

Cytonn Note on the FY'2026/27 Budget Estimates

The National Treasury presented its [Budget Estimates](#) for the next fiscal year, FY'2026/27. Notably, the budget estimates recorded a 1.5% increase to Kshs 4.8 tn from the previous estimates of Kshs 4.7 tn in the Budget Policy Statement for FY'2026/27 and a 3.2% increase from the Kshs 4.6 tn in FY'2025/26 as per the Supplementary Budget I. Additionally, total revenue is set to increase by 2.7% to Kshs 3.6 tn in FY'2026/27 from Kshs 3.4 tn in FY'2025/26 as per the Supplementary Budget I. The government's FY'2026/27 budget is anchored on several key strategic priorities. In addition to the core Bottom-Up Economic Transformation Agenda (BETA) and the Medium-Term Revenue Strategy (MTRS), the budget also provides targeted allocations to the National Infrastructure Fund (NIF) and the Sovereign Wealth Fund (SWF). Furthermore, it incorporates a Whole-of-Government approach within the fiscal consolidation framework to enhance institutional coordination and synergy across all levels of government.

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

- i. A comparison of the Supplementary Budget I FY'2025/26 budget and the projected FY'2026/27 budget as per the 2026 Budget Estimates,
- ii. Analysis and House-view on Key Aspects of the FY'2026/27 Budget Estimates, and,
- iii. Conclusion,

Section I: A comparison of the FY'2025/26 Supplementary Budget and the projected FY'2026/27 budget as per the FY'2026/27 Budget Estimates

Below is a summary of the major changes as per the FY'2026/27 Budget Estimates:

Cytonn Report: Comparison of 2025/26 and 2026/27 Fiscal Year Budgets as per the FY'2026/27 Budget Estimates					
	FY'2025/2026 Revised Estimates (a)	FY'2026/2027 BPS (b)	FY'2026/2027 Budget Estimates (c)	% change	
				2025/26 to 2026/27 (a/b)	2025/26 to 2026/27 (b/c)
Total revenue	3,399.1	3,534.2	3,629.7	6.8%	2.7%
External grants	39.9	54.4	43.6	9.3%	(19.9%)
Total revenue & external grants	3,439.0	3,588.6	3,673.3	6.8%	2.4%
Recurrent expenditure	3,393.2	3,464.6	3,538.7	4.3%	2.1%
Development expenditure & Net Lending	758.4	753.4	749	(1.2%)	(0.6%)
County governments + contingencies	486.8	497.5	497.5	2.2%	0.0%
Total expenditure	4,638.4	4,715.5	4,785.2	3.2%	1.5%
Fiscal deficit excluding grants	1,199.4	1,126.9	1,111.9	(7.3%)	(1.3%)
Deficit as % of GDP	6.43%	5.30%	5.34%	(17.0%)	0.8%
Net foreign borrowing	225.8	225.5	116.2	(48.5%)	(48.5%)
Net domestic borrowing	973.6	901.4	995.7	2.3%	10.5%
Total borrowing	1,199.4	1,126.9	1,111.9	(7.3%)	(1.3%)
GDP Estimate	18,642.5	20,947.4	20,816.8	11.7%	(0.6%)

Source: National Treasury, Amounts in Kshs bns

Some of the key take-outs include;

- i. The FY'2026/27 budget estimates point to a 3.2% increase of the budget, to Kshs 4.8 tn from Kshs 4.6 tn in the FY'2025/26 Supplementary Budget I,
- ii. Recurrent expenditure is set to increase by 2.1% to Kshs 3.53 tn, from Kshs 3.46 tn as per the Budget Policy Statement and a 4.3% increase from Kshs 3.4 tn as per the Supplementary Budget I FY'2025/26, while development expenditure and net lending is projected to decrease by 0.6% and 1.2% to Kshs 749.0 bn from Kshs 753.4 bn and Kshs 758.4 bn as per the FY'2026/27 Budget Policy Statement and the Supplementary Budget I FY'2025/26 respectively. Under recurrent expenditures, interest payments expenditures and pension increased by 9.7% to Kshs 1.5 tn, from Kshs 1.3 tn, in the FY'2025/26 Supplementary Budget I,
- iii. The budget deficit is projected to decline by 7.3% to Kshs 1.1 tn representing 5.3% of GDP from the projected Kshs 1.2 bn which is 6.4% of GDP in the FY'2025/26 Supplementary Budget I; in line with the International Monetary Fund's (IMF's) recommendation, in a bid to reduce Kenya's public debt requirements,
- iv. Total revenue and grants is projected to increase by 6.8% to Kshs 3.7 tn, from Kshs 3.4 tn in the FY'2025/26 Supplementary Budget I, supported by measures already in place to boost revenue performance. KRA is being strengthened through technology investment to modernise the tax framework, improve compliance, broaden the tax base and seal leakages under the National Tax Policy and Medium-Term Revenue Strategy. Non-tax revenue collections across MDAs are being enhanced through service-based reforms, while Treasury Single Account automation, accrual-based accounting under IPSAS standards, and pension administration digitisation are expected to strengthen expenditure discipline and reduce fiscal leakages. Structural rationalisation of state corporations under the Government-Owned Enterprises Act 2025 further aims to reduce contingent liabilities on the exchequer
- v. Total borrowing is expected to decline by 7.3% to Kshs 1.1 tn from Kshs 1.2 tn as per the FY 2025/26 Supplementary Budget I, in a bid to reduce Kenya's public debt burden. The Present Value of total public debt stood at 65.3% of GDP as at June 2025, 10.3% points above the approved benchmark of 55.0% of GDP as set by the EAC Monetary Union Protocol, the World Bank Country Policy and Institutional Assessment Index, and the IMF threshold. Notably, the debt ratio is projected to marginally worsen to 65.6% in 2026 before embarking on a gradual declining path to 65.0% in 2027, 64.2% in 2028 and 63.1% by 2029, still remaining above the 55.0% benchmark throughout the forecast horizon, underscoring the urgency of the Government's fiscal consolidation effort, and,
- vi. Debt financing of the 2026/27 budget is estimated to consist of 89.5% domestic debt and 10.5% foreign debt, from 81.2% domestic and 18.8% foreign as per the FY'2025/26 Supplementary Budget I.

Section II: Analysis and House-view on Key Aspects of the FY'2026/27 Budget Estimates

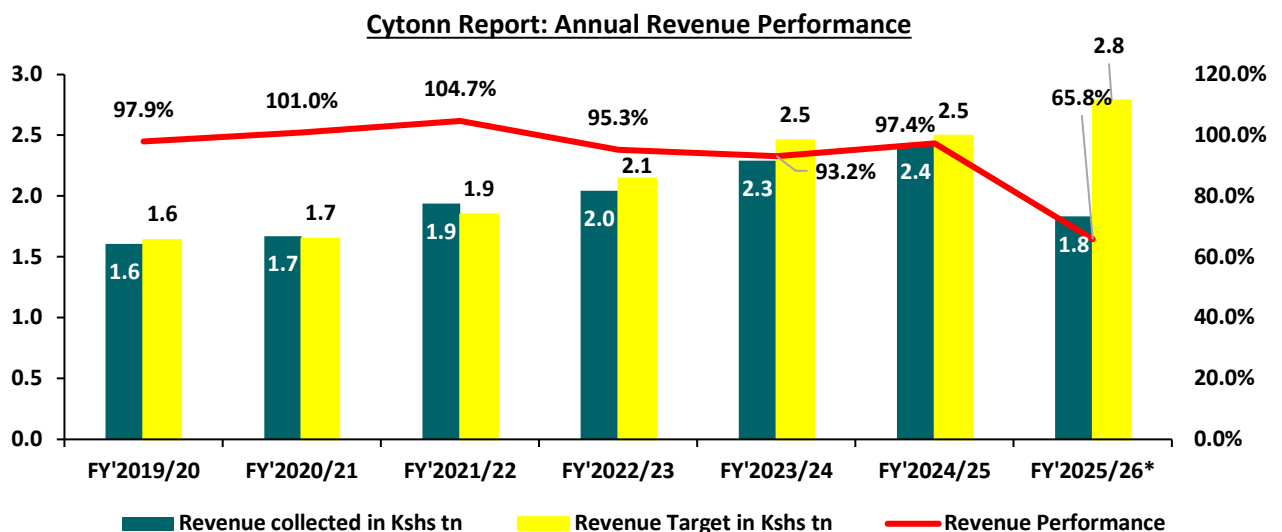
Below we give our analysis and view on various aspects of the 2026 Budget Estimates:

1. Revenue collection Fiscal Policy Framework:

The estimates target a total revenue collection of Kshs 3.6 tn which is 17.4% of the GDP, where ordinary revenues are projected to come in at Kshs 2.9 tn representing 14.3% of GDP. The ongoing reforms in tax policy and revenue administration are expected to support revenue performance over the medium term, as the Government continues to implement the National Tax Policy and Medium-Term Revenue Strategy both aimed at simplifying and harmonising tax laws, rationalising tax expenditures, and broadening the tax

base to raise tax revenue to above 20.0% of GDP. On the administration side, the Kenya Revenue Authority is being strengthened through sustained investment in technology to modernise the tax framework, improve compliance, strengthen customs valuation, and seal revenue leakages. These measures are complemented by reforms on non-tax revenue collections across Ministries, Departments and Agencies to improve service-based revenue performance.

However, the performance of tax revenue collection has consistently remained below set targets, on account of a challenging business environment and structural revenue gaps. According to Exchequer Issues, ordinary revenue as at 31st March 2026 stood at Kshs 2.8 tn, representing 14.9% of GDP which is still well below the medium-term revenue strategy target of above 20.0% of GDP. Tax revenue over the same period stood at Kshs 1.7 tn, equivalent to 88.1% of the prorated Kshs 2.0 tn and 66.0% of the FY'2025/26 full-year estimates of Kshs 2.6 tn, an indicative of the persistent shortfall that continues to constrain fiscal space. This underperformance underpins the Government's renewed push on KRA reforms and tax base broadening as core pillars of the FY'2026/27 revenue mobilization framework. The chart below represents revenue performance over the years:



*Revenue collection up to ninth month of the year

The Government's goal is to reduce the fiscal deficit and stabilise growth in public debt while ensuring debt sustainability. This is to be achieved through a combination of revenue enhancement initiatives and expenditure rationalisation, with the fiscal deficit projected to narrow to Kshs 1.1 tn, representing 5.3% of the GDP from Kshs 1.2 tn, representing 6.4% of the GDP as per the Supplementary Budget I FY'2025/26, and further declining to 3.3% of GDP by FY'2028/29. We are of the view that the higher targeted revenue collection will be driven primarily by improved compliance and administrative efficiency rather than the introduction of new tax measures, as the Government's revenue strategy is anchored on broadening the tax base and sealing leakages through KRA modernisation, complemented by public financial management reforms including full implementation of the e-Government procurement system, automation of the Treasury Single Account, and digitisation of pension administration under the Enterprise Resource Planning framework rather than imposing additional tax burdens on existing taxpayers.

2. Expenditure Projections:

Total gross expenditure for FY'2026/27 is projected to increase by 3.2% to Kshs 4.8 tn, from Kshs 4.6 tn as per the approved Supplementary Budget estimates FY'2025/26. Both recurrent and development expenditures are set to increase, with recurrent expenditure increasing by 4.3% to Kshs 3.5 bn from Kshs

3.3 tn in the FY'2025/26 Supplementary Budget. The increase in recurrent expenditure continues to be driven by elevated interest payments, with domestic interest projected to increase by 11.3% to Kshs 1.2 tn from Kshs 1.1 tn as per the FY'2025/26 Supplementary Budget. Despite development expenditure remaining a stated priority, it declined by 1.2% to Kshs 749.0 bn from Kshs 758.4 bn as per the FY'2025/26 Supplementary Budget. One of the key concerns over the period has been the proportion of recurrent expenditure compared to development spending which as per the estimates is expected to come in at 73.2% against 16.4%, respectively, with the development ratio still below the statutory 30.0% minimum under the Public Finance Management Act.

We are of the view that the quality of fiscal consolidation remains a concern, because the burden of adjustment continues to fall disproportionately on development spending. While recurrent expenditure is maintained at 17.0% of GDP, development spending is constrained at only 3.6% of GDP, meaning the cuts are concentrated on investment rather than consumption. This approach risks undermining the economy's medium-term growth potential, since development expenditure finances infrastructure, industrialization, and value chain expansion, which are the very drivers of productivity and competitiveness. At a time when the Bottom-Up Economic Transformation Agenda (BETA) demands accelerated productive investment to unlock jobs, expand capacity, and strengthen resilience, reducing development allocations weakens the foundations for sustainable growth, making the consolidation path problematic. To reduce government expenditure, and in turn what needs to be plugged in through borrowing, we suggest the following:

- **Enforce Expenditure Rationalization:** Following the revised fiscal framework, implement a 25.0% reduction in non-priority recurrent expenditure, including freezing foreign travel, workshops, and discretionary allowances. Introduce a hiring freeze outside critical sectors (health, education, security) to contain wage bill growth.
- **Rationalize Grants and Transfers:** Cap government grants to parastatals at no more than 65.0% of approved budgets, with disbursement tied to performance audits. Consolidate overlapping agencies to eliminate duplication and reduce administrative overhead.
- **Safeguard Development Allocations:** maintain development expenditure at a minimum of 4.0% of GDP, but scale down low-impact capital projects by 20.0%. Require co-financing from private sector and development partners, ensuring funds are directed toward high-multiplier projects such as logistics corridors, energy reliability, and digital infrastructure.
- **Prioritize High-Multiplier Investments** Direct development expenditure toward sectors with measurable spillovers: logistics corridors, energy reliability, and digital infrastructure. These reduce structural bottlenecks, crowd in private capital, and expand the tax base which is a credible path to debt sustainability

3. Deficit Financing:

From the tabled estimates, the fiscal deficit is projected at 5.3% of GDP, whose funding will be through a net external borrowing of Kshs 116.2 bn coupled with a net domestic borrowing of Kshs 995.7 bn. The total new public debt requirement for the FY'2026/27 is set to decline by 7.3% to Kshs 1.1 tn from Kshs 1.2 tn, in FY'2025/26, as per the Supplementary Budget. Notably, according to the estimates, external borrowing to domestic borrowing composition is estimated to shift to 10:90, from 19:81 as per the FY'2025/26 Supplementary Budget.

Considering the projected revenues and expenditures, for the medium term, borrowed funds shall be strictly directed toward financing development expenditure and not recurrent expenditure, in line with Section 15 of the Public Finance Management (PFM) Act. Notably, the composition of external to domestic borrowing is expected to remain heavily tilted toward domestic sources, underscoring the need for resource allocation toward the Bottom-Up Economic Transformation Agenda (BETA), which prioritizes agriculture, MSMEs, affordable housing, healthcare, and digital infrastructure..

Section III: Conclusion

In conclusion, the FY'2026/27 Budget reflects a deliberate move toward fiscal consolidation while safeguarding growth priorities. The fiscal deficit is projected at 5.3% of GDP, financed through a balanced mix of external and domestic borrowing, with strict adherence to the Public Finance Management (PFM) Act requiring that borrowed funds be directed only toward development expenditure. While the framework signals discipline, its success remains contingent on the government's ability to expand the tax base, enhance compliance, and seal revenue leakages, particularly in the informal sector. Debt sustainability remains a pressing concern, with the public debt-to-GDP ratio still elevated above the benchmark, underscoring the importance of operationalizing the National Investment Fund (NIF) and Sovereign Wealth Fund (SWF) to strengthen resource mobilization. Implementation will be anchored on a whole-of-government approach, aligning ministries, departments, and agencies to the Bottom-Up Economic Transformation Agenda (BETA), with priority investments in agriculture, MSMEs, affordable housing, healthcare, and digital infrastructure. In our view, the budget is less expansionary than previous cycles, reflecting a consolidation stance that prioritizes stability over aggressive spending. However, the outlook is highly vulnerable to external shocks including volatile global commodity prices, exchange rate pressures, and geopolitical risks, which the government itself has emphasized as critical threats to fiscal performance. This balance positions the economy for resilience, but the medium-term trajectory will depend on how effectively these external risks are managed alongside domestic revenue mobilization.