FY24 Supplementary Budget dials up fiscal deficit by 100bps to 5.4%

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Credibility on the line

The FY24 Supplementary Budget was tabled in the National Assembly last week on Thursday 26th October 2023, signaling a 100bps increase in the target fiscal deficit to 5.4% of GDP. The tabling of the Supplementary Budget was in line with the timelines for achieving certain structural benchmarks in the last IMF programme review. Although the Cabinet had telegraphed intent of trimming down recurrent expenditure by 10.0% in early October, our assessment of the revised budget shows otherwise. Furthermore, although the IMF had alluded to a FY24 Supplementary Budget issuing from FY23 spillovers, our interpretation of the tabled budget does not persuade this argument. If anything, the publishing of a special audit on Supplementary Budget effectiveness that was due by end September appears open-ended. Against this background and the wider fiscal slippage, the ongoing IMF mission may be inopportune for the fiscal authorities.

Highlights of the FY24 Supplementary budget

- Total expenditure has been increased by KES 284.3bn (KES 187.3bn excluding debt amortizations). Interest payments have jumped up to KES 918.8bn (+KES 143.7bn), which we largely attribute to exchange rate adjustments on external interest payments. Spending to the national government has increased by KES 41.8bn. Disaggregating these further shows that recurrent spending increased by KES 83.8bn whereas development spending was slashed by KES 42.0bn.
- Appropriation-in-Aid revenue was adjusted higher by KES 33.4bn, which revises the FY24 total revenue to KES 3.0tn. With no other accompanying revenue estimates data, we have assumed the guidance in the draft 2023 Budget Review Outlook Paper (BROP) which maintained the status quo in the FY24 revenue figures. Under this scenario, fiscal deficit budges to KES 872.8bn (5.4% of GDP).
- The estimated financing in the FY24 Supplementary Budget somewhat mirrors the estimates in the 2023 BROP. Specifically, domestic borrowing in FY24 narrowed from KES 587.4bn to KES 419.8bn, largely on increased inflows from both multilateral and commercial creditors.

Our views:

Why put money where your mouth is not?

- The October 3, 2023 brief from the Cabinet "sanctioned the reduction of the recurrent budget of each Ministry and State Department by ten percent (10%)". This baseline scenario would have led to a cut of KES 130.3bn (0.8% of GDP) in recurrent expenditure excluding spending funded from Appropriation-in-Aid revenue. Nonetheless, the recurrent expenditure was revised upwards by KES 83.8bn which lends some credibility deficit.
- Although spending in FY23 budget fell short by KES 148.4bn, the only notable spillover from the previous fiscal year that was carried forward was KES 4.5bn fuel subsidy arrears. The spending miss can be attributed to the revenue shortfalls in FY23, and we think that the fiscal authorities opted not to rollover the unmet expenditure demands into FY24 budget. This notwithstanding, the Supplementary budget was also triggered by emergency spending, as stipulated by Article 223 of the Constitution, during the first quarter of FY24.
- The fiscal authorities also responded to mitigate the emerging pain points in the Supplementary Budget. An amount of KES 8.7bn was allocated to mitigate potential drought effect and an additional KES 14.2bn towards food security measures. We also flag increased spending – cumulative KES 34.9bn – to enhance tertiary education sector following the rollout of the New Funding Model. Nevertheless, we view these expenditure items not as spillovers but as unforeseen spending needs.

Medium Term Revenue Strategy spells out longer-term measures; more immediate plans missing

- FY23 tax revenue miss came in at KES 112bn (0.8% of GDP) amidst the challenging macro-economic backdrop that resulted in the second Supplementary Budget. Although the Finance Act 2023 is penciled to generate additional KES 214.0bn tax revenue in FY24, the revenue outturn has been less satisfactory with the 11.7% shortfall during July -September 2023 period. With our view that the High Court judgment scheduled later this month is expected to maintain the Finance Act 2023, despite the legal challenge, we flag some risks with the tax revenue outturn going forward.
- On a more positive note, the Medium-Term Revenue Strategy was publicized for public participation last month. The Strategy is expected to be implemented over FY25 – FY27 budgets and increase revenue-to-GDP ratio to 20.9% in FY27 (baseline of 17.0%). In the immediate term, the fiscal authorities are yet to implement some tax corrective measures – more so around VAT tax stream - to bring on track its revenue outturn in the current fiscal year, despite commitment to the IMF in the May 2023 review.

Domestic financing revised lower although the completion of the IMF review should give rates direction

- The Supplementary Budget cements the lower domestic borrowing target of KES 419.8bn as penciled in the draft 2023 BROP. Amidst the higher rates environment, the authorities' borrowing profile in the current FY24 has been at the short end of the yield curve. The ongoing primary bond sale for an amortizing 6.5-year infrastructure bond may partially meet the pent-up demand in the market, but the dearth in longer-tenor issues will keep the yield curve inverted.
- This leaves the market to monitor progress of the ongoing IMF mission to Kenya for the sixth review of the Extended Fund Facility/Extended Credit Facility (EFF/ECF) programme. With the quantitative performance criteria target of primary budget deficit balance (KES 150.0bn -vs- KES 158.0bn) met, whereas tax revenue of KES 1.9tn falling short of the targeted KES 2.0tn, the performance of the June 2023 fiscal targets was patchy. Playing the devil's advocate, the fiscal authorities would argue that there were mid-year FY23 budget adjustments that affected the outturn. Nevertheless, we flag the delay in the publishing of the special audit on Supplementary budget effectiveness, the slow pace of SOE reforms and the start-stop of the fuel subsidy as downsides in the ongoing IMF sixth review.

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