

## President Putin's address: military - well done, now the economy's turn?

President Putin started with ambitious economic plans, but finished with a discussion of various military achievements. Whether this means a shift from military to economic priorities is yet to be seen.



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### Highlights of the two-hour speech

Expectations were high ahead of President Putin's address to the Federation Council. Why?

Many expected to get more colour on the economic reform plan only after the upcoming presidential elections (later in March) and which Mr Putin is expected to win easily. The first half of his more than two hour speech looked ambitious from this perspective, with the President referring to investments in human capital (via extra spending on education and healthcare) and in fixed capital (including infrastructure, transport, IT, city and town renovation, and residential real estate). His thoughts on GDP growth drivers were centred around higher labour productivity, investments (to reach 27% of GDP), SMEs and non-energy exports. The plan is to raise GDP per capita 1.5x by the mid-2020s and to cut the poverty rate by half over the next 6 years.

President Putin noted that there are only limited funding sources available to cover the outlined

spending priorities, so fiscal policy should be readjusted to be more efficient. The tax system should be developed further and then fixed in order to provide predictability and so help fiscal policy to be more growth-oriented. Apart from this, Mr Putin once again gave credit to the CBR for lowering inflation, but asked the regulator to work more closely with the government to stimulate economic growth via further key rate cuts. He also supported the CBR approach to cleaning up the banking sector.

What was very surprising was that the economic part of the address quickly switched to a nearly hour-long discussion of military achievements, extensively supplemented by presentations of the most recent types of weapon and strategic missile. The core message referred to an unfriendly and provocative US/Western policy, forcing Russia to react in order to support its defensive capabilities. By the end it all looked like a speech for military specialists rather than for Council members.

## How should investors react?

This is a very good question. In the economic part of the address, a lack of strongly-populist suggestions together with a sensible list of proposed measures looked reasonable, even if ambitious. Its thrust was later reaffirmed by MinFin comments that the fiscal rule is here to stay, there won't be additional borrowings in 2018 to fund the stated priorities, and spending will need to be re-aligned, together with the help of a readjusted tax system and aimed at reaching 3.7-3.8% GDP growth in coming years. CBR independence also hasn't been compromised, in our view, despite the wording on its co-operation with the cabinet on growth. In February the CBR already noted some more focus on growth vs inflation risks. So, it all appeared to be a mix of preserving macroeconomic stability together with ambitious measures to increase GDP growth and to moderate and manage fiscal challenges.

But will investors "buy" all these economic measures, after being presented with slides on advanced Russian weaponry and its apparently unlimited capabilities directly after an apparently attractive economic story, even if it is generally accepted that Russia-US relations are near bottom and the excessive focus on military success is mostly targeting a local audience ahead of the presidential elections? We doubt the announced economic plans will be factored into higher investment recommendations unless the market sees that the measures are being implemented without there being extra threats to well-appreciated macroeconomic stability. So, wait-and-see mode is here to stay, especially given the poor track-record in implementing many of the previous economic targets from May-12. Geopolitical risks will surely remain key in investor considerations.

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