Cytonn INVESTMENTS

The Draft 2024 Budget Policy Statement Note

The National Treasury released the Draft 2024 Budget Policy Statement, in line with section 25 of the Public Finance Management (PFM) Act, 2012 which requires the National Treasury to seek and take into account the views of stakeholders and the public in preparing the Budget Policy Statement (BPS), before submission to Cabinet for approval and the subsequent submission to Parliament. The statement expresses the priority economic policies, structural reforms and the sectoral expenditure programs to be implemented under the Medium-Term Expenditure Framework for FY 2024/25– 27/28.

As such, we will be reviewing the statement and discuss the following:

i. A comparison of the FY2023/24 Supplementary budget and the projected FY'2024/2025 budget as per the Draft 2024 BPS,
ii. Our analysis and view of key aspects of the budget,
iii. Recovery Strategy, and,
iv. Conclusion and key areas of improvement,

Section I: A comparison of the FY'2023/24 Supplementary Budget and the projected FY'2024/25 budget as per the Draft 2024 BPS

Below is a summary of the major changes as per the BPS 2024 from the expected FY'2024/2025 budget performance:

Comparison of 2023/24 and 2024/25 Fiscal Year Budgets as per The 2024 Budget Policy Statement				
	FY'2022/2023 Budget Outturn	FY'2023/2024 Revised Estimates	FY'2024/2025 BPS	% change 2023/24 to 2024/25
Total revenue	2,360.5	3,022.7	3,435.0	13.6%
External grants	23.1	47.4	49.3	4.0%
Total revenue & external grants	**2,383.6**	**3,070.1**	**3,484.3**	**13.5%**
Recurrent expenditure	2,311.6	2,761.3	2,859.3	3.5%
Development expenditure & Net Lending	493.7	745.1	877.8	17.8%
County governments + contingencies	415.8	425.0	451.1	6.1%
Total expenditure	3,221.0	3,931.4	4,188.2	6.5%
Fiscal deficit excluding grants	**860.5**	**861.3**	**703.9**	**(18.3%)**
Deficit as % of GDP (Including grants)	5.9%	5.3%	3.9%	(1.4%)
Net foreign borrowing	310.8	412.1	326.1	(20.9%)
Net domestic borrowing	459.5	449.2	377.7	(15.9%)
Total borrowing	770.3	861.3	703.9	(18.3%)
GDP Estimate	14,274.4	16,158.4	18,015.2	11.5%

Key take-outs from the table include:

i. Revenue is projected to increase by 13.6% to Kshs 3.4 tn from Kshs 3.0 tn as per FY'2023/24 revised budget estimates, with proposals such as expanding the tax base already in place to work towards increasing the amount of revenue collected in the next fiscal year,
ii. The 2024 BPS points to a 6.5% increase of the total expenditure, to Kshs 4.2 tn from Kshs 3.9 tn in the FY' 2023/24 revised budget estimates,

iii. Development expenditure is set to increase at a higher rate than recurrent expenditure; with development expenditure increasing by 17.8% to Kshs 877.8 bn from Kshs 745.1 bn as per the supplementary budget, while recurrent expenditure is projected to increase by 3.5% to Kshs 2.9 tn from Kshs 2.8 tn as per the FY'2023/24 supplementary budget. However, the recurrent expenditure will still constitute the largest allocation of 68.3% while development will be allocated 21.0%
iv. The budget deficit is projected to decline to Kshs 703.9 bn (3.9% of GDP) in FY'2024/2025, from the projected Kshs 861.3 bn (5.3% of GDP) in the FY'2023/24 revised budget; The decline is in line with the International Monetary Fund's (IMF's) recommendation for fiscal consolidation, as the country seeks to reduce Kenya's public debt requirements,
v. The total borrowing requirement is expected to decline by 18.3% to Kshs 703.9 bn from Kshs 861.3 bn as per the FY'2023/24 revised budget , in a bid to reduce Kenya's public debt burden which is estimated at 72.6% of GDP as of September 2023, 22.6% points above the East African Community (EAC) Monetary Union Protocol, the World Bank Country Policy and Institutional Assessment Index, as well as, the IMF threshold of 50.0%, and,
vi. Debt financing for the 2024/25 budget is estimated to consist of 46.3% foreign debt and 53.7% domestic debt, a change from the 47.8% foreign and 52.2% domestic as projected in the revised FY' 2023/24.

. Section II: Analysis and house-view on key aspects of the BPS:

Below we give our analysis and view on various aspects of the Budget Policy Statement:

1. Revenue

In FY 2024/25, revenue collection including Appropriation-in-Aid (A.i.A) is projected to increase by 13.6% to Kshs 3.4 tn, up from the estimated Kshs 3.0 tn as per the FY 2023/24 Supplementary budget, mainly underpinned by the ongoing tax policy reforms and revenue collection measures geared towards increasing the tax base. Ordinary revenues is expected to amount to Kshs 2.9 tn in FY 2024/25 up from the estimated Kshs 2.6 tn in FY 2023/24 Supplementary budget.

Revenue collection recorded a slightly higher growth of 13.2% for the period to November 2023 to Kshs 1,011.5 bn, compared to a growth of 10.6% over a similar period in 2022, however performed below the target by Kshs 98.7 bn. The performance is partly attributed to the rising cost of living, which has impacted the business environment negatively, leading to lower tax remittances.

To address the shortfall, going forward, the government has been implementing various tax policy measures through the Tax Amendment Law and the Finance Act, 2023, intending to improve collections. Some of the reforms going forward include:

i. The government will focus on implementation of the Finance Act 2023 to boost revenue, which will result to an estimated tax effort of 16.3% of GDP in FY'2023/24
ii. KRA will also implement the strengthening of Tax administrations through incorporating technology to seal leakages, enhancing the iTax and Integrated Customs Management System (Icms), and use of e-TIMS (Tax Management System)
iii. Implementation of the National Tax Policy to improve on administrative effectiveness, uniformity and offer clarity on tax laws, as well as control tax expenditures.
iv. The government will also strengthen revenue mobilization efforts to 20.0% of GDP by implementing the Medium-Term Revenue Strategy (MTRS) to guide on how to further boost revenue collection.

We are of the view that the higher targeted revenue collection for FY'2024/2025 was expected given the current administration's focus on expanding the tax base to include the informal sector, increasing the excise duty tax, VAT, and the roll-out of the e-TIMS system to improve VAT collection margins. However, the upward revision of taxes comes at a time when the business environment remains subdued, underpinned by the elevated inflationary pressures and increased taxes that has suppressed business production levels. As such, the low production performance will weigh down on the projected revenue performance. We however expect that business performance will be partly supported by the ongoing strengthening of the Kenyan Shilling against the Dollar and other strong currencies.

2. **Expenditure**

As per the 2024 BPS, total expenditure is set to increase by 6.5% to Kshs 4.2 tn from Kshs 3.9 tn in FY 2023/24 as per the Supplementary budget. Development expenditure is set to increase at a higher rate than recurrent expenditure; with the development expenditure increasing by 17.8% to Kshs 877.8 bn from Kshs 745.1 bn in FY'2022/23 as per the Supplementary budget, while recurrent expenditure is projected to increase by 3.5% to Kshs 2.9 tn from Kshs 2.8 tn in FY'2023/24. One of the key concerns lies in the proportion of recurrent expenditure compared to development spending which as per the BPS is expected to come in at 68.3% against 21.0%, respectively.

In line with the Government's consolidation strategy, total expenditure and net lending for the eleven months to November 2023 came in at Kshs 1,160.8 bn, which was Kshs 335.7 bn below the projected amount of Kshs 1,496.4 bn. Recurrent spending amounted to Kshs 920.8 bn while development expenditures and transfer to County Governments were Kshs 132.4 bn and Kshs 107.5 bn, respectively.

Recurrent expenditure falling below target by Kshs 166.7 bn was mainly attributable to lower than targeted expenditure on pensions, operations and maintenance and other CFC domestic and external interest. Due to the lower than expected expenditure side, coupled with the rise in revenue collections during the eleven months to November 2023 an overall deficit of Kshs 144.4 bn was recorded, which was below the projected deficit of Kshs 379.7 bn for the period. This deficit was financed through net domestic financing of Kshs 156.2 bn and net foreign borrowing of Kshs 23.4 bn.

Key to note, the projected recurrent expenditure is still high despite the significant increase in the development expenditure. As such, the quality of fiscal consolidation remains a concern and this could potentially compromise the growth potential of the economy. To reduce government expenditure, and in turn what needs to be plugged in through borrowing, we suggest the following:

i. **Enhancing Public-Private Partnerships (PPPs)** – The government should involve the private sector in development as this will increase efficiency while reducing pressure on the government. This should be done by removing bottlenecks to PPPs and joint ventures to attract more private investors to attract more development projects especially the infrastructure ones,

ii. **Reduction of The Public Wage Bill** – This should be done through rationalization of the public office roles we currently have by getting rid of redundancies in the representation of counties and constituencies, and, etc. and relooking at the salaries, allowances and benefits earned,

iii. **Privatization of Parastatals** - The government should revive economic performance of parastatals or privatize poorly performing ones to release capital, lower debt and also to prevent the widening of debt from losses and inefficiencies. Fortunately, the government has identified this as a suitable approach and has started the process of privatizing at least 24 state owned firms through the Privatization Commission,

iv. **Enhancing Efforts to Fight Corruption** – The government should ensure efficiency and advance efforts to fight corruption, as funds lost to corruption are estimated at roughly a third of the national budget (Estimates from the Ethics and Anti-Corruption Commission). Kenya has been engaged in the fight against corruption since the 1960's, without successfully being able to get rid of recurrent scandals involving huge sums of public funds that are inflating the expenditure but not impacting the lives of the common Kenyan, and,

v. **Prioritizing Impactful Development Projects** – To ensure fiscal consolidation and manage expenditure, the government should give priority to completing ongoing development projects after thorough auditing. Further, it is essential for the government to also concentrate on ensuring that Development budget is more concentrated on projects that have high social benefits and high economic return. Going forward, development budget absorption needs to improve as most fiscal years end in an under-absorbed development budget and an over-spent recurrent budget. Development projects need to be prioritized and better planning incorporated to match fund availability to project execution, and measures taken to improve the public procurement process; while also being prudent in recurrent spending.

3. Public Debt

From the Draft Policy Statement, the total new public debt requirement for the FY 2024/25 is set to decline by 18.3% to Kshs 703.9 bn from the projected Kshs 861.3 bn, in FY'2023/24. The public debt requirement mix is projected to comprise of 46.3% foreign debt and 53.7% domestic debt, compared to the 47.8% foreign debt and 52.2% domestic debt as per the Supplementary budget FY'2023/2024, remaining relatively unchanged. However, through the 2024 Medium-Term Debt Management Strategy (MDTS), the government is working towards reducing net domestic borrowing and external borrowing to 45:55 from the prior proposal of 50:50 in 2023 MDTS, through gradual decrease in Treasury Bills and increase in concessional borrowing.

A decrease in domestic debt composition could have the following two results:

i. On a positive note, a decrease in the crowding out of the private sector because when the government's appetite for local debt is high, the rates on government securities remain attractive. As a result, more commercial banks will be inclined not to lend to the private sector due to elevated credit risks on borrowers, and this has been exuberated by the elevated Non-Performing Loans in the private sector coming in at 14.8% in December 2023, from 13.3% in December 2022 due to tough economic situations, and,

ii. However, an increase in external financing would increase the country's exposure to external shocks, as the more we owe in foreign currency, the more exposed we are to any shocks in the foreign markets. Given the volatility in value of the shilling against the dollar, vis-à-vis 67.5% of the total debt being US dollar denominated, a lower reliance on foreign debt will help control the amount owed in both interest and principle payments, and,

Debt sustainability continues to be a key concern, with the country's public debt–to-GDP ratio having increased considerably over the past five years to 72.6% as at September 2023, from 59.2% during the same period in 2018. The surging levels of public debt have elevated the risk of debt sustainability with International Monetary Fund categorizing Kenya as one of the country's under risk of high debt distress. As of January 2024, Kenya's debt service to revenue ratio stood at 60.6%, which is 30.6% points above the recommended IMF's threshold of 30.0%. The sustained level of debt service to revenue ratio above the recommended threshold is a worrying sign, elevating the refinancing risk following shocks arising from the pandemic and global supply disruptions accelerated by the ongoing Russian-Ukrainian conflict.

Below are some actionable steps the government can take towards debt sustainability;

i. **Restructuring of Debt Mix**- The government should prioritize concessional borrowing to reduce the amounts paid in debt service and reduce its dependence on commercial borrowings which are usually expensive and has been increasing debt servicing cost. Further, commercial borrowing should be limited to development projects with high financial and economic returns, to ensure that more expensive debt is invested in projects that yield more than the market rate charged,
ii. **Improving Capital Markets**- The government should channel efforts towards strengthening the Capital Markets structure to ease the pooling of funds by investors to undertake development projects instead of the government heavily undertaking capital projects on their own. Key to note, our capital markets remain dormant with banking markets having mobilized Kshs 5.5 tn in deposits compared to Collective Investment Schemes at only Kshs 0.2 tn, hence the need to increase support to the sector,
iii. **Fiscal Consolidation** – The main attribute to higher fiscal deficit is higher expenditure compared to lower revenue collections consequently leading to increased borrowing to finance the deficit. However, the government can bridge the deficit gap by implementing robust fiscal consolidation through expenditure reduction by introducing austerity measures and reducing amounts extended to recurrent expenditure and capital-intensive projects but mainly focus on projects with high social impact or a higher economic return. The government can also focus on completing pending projects whose economic benefits will be transmitted into the economy and support overall economic growth instead of starting new ones,
iv. **Improving the Country's Export**- The government can focus on developing certain sectors to build an export-driven economy by formulating export and manufacturing policies. Encouraging growth in the manufacturing sector will help increase the value of our exports leading to an improved current account, and,
v. **Improve the Efficiency of Public Debt Management Office** –The directorate was established to minimize the cost of public debt management, promote development of market for government debt securities and ensure sharing of benefits and costs of the debt between different generations. However, the authority should also have a mandate of solving Kenya's debt problems which have been more of a lack of fiscal discipline coupled with the inadequate political will to fight corruption so as to avoid pilferage. The authority should also be given the mandate to monitor expenditure and funds allocation to specific projects.

Section III: Conclusion

The 2024 Budget Policy Statement is the second to be prepared under the new administration with the main aim of realizing the administration's main objective of achieving the Bottom-Up economic model. The BPS comes at a time when the country, and the rest of the world is starting to recover from economic turmoil attributable to ongoing geo-political conflicts, elevated global inflation and supply chain disruptions. As such, the formulation of the BPS is hinged on solving these problems and ascertain economic recovery projected at 5.5% GDP in 2024. In the event of an economic downturn, the measures would be negative discouraging entrepreneurship, growth of SME and depress earnings growth in the private sector. From the statement, the implementation of the budget will rely more on increased revenue collection with the treasury putting on proposals to achieve the revenue target of Kshs 3.4 tn. The statement has also indicated a reduction in government debt to ensure fiscal consolidation to ease on the debt burden of the country. In line with its manifesto, the Kenya Kwanza regime has also proposed a marginal increase in recurrent expenditure by 3.5%, but significantly increased the development expenditure by 17.8% to help push the key development agendas. The proposed budget is also set to have a deficit that will be met through a mix of domestic and foreign borrowing which will reach Kshs 703.9 bn compared to Kshs 861.3 mn in the FY’2023/24 revised budget, with a probability of a decrease in the net domestic borrowing and an increase in the net foreign financing to match the proposed ratio of 45:55.