

EXCHANGE RATE HITS 1300 ON RAPID GROWTH OF NET FOREIGN EXCHANGE UTFLOWS IN FORM OF GOODS IMPORTS, SERVICES PAYMENTS, TRANSFERS OF NET PROFIT RELATED TO EXPANSION OF THE ECONOMY AND ACTIVE BUSINESS OPERATIONS

According to Bank of Mongolia (BOM, mongolbank.mn) on 10/25/2011, Board of Directors of BOM decided to increase policy rate by 0.5 points to 12.25%

- Speed of inflation is increasing and it is including more and more goods and services, currently it is 10.5% nationwide and 11.9% in UB
- Factors such as speedy expansion of fiscal expenditures are, cash handouts from Human Development Fund, rapid credit growth are increasing total demand
- Sudden increase in demand while total supply and real economic factors have not significantly risen is creating pressure to growth of base prices
- This is proved by YTD increase of 11.3% in prices of non-food items
- 2011 budget amendment and 2012 draft budget have procyclical features and has a risk increasing significantly total demand and inflation and bringing macro-economic instability
- Also debt crisis in Europe, stagnation of the USA economy is likely to create unfavorable world economic and financial environment in coming years
- Therefore Bank of Mongolia is taking measure of raising policy rate in order to reduce speed of inflation, cooling overheating of the economy and protecting macro-economic stability

Bank of Mongolia information regarding external sector

- Total foreign exchange flow has increased 1.7 times yoy as of October 21, 2011
- Inflows increased by 57% YTD outflow increased 80% yoy
- Inbound net foreign exchange flow declined 51% yoy
- Inbound net USD flow increased by 14% yoy and reached 824M USD.
- rapid growth of foreign exchange outflow in form of goods imports, services payments, transfers of net profit is related to expansion of the economy and active business operations
- As of 2011 Q3 YTD Mongolia's external trade turnover has risen 92% yoy to 8.2B USD, exports by 67% yoy to 3.3B USD, import by 115% yoy to 4.8B USD. Trade deficit has increased 6.2 times to 1.5B USD, trade deficit of goods paid in foreign exchange increased 8 times to 441M USD
- 73% of total exports are coal, copper concentrate and iron ore
- 51% of total imports are machinery, equipment, spare parts, transportation vehicles and petroleum products
- Current balance of Balance of payments of Mongolia has a loss of 1.4 billion in first 8 months of 2011 including deficit of 1.3B USD in foreign trade in goods and services, capital and financial balance of payments has a surplus of 1.9B USD, within that net amount of FDI reached 2.4 billion USD therefore total balance of payments has surplus of 220M USD.
- Amount of external debt of Mongolia as of H1 2011 is 8.1B USD, from those 67% of loans from abroad by citizens and enterprises and intercompany loans by subsidiaries and head companies, 23% is Government's, 7% are banks', 3% is Bank of Mongolia's from IMF.

Conclusion

- Bank of Mongolia USD exchange rate today is 1300.69MNT. Last time exchange rate was 1300 was on 10/20/2010, almost exactly a year ago
- Foreign exchange outflow is in form of goods imports, services payments, and net income deficit also in repayment of loans.
- Although USD inflow is positive total foreign exchange inflow (USD, RNB, EUR, others) declined 51%
- This is the factor behind recent depreciation of MNT
- 1300 is 3% variation of 10 months, generally MNT is still stable
- Although MNT depreciation is compounding carry-loss to all MNT-denominated losses, particularly negatively affecting foreign investment into MSE equities, this is a normal market volatility
- Current tightening of monetary policy is welcome, but more needs to be done. The central bank should use a variety of tools. The policy interest rate should be further increased. For much of the year it has remained close to the pace of increase of underlying inflation, allowing for a very rapid pace of credit growth
- Interest rate hikes alone, however, will not be sufficient. In addition, a range of macro-prudential measures should be implemented to help slow the pace of credit growth. These include measures to increase capital adequacy requirements, start to require provisions on new lending, raise reserve requirements, and tighten liquidity ratios. At this stage in the business cycle it is especially important to proactively manage risks and strictly enforce prudential regulations in order to prevent the buildup of future credit quality problems in the banking system

CHIEF INVESTMENT STRATEGIST

Dale Choi

Frontier Securities
Blue Sky Tower Suite 705
Peace Avenue, 17
Sukhbaatar District, 1st khoroo
Ulaanbaatar, MONGOLIA

staff@frontier.mn

(T) 976-7011-9999

(F) 976-7011-1991

About Frontier Securities

Frontier Securities, based in Ulaanbaatar, Mongolia is a Mongolia's pioneer boutique international investment bank with a seat on Mongolian Stock Exchange working to provide clients with best of both worlds: investment bank with on-the-ground presence and expertise in frontier markets with full cross border service capabilities and international financial markets experience/know-how with particular strengths in Asian financial markets of Hong Kong, Tokyo and Singapore. Information about the firm is available at www.frontier.mn.

Authorized and regulated by the Financial Regulatory Committee

Reduce your environmental footprint. Print only if necessary.

Frontier Securities Limited Disclaimer and Confidentiality Note

This email and any attachments are confidential and may also be privileged. If you are not the addressee, do not disclose, copy, circulate or in any other way use or rely on the information contained in this email or any attachments. If received in error, notify the sender immediately and delete this email and any attachments from your system. Emails cannot be guaranteed to be secure or error free as the message and any attachments could be intercepted, corrupted, lost, delayed, incomplete or amended. Frontier Securities LLC does not accept liability for damage caused by this email or any attachments and may monitor email traffic.

Frontier Securities is incorporated in Mongolia with limited liability under the existing laws of Mongolia, having its principal office of business at #705, Blue Sky Tower, Peace Avenue, 1st khoroo, Sukhbaatar district, Ulaanbaatar, Mongolia and having a Company Registration number of 5127505.

This e-mail and its attachments and any rights attaching hereto (collectively called "Information") are for informational purposes only. The Information has been given in good faith but without guarantee and unless the context clearly indicates otherwise is the property of Frontier Securities, a company incorporated in Mongolia. As Frontier Securities cannot guarantee the genuineness or completeness of the Information, the Information is not legally binding.

The Information is confidential, may be legally privileged and is intended solely for the use of the individual or entity to whom it is addressed. Unauthorized disclosure, copying or distribution of the Information is strictly prohibited and the recipient of the Information shall not redistribute the Information in any form to a third party. If you received this Information in error please tell Frontier Securities by reply (or telephone the sender) and delete all copies on your system.

The Information is not intended as an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. All market prices, data and other information are not warranted as to completeness or accuracy and are subject to change without notice. Any comments or statements made herein do not necessarily reflect those of Frontier Securities, its subsidiaries and affiliates.

Frontier Securities has taken precautions to minimize the risk of transmitting software viruses, but advises you to carry out your own virus checks on any attachment to this message. Frontier Securities cannot accept liability for any loss or damage caused by software viruses.