KENYA | MACROECONOMIC UPDATE | BUDGET ANALYSIS | INSIGHTS

FUNDAMENTALS

KENYA: FY23 SUPPLEMENTARY BUDGET POSES CREDIBILITY DEFICIT

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IN BRIEF

- The National Treasury published the FY23 Supplementary Budget documents last week, which will be tabled in the National Assembly today (14 February, 2023).
- Subsequently, the Budget & Appropriations Committee will table its recommendation report before a Supplementary Appropriations Bill is introduced and approved by the National Assembly
- The FY23 Supplementary Budget was presented to the Cabinet at the end of January 2023, in line with the IMF programme's structural benchmark
- Although President Ruto had hinted at an ambitious KES 300.0bn slash in budget spending by the national government, the published documents show a modest KES 13.3bn reduction in spending by the national government.
- While there is still policy inertia around the unsustainable fuel subsidy, the government is weaning its extraordinary support to two SOEs; Kenya Power and Kenya Airways.
- Although the undisbursed KES 29.6bn as equitable revenue to counties portends some legal challenges, we do not see the bicameral Parliament making a big fuss out of it.
- The fiscal deficit target in the revised FY23 budget narrows from 6.2% to 5.7%, but we opine this is cosmetic based on an ambitious upward FY23 nominal GDP revision
- We are likely to see investors piling up on duration as the presumed KES 300bn spending cut, hitherto government's open mouth operations, has not materialized in the FY23 supplementary budget.

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Credibility deficit with lower budget cuts

The overall reduction of KES 13.3bn in spending by the national government (that is, KES 203.9bn aggregate additions offset with KES 217.2bn aggregate reductions) pales the KES 300bn spending cut (2.1% of GDP) that the new administration targeted. President William Ruto hinted at this ambitious austerity plan, 14.1% of the initial budget allocation to the national government, to rein in spiraling public debt. The President doubled down signaling that the spending reduction will lead to an equivalent net reduction in initial FY23 borrowing target (KES 862.9bn; 6.2% of GDP). What the new administration failed to communicate clearly is that the KES 300bn target reduction was to offset additional FY23[1] spending needs. As such, the FY23 budget may suffer credibility deficit, which could spook the market as investors digest the ramifications of the supplementary budget.

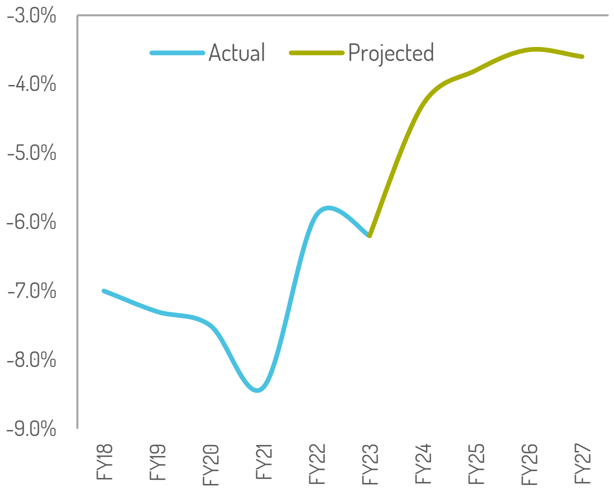
That said, the supplementary budget was presented to Cabinet as part of the ongoing IMF programme's structural benchmark by the target deadline of end-January 2023. The proximate cause for upward adjustment on the initial FY23 budget stemmed from subsidies towards maize flour and fertilizers, Junior High School capitation, additional teacher recruitment programme, provision towards revenue mobilization, and procurement and distribution of relief food to the most vulnerable from the ongoing drought situation. The new administration's pet project, the Financial Inclusion Fund – colloquially, Hustler Fund – has been allocated a seed capital KES 20.0bn in the FY23 supplementary budget. However, the expected rolling over of other affordable credit products (in addition to the personal finance product targeting individuals) poses more upward budgetary pressure at the tail end of FY23. Budget rationalizations and downward calibration of wages, in line with the National Treasury's Circular No. 8/2022 that detailed guidelines on FY23 supplementary budget, offset the upward budget adjustments.

At the IMF's crosshairs

Nonetheless, the FY23 supplementary budget lays bare the policy inertia around the removal of fuel subsidy. Despite President Ruto's admission that fuel subsidy has been removed, there has been KES 42.7bn allocation to compensate the Oil Market Companies (OMCs). With diesel being cross-subsidized using Petrol, Kerosene is left as the sole product being subsidized by the government in the recent monthly fuel pump price review (Jan-2023). Furthermore, there has been a clear sticking of the head firmly in the sand, in that the Petroleum Development Levy – that funds the fuel subsidy – is priced at KES 0.40 for a litre price of Kerosene. Yet, the per litre cost of the Kerosene subsidy is at KES 25.1. In short, we believe that the fuel subsidy programme is unsustainable and unless there is a firm policy by the administration to allow market forces to rein, the fuel backstop will continue straining the fiscus.

On a positive note, the Supplementary budget has baked in limited extraordinary support to two SOEs; power distributor, Kenya Power and national airline, Kenya Airways (KQ). The allocation to Kenya Power has been slashed by KES 3.5bn as the government weans itself from supporting the power distributor in the 1-year period that 15.0% electricity tariff cut had been in place (that is, the 2022 calendar year). Currently, Kenya Power's retail electricity tariff proposal – that seeks to raise tariffs and restore the power distributor's topline's sustainability – is undergoing public participation process before the energy regulator, Energy and Petroleum Regulatory Authority (EPRA), provides guidance whether the proposed tariff changes will take effect. As for KQ, the Supplementary budget suggests that the novation of the national airline's guaranteed debt (USD 485mn) is on track. This resulted in a KES 12.4bn increase in the guaranteed debt sub-component of the Consolidated Fund Services, as the government honours KQ's debt obligations this FY23.

FISCAL DEFICIT, Percentage of GDP



SOURCE: THE NATIONAL TREASURY, ICAMMU

[1] July 1st 2022 – June 30th 2023

Squaring the Circle

The National Treasury has also squared the circle regarding outstanding arrears totaling KES 29.6bn that was the equitable revenue share to the county governments which remained outstanding at the end of FY22. In September 2022, the National Treasury reported that these arrears to the counties had been fully paid out, so the inclusion in the supplementary budget is to regularize the payments. But we still see legal issues cropping up in the future. Under Kenyan law, the ordinary revenue (tax plus non-tax revenue) is split between the national government and county governments. Although ordinary revenue surpassed its target marginally (KES 1.92tn -vs- KES 1.85tn target), it's a conundrum that equitable revenue share to counties fell in arrears. The National Treasury has stirred some controversy with the claim that the arrears were "*due to delay in the receipt of some programmed financing*". Although we do not foresee the bicameral Parliament making a big fuss out of this anomaly, we do expect the Senate laying greater emphasis on up-to-time disbursement of equitable revenue share to counties this FY23.

Cosmetic narrowing of the fiscal deficit

Although National Treasury has baked in a decline in FY23 fiscal deficit, from 6.2% (initial budget) to 5.7% (revised budget), we hold the view this is cosmetic. From our calculations, aggregate net borrowing has declined from KES 862.9bn to KES 823.3bn, which implies that the FY23 nominal GDP has been revised upwards by 3.2% (from KES 14.0tn to KES 14.4tn). With drought dragging the c. 20.0%-weighted agriculture sector and inflation cooling on base effect, the 13.4% y/y growth in the FY23 nominal GDP may be ambitious. As such, we expect FY23 fiscal deficit at 5.9% on account of the growth concerns.

We believe investors will start piling up on their duration in the rates market. T-Bills have posted an average 150.4% subscription rates in the last six weekly auctions, with outsized demand on the 91-day T-Bills (5.3x the target amount). This month's T-Bond primary – re-opening of a 4.5-year and a new 10-year bonds – was disappointing with an overall 39.1% subscription rate. As posited in our November 2022 report, Whack-a-mole headache, there was an unresolved uncertainty, hence the preference for discounted securities. We are likely to see a risk-on sentiment at the rates' tail-end in upcoming auctions as the FY23 supplementary budget did not materialize the KES 300bn spending cuts, and ultimately reduction in domestic borrowing, hitherto the government's open *mouth* operations hinted at.

FY23 SUPPLEMENTARY BUDGET

	KES, BN's		
	Initial Budget	Revised Budget	Changes
National Government	**2,119.26**	**2,105.94**	**(13.31)**
Recurrent	1,403.90	1,496.88	92.97
Development	715.35	609.07	(106.29)
Consolidated Fund Services	**1,571.84**	**1,552.94**	**(18.90)**
Interest	690.65	675.82	(14.83)
Debt Amortizations	702.47	685.16	(17.30)
Pensions	171.83	172.64	0.81
Guaranteed Debt	2.26	14.68	12.41
Others	4.63	4.64	0.01
Equitable revenue share to counties	**370.00**	**399.60**	**29.60**
TOTAL	**4,061.10**	**4,058.49**	**(2.61)**

SOURCE: THE NATIONAL TREASURY, ICAMMU

FY23 CHANGES IN FINANCING, KES BN

Revised Revenue (A)	**66.40**
Revised Spending	
National Government	(13.31)
CFS, excl Amortizations	(1.59)
Counties	29.60
Aggregate (B)	**14.69**
Financing Needs (B - A)	**(51.71)**
lower revised Grants*	(5.20)
Revised Financing	(56.91)
lower Amortization**	17.30
Net reduction in Financing (C)	**(39.60)**
Initial Financing (D)	862.90
Revised Financing (C + D)	**823.30**

*As per the 2023 Draft Budget Policy Statement, Grants has been revised lower from KES 33.3bn to KES 28.1bn in FY23. This has increased the financing needs

*As debt amortizations has been revised lower, and assuming external debt disbursements are unchanged as per the initial FY23 budget estimates, this has led to higher net external financing

SOURCE: THE NATIONAL TREASURY, ICAMMU ESTIMATES

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