Kazakhstan Is the Latest Oil-Curse Casualty

 AUG 20, 2015 10:17 AM EDT

By Leonid Bershidsky

In recent months, opponents of Russian President Vladimir Putin have often held up Kazakhstan as an example to Russia: Here, they said, is a post-Soviet state that has confidently converted its resource wealth into foreign investment, infrastructural development, steady growth and friendly relations with the West, Russia and China. That myth just went up in flames.

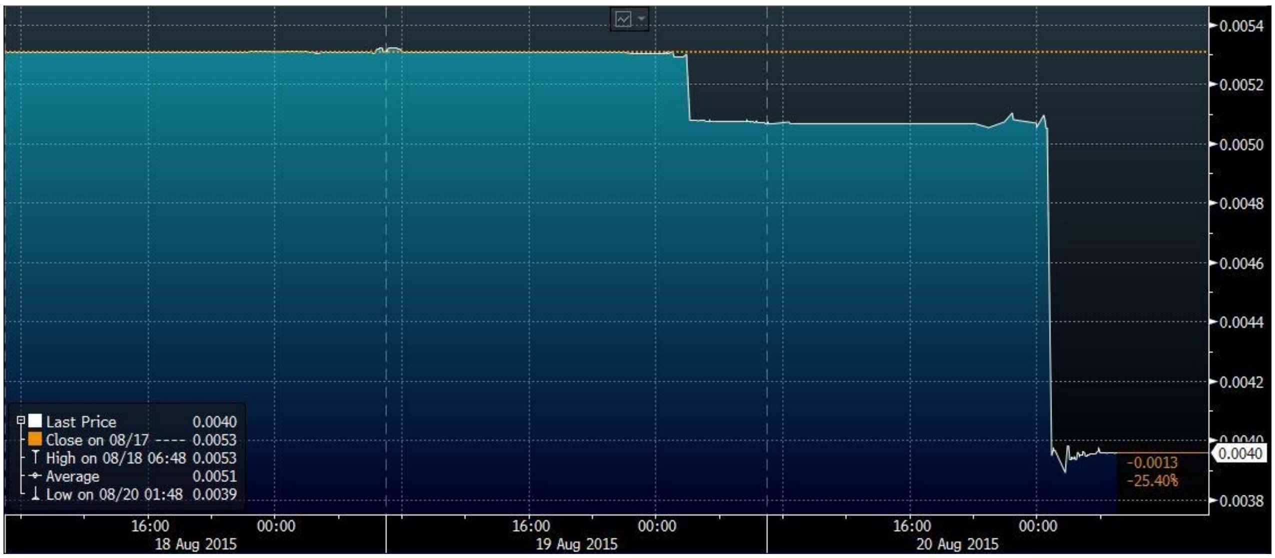
Thursday, the Central Asian state -- with proven oil reserves almost as large as the U.S. and a population of just 17 million -- was forced to float its currency; the tenge promptly lost 25 percent of its value.

There are no more tigers among commodity-based economies. Emerging nations that boomed while commodity prices were high and failed to convert their windfall into a lasting competitive advantage all face a rough patch. The $1 trillion capital outflow from them over the past 13 months is no speculative accident.

Last month, Kazakh websites shared the triumphant news that the country's per capita gross domestic product, in current U.S. dollars, was about to exceed Russia's this year. That was possible: According to Bloomberg consensus forecasts, Russia's economy will shrink 3.6 percent this year, while Kazakhstan is expected to post 1.5 percent output growth. In May, Kazakhstan's central bank governor, Kairat Kelimbetov, predicted even higher growth -- at 3 percent of gross domestic product -- and promised "no devaluation."

That was during the short-lived rebound of oil prices to about $70 a barrel. On Wednesday, however, President Nursultan Nazarbayev, who has been running

Kazakhstan since it was a Soviet republic, called on his government to prepare for five years of $30 to $40 per barrel oil and cheap metals, limited investment and lower demand for Kazakh exports in Russia and China. Nazarbayev's advice is never ignored in Kazakhstan. So the central bank, which last devalued the tenge in February 2014, has stopped defending it, abolishing its costly peg to the dollar (as Russia did last fall):



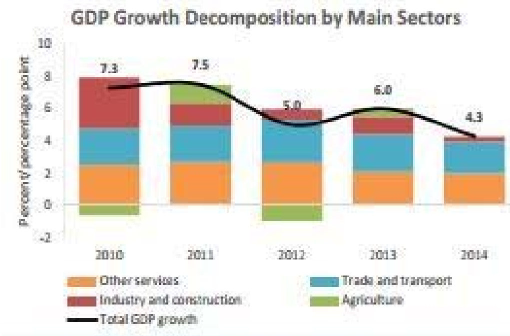
SOURCE: BLOOMBERG

TENGE TO THE U.S. DOLLAR.

Exchange offices and ATMs quickly ran out of dollars. Kazakhs will now have to adjust to paying more for imported goods, and growth expectations will have to be reconsidered. Higher inflation will undermine domestic demand.

Unlike the Russian political leadership, which has talked for more than a decade about the need to weaken the country's oil dependence, but instead lavished oil revenue on the public sector, Kazakhstan was never shy about developing a commodity-based economy first, as a foundation for the future development of manufacturing and technology later. Every year since at least 2001, mining and oil production have been the biggest magnets for foreign direct investment in Nazarbayev's relatively benign if corrupt dictatorship. This tripled oil production and more than doubled metals output between 1990 and 2014.

Until very recently, this commodity-based business model rewarded the country with steady, above 5 percent annual growth. Almost all of Kazakhstan's expansion last year was driven by trade, transport and services:



Source: Statistical Office of Kazakhstan.

The Kazakh government had said it would increase the non-oil share of exports to 70 percent by 2025, but for now, crude oil still accounts for 55 percent of exports. Metals provide an additional 14 percent. The share of manufactured goods in exports remains negligible. Kazakhstan has developed the base it wanted, but, like Russia, built little upon it apart from a consumption boom and some showcase infrastructure projects, including a new capital, Astana. Putin invested $50 billion and a lot of political capital in the 2014 Winter Olympics in Sochi. For Nazarbayev, Expo 2017, set to take place in Astana, is the same kind of vanity event, though the price tag is a more modest $3 billion.

On Wednesday, Nazarbayev said:

> In previous years, we built a lot, increased employment and pay. Now, however, there is a shortage of funds, so expenditure on new projects will be strictly limited by the possibility of increasing revenue. So we must declare a moratorium on all kinds of initiatives until 2018.

He's probably glad the country's biggest city, Almaty, recently lost its bid for the 2022 Winter Olympics to Beijing.

Kazakhstan's problem is not the same as that of some other former Soviet countries that were forced to devalue their currencies and cut spending as Russia's economy shrank, because of the loss of exports and remittances that caused. Kazakhstan's exports to its northern neighbor only reach 9 percent --

compared to 28 percent for Moldova or 19 percent for Armenia -- despite its membership in the Moscow-centric Eurasian Union, Putin's makeshift alternative to the European Union. The Central Asian country is indeed suffering from overdependence, but on oil and metal markets, not on Russia's fortunes.

Those emerging countries not hooked on commodity export revenues are suffering too -- from a slowdown in that big net commodity importer, China, or from investors' persistent tendency to lump all relatively new markets together and pull out of them at the same time. The emerging markets that were the big growth story of the last two decades are now a toxic brew of overlapping and interconnected reasons for poor economic performance. Still, it's commodity exporters such as Kazakhstan that face the toughest battle, if they want to lift themselves above the other resubmerging economies.

They had their big chance while the world thought it was preparing for decades of mineral scarcity -- and they blew it on baubles, buildings and big events. Now, they need to reinvent themselves as smarter economies without the luck of export tailwinds, which will be a lot harder.

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