FY 2022/23 Budget Review

On 7th April, the National Treasury Secretary, Hon. Ambassador Ukur Yatani, presented the proposed budget, **KES 3.34Tn** (23.90% of GDP) for FY 2022/2023. The budget reading came two months ahead of the normal June reading, owing to the upcoming elections in August. Total revenue is expected to come in at **KES 2.48Tn** (17.50% of GDP). The fiscal deficit will stand at **KES 862.50Bn** (6.20% of GDP) and will be financed by net external borrowing of **KES 280.70Bn** (2.00% of GDP) and net domestic borrowing of **KES 581.70Bn** (4.20% of GDP).

The CS also announced a proposed new method of calculating the public debt ceiling (at 55.00% of GDP), compared to the current constant figure of **KES 9,000.00Bn**. At the current debt levels of **KES 8.6Tn,** the new method is already in breach of the ceiling with an estimated GDP of **KES 14.00Tn**. Our view is that for the proposed method to work GDP has to grow faster than the debt, a fete that has not been achieved in the recent past. We recommend prudent debt management through current debt restructuring through the extension of maturities mostly for local debts. Indeed, to lighten the borrowing burden the government should embrace off-balance-sheet funding through Public-Private Partnerships (PPP).

Key Macroeconomic Highlights

- **GDP Growth -** The CS indicated that GDP is expected to have expanded by 7.60% in 2021 better than the 0.30% contraction in 2020, after impressive rebounds mostly in Q1 and Q3. Recovery was likely driven by rebounds in sectors such as, Education, Mining, Accommodation and Manufacturing. We still view the 6.00% expected growth in 2022 as ambitious given the challenges already at hand; the Agricultural sector is facing production shortfalls as input costs escalate and the threat of reduced rainfall persists. Elections, later in August, are likely to delay investment decisions and hence cool down economic activity. Additionally, the geopolitical events across the world coupled with the existing presence of COVID-19 in China are likely to slow down international trade.

- **Inflation** – Currently standing at 5.56% from 5.08% in February owing to the rising food and fuel-related indices, with the CPI index increasing to 120.14. The food and non-alcoholic beverage index increased by **9.92% y/y**; the housing and utilities index increased by **4.91% y/y** and the price of electricity reduced by **11.13% y/y**. We believe that global factors such as: elevated inflation, supply chain challenges and the rise in the price of fuel prices are driving up prices of commodities locally. We foresee the 10.00% increase in excise duty for commodities, with the exemption of petroleum products, as likely to add inflationary pressure later in the year.

- **Currency -** Kenyan shilling has continued the losing streak against the USD and other major currencies with a YTD depreciation of 1.90% to **KES 115.29**. The CBK's usable forex reserves currently stand at **USD 8,373 Mn** which is **4.98 months** of import cover, above the recommended mark of 4 months. We expect the local currency to remain under pressure due to increased dollar demand on the back of elevated global oil prices due to the Russia-Ukraine war disrupting the global energy sector, soaring commodity prices and disrupted supply chains; and reduced dollar receipts from key export earning sectors.

11th April 2022

Sovereign Credit Rating:

Moody's: B2 (negative)

Fitch: B+ (negative)

S&P: B (stable)

GDP (2021 Est) : 7.6%

March Inflation: 5.56%

Interbank rate (8th April): 4.75%

C.B.R (March 2022): 7.00%

91-Day T-Bill (Latest): 7.377%

182-Day T-Bill (Latest): 8.219%

364-Day T-Bill (Latest): 9.743%

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Revenue Collection

Total revenue collections are estimated to hit **KES 2,479.00Bn** (17.50% of GDP) an 18.05% increase from the **KES 2,100.00Bn** to be collected in the current fiscal year. Ordinary revenue for FY22/23 is projected at **KES 2,141.60Bn** which is a 20.61% increase from the current year. In order to achieve this, the government plans to broaden the tax base and introduce tax reforms.

Table 1: Budget Breakdown

Budget Item	FY21/22(KESBn)	FY22/23(KES Bn)	% Change
Expenditure			
Recurrent Expenditure	2,406.40	2,668.30	10.86%
Development Expenditure	623.50	674.40	8.16%
Total Expenditure	3,029.90	3,342.70	10.31%
Revenues	**2,100.00**	**2,479.00**	**18.05%**
Ordinary Revenue	1,775.60	2,141.60	20.61%
Deficit Financing	**1,024.30**	**862.50**	**(15.80%)**
Domestic Borrowing	658.50	581.70	(11.66%)
External Borrowing	365.80	280.70	(23.26%)

Source: National Treasury, AIB-AXYS Analyst Estimates

Expenditure

Total expenditure for FY22/23 is projected at **KES 3.34 Trillion** which is equivalent to 23.90% of GDP, a 10.31% increase from the current year. We remain concerned about the faster growth in recurrent expenditure(+10.86% to **KES 2.668.30Bn**) compared to development expenditure (+8.16% to **KES 674.40Bn**). Allocation to counties was maintained at **KES 407.00Bn**, similar to the current fiscal year. Key allocations have been made to Education (**KES 513.80Bn**), National Security (**KES 317.90Bn**) and the Big Four Agenda (**KES 146.90Bn**).

Budget Deficit

The deficit is estimated to decrease by 15.80% to **KES 862.50Bn (6.20% of GDP)** from **KES 1,024.30Bn (8.10% of GDP)**. The government's huge appetite for debt remains a worrying concern with over 54.00% of net revenues projected to be directed towards debt. The majority of the deficit, **KES 581.70Bn**, will be financed in the domestic market (-11.66% decrease from the current fiscal year) increasing the risk of crowding out effect of local businesses, as banks continue to favour lending to the government. External borrowing will come in at **KES 280.70Bn** with expectations of additional Eurobond issues amid a change of strategy to more concessional loans. We recommend the 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 an 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**.

Our view - We welcome the news of the drafting of a national tax policy, as it will provide clear guidelines especially for foreign investors who have face the challenge of inconsistent tax laws. We expect increased pressure on the Kenya Revenue Authority to meet revenue targets through widening the tax base, increased tax compliance, and aggressive pursuit of tax cheats. However, these efforts may be curtailed by slower than projected economic recovery, as this budget will be implemented during the upcoming electioneering period, as well as, face further exposure to the uncertainties occasioned by the ongoing global crises. We foresee, several adjustments accompanied by supplementary budgets as it will largely be implemented by the incoming government who are likely to hold differing development and expenditure objectives.

Table 2: Effects of Proposed Tax Changes on NSE Listed Companies

	Change	Affected Listed Company	Nature of Effect
1.	Introduction of a 15% excise duty on fees charged by media stations for advertisements of Alcoholic, gaming and betting.	Nation Media Group, Standard Media Group, WPP Scan Group	We foresee the new tax reducing advertisement revenue to an already struggling industry. Advertising may shift to non-media station channels such as social media influencers.
2.	Introduction of a 15% excise duty on fees charged by media stations for advertisements of Alcoholic, gaming and betting.	East African Breweries (EABL)	We foresee the new tax increasing marketing costs for the alcoholic and gaming industry. We anticipate the company will adopt digital channels of advertising which are not within the excise duty framework.
3.	Change of Excise Duty regime for liquid Nicotine to KES 70/ml from KES 1200/kg	BAT Kenya Plc	We view the increased taxes as a negative for BAT. Indeed, this limits BAT's rollout of new and innovative products as high prices are likely to discourage uptake
4.	Proposal to include unlisted Real Estate Investment Trusts (REITs) in investments by Pension Schemes	Insurance Companies	We view this as positive for the pension industry portfolio diversification as well as returns in Equities being volatile
5.	Proposal to require motor cycles and three wheelers to procure insurance covers for their passengers	Insurance Companies	We view the implementation as a positive for the insurance sector in terms of increased premiums. However, given the rising number of motorcycle accidents the claims are likely to also increase
6.	Tax deduction on cash donations to all charitable organizations	All Listed Companies	As listed companies continue considering ESG reporting social impact is being highly considered. Opening contributions to all charitable organization widens the options for social impact
7.	Introduction of taxation on gains made by a non-resident from transactions in financial derivatives in Kenya	Derivatives Market	We view this as negative to the growth of the infant local derivatives market. Foreign investors already hold significant portions of trading at the NSE.

Source: National Treasury, AIB-AXYS Analyst Estimates

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