Living from loan to loan

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FULL TEXT

It was one of the fastest-growing emerging markets during the commodities boom. Since the bust, the government and ordinary Mongolians have traded a culture of self-sufficiency for deep indebtedness. By Lucy Hornby

A person in debt can't rise up, an animal with worms can't get fat - Mongolian folk saying

Presiding over skinned sheep carcases in Ulan Bator's largest wholesale meat market, stall owner Gantulkhuur has become one small part in the debt binge rippling through Mongolia . She whips out a small ledger. Names and numbers in neat Cyrillic script crowd tighter and tighter on the pages, as her accounts have been taken over by retailers buying on credit. The retailers, for their part, are selling smaller cuts of mutton, Mongolia's staple food, or cheaper intestines and organs as their customers try to eke out their savings.

"I used to sell all my meat in a day, but now I don't," she says. "People's buying power has decreased."

Mongolia was a darling among emerging markets during the commodities boom. Foreign miners flocked to exploit the mineral wealth under its grasslands and deserts, pushing up growth in gross domestic product by 17 per cent in 2011. But after a debt-fuelled spending spree at the peak of the cycle, the landlocked country is now one of the worst hit by the downturn.

Mongolia's efforts to extricate itself highlight the dangers of the "resource curse" - the notion that countries blessed with tremendous natural resources find themselves at the mercy of wealth-destroying boom-bust cycles. Success will allow the buffer state to continue balancing between China and Russia by attracting "third neighbour" allies like Japan or the US. Failure could upend that careful balance in China's favour, dragging Mongolia into its orbit just like Cambodia , Laos or some of the weaker Central Asian nations.

In recent weeks the government has announced a trimmed budget and raised interest rates by 4.5 percentage points to staunch a weakening currency . International financial institutions are preparing to offer loans if Mongolia requests assistance to overcome a looming payments crunch next year.

Meanwhile, Chinese creditors are making a case for greater investment concessions in an echo of complaints from western investors. Even if the fiscal crisis is navigated, individuals and businesses are struggling with debt at extortionate interest rates. Once known for their nomadic lifestyle, Mongolians have become a majority urban people, trading a culture of self-sufficiency for one in which nearly everyone owes money.

An influx of mining cash helped create jobs and social welfare programmes that reduced the poverty rate to 22 per cent by 2014 , from 39 per cent four years before, according to the World Bank. But living in cities also means paying for everything, from food to clothing to childcare, while jobs and cash handouts are drying up.

Reform opportunity

Gantulkhuur says the switch from cash to credit accelerated last autumn as life got "a bit difficult". But then she pauses: "Is it OK to talk to you? I am worried I am shedding a bad light on Mongolia."

Over the past month Mongolia's government has consolidated budgets and revealed to an alarmed public that, even with spending cuts, the budget deficit will reach 18 per cent of GDP this year, well above the statutory limit of 4 per cent, while government debt would reach 78 per cent of GDP, far above the 55 per cent target.

The announcements led to a surge in purchases of dollars, which caused the tugrik to weaken precipitously, making it the world's worst-performing currency in August. That triggered a rise in rates to 15 per cent and restrictions on the amount of foreign currency that could be withdrawn in a day.

Mongolia's total external debt is now estimated at $23.5bn, nearly twice its $12bn economy. Of that, government debt is about $8.4bn. Over the past year, "the situation has got a lot worse but it is an opportunity for us to reform our economy", says Zandanshatar Gombojav, a member of parliament who has spent his career in a number of financial posts for the ruling Mongolia People's party .

Reform efforts consist of a mix of belt-tightening and promotion of new mining projects in the hope that the commodity cycle will soon recover.

Hefty repayments begin in March, when a $580m bond issued by the Development Bank of Mongolia comes due. The country must repay $1.7bn-$1.8bn over the next two years, including a swap agreement with China's central bank.

Mongolia has not formally requested assistance from the International Monetary Fund but it is expected to do so this autumn. Once it does, the Asian Development Bank , World Bank and Japan, its largest source of development aid, could chip in at interest rates of about 1 per cent, considerably less than its existing obligations. China's Asian Infrastructure Investment Bank might also lend to new projects, at rates of up to 2.5 per cent.

Mongolia tapped the IMF in 2009 and paid off the $232m loan early thanks to strong prices for coal and copper, its main exports. This time around, public finances again depend on a recovery in commodity prices. The $5.3bn expansion of the Oyu Tolgoi copper and gold mine is expected to start producing significantly around 2021.

But Ulan Bator will not see dividends from the project for as long as 15 years, thanks to an arrangement whereby Rio Tinto finances its one-third share of the costs at Libor plus annual interest of 6.5 per cent.

Borrowing culture

Neither the MPP nor the Democratic party, which lost in a landslide in July, could resist raising social spending commitments before every election over the past decade as politicians basked in the promise of windfall mining revenues. Many initiatives were kept off the official budget to avoid the 4 per cent deficit ceiling.

Programmes included better salaries for civil servants and popular payouts like the monthly "child money" or student subsidies. Other loans were taken out to fund ambitious mining projects that never expanded as quickly as planned, leaving the payments extended over a longer period than anticipated. And then there were the international bonds, the most recent issued at 10.5 per cent. "No other country borrows at such high rates as Mongolia," one foreign banker said. "Other countries might be worse risks but they simply don't come into the market."

Borrowing has transformed Mongolian life. Subsidised mortgages with a repayment rate of 8 per cent made apartments affordable for young middle-class couples and fed a property bubble on the back of the mining boom. Road projects to connect every aimag , or province, have opened the land to domestic and foreign tourists. Far-flung scenic spots are now accessible to car owners on overnight outings. There has been a proliferation of tiny tour agencies run by English-speaking Mongolians in possession of a Land Rover.

One-off payments for roads and infrastructure IOUs make up a good portion of this year's budget deficit, potentially putting Mongolia on a relatively sounder footing of a deficit of about 12 per cent of GDP by next year. But the loans taken out by miners who were caught in the downturn or concessionaires who won the road tenders are causing concern.

Many suspect that construction groups sought Chinese loans at lower rates of interest than are available in Mongolia. The tugrik's depreciation against the dollar and the renminbi will make those more difficult to repay.

This is Mongolia's deepest collective fear. Conquerors of much of Eurasia 800 years ago, Mongolian territory has gradually diminished until the remnants were divided by the Soviets and the Chinese in the early 20th century. The country today consists of mountains, grassland and deserts as big as France and has been democratically governed since the 1990s after decades as a Soviet satellite. Most of its people are aware that 3m Mongolians cannot compete with China's 1.3bn citizens beyond the Gobi desert.

These days, the desert is no barrier to indebtedness. The extent to which corporations - or the businessmenturned-MPs that control them - are in debt to China is anyone's guess.

In defending the tugrik the central bank has drawn down about Rmb11bn ($1.6bn) of a Rmb15bn swap agreement with the People's Bank of China, which was offered at 6.5 per cent interest. Mongolian politicians expect the swap to be extended when it expires in 2017. The Chinese have become impatient at delays and contractual changes on proposed mining, industrial and dam projects.

Mongolian banks are lobbying hard to prevent the Bank of China from establishing a branch in Ulan Bator, ostensibly to serve the 7,000 small Chinese businesses in the country. Mongolian banks lend at annual rates of 22-28 per cent and private lenders offer about 36 per cent interest. By contrast, average Chinese corporate bank lending rates were 5.6 per cent in June and 10-20 per cent is common in the Chinese shadow banking market.

Fears of encroachment

Mongolian bankers fear Chinese businesses will gain a sudden advantage as borrowers quickly refinance at Chinese rates. That would pull the rug out from under local banks, increasing the economy's dependence on China.

"They will swallow Mongolia," one businessman concluded gloomily. "In a few decades we'll be the autonomous region of Outer Mongolia."

Already, Mongolia's private lenders have been burnt by the tugrik depreciation. Many borrowed overseas at cheaper rates to lend to car buyers, small businesses and distressed individuals in Mongolia. Some of that borrowing finances the pawnshops around Ulan Bator whose yellow signs advertise loans for televisions, phones and laptops. Some pawnshops had signs taped to the door advertising 14-day loans at 9 per cent interest. A woman working in a shop with better rates - 8 per cent over 30 days - said she has seen a steady flow of customers but the value of items has deteriorated over the past year.

Zandanshatar, the MP, says many people have borrowed against their pensions and salaries through 2018. "That is another sign of the liquidity problem."

Banks charge a punishing 18 per cent for borrowing against pensions, increasing the general indebtedness of the poor. The problem is acute in the ger districts, the sprawling settlements of migrants that have turned Ulan Bator into home for more than half of Mongolia's population. The busy, ramshackle areas are barely supplied with power or water. Social subsidy programmes like the monthly payments of $9 for each child are a lifeline for many families.

In a quiet restaurant decorated with striped green wallpaper and lace curtains, customers join in a lively discussion of the public finances as well as their own. Most see the two as linked, and worry about dependence on China. Erdenebayar, the restaurant owner, is "living from loan to loan", after an ill-timed decision to go into the business just as the commodity cycle turned.

"Although Mongolians are working, we are in debt. We owe money to other countries," he says. "As a Mongolian, obviously I am concerned."

On the steppes

Nomadic herders face a very modern ritual

Even Mongolia's nomads have been caught up in the country's debt problem. Loans have become an annual ritual on Mongolia's steppes, where herders capitalising on a growing market for cashmere are hostage to a downward cycle of falling margins and deteriorating pastures.

In the spring, herders sell wool; in the autumn, meat. Sales go to pay off old loans and take new ones at rates that often exceed 20 per cent a year. The catch is the larger the herd, the easier it is to get bank loans but the larger herds also destroy the pastureland faster than new grasses can grow.

The goats, which grow cashmere as an undercoat, are especially destructive. Cashmere is a cash crop and a useful export for Mongolia, what one tourist website refers to as "the nomad's ATM".

But goats destroy pasture far more than camels, horses or cattle and the deterioration in the quality and variety of grasses forces herders to raise more animals to eke out more cash from the same land.

The government says it is trying to encourage quality over quantity. But if every herder culls enough to restore the

pastureland the crash in meat prices would eat away at their ability to pay off the banks.
"Every herder has a loan. The more livestock you have the bigger the loan," says Batzorig, a 20-year-old, motorcycle-riding herder with a wide smile and 2m tugriks ($900) of debt, equivalent to about three months' wages in a city job.
Batzorig and his younger brother have their mother to thank for cutting their dependence on the herding cycle. A few years ago, she trimmed the family animals from 1,000 to 600 and bought a house in a town.
Speed read
Crisis management Rates have been raised by 4.5 percentage points and the budget trimmed in a bid to reduce debt
Falling due The country must repay $1.7bn-$1.8bn over the next two years, including a swap agreement with China

Competition fear Mongolian banks are lobbying hard to prevent Bank of China from opening a branch in Ulan Bator

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