

BOM SHOULD NOT TRY TO APPRECIATE THE EXCHANGE RATE

According to IMF on January 25, 2011 IMF Representative to Mongolia Steven Barnett stated following to Mongolian media

- Regarding January 2, 2012 raise by petroleum importers of fuel retail prices by Tog 300 per liter

We have not looked specifically at the petroleum market in Mongolia, so I would rather not comment on that.

However, I would like to make a general point. The cost of petroleum in a country depends on the international price of oil—typically quoted in US\$--and the country's exchange rate. So, it is natural for the price, which of course should be linked to the cost, to move with changes in global oil prices and the exchange rate.

- Regarding views of many Mongolian businessmen and economists that the Bank of Mongolia should be held responsible for the increase in petroleum prices

I disagree completely. In fact, we have consistently applauded the BOM—and continue to do so—for their management of the flexible exchange rate regime. Indeed, the tightly managed exchange rate in 2008 was a key factor behind the last economic crisis. Therefore, we see the continuation of the flexible exchange rate regime as a critical line of defense for preventing another crisis.

This is especially important because of the irresponsible fiscal policy that has been put in place by the government. The extraordinary growth in spending is overheating the economy, leading to high inflation, rapid growth in imports due to excessive domestic demand, and macroeconomic uncertainty—and these factors are influencing the exchange rate. The BOM is doing the right thing by allowing the exchange rate to move in line with the evolving market conditions.

- Regarding BOM's intervention on the FX market to reverse the recent depreciation

We support intervention to smooth excess volatility in the foreign exchange market but not to resist depreciation (or appreciation) pressure. Smoothing excess volatility is fundamentally different than intervention aimed at targeting a specific exchange rate or preventing depreciation. In particular, under a flexible exchange rate regime the market guides the exchange rate up or down based on evolving conditions. Intervention takes place only to smooth out the impact of say a particularly large transaction or other short-term disturbance in the market.

- Regarding Mongolia's international reserves that now stand at over US\$ 2 billion and how sufficient are they by international standards

The level of reserves is adequate to comfortably support the existing flexible exchange rate regime. Indeed, that is one of the big benefits of the current flexible exchange rate system. In this regard, it is worth recalling how the fixed exchange rate policy in place previously was a key contributor to the last crisis. Specifically, the BOM was running out of international reserves in a destined-to-fail attempt to defend the exchange rate and the crisis came to a head as the BOM came close to running out of reserves.

The bottom-line, therefore, is that the flexible exchange rate regime in place now is critical for avoiding a repeat of that crisis. Especially critical given that fiscal policy has returned to the boom-bust ways of 2006-8.

- Regarding the reasons for the US\$ appreciation in Mongolia and in contrast, globally, the US\$ and Euro depreciation

As a general rule, economists are not very good at forecasting short-run (less than a year) changes in the exchange rate. Or, put differently, short-run fluctuations in the exchange rate are inherently difficult to understand, as they reflect evolving market conditions and sentiment. Having said that, many factors could be behind the recent moves, including external considerations (such as an increase in global risk aversion which has tended to cause the U.S. dollar to appreciate and the euro to depreciate in 2011) and domestic factors (such as concerns over macroeconomic stability related to the government's fiscal policy which has tended to put downward pressure on Mongolia's currency).

- Regarding policies and measures needed down the road to appreciate the exchange rate and thereby bring down prices of goods

No policies are needed, as the BOM should not try to appreciate the exchange rate. The flexible exchange rate regime currently in place is the best policy for Mongolia. And, a flexible exchange rate regime means that the central bank does not try to appreciate nor depreciate the rate.

The best way to control inflation is to have a more responsible fiscal policy. The extraordinary increase in government spending in 2011 and planned for under the 2012 budget are the key drivers of rising prices of goods. The public's well-placed concern about rising cost of living should be addressed, therefore, towards fiscal policy and not the BOM.



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