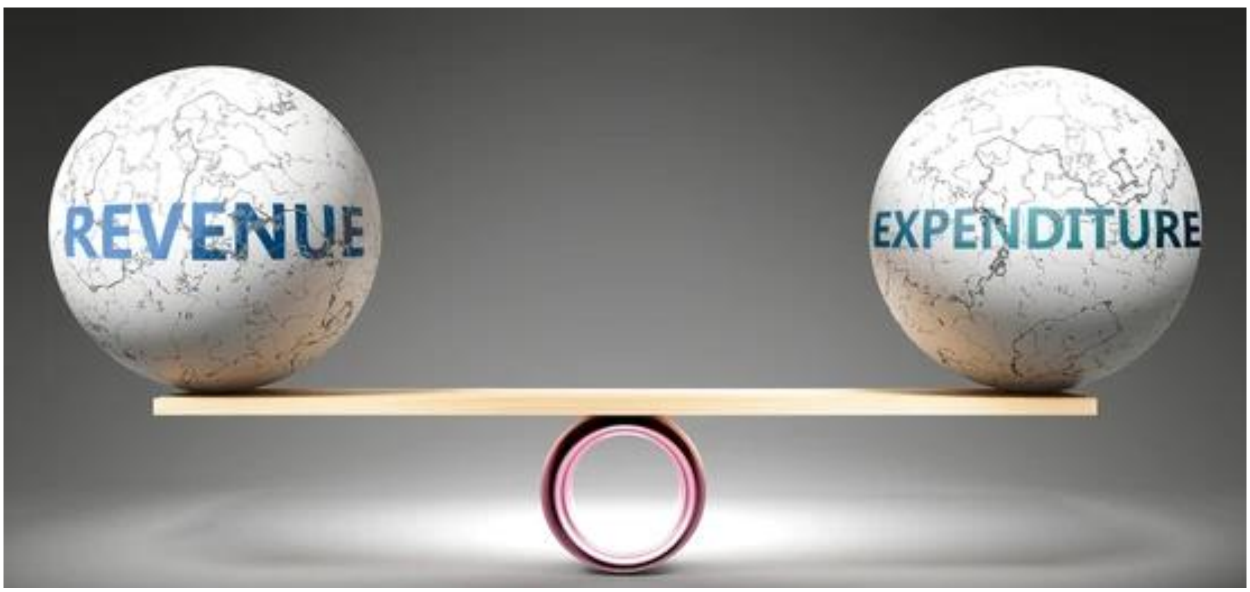
Kingdom Securities Limited

Actual Revenues and Exchequers Issues Fiscal Year 2021-2022 and the Outlook 2022-2023



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Overview

The Exchequer figures for the fiscal year 2021-2022 showed underperformance of both revenues and expense at 91.7% and 92.3% respectively. Kenya Revenue Authority (KRA) set a record collecting KES 2,031Bn, 21.7% higher compared to KES 1,669Bn collected in 2020-2021. The performance was supported by technology deployment, increased vigilance, Voluntary Tax Disclosure Program (VTDP) and collaboration with different economic players.

The government retracted on issuing Eurobond to helped plug revenue deficit due to high yield. The revenue hole was partially covered by the tax revenue collection performance and concessionary borrowing from development partners.

We forecast a challenge in meeting revenue targets for 2022-2023 with the World Bank projecting Global growth to slump from 5.7% in 2021 to 2.9% in 2022. The World Bank cited the ongoing Russia-Ukraine, supply chain challenges, Covid-19 lockdown in China leading to slowdown in global production. These factors have led to due to global inflationary pressure leading to inflated cost of production, high petroleum prices, lower consumer income and excessive cost of financing in the local economy due to rate hike.

Expense will remain on track as the new government set base especially with management of government debt levels and recurrent expenditure to rewards constituents that voted for it.

2021-2022

Revenue Performance 91.7%

Expenditure Performance 92.3%

2021-2022

KRA Revenue Collection

KES 2,031Bn +21.7%

2022

Global GDP Growth Projection 2.9%

Sub- Sahara Projected Growth 3.7%

Kenya GDP Growth Projection 5.5%

Actual Revenues and Net Exchequer Issues Fiscal Year 2021-2022

The government close d the fiscal year on June 30th, 2022, with the exchequer figures showing under performance on both revenues and expenditure. Revenue attained was at 91.7% supported by a 103.1% tax revenue achievement and 116.9% performance on non-tax revenues. Expenses performance was at 92.3% with recurrent expenses standing at 97.9%. Public debt management was at 90.5% while development expenditure undershot target at 80.4%.

Exchequer balance was KES 616.55Bn and is expected to decline as the final ministry figures are reconciled.

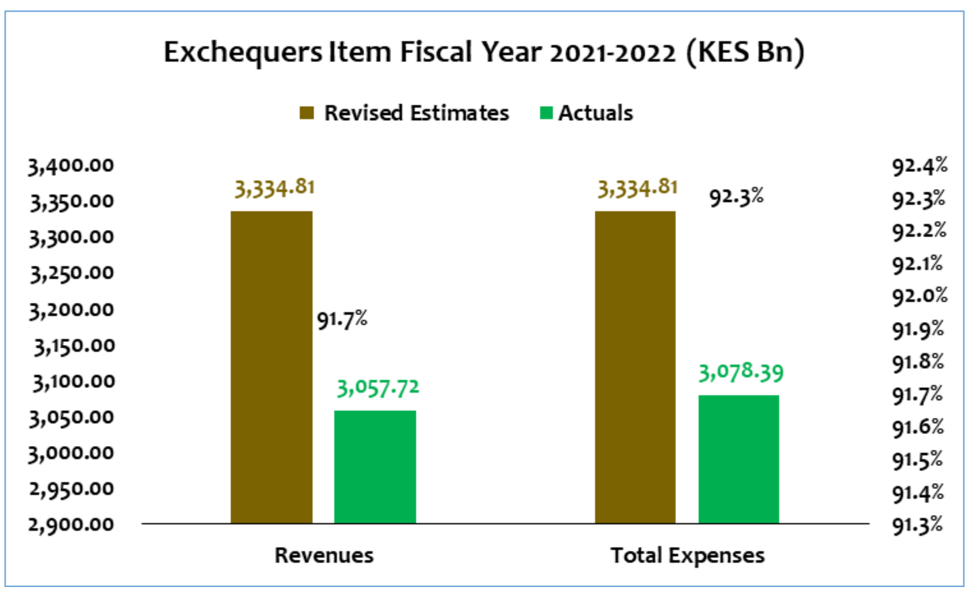


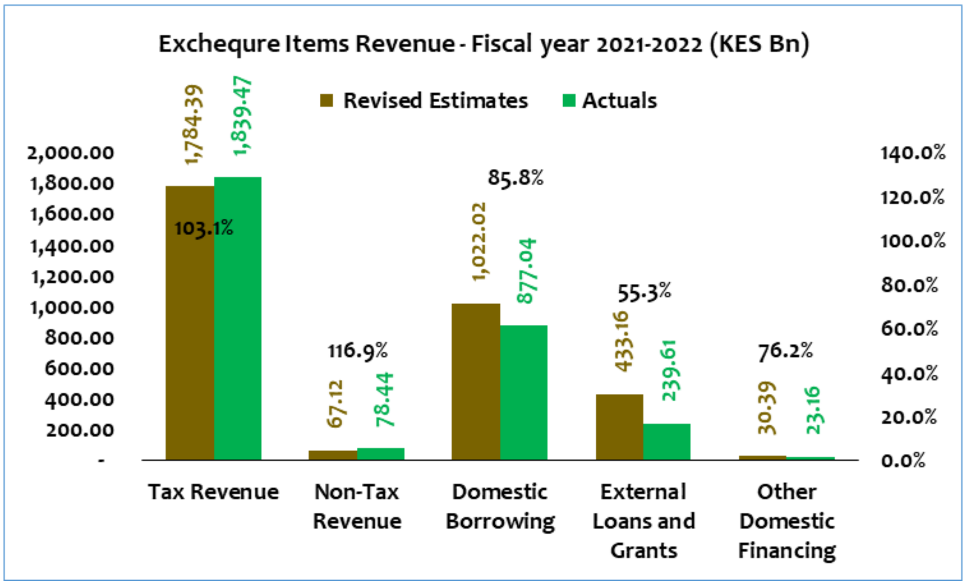
Figure 1: Revenues and Expenditures

Source: KSL, Treasury KE

Revenue Items

Revenues under-performance was due to a turnaround by the government from issuing a USD 1.00Bn Eurobond after yields spiked due to the weak global economic outlook and inflationary pressure globally leading to central bank rate hikes in developed economies, tight liquidity in the local economy, depreciation of the shilling against the USD, declining forex reserves and the general election risk.

Overall revenues performed at 91.7% of revised estimates. This was boosted by a 103.1% in tax revenues and 116.9% in non-tax revenues.



Domestic Taxes KES 1,297.00Bn, Performance 102.4%

Customs Taxes KES 728.53Bn Performance 103.7%

Figure 2: Exchequer Revenues Items — Source: KSL, Treasury KE

Kenya Revenue Authority (KRA) collected KES 2,031Bn from a revised target of KES 1,976Bn, a KES 55.0Bn surplus. The collection was 21.7% higher compared to KES 1,669Bn collected in 2020-2021 fiscal year. The collection is attributed to

- Recovery of the economy post Covid-19 effects
- Increase in technology use on collection to seal revenue loopholes.
- Increase in tax base compared to the previous year
- Increase in prices due to surging in cost of production leading to inflationary adjustment of prices
- Recovery of the job market which led to increase in income tax
- Voluntary Tax Disclosure Program (VTDP) - allows taxpayer to disclose tax liabilities previously undeclared and enjoy full or partial relief of penalties and interest.

Tax Item (KES Bn)	Target	Actual	Surplus	Performance
Domestic Taxes	1,267.00	1,297.00	30.00	**102.4%**
Customs	702.82	728.53	25.71	**103.7%**
Non-Oil Taxes	446.52	480.55	34.03	**107.6%**
Oil Taxes	256.31	247.99	(8.32)	**96.8%**
Corporate Tax	218.16	242.02	23.86	**110.9%**
PAYE	455.13	461.82	6.69	**101.5%**

Table 1: Tax Revenue Performance — Source: KSL, KRA

During the fiscal year, domestic borrowing targets was under achieved at 87.0%. T-Bonds achieved 147.1% subscription while acceptance performance on issue was at 118.8%. T-Bills subscriptions were at KES 1,023.57Bn or 82.0% subscription and a performance of 75.9%.

Underperformance of domestic borrowing can be attributed to low foreign investors on the recent infrastructure bond, upward shift on the yield curve, tight liquidity and CBK management of cost of financing.

Externa borrowing was mostly supported by concessionary borrowing from IMF, World Bank and African Development Bank. The under achievement was driven by failure of the government to issue the USD 1.00Bn Eurobond that had been budgeted.

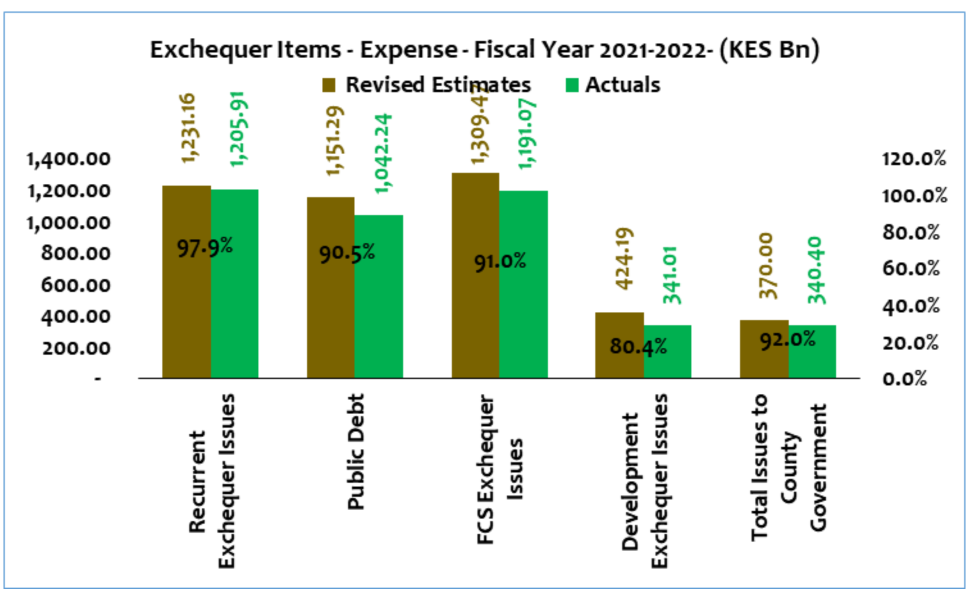
Exchequer Expense Items

Expense performance was at 97.9% with key ministries Interior, Defense, Early Learning and Basic Education and TSC utilizing 98.0%, 98.5%, 99.2% and 99.6% of their revised budget.

Public debt payout was 90.5% of budget with the government managing to restructure the short-term loan by acquiring concessionary loans from development partners IMF, World Bank and AfDB.

Absorption of development expenditure remained low at 80.4% of revised estimates which had been adjusted upwards by 9.0% from initial budget of KES 389.23Bn to KES 424.19Bn. This can be credited to slow-uptake due to the expected change of guard after the general elections.

Countries received KES 340.40Bn of the planned KES 370.00Bn, a 92.0% disbursement. The figure of KES 370.00Bn was 27.3% of the pegged 2016/2017 fiscal year Revenues of KES 1,357.70Bn audited accounts approved by the National Assembly. The figure was 20.8% of projected 2021-2022 revenues of KES 1,775.62Bn which was above the 15.0% of all revenue collected by the national government as per the constitution requirement.



Recurrent Expenses
KES 1,205.91Bn,
Performance 97.9%

Public Debt

KES 1,4042.24Bn
Performance 90.5%

Figure 3: Exchequer Expenses Items

Source: KSL, Treasury KE

Outlook 2022-2023

Budget Item		2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Expenditure		**2,749.5**	**3,154.3**	**3,324.4**	**3,550.9**	**3,865.3**	**4,214.6**
	Recurrent	1,796.6	2,071.8	2,201.0	2,359.9	2,569.3	2,804.9
	Development	553.9	667.9	711.5	773.8	873.5	962.3
	Interest Payment	495.1	605.3	687.9	712.2	758.3	796.8
	Equitable share to Counties	346.2	370.0	370.0	375.0	380.2	405.2
	Conditional Allocation to Counties	52.8	39.9	36.5	37.7	37.7	37.7
Expenditure to GDP		**24.3%**	**25.0%**	**23.7%**	**22.8%**	**22.2%**	**21.5%**
Budget Item		**2020-21**	**2021-22**	**2022-23**	**2023-24**	**2024-25**	**2025-26**
Revenues		**1,783.7**	**2,063.1**	**2,431.4**	**2,820.8**	**3,164.0**	**3,533.8**
	Income Tax	694.10	817.90	997.30	1,178.60	1,285.70	1,460.10
	VAT	410.80	477.10	584.70	691.60	792.70	896.20
	Excise Duty	216.30	259.60	297.20	346.90	395.10	453.00
	Import Duty	108.40	118.80	144.90	170.40	181.40	204.00
	A-in-A	221.70	263.00	289.80	304.50	323.30	344.60
	Other Taxes	87.40	91.20	86.00	95.70	133.10	140.80
Revenue to GDP		**15.8%**	**16.3%**	**17.4%**	**18.1%**	**18.2%**	**18.1%**
Budget Item		**2020-21**	**2021-22**	**2022-23**	**2023-24**	**2024-25**	**2025-26**
Deficit		**950.2**	**1,029.3**	**846.1**	**682.0**	**670.0**	**627.5**
	Net Foreign	323.3	412.5	275.9	192.3	95.4	125.5
	Net Domestic	626.9	616.8	570.2	489.8	574.7	502.1
GDP Target		**11,304.1**	**12,628.1**	**14,002.1**	**15,604.6**	**17,401.9**	**19,577.0**
Fiscal Deficit		**8.4%**	**8.2%**	**6.0%**	**4.4%**	**3.9%**	**3.2%**

Table 2: Fiscal Budget 2022-2023 Source: KSL, Treasury KE

According to the 202-2023 Budget, revenue target stands at KES 2,431.40Bn, 17.9% higher than KES 2,063.1Bn in 2021-2022. Revenues have continued to hit below target 16.3% against a target of 17.5% of GDP in 2021-2022 leading to a fiscal deficit of 8.2% going contrary to the government target of 7.5%.

KRA record collection of KES 2,031.00Bn in 2021-2022 has set a high precedent with the authority budgeted to collect KES 2,254.11Bn, 11.0% higher. This will continue to see KRA remain vigilant even after introduction of Tax Invoice Management System (TIMS) to improve on VAT compliance.

Tax revenues are bound to face headwinds on especially caused by inflationary pressure which will lead to high cost of production forcing producers to pass to consumers who will end up cutting consumption due to income constraints. This will have a loop effect with produces cutting production and labor leading to higher unemployment and lower consumption income. The Stanbic PMI was 46.3 in July 2022, down from 46.8 in June 2022 and 50.6 in July 2021.

The constrain can be reflected on the high non-performing loans of 14.7% in June 2022 vs 14.1% in May 2022 and 14.0% in June 2021 despite the increasing private sector credit to 12.3% in June 2022 from 11.9% and 7.7% in May 2022 and June 2021, respectively.

June 2021
Private Credit Growth
7.7%
NPLs 14.0%
PMI 51.0

June 2022
Private Credit Growth
12.3%
NPLs 14.7%
PMI 46.8

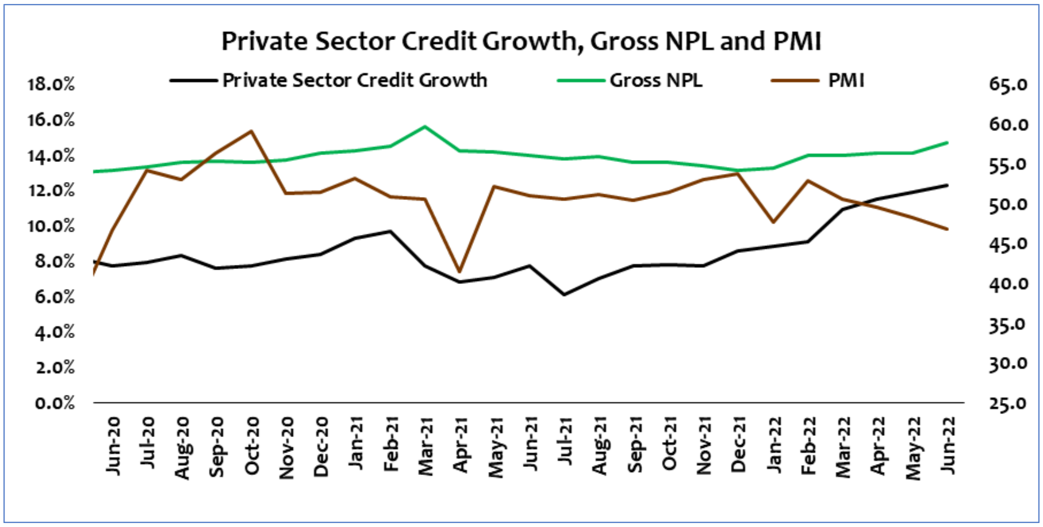


Figure 4: NPLs, PMI and Private Credit Growth Source: KSL, Treasury KE

The government commitment to fiscal consolidation remains a myth as expenses are budgeted to grow by 5.4% with recurrent expenditure growing by 6.2%. We wait to see what changes the new government will implement to remain committed to IMF and World Bank requirements of fiscal consolidation and revenue growth.

County allocation: The figure of KES 370.00Bn is 26.17% of the 2017/2018 fiscal year revenues of KES 1,413.69Bn as per audited reports approved by the National Assembly. The figure remains 17.3% of projected 2022-2023 revenues of KES 2.141.58Bn which is above the 15% allowable by the constitution. We project the County allocation figures will go up in the 2023-2024 budget to meet the Constitutional requirement of 15%.

Net domestic borrowing target stands at KES 570.2Bn which was 15.9% lower compared to the revied figure of KES 678.08Bn in 2021-22. The revenue targets are over ambitious which will lead to an upwards adjustment on the net domestic debt levels putting further pressure on the government expense management. This is an indication of the competition between government and private sector credit growth is set to continue.

Our View

- Current global macroeconomic environment does not sit well with the government plans on either growth or deficit management. Slowdown in global GDP growth, high inflation, weakening shilling against the US dollar, constraint on revenue growth and poor weather creates a wider rift on government assumptions.
- The government remains over ambitious in all aspects. They assume a 4-year average Real GDP growth rate of 6.5% and a stable inflation of 5.0%.KRA intends to grow tax revenues from KES 2,031Bn in 2021-2022 to KES 6,831Bn in 2023-2024, an 83.4% 2-year CAGR.
- Cutting expenditure to a low of 23.7% from and growing revenues to 17.4% of nominal GDP.
- Cut debt to 55.4% of nominal GDP by 2025-2026 from 63.6% in 2021-2022.The government retraction from issuing a Eurobond creates a larger hole to fill which will tilt the domestic debt market towards investors.
- As the new administration will be settling in, one of the major key appointments will be on the CBK governor with the current Governor's term ending in June 2023.
- The current high non-performing loans will force blanks to shift from private credit lending to government securities leading to slow growth of the economy.

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