FY’2018/2019 Budget Outturn Note

Last week, the National Treasury released the budgetary review for the 2018/2019 financial year. Below are the key take-outs:

Q4’ FY 2018/2019 Budget Outturn					
Amounts in Kshs bns unless stated otherwise					
Item	FY'2017/2018	FY'2018/2019			
	Collected/Spent	Collected/Spent	Target	% met	Change y/y
Total revenue	1,522.4	1,671.1	1,794.3	93.1%	9.8%
External grants	26.5	19.7	34.7	56.7%	-25.6%
Total revenue & external grants	**1,548.9**	**1,690.8**	**1,829.0**	92.4%	9.2%
Recurrent expenditure	1,349.7	1,496.2	1,574.1	95.1%	10.9%
Development expenditure & Net Lending	469.7	542.0	598.1	90.6%	15.4%
County Governments + Contingencies	327.3	367.7	369.7	99.5%	12.4%
Total expenditure	2,146.7	2,405.9	2,541.9	94.7%	12.1%
Fiscal deficit excluding grants	**(597.7)**	**(715.2)**	**(712.8)**		19.6%
Deficit(excluding grants) as % of GDP	7.0%	7.5%	7.5%		
Net foreign borrowing	355.0	414.5	391.2	106.0%	16.8%
Net domestic borrowing	273.7	303.7	255.4	118.9%	10.9%
Other domestic financing	2.6	2.9	3.9	73.3%	9.7%
Total borrowing	631.3	721.1	650.5	110.8%	14.2%
GDP Estimate	8,524.7	9,510.4	9,510.4		

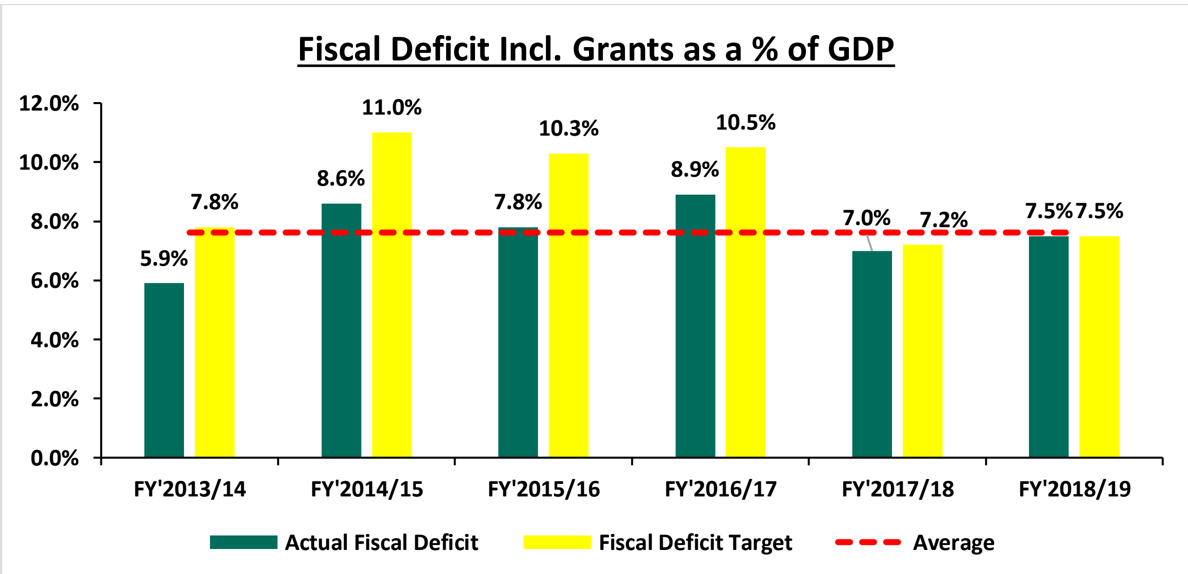
i. **Expenditure**: Total expenditure amounted to Kshs 2.4 tn, a 12.1% increase from Kshs 2.1 tn recorded the same period last year. This was 94.7% of the Kshs 2.5 tn target, with a significant share of the expenditure being on recurrent expenditure, which accounted for 62.2% of total expenditure, a slight decline from 62.9% in FY’2017/2018. Development expenditure only accounted for 22.5%. Total expenditure was, however, 6.3% lower than the targeted expenditure as per the budget, an indication that the austerity measures undertaken by the government were taking effect. The lower expenditure was mainly attributed to lower expenditure recorded in operation and maintenance, pension and wages and salaries expenditures, which came in at Kshs 590.9 bn, Kshs 70.8 bn, and Kshs 417.5 bn, respectively, against target expenditures of Kshs 647.4 bn, Kshs 84.8 and Kshs 428.0 bn, respectively.

ii. **Revenue collection**: Total revenue collected in FY’2018/2019 amounted to Kshs 1.7 tn, a 9.2% increase from Kshs 1.5 tn collected during the same period the previous year, meeting 93.1% of the budgetary target for the year of Kshs 1.8 tn. Ordinary revenue collection from taxes excluding Appropriation in Aid was at Kshs 1.5 tn, a 9.7% increase from Kshs 1.4 tn collected in FY’2017/2018, against a target of Kshs 1.6 tn, thus the Kenya Revenue Authority managed to meet 94.3% of the set target as per the budget, equivalent to 17.9% of GDP.

The table below gives a breakdown of revenue as collected:

FY' 2018/2019 Budget Outturn					
Item	FY'2017/2018	FY'2018/2019			
	Collected/Spent	Collected/Spent	Target	% met	Change y/y
Total revenue	1,522.4	1,671.1	1,794.3	93.1%	9.8%
External grants	26.5	19.7	34.7	56.7%	-25.6%
Total revenue & external grants	**1,548.9**	**1,690.8**	**1,829.0**	92.4%	9.2%
Recurrent expenditure	1,349.7	1,496.2	1,574.1	95.1%	10.9%
Development expenditure & Net Lending	469.7	542.0	598.1	90.6%	15.4%
County governments contingencies	327.3	367.7	369.7	99.5%	12.4%
Total expenditure	2,146.7	2,405.9	2,541.9	94.7%	12.1%
Fiscal deficit excluding grants (commitment basis)	**(624.2)**	**(734.9)**	**(747.6)**		17.7%
Fiscal deficit including grants (commitment basis)	**(597.7)**	**(715.2)**	**(712.8)**		
Adjustment to cash basis	**(34.7)**	**(5.9)**	**62.3**		
Fiscal deficit including grants (cash basis)	**(632.4)**	**(721.1)**	**(650.5)**		
Deficit(excluding grants) as % of GDP	7.3%	7.7%	7.9%		
Net foreign borrowing	355.0	414.5	391.2	106.0%	16.8%
Net domestic borrowing	273.7	303.7	255.4	118.9%	10.9%
Other domestic financing	2.6	2.9	3.9	73.3%	9.7%
Total borrowing	631.3	721.1	650.5	110.8%	14.2%
GDP Estimate	8,524.7	9,510.4	9,510.4		

iii. **Fiscal Deficit:** The fiscal deficit in the period stood at Kshs 715.2 bn (equivalent to 7.5% of GDP), against the targeted deficit of Kshs 712.8 bn (equivalent to 7.5% of GDP). Compared to the same period in FY 2017/2018, the fiscal deficit in the period stood Kshs 597.7 bn (equivalent to 7.0% of GDP). Government expenditure has persistently been on an upward trend over the last decade but more pronounced from the FY 2013/2014, largely due to (i) Devolution effect from setting up County Governments and other Constitutional offices, (ii) Adjustments in public servants wage, (iii) Implementation of infrastructure developments such as Phase 1 of the SGR, and (iv) Rising debt servicing costs. Revenue collection, on the other hand, growing at a slower pace relative to expenditure, has resulted in the widening fiscal deficit as illustrated in the chart below;



To plug in the deficit, total borrowing for the year came in at Kshs 721.1 bn, comprising of Kshs 303.7 bn in domestic borrowing and Kshs 414.5 bn through external financing. This brought the debt mix to 57:43 for foreign and domestic borrowing, respectively, against a target of 60:40 for the year. This increased the stock of the gross public debt by Kshs 770.1 bn from Kshs 5.0 tn as at end of June 2018 to Kshs 5.8 tn by 30th June 2019, comprising of 52.0% external debt and 48.0% domestic debt by end June, 2019. Since FY'2013/2014, the deficit has grown by 139.0%, from Kshs 299.2 bn to Kshs 715.2 bn mainly due to the faster 85.0% rise in expenditure, which has outpaced the 71.5% rise in revenue collected. Going forward, the Government is aiming at reducing the fiscal deficit through austerity measures aimed at capping the expenditure coupled with revenue mobilization measures in order to achieve its fiscal deficit target, which is at 5.6% for FY'2019/2020.

The government has an ambitious revenue target of Kshs 2.1 tn, a 10.5% increase from the Kshs 1.9 tn target as per the FY'2018/2019 revised Budget, and a 9.2% increase from Kshs 1.5 tn in actual revenue collected in the FY'2018/2019. Some of the revenue measures put in place as highlighted in the Budget Statement for the fiscal year 2019/20 in order to achieve this target are as below:

a. **Increase in capital gains tax rate (CGT)** - The CS increased capital gains tax charged on property transfer from 5.0% to 12.5%. CGT, the tax chargeable on the entire gain accruing to a company or an individual upon the transfer of property situated in Kenya, was re-introduced in 2015 after being suspended in 1985. Transfer of property necessitated by the restructuring of corporate entities will, however, be exempt from this tax to allow for the seamless restructuring of corporate entities with the aim of increasing efficiency and market penetration. We expect the increased CGT rate to result in increased government revenue collection from the real estate sector,
b. **Re-introduction of the turnover tax**- The CS re-introduced the turnover tax at the rate of 3.0% on the gross turnover accounted for every month, which will affect taxpayers whose business income does not exceed Kshs 5.0 mn per annum. The turnover tax will apply in addition to the presumptive tax that was introduced through the Finance Act 2018. We, however, do not expect the turnover tax to lead to increased revenues owing to non-compliance by the largely informal sector, which had initially led to it being scrapped off as the target (informal sector), proved hard to police, coupled with high administrative costs and capacity constraints,
c. **Withholding Tax**- In a bid to expand the tax base and increase revenue collection, the CS proposed to add the following services, for the purposes of withholding tax, as part of professional services. They include; security services, cleaning and fumigation, catering services offered outside hotel premises, transportation of goods excluding air transport services, and sales, promotion, marketing, and advertising. We expect that through this initiative, the government will enhance tax compliance by widening the tax net. However, this will be accompanied by a subsequent increase in administrative burdens to be incurred in the collection and remittance of the withholding tax,
d. **Introduction of excise duty on betting activities**- the CS proposed the introduction of excise duty on betting activities charged at 10.0% of the amount wagered. This measure aims to curb the negative social effects brought about by betting in the country, and
e. **Increased excise duty on cigarettes, wines, and spirits**- the CS proposed to increase the excise duty rates on cigarettes, wines, and spirits by 15.0% in addition to the inflationary increase, effective as from 1st July 2019. This increase in the excise duty rate on cigarettes, wines, and spirits, is on account of a decline in the excise duty revenue over the years.

Owing to the austerity measures and revenue enhancement put in place, we are of the view that this puts the Government in a conundrum. Both these measures mean taking a contractionary stance going forward. Revenue enhancement will be based on increased taxation piling more pressure on the private sector whose contribution to economic growth has been dwindling due to reduced access to credit following implementation of the interest rate cap. Austerity measures, on the other hand, though commendable, mean reduced Government expenditure in an economy whose economic growth is mainly driven by the same.