

### **The Draft 2026 Budget Policy Statement Note**

The National Treasury released the [Draft 2026 Budget Policy Statement](#) (BPS) in line with Section 25 of the Public Finance Management (PFM) Act, 2012, which mandates the Treasury to incorporate stakeholder and public views during the preparation of the BPS. Following this consultative process, the BPS is submitted to Cabinet for approval and subsequently presented to Parliament for discussion and adoption. The statement outlines priority economic policies, structural reforms, and sectoral expenditure programs to be implemented under the Medium-Term Expenditure Framework (FY'2025/26–2027/28).

As such, this review focuses on the following:

- i. A comparison of FY 2025/26 budget and the projected FY 2026/27 budget as per the Draft 2026 BPS,
- ii. Our analysis and assessment of key aspects of the budget,
- iii. Recovery strategy and measures to enhance fiscal performance, and
- iv. Conclusion and key areas for improvement.

### **Section I: A Comparison of the FY'2025/26 Budget and the Projected FY'2026/27 Budget as per the Draft 2026 BPS**

Below is a summary of the major changes as per the Draft BPS 2026 from the expected FY'2025/2026 budget performance:

Comparison of 2024/25 and 2025/26 Fiscal Year Budgets as per the 2026 Budget Policy Statement				
	FY'2024/2025 Budget Outturn	FY'2025/2026 (Budget)	FY'2026/2027 BPS	% change 2024/25 to 2025/26
Total revenue	2,923.6	3,321.7	3,487.0	5.0%
External grants	33.3	47.2	48.8	3.4%
<b>Total revenue &amp; external grants</b>	<b>2,956.9</b>	<b>3,368.9</b>	<b>3,535.8</b>	<b>5.0%</b>
Recurrent expenditure	2,948.4	3,134.1	3,431.2	9.5%
Development expenditure & Net Lending	582.9	649.0	759.1	17.0%
County governments + contingencies	444.6	484.8	446.6	(7.9%)
Total expenditure	3,975.9	4,269.9	4,641.9	8.7%
<b>Fiscal deficit including grants</b>	<b>1,019.0</b>	<b>901.0</b>	<b>1,106.1</b>	<b>22.8%</b>
Deficit as % of GDP	5.9%	4.7%	5.3%	0.6%
Net foreign borrowing	179.7	287.4	99.5	(65.4%)
Net domestic borrowing	854.5	613.5	1006.6	64.1%
Total borrowing	1034.2	901	1106.1	22.8%
GDP Estimate	17,148.7	19,006.2	20,916.8	10.1%

Key take-outs from the table include:

- i. Total revenue, including external grants, is projected to increase by 5.0% to Kshs 3,487.0 bn in FY 2026/27 from Kshs 3,321.7 bn in FY 2025/26. External grants are expected to rise by 3.4% to Kshs 48.8 bn, bringing total revenue and grants to Kshs 3,535.8 bn, a 5.0% increase.
- ii. Total expenditure is projected to increase by 8.7% to Kshs 4,641.9 bn in FY 2026/27 from Kshs 4,269.9 bn in FY 2025/26.

- iii. Development expenditure & net lending is set to rise by 17.0% to KSh 759.1 bn, while recurrent expenditure is projected to increase by 9.5% to Kshs 3,431.2 bn. Recurrent expenditure remains the largest share of total spending accounting for 73.9%, with development expenditure 16.4%.
- iv. The fiscal deficit (including grants) is projected to increase to Kshs 1,106.1 bn in FY 2026/27 from Kshs 901.0 bn in FY 2025/26, with the deficit as a share of GDP rising slightly to 5.3% from 4.7%.
- v. Total borrowing is projected to rise to Kshs 1,106.1 bn from Kshs 901.0 bn in FY 2025/26. This comprises net foreign borrowing of Kshs 99.5 bn and net domestic borrowing of Kshs 1,006.6 bn, reflecting the financing of the fiscal deficit.
- vi. GDP is projected to grow by 10.1% to Kshs 20,916.8 bn in FY 2026/27 from Kshs 19,006.2 bn in FY 2025/26, providing some fiscal space for the planned expenditure increase.

## 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 2026/27, revenue collection including Appropriation-in-Aid (A.i.A) is projected to increase by 5.0% to Kshs 3,487.0 bn, up from Kshs 3,321.7 bn in FY 2025/26, mainly underpinned by ongoing tax policy reforms and revenue collection measures aimed at expanding the tax base and improving compliance. Ordinary revenues are projected to increase proportionally, contributing to total revenue growth.

Revenue collection inclusive of grants recorded a slower growth in FY 2025/26 of 13.9% growth to Kshs 3368.9 bn in FY 2025/26 from Kshs 2,956.9 bn in FY 2024/25, reflecting challenges in meeting targets during the period. This underperformance was primarily due to below-target tax collections, which, despite reforms, were affected by economic disruptions and a slowdown in business activities. Key factors included policy uncertainties, protests, and a rising cost of living, which negatively impacted the business environment and led to lower-than-expected tax remittances, even in the context of higher tax rates.

To address revenue shortfalls and broaden the tax base, the Kenyan government introduced several measures under the [Finance Bill 2025](#), effective from 1st July 2025. Key reforms include:

- i. **Restriction of Tax Loss Carryovers:** Tax losses can now only be carried forward for a maximum of 5 years, impacting long-term capital-intensive projects.
- ii. **Capital Gains Adjustments:** Elimination of the ability to deduct past capital losses from future gains and removal of exemptions on income already taxed, increasing effective tax rates for some investors.
- iii. **Exemptions for NIFCA Companies:** Dividends from companies certified by the Nairobi International Financial Centre Authority (NIFCA) with minimum reinvestments are exempt from tax, incentivizing reinvestment.
- iv. **Corporate Income Tax Relief for NIFCA Companies and Start-ups:** Reduced rates of 15.0% for eligible NIFCA companies (first 10 years) and start-ups (first 3 years), then 20.0% thereafter, promoting investment and job creation.
- v. **Digital Asset Tax Adjustment:** Rate reduced from 3.0% to 1.5% on transfer or exchange value, fostering higher trading volumes and stimulating the digital economy.

- vi. **Country-by-Country Reporting (CbCR) Updates:** Only one designated entity in Kenya files CbCR for multinational groups, and exemptions for resident surrogate parent entities are removed, aligning with international BEPS Action 13 standards.
- vii. **Targeted Measures to Seal Revenue Leakages:** The Bill focuses on limiting deductions, streamlining exemptions, and closing loopholes to increase revenue collection without aggressive tax hikes.

These reforms are designed to enhance compliance, broaden the tax base, and generate additional revenues while balancing investment incentives and economic growth.

We are of the view that the higher targeted revenue collection for FY 2026/27 was expected given the current administration's focus on expanding the tax base to include the informal sector, increasing excise duty, 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 cost of living remains elevated and as such we expect this to weigh down on the projected revenue performance. We however expect that revenue performance will be partly supported by the stability of the Kenyan Shilling against the Dollar and other strong currencies and the easing of inflationary pressures.

## 2. Expenditure

As per the 2026 BPS, total expenditure is projected at Kshs 4,641.9 bn in FY 2026/27, a 8.7% growth from 4,269.9 in FY 2025/26, with recurrent expenditure projected at Kshs 3,431.2 bn, development expenditure and net lending at Kshs 759.1 bn, and county governments plus contingencies at Kshs 446.6 bn. This reflects faster growth in development expenditure of 17.0% relative to recurrent expenditure of 9.5%, while allocations to county governments and contingencies are projected to decrease by 7.9%, highlighting the government's focus on development priorities and fiscal consolidation.

In line with the Government's fiscal consolidation strategy, total expenditure and net lending for the eleven months to November 2025 amounted to Kshs 1,773.1 bn, which was Kshs 74.2 bn below the prorated target of Kshs 1,847.3 bn, translating to an execution rate of 96.0%. Recurrent expenditure amounted to Kshs 594.6 bn, while development expenditure and transfers to county governments stood at Kshs 121.8 bn and Kshs 137.0 bn, respectively, against prorated targets of Kshs 169.6 bn and Kshs 172.9 bn. Development expenditure and county allocations fell below target by Kshs 47.8 bn and Kshs 35.9 bn, respectively, mainly due to lower-than-anticipated absorption of both foreign and domestically financed projects. In contrast, recurrent expenditure was slightly below the prorated target by Kshs 18.1 bn, largely attributable to lower spending on pensions, operations and maintenance, and Consolidated Fund Services (CFS), including domestic and external interest payments.

Given that the revenue shortfall of Kshs 189.4 bn (total revenue of Kshs 958.4 bn against a prorated target of Kshs 1,147.8 bn) exceeded the expenditure shortfall of Kshs 74.2 bn, an overall fiscal deficit of Kshs 814.7 bn was recorded, surpassing the prorated target deficit of Kshs 699.5 bn for the period. The deficit was financed through net domestic borrowing of Kshs 622.7 bn and net foreign borrowing of Kshs 222.0 bn

The government plans to strengthen expenditure control and enhance public spending efficiency through several measures:

- i. **Austerity and Transparency:** Implement austerity measures to reduce recurrent expenditure, roll out an end-to-end e-procurement system for transparency, and scale up Public-Private Partnerships (PPPs) for viable projects. Governance reforms targeting state corporations will also be expedited.
- ii. **Treasury Single Account (TSA):** The Government is implementing the TSA in phases over a three-year period to enhance cash management, transparency, and fiscal discipline. The rollout commenced with

national government entities in FY 2024/25, will be extended to county governments in FY 2025/26, and will cover other public entities by FY 2026/27, enabling more efficient consolidation and utilization of public funds.

- iii. **Accrual Accounting:** Transitioning from cash-based to accrual accounting will enhance resource management and fiscal reporting, with assets and liabilities recognized over a three-year period.
- iv. **Zero-Based Budgeting:** The government will entrench Zero-Based Budgeting in FY 2025/26, using a new budgeting tool for streamlined costing and prioritization.
- v. **Public Investment Management (PIM):** Reforms will prioritize completing ongoing projects, assess environmental risks, and integrate PPP projects. PIM systems will be expanded across all government levels.
- vi. **Assets and Liabilities Management:** The government will standardize and digitize asset management, develop an asset valuation framework, and introduce an asset tagging system to enhance visibility and utilization.
- vii. **Leasing Framework:** A standardized leasing framework will address inconsistencies in leasing practices across public entities.
- viii. **Pension Reforms:** Governance of the Public Service Superannuation Scheme (PSSS) will be delinked from non-contributory schemes. Digitization and re-engineering of pension systems will improve accuracy and timely payments, supported by actuarial evaluations for sustainability.

Despite the notable increase in development expenditure, projected recurrent expenditure remains elevated, raising concerns about the quality of fiscal consolidation and its potential implications for long-term economic growth. To reduce government expenditure and, consequently, borrowing requirements, we recommend 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 35 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 Budget Policy Statement, the total new public debt requirement for FY 2026/27 is projected at Kshs 1,106.1 bn, up from Kshs 901.0 bn in FY 2025/26, representing a 22.8% increase. The composition of borrowing shows a continued emphasis on domestic financing, with net domestic borrowing projected at Kshs 1,006.6 bn up from Kshs 613.5 bn in FY 2025/26, while net foreign borrowing is expected to decline to Kshs 99.5 bn down from Kshs 287.4 bn in FY 2025/26, reflecting a marked shift towards domestic sources. The Government plans to continue meeting its borrowing needs through a combination of domestic and external financing, with external borrowing primarily sourced from multilateral and bilateral lenders, alongside limited commercial borrowing, and a strong focus on concessional financing. Non-concessional and commercial borrowing will be strictly restricted to projects aligned with the national development agenda and only where concessional financing options are unavailable.

In response to global challenges such as supply chain disruptions and rising external financing costs, the government will closely monitor macroeconomic conditions before accessing international capital markets through sovereign bonds or liability management operations. Additionally, it will explore innovative financing options, including green and climate-related financing, and expand into new markets with instruments like Panda and Samurai bonds to diversify funding sources.

Domestically, the government recognizes the critical role of local borrowing, which has historically accounted for more than half of its funding needs, and is focused on lengthening the public debt maturity profile through issuance of medium to long-term bonds. To enhance this market, reforms will focus on improving efficiency, diversifying the investor base, and ensuring stability. The M-Akiba bond platform will be revamped to make government securities more accessible to retail investors, fostering financial inclusion and a culture of saving.

Despite the decline in the public debt-to-GDP ratio to 67.4% in December 2024, debt sustainability remains a key concern for Kenya. The International Monetary Fund (IMF) debt sustainability analysis classifies Kenya's public debt as sustainable, with the country rated a medium performer under the Debt Carrying Capacity (DCC) framework. However, debt-servicing pressures remain elevated. As at FY 2024/25, Kenya's debt service-to-revenue ratio stood at 64.2%, which is well above the IMF's recommended threshold of 30.0%

The persistence of debt service levels above the recommended threshold signals heightened liquidity and refinancing risks, particularly in the event of external shocks such as global supply chain disruptions and tightening global financial conditions. To enhance debt sustainability, the Government intends to prioritize fiscal consolidation measures aimed at moderating debt accumulation, strengthening revenue mobilization, and reducing debt servicing costs over the medium term.

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, rather than relying heavily on direct government financing. Key to note, our capital markets remain relatively shallow, with banking deposits having mobilized Kshs 5.8 tn compared to Collective Investment Schemes at only Kshs 0.7 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 2026/27 Budget Policy Statement is the fourth to be prepared under the current administration and aims to advance the Bottom-Up Economic Transformation Agenda. The BPS is formulated against a backdrop of moderating economic activity in FY'2026, with estimated GDP growth projected at 5.3% in FY 2026/27. Implementation of the budget will rely heavily on enhanced revenue mobilization, with the Treasury targeting revenues of Kshs 3,487.0 bn. The BPS emphasizes fiscal consolidation through reduced debt accumulation to ease the country's overall debt burden. In line with the administration's manifesto, recurrent expenditure is projected to increase by 9.5% to Kshs 3,431.2 bn, while development expenditure and net lending is set to rise by 17.0% to Kshs 759.1 bn to support key development priorities. The FY 2026/27 fiscal deficit is projected at Kshs 1,106.1 bn, to be financed through a mix of domestic and external borrowing, compared to Kshs 901.0 bn in the FY 2025/26 budget