mine is forecasted to account for one-third of Mongolia's entire economy.

Oyu Tolgoi's development could catapult this landlocked nation into the global minerals Premier League, and in the process give a much-needed kick-start to its economy, many of whose 3 million citizens live a nomadic life that has changed little for hundreds of years.

A number of hurdles persist, however, notably the poor transport infrastructure. In the absence of a direct rail link, the mine's copper has to be carried to China — the main customer – by truck across the desert, pushing up the overall cost in a market where commodity prices are already very low.

The future of the Tavan Tolgoi coal mine in southern Mongolia, one of the world's largest undeveloped coal deposits, is less certain. Progress on this site has been held up, with the consortium of Mongolia's Energy Resources, China's Shenhua Energy and Japan's Sumitomo Corporation yet to seal a contract, although Premier Saikhanbileg is confident that a solution can be found. Capital Ulaanbaatar's new power plant, known as CHP5, on the other hand, looks set to go ahead in 2016, offering cleaner energy to meet rising demand.

1 *Rio, Mongolia Agree to Restart Oyu Tolgoi Development,* Bloomberg Business, 18 May 2015.

Ulaanbaatar's Master Plan 2030 aims to create a sustainable, safe and healthy city, with a green belt around the edges, offering numerous opportunities for private developers.

Open for business

Mongolia's checkered history of 'resource nationalism' reflects an innate conservatism over the country's future, with fears that foreign powers could exploit the huge natural resource base without due regard to the country's people, heritage and environment. The current Prime Minister, in place since late 2014, has sought to allay such fears, arguing that foreign investment can help revive a worsening economy, and embarking on a major charm offensive to woo foreign investors.

The Prime Minister has made several road trips to Europe, the US, the Middle East and Asia, sending out a message that Mongolia is very much open for business. Although the country's estimated US$1.3 trillion-worth of mineral deposits is the obvious attraction,[2] investment is also needed in infrastructure, roads, railways, power plants, renewable energy, leisure, housing and tourism. Ulaanbaatar's Master Plan 2030 aims to create a sustainable, safe and healthy city, with a green belt around the edges, offering numerous opportunities for private developers. In addition, housing for approximately 30,000 Oyu Tolgoi workers and their families will be needed, with all the associated facilities such as schools, hospitals, housing and retail units.

A much-delayed 240 kilometer (km) rail link from the Tavan Tolgoi coal mine to the Chinese border is planned, with hopes that a spur to Oyu Tolgoi will follow, reducing freight costs. India has also come into the picture, providing a US$1 billion line of credit to help fund a range of infrastructure projects,[3] while the Japan International Cooperation Agency (JICA) has been the largest institutional investor in recent years, funding the new Ulaanbaatar airport (due to open in 2017). The World Bank, the Asian Development Bank and the European Bank for Reconstruction and Development have also been investing substantial amounts in Mongolia.

Given the dependence upon China for exports, the latter's economic downturn remains a worry for the Mongolian economy. Over the mid-to-longer-term, China will continue to need coal for its power stations, and copper for phones, cars, power generation and houses. Oyu Tolgoi's copper mine will take several years to reach full output, during which time the Chinese market should hopefully have revived.

Having been stung by events in recent years, investors may need time to regain their confidence, and will continue to watch the political situation closely. With another election due in 2016, there are still some lingering fears over a return to a more nationalistic regime. However, when a global giant like Rio Tinto sees value in a resurgent Mongolia, the rest of the world is likely to sit up and listen, and consider the potential of this unique country at a pivotal and exciting stage in its development.

Talking points

- Mongolia hosts 10 percent of the world's known coal reserves[4]
- Oyu Tolgoi will be one of the largest copper and gold developments in the world, with an estimated 2.7 million tonnes of recoverable copper and 1.7 million ounces of recoverable gold[5]
- Despite a recent slowdown in growth, over the last decade, Mongolia's GDP per capita has more than tripled[6]
- Forty percent of Mongolia's 3 million population live in the capital Ulaanbaatar.[7]

2 Mongolia is seeking British investment, the country's PM says, Asia House, 3 July 2015.

3 *India Extends Mongolia $1 Billion Credit Line for Infrastructure,* Bloomberg, 17 May 2015.

4 Mongolia is seeking British investment, the country's PM says, Asia House, 3 July 2015.

5 Ibid.

6 Mongolia GDP 1981–2015, Trading Economics, 2015.

7 Mongolia to be transformed by giant Rio Tinto copper mine, Daily Telegraph, 23 May 2015.

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