


# KENYA FY 23/24 BUDGET ANALYSIS

research@aib-axysafrica.com

# FY 2023/24 Budget Review

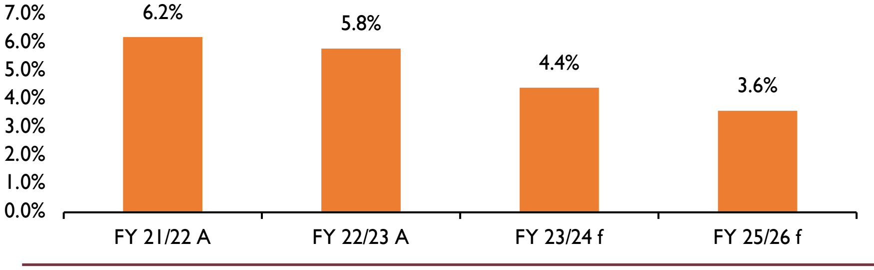
On 15th June, the National Treasury Secretary, Prof Njuguna Ndung'u, presented the proposed FY 2023/2024 **KES 3.68Tn** (22.60% of GDP) budget which was 8.74% higher than final FY 22/23 estimates. Total revenue is expected to come in at **KES 2.92Tn** (17.90% of GDP). The fiscal deficit will stand at **KES 717.98Bn (4.40% of GDP)** and will be financed by net external borrowing of **KES 131.47Bn** (0.80% of GDP) and net domestic borrowing of **KES 598.32Bn**(3.60% of GDP).

The budget is largely focused thematic priorities around key features of the Kenya kwanza manifesto. As such, a recurring inclination on the bottom-up economic transformation Agenda and climate change mitigation and adaptation. Notably, the CS pointed to the need for public debt management despite the current debt situation facing elevated risk of default. Additionally, the CS announced a proposed new method of calculating public debt ceiling which should be a percentage of the GDP in present value terms (Current limit is a constant figure of KES 10.00Tn). Our view is that for the proposed method to work GDP must grow faster than the debt, a fete that has not been achieved in recent past. We recommend prudent expenditure control to ease the pressure on the need to pile up more debt. Indeed, to lighten borrowing burden the government should embrace off-balance sheet funding through Public Private Partnerships (PPP).

## Key Macroeconomic Highlights

- **GDP Growth** – As per KNBS, Kenyan GDP expanded by 4.80% in 2022 lower than the 7.60% growth in 2021. The slower GDP growth was driven by a decline in the agriculture, manufacturing and retail trade sectors despite a recovery in the services sector. We still view the 5.50% expected growth in 2023 as ambitious given the prevailing macro challenges ; Agriculture sector is facing production shortfalls as input costs escalate and the threat of inconsistent rainfall persists. Additionally, the manufacturing sector continues to face high input costs.
- **Inflation** – Currently standing at 8.00% from 7.90% in April owing to the rising food and fuel related indices, with the CPI index increasing to 133.01. The food and non-alcoholic beverages index increased 10bps to 10.20 % y/y in May 2023 and the housing utilities and transport indices increased marginally to 9.70% and 10.10%, respectively y/y. We foresee the various exemptions on LPG products to be positive to consumers. However, we expect the proposed 16.00% VAT on fuel to have multiplier effects across all sectors due to higher fuel prices thus imposing additional inflationary pressure.
- **Currency** - Kenyan shilling has continued the loosing streak against the USD and other major currencies with a YTD depreciation of 13.41% to **KES 139.87**. The CBK's usable forex reserves currently stand at **USD 7.459 Mn** which is **4.11 months** of import cover, above the recommended mark of 4 months. We expect the local currency to continue coming under pressure due to the increased dollar demand from importers on the back of the prevailing high global commodities prices, and reduced dollar inflows from key export-earning sectors.

Chart 1: Budget Deficit as a % of GDP is Expected to Decline




**20th June 2023**

Sovereign Credit Rating:

Moody's: B3 (negative)

Fitch: B (Stable)

S&P: B (Negative)

GDP (2023 Est) : 5.50%

May Inflation: 8.00%

Interbank rate (19th June 23): 9.64%

C.B.R (May 2023): 9.50%

91-Day T-Bill (Latest): 11.64%

182-Day T-Bill (Latest): 11.65%

364-Day T-Bill (Latest): 11.73%


Analyst

Solomon Kariuki

Stacy Makau

+254114842208

research@aib-axysafrica.com

Table 1: Budget Summary

| | Supp I FY22/23 | FY23/24 Estimates | % Change |
|---|---|---|---|
| Expenditure | | | |
| Recurrent | 2,366.50 | 2,551.05 | 7.80% |
| Development | 618.16 | 743.52 | 20.28% |
| County Allocation | 399.60 | 385.43 | -3.55% |
| Total Expenditure | 3,384.26 | 3,679.99 | 8.74% |
| | | | |
| Ordinary Revenue | 2,191.99 | 2,571.16 | 17.30% |
| Appropriation-in-Aid | 336.84 | 348.68 | 3.52% |
| Grants | 31.43 | 42.17 | 34.20% |
| Revenues | 2,560.25 | 2,962.01 | 15.69% |
| | | | |
| Domestic Borrowing | 425.11 | 598.32 | 40.74% |
| External Borrowing | 395.76 | 131.47 | -66.78% |
| Other Financing | -3.14 | -11.81 | 276.11% |
| Deficit Financing | 817.73 | 717.98 | -12.20% |

Source: National Treasury, AIB-AXYS Analyst Estimates

**Revenue Collection -** Total revenue collections are estimated to hit **KES 2,962.01Bn** (17.90% of GDP) a 15.69% increase from the **KES 2,560.25Bn** to be collected in the current fiscal year. Ordinary revenue for FY23/24 is projected at **KES 2,571.16Bn** which is a 17.30% increase from the current year. In order to achieve this, the government plans to broaden the tax base and introduce tax reforms. However, the government is already at 90.05% of the prorated target for the current fiscal year with a low possibility of meeting the set target. As such, we see the FY 23/24 target as ambitious given the current tough macro economic environment.

**Expenditure -** Total expenditure for FY23/24 is projected at **KES 3.679.99 trillion** which is equivalent to 22.60% of GDP, an 8.74% increase from the current year. Notably, development expenditure has increased faster (+20.28% to **KES 743.52Bn**) compared to recurrent expenditure (+7.80% to **KES 2,551.05Bn**). However, we maintain concerns on under absorption of the development budget as seen in the 53% absorption in the current fiscal year. We are likely to see majority of the development budget go to settling pending contractor bills from previous years. Allocation to counties was at **KES 429.63Bn** which includes KES 385.43Bn to the equitable share. Other key allocations have been made to Education (**KES 628.60Bn**), National Security (**KES 189.20Bn**) and Health (**KES 141.20Bn**).

**Budget Deficit -** The deficit is estimated to decrease by 12.20% to **KES 717.98Bn (4.40% of GDP)**. Government's huge appetite for debt remains a worrying concern with over 54.87% of net revenues projected to be directed towards debt. Majority of the deficit, **KES 598.32Bn**, will be financed in the domestic market (+40.74% increase from the current fiscal year) increasing the risk of crowding out effect of local businesses, as banks continue to favor lending to the government. External net borrowing will come in at **KES 131.47Bn** where the gross borrowing will be KES 607.06Bn to factor in the USD 2.00Bn Eurobond maturity in 2024. Notably, majority of the external debt will be commercial debt despite the high yields environment leading to higher issuance rates. We recommend an increased adoption of the PPP Act 2021 so that the funding of key infrastructure projects can be financed using the PPP model, which will ease the borrowing burden. **We ,therefore, expect a further upward shift in the yield curve due to the increase in interest rates as the government is likely to accept aggressive bids as it seeks to meet its domestic borrowing target**.

Table 2: Thematic Areas of the Bottom-Up Economic Transformation Agenda

| | Thematic Area | GDP sector | Contribution to GDP * | Allocated Amount | Our Comments |
|---|---|---|---|---|---|
| 1. | Agricultural Transformation and Inclusive growth | Agriculture | 14.81% | KES 49.90Bn | • We expect the allocation to lower the cost of farm inputs e.g. fertilizer subsidy and support production initiatives such as irrigation. As such we see this as positive to the struggling sector and should stimulate agricultural related economic growth. |
| 2. | Transforming the Micro, Small and Medium Enterprise (MSME) Economy. | Financial and Insurance | 8.86% | KES 10.85Bn | • We believe that the budgetary allocation to MSME economy will facilitate the growth and development of these enterprises through enabling access to affordable credit, creating more jobs and stimulating economic activity. |
| 3. | Housing and Settlement | Construction<br><br>Real Estate | 16.76% | KES 35.20Bn | • The allocation to housing and settlement is in line with the government's commitment to provide affordable housing while stimulating economic growth and creation of jobs. This allocation is expected to be supplemented with the housing levy funds if approved in the finance bill 2023. |
| 4. | Enhancing Quality and Affordable Healthcare | Health | 2.24% | KES 141.20Bn | • We believe the allocation to healthcare will support the UHC Program and additionally facilitate the development and improvement of healthcare infrastructure. However, challenges in institutions such as NHIF are likely to weigh down on additional benefits from the funding. |
| 5. | Digital Superhighway and Creative Economy | Information and Communication | 3.24% | KES 15.10Bn | • We expect that the allocation will pave way for digitization and automation to boost productivity and competitiveness by lowering information asymmetry. The allocation is likely to boost internet connectivity through installation of additional digital infrastructure. |
| 6. | Improving National Security | Public Administration | 6.16% | KES 338.20Bn | • We believe that the allocation will enable the country to strengthen its defense capabilities and create a secure environment for investment. |
| 7. | Investing in Critical Infrastructure | Construction<br><br>Transportation and Storage<br><br>Electricity and Water Supply | 19.12% | KES 409.23Bn | • We believe the allocation to vital infrastructure will foster an environment that will support economic recovery, attract investments, create jobs and facilitate trade. We expect that the allocation is critical in improving connectivity and mobility within the country. |
| 8. | Improving Education Outcomes | Education | 5.05% | KES 628.60Bn | • We expect that the allocation will continue addressing the challenges in the education sectors , mores so relating to the implementation of the CBC system. We expect the hiring of additional teachers (Junior secondary schools have been facing teaching staff shortage) and enhancing the learning infrastructure. |
| 9. | Supporting Manufacturing for Job Creation | Manufacturing | 8.51% | KES 26.90Bn | • We see that the allocation as insufficient to solve the challenges facing the sector. With an ambition of the economy being more manufacturing driven we expected a higher allocation as well as initiatives to spur further manufacturing activities. As such, we do not expect much impact on the sector. |
| 10. | Stimulating Tourism growth, Sports, Culture and Recreation and Arts | Accommodation and Restaurant | 1.05% | KES 22.10Bn | • We expect that the allocation will lead to the creation of jobs as well as increase revenue hence supporting the growth of these sectors. We expect the allocation will assist cultural creation and creative economy. |
| 11. | Environmental Protection, Water and Natural Resources | Electricity and Water Supply | 2.59% | KES 78.90Bn | • If well implemented the allocation will be a great head start in the conservation of natural habitats and ecosystems, increase accessibility to clean water and aid in climate change adaptation strategies. Lower water levels have been negative on hydro power production leading to more usage of diesel power production. |

*Contribution to GDP is as of Q3'22

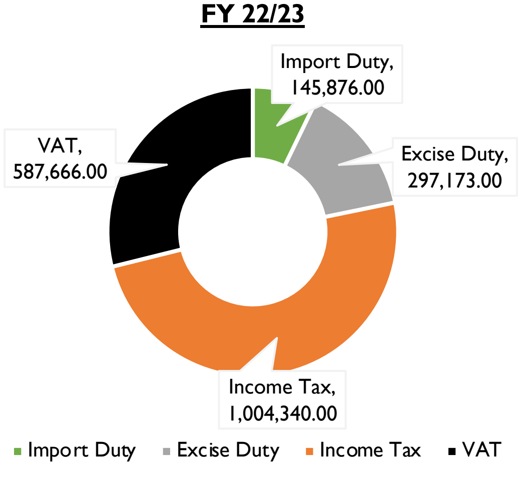
** Allocation figures are as reported in the budget speech, figures from other sources might differ.

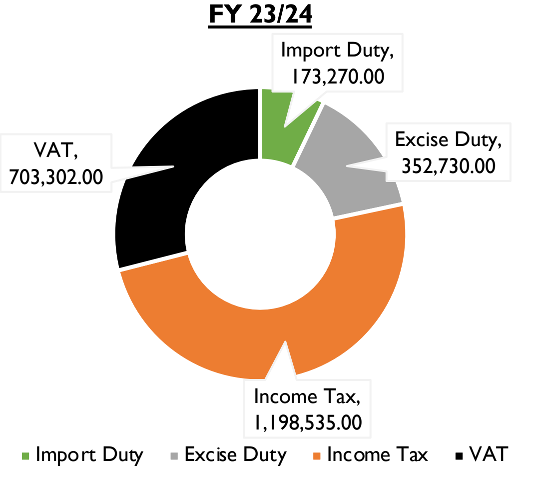
Source: National Treasury, AIB-AXYS Analyst Estimates

Table 3: Proposed Policy, Legal and Institutional Reforms in 2023/2034 Budget

| | Reforms | Sector Affected | Our Comments |
|---|---|---|---|
| 1. | Procurement | Government | • We foresee the full roll out of the e-Government Procurement system as a positive move as it will enhance efficiency in procurement at both National and County levels which could see the reduction in expenditure for the government by reducing duplication. |
| | | National treasury | • We expect the re-engineering of the AGPO portal with aims to allow for real-time registration will better enable women, youth and persons with disabilities to access available government procurement opportunities as well as quicker access to capital. |
| 2. | State Corporation | KPLC | • The plan to restructure and offset some of KPLC's debt is positive for cashflow management. We also welcome the increased private sector representation within KPLC as it will improve corporate governance. However, we view the intention to lower the system losses to 14.4% from 22.4% as ambitious as that has been the plan in the last few years with inadequate success. |
| | | KQ | • We foresee the governments plans to turnaround the airline into profitability as positive for the national carrier which has been facing financial turbulence requiring support from the government. |
| 3. | Financial Sector Stability and Development | CBK | • We expect that efforts made by CBK along with other agencies and regulators to ensure oversight of Digital Credit Providers will enhance customer protection in terms of accessing credit.<br>• We expect that the launch of an improved Central Securities Depository code by the CBK will improve access to government securities investment for retail investors. |
| 4. | Deposit Insurance | Kenya Deposit Insurance Corporation | • We expect the reviewing of the present coverage limit by establishing whether current coverage is adequate for MSME's will improve depositor protection. |
| 5. | Pension Reforms | National Treasury | • We expect that the development of the Kenya National Entrepreneurs Saving Trust (KNEST) by the National Treasury will consequently increase pension coverage in the country through expansion of pension coverage to the informal sector. |

Chart 2: Tax Revenue Comparison FY 22/23 VS FY 23/24




Source: National Treasury, AIB-AXYS Analyst Estimates

Table 4: Effects of Proposed Tax Changes on NSE Listed Companies

| | Change | Affected Listed Company | Nature of Effect |
|---|---|---|---|
| 1. | Change of LPG products to Zero Rate from VAT | Total | We foresee the zero rating of LPG will lead to the decrease in the price hence encouraging use consequently increasing demand. |
| 2. | Removal of VAT for aircrafts, parts and engines | Nairobi Business Ventures, KQ | We foresee the removal of the tax as a positive as it will reduce the cost of business and operating expenses. |
| 3. | Reduction of excise duty on fees charged for money transfer services by banks, money transfer agencies and other financial service providers to 15% from 20%. | Banking and Telco | We view the reduced tax as positive for banks and telcos which could see an increase in transfer volumes. Additionally, with the reduced tax, there is promotion of financial inclusion. |
| 4. | Reduction of excise duty on fees charged to money transfers on cellular mobile providers to 10% from 12% of excisable value. | Safaricom | We view the reduced tax as positive for Safaricom as it will make transactions more affordable which could spur an increase in transaction volumes. |
| 5. | Introduction withholding tax on payments in respect to promotion and advertising at 5%. | All counters | We foresee the new tax will increase marketing costs for listed companies that engage in sales promotions, marketing and advertising services with residents. |
| 6. | Introduction of excise duty of imported cement at a rate of 10% of the value. | Bamburi<br>East African Portland Cement | We view the introduction of the tax as negative for local cement producers as majority of the clinker used locally ( our estimates are 80.00%) is imported. As such the cost of production for cement is likely to go up.<br>However, this could be positive for local clinker producers such as EAPC who are likely to see more sales on local clinker. |
| 7. | Introduction of 15% excise duty charges on advertisement of alcoholic beverages, betting and gaming | EABL, SCAN | We foresee the new tax increasing marketing costs for the alcoholic and gaming industry. We anticipate the companies will adopt digital channels of advertising which are not within the excise duty framework. |
| 8. | Introduction of excise duty on imported paints at 15% | Crown | We view the introduction of the new tax as positive as it will strengthen the competitiveness of locally manufactured paints. |

## Our view

**The Positives** - We welcome the news on exploration of potential liability management regarding public debt, more so the upcoming Eurobond 2024 maturity. The continued agriculture sector related subsidies are welcome relief for farmers in reducing farm inputs. We commend the establishment of the pending bills verification committee to review and settle delayed liabilities which is a welcome relief to players in the banking sector who provided the financing resulting to non-performing loans. Notably, the intention to reduce the fiscal deficit and thus need for borrowing is also welcome and positive for debt sustainability.

**Our Concerns** - We remained concerned with the potential for inadequate implementation of the budget allocations in some sectors. Our expectations of measures to tame wasteful expenditure were not addressed in the budget presentation. Therefore, we likely to see continued out of line expenditure through irregular procurement related activities and unapproved spending.  We foresee KRA missing the set tax revenue target for FY 23/24 owing to the tough operating environment. Additionally, we expect increased pressure on KRA to meet revenue targets through widening the tax base, increased tax compliance, and aggressive pursuit of tax cheats. We foresee, areas of conflict between the county and national governments especially in health care and housing which are constitutionally allocated to counties. As such, we view this as a double allocation of funds which could have been directed to other needy sectors.

## CONTACTS:


**Research Desk**

**Solomon Kariuki**
Research Analyst

**Stacy Makau**
Research Analyst

**Email:** research@aib-axysafrica.com

**Equities Dealing**

**Bernard Kung'u**

**Benard Gichuru**

**Brian Tanui**

**Samuel Githinji**

**Sheema Shah**

**Samuel Wachira**

**Email**: trading@aib-axysafrica.com

**Bond Dealing**

**Crispus Otieno**

**Titus Marenye**

**Email**: trading@aib-axysafrica.com