

Flash note
17 January 2019Growth boost mission is possible with
the new prime minister of Russia

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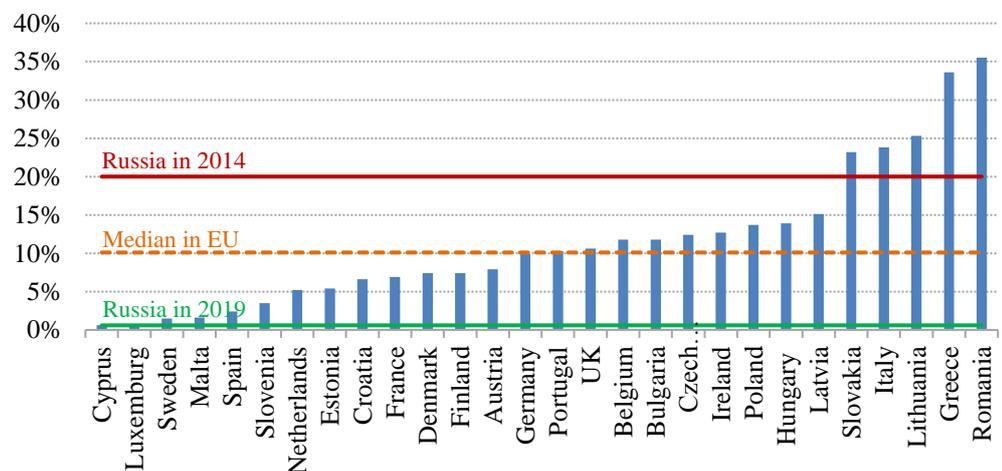
On 16th of January 2020, the President of Russia Vladimir Putin announced Michael Mishustin as the new prime minister of Russia. Since 2010, Mishustin headed the Federal Tax Service. During his tenure on this position, Russia became one of the world leaders in terms of efficiency of tax service.

Russian economy is likely to surprise on a growth side if achievements of Mishustin in his new role will be comparable to what he achieved during 10 years in the tax service.

Closed the VAT gap

The VAT gap, which is the overall difference between the expected VAT revenue and the amount actually collected, is a problem for many countries. For instance, in 2017 the median VAT gap in the EU was above 10%. The smallest gap was recorded in Cyprus (0.6%), Luxemburg (0.7%) and Sweden (1.5%), while in Romania and Greece it was 35.5% and 33.6%, respectively.

VAT gap in EU countries, 2017



Source: The European Commission, Federal Tax Service of Russia, TKB Investment Partners

Mishustin has managed to solve this problem for Russia. From 2014 to 2019, the VAT gap has fallen from around 20% to 0.6%, which is one of the lowest figures in the world. This is a result of digitalization of tax system. Back in 2015, the Federal Tax Service (FTS) introduced automated system for monitoring VAT refunds, which tracks value chain and allows identifying tax evasion. Automatization has enabled to increase tax revenues by 39.6% over the five years from the 2014 level.

Big changes in FTS have also taken place in the system of the service work, where Mishustin introduced the model to reduce inspections by analyzing risks associated with certain taxpayers. If earlier every third taxpayer was

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the subject of inspection, now the tax authorities check one company out of 4000. In addition, Mishustin initiated a number of innovations, facilitating the communications between the residents and the FTS, making tax services available online so there is no longer need to visit tax office.

Member of a liberal team

During his career in state series since 1998, Mishustin used to work with Boris Fedorov, Herman Gref and Alexei Kudrin. Fedorov made substantial contribution to macro stabilization in Russian in the 90s, i.e. he helped to fight hyperinflation in Russia. Inflation went down from 2509% in 1992 to 215% in 1994. German Gref and Alexei Kudrin had a notable contribution to the reform in Russian in 2000s, i.e. Kudrin created the reserve fund, which helped Russian budget during crises of 2008-2009 and 2014-2015 while Gref created the economic strategy for the 2000-2010, which helped economy to grow by almost 80% in real terms over that period.

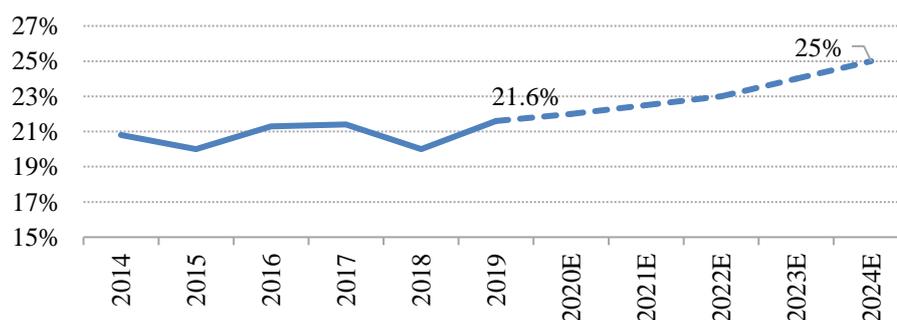
They showed signs of trust in Mishustin in the past. During 2008-2010 he was the head of several companies in UFG group, which was founded by Fedorov. Kudrin invited Mishustin to be the Head of the FTS in 2010.

Growth boost challenge

In his new position, the new prime minister has another ambitious goal to reach – improvement of the Russia economy growth path. Russian economic growth has been low for many years: the average GDP growth during the last three years is 1.7%. Vladimir Putin wants it to accelerate to at least 3%. In his speech addressed to the Federal Assembly, the President set the goal to achieve the higher GDP growth than the global average one in 2021. To achieve this goal, it is necessary to implement structural changes in National projects that imply infrastructure investments and economic modernization. The President's goal is to boost the annual investment growth by 5% starting from this year, and to increase the share of investment in the country's GDP to 25% by 2024 from the current 21.6%.

We think that Mishustin is likely to stay for long, as the aim of boosting the investments to 25% of GDP should take 4-5 years.

The share of investments in GDP



Source: Rosstat, TKB Investment Partners

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Improved outlook for the Russian equity market

Mishustin appointment improved the chances of Russian market to get a boost from positive surprises on economy growth side. The consensus is that the Russian market is not a growth story as there is not much can be expected from its economy. For example, the IMF expects Russia's average annual GDP growth over the next five years to be around 2%. Russian economy is likely to grow materially more if achievements of Mishustin in his new role will be comparable to what he achieved during 10 years in the tax service.

On the other hand his appointment decreases our expectations regarding the key rate cut by the Russian Central Bank (CBR) over the next 3-5 years to 75-100 bps. We expected around 150 bps cut over the next 3-5 years in the end of November 2019 paper [“Russian equities: fat-tire bike for riding the bumpy road of the global equity market”](#). Since that time, the CBR cut rates once by 25 bps. Our expectation was following the assumption that inflation is likely to reach 4% in the long term gradually moving to this level from around 3.5% average level for 2020-2021. Successful measures to boost investments in the infrastructure is likely to result in more aggressive move of inflation to 4% with the possible overshoot above this level from time to time. It is still not enough information to make 3-4% annual GDP growth for Russia as our base case scenario for the long term. However, improved chances of this to happen are enough for us to become more cautious in our base case scenario for the key rate cut.

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