INSTITUTE OF PUBLIC FINANCE

ASSESSING SHIFTS IN FISCAL PRIORITIES

IN THE FY 2026/27 BUDGET

August 2026

Key Messages

The FY 2026/27 Approved Budget narrows the fiscal deficit compared with the FY 2025/26 budget by keeping expenditure growth below projected revenue growth.However, this is achieved through an overly optimistic revenue projection. In addition, rising debt-servicing costs raise doubts about whether the government will achieve meaningful fiscal consolidation. Expenditure reprioritization towards health and education relative to 2025/26 will support the delivery of essential services; however, reduced development spending may constrain long-term economic growth.

This analysis finds that:

- The FY 2026/27 budget relies on ambitious revenue targets to support fiscal consolidation. Last year, revenue fell short by 4 percent of projection, and this year's revenue target is premised on absolute revenue growth of 15 percent, which is inconsistent with average year to year revenue growth of 8 percent in recent years.

- Expenditure is projected to grow more slowly in the approved FY 2026/27 budget than revenue, but past experience suggests that supplementary budgets will lead to upward revisions of expenditures during the year. Initial budget estimates have increased by an average of 8.5% through supplementary budgets over the past four years. For instance, FY 2025/26 Supplementary I increased expenditure by KSh 368.6 billion (8.6%) from the original KSh 4,291.9 billion, raising concerns about the credibility of initial budget estimates.

- The FY 2026/27 approved budget increased spending priorities toward social sectors and governance[1] by KSh 84.4 billion relative to the FY 2025/26 Supplementary I budget. At the same time, development expenditure declined by KSh 111.6 billion to just 16% of total expenditure, well below the 30% minimum required for development expenditure. Although this supports delivery of social services, lower development spending could constrain long-term economic growth.

- Debt servicing continues to consume a large share of ordinary revenue (75%), limiting fiscal space for development and essential public services.

[1] *Education, Environment Protection, Water and Natural Resources (EPWNR), Social Protection, Culture and Recreation (SPCR), Health and Governance Justice Law and Order (GJLO)*

1 Fiscal consolidation remains vulnerable to revenue underperformance and debt servicing pressure

Fiscal consolidation remains vulnerable to overly optimistic revenue projections despite restrained expenditure growth relative to revenue growth. Total revenue is projected to increase by 15 percent, from Ksh 3.17 trillion in FY 2025/26 to Ksh 3.63 trillion, outpacing the projected 8 percent increase in total expenditure and net lending. However, the FY 2026/27 revenue target is overly optimistic given Kenya's persistent history of revenue underperformance. This is evidenced by the FY 2025/26 revenue outturn, which fell short of the target by KSh 125 billion (4.4 %). Projected ordinary revenue of KSh 2,985.7 billion is also overly ambitious. The averages growth rate over the past three years has been eight percent, so a more realistic outturn for the FY 2026/27 would be a target of KSh 2,794.1 billion, eight percent above actual ordinary revenues for FY 2025/26.

Whereas expenditures are projected to grow at a slower rate than revenues, the government consistently revises expenditures upwards through Supplementary Budgets. Initial budget estimates have increased by an average of about 8.5% following supplementary budget adjustments over the past four years. For example, the FY 2025/26 Supplementary I budget increased expenditure by KSh 368.6 billion, equivalent to an 8.6% increase over the original budget of KSh 4,291.9 billion. In addition, likely revenue underperformance could further widen the fiscal deficit beyond the FY 2026/27 target. As Kenya approaches the 2027 elections, expenditure pressures will increase further, limiting the prospects for sustained fiscal consolidation.

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The additional allocations are earmarked for priority programmes, including the Community Health Promoters (CHPs) programme, County Aggregation and Industrial Parks (CAIPs), climate resilience investments under the Financing Locally-Led Climate Action (FLLoCA) programme, and agricultural initiatives such as the Food Systems Resilience Project (FSRP) and the National Agricultural Value Chain Development Project (NAVCDP). While these allocations strengthen financing for national development priorities at the county level, they also reduce counties' flexibility to allocate resources according to local priorities. For example, counties are required to provide matching funds of KSh 250 million each for the CAIPs programme. Moreover, the benefits of the increased allocations will depend on timely disbursement, effective coordination between the national and county governments, and stronger absorption capacity to ensure that the additional resources translate into improved service delivery and development outcomes.

Table 1: While there is an increase in general expenditure, the minimal increase in development expenditure with respect to recurrent may slow progress

Ksh Billion	FY 2025/26 Actual	Budget Estimates FY 2026/27	Difference	Difference (%)
Total Revenue	**3,168.80**	**3,630.60**	**461.8**	15%
Total Expenditure & Net Lending (A+B+C+D)	**4,466.20**	**4,819.40**	**353.2**	8%
A. Recurrent Expenditure	3,290.20	3,565.60	275.4	8%
O/W: Total Debt interest	1,126.60	1,194.00	67.4	6%
Pension and other CFS	180.5	247.1	66.6	37%
B. Development Expenditure	738.5	750.8	12.3	2%
C. Counties' Equitable Share	415	428	13	3%
D. County conditional allocations	22.5	75.7	53.2	236%
Grants	**20.7**	**43.6**	**22.9**	111%
Fiscal Deficit	**1,276.70**	**1,145.20**	**(131.5)**	-10%
Total Debt Redemption	**1,218.10**	**1,029.10**	**(189.0)**	-16%
Domestic	544.3	690.1	145.8	27%
External	673.8	339	(334.8)	-50%

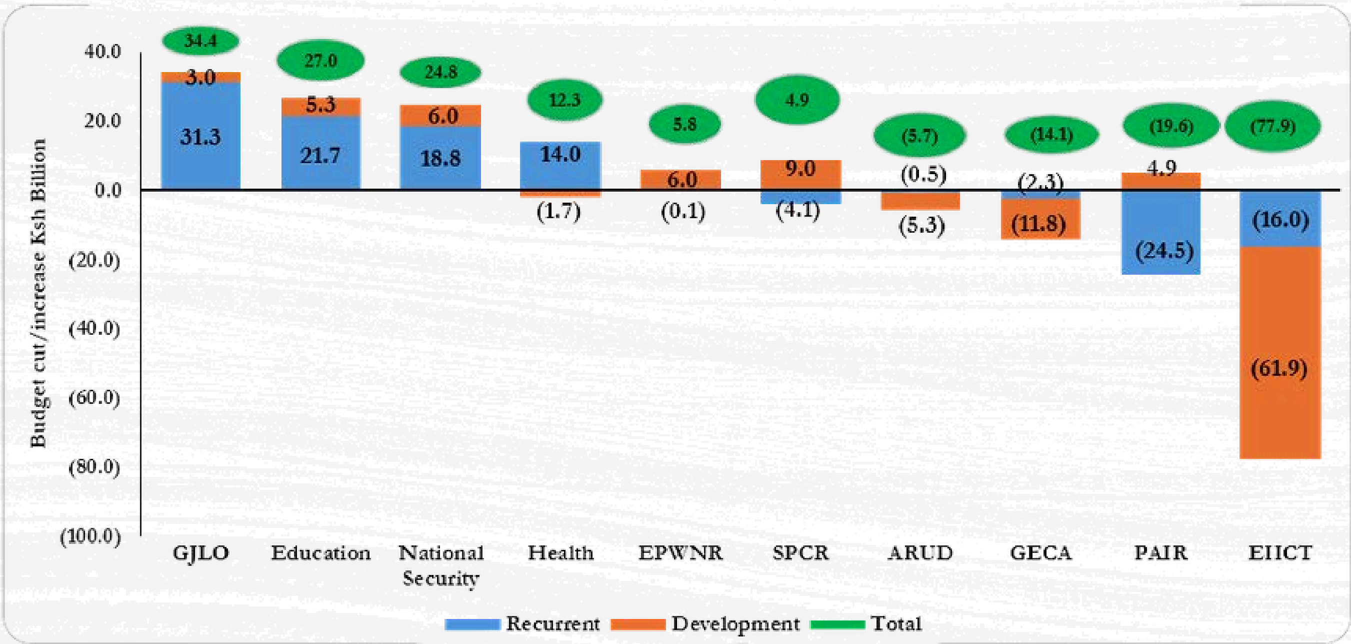
Data source: FY 2025/26 Budget performance report and Approved FY2026/27 Budget

Consistent with persistent fiscal deficit, debt servicing remains a major constraint on fiscal space despite a modest decline in overall debt service obligations. The FY 2026/27 Approved Budget reduced total public debt service from Ksh 2.34 trillion in Supp I FY2025/26 to Ksh 2.22 trillion (1.194 trillion in debt interest, and 1.029 trillion in debt redemption, see Table 1), largely due to a sharp decline in external debt redemption that offsets higher domestic redemptions. However, interest payments increased from Ksh 883.8 billion to Ksh 941.4 billion for domestic debt and from Ksh 242.8 billion to Ksh 252.6 billion for external debt during the same period (for a total of 1.194 trillion in FY 2026/27, see Table 1), reflecting increasing cost of borrowing. Total debt service consumes approximately 75% of ordinary revenue, with interest payments alone accounting for about 40%, significantly constraining fiscal space for development and essential public services. While lower principal repayments provide some short-term fiscal relief, the rising interest burden reflects the cost of past borrowing and continues to constrain fiscal flexibility. This underscores the importance of strengthening medium-term debt management by reducing reliance on expensive short-term borrowing, prioritizing concessional financing where feasible, and maintaining fiscal discipline to contain future debt servicing costs.

2 Spending Reprioritized Towards Social Sectors at the Expense of Development

The FY 2026/27 budget estimates reflect a clear shift in expenditure priorities towards governance, education, security and health, while reducing allocations to infrastructure and productive sectors like Energy, Industries, Trade among others compared to Supp I FY2025/26 budget. The Governance, Justice, Law and Order (GJLO) sector recorded the largest increase (Ksh 34.4 billion), largely driven by higher recurrent spending to management of electoral process, National Police Service, defense, judiciary and constitutional institutions. Education received the second-largest increase (Ksh 27.0 billion), mainly to support teacher remuneration, capitation and higher education, reinforcing the government's commitment to implementing Competency-Based Education (CBE). National Security allocations rose by Ksh 24.8 billion to enhance operational capacity and the defence industrialization program (building local manufacturing for military equipment), while Health gained Ksh 12.3 billion, primarily to finance the rollout of the Social Health Insurance Fund (SHIF) and sustain healthcare service delivery. Meanwhile, the Ksh 5.8 billion increase in the Environment, Protection, Water and Natural Resources sector, driven by development expenditure, signals continued support for climate resilience and water infrastructure investments.

Figure 2: Governance and Social Sectors received budget increase compared to Infrastructure and other development-oriented sectors.



Data source: FY 2025/26 Supp II and FY 2026/27 Approved Budget Estimates

Conversely, fiscal consolidation was supported largely through significant reductions in development spending in Energy, Infrastructure and ICT (EIICT), followed by PAIR, GECA and ARUD. These reductions indicate that the government is creating fiscal space primarily by scaling back capital investments. The largest cuts in EIICT are likely to slow infrastructure expansion, digital transformation and energy investments, while lower allocations to ARUD may constrain agricultural productivity, food security and rural development. Similarly, reduced development spending in GECA could limit support for trade, industrialization and private sector development, while cuts in PAIR may delay strategic government operations like public service digitization and human rights and governance oversight. Although these expenditure adjustments help contain the fiscal deficit in the short term, sustained reductions in capital investment risk weakening long-term economic growth, job creation, productivity gains and the expansion of the future tax base. Balancing fiscal consolidation with adequate investment in productive sectors will therefore be essential to sustain inclusive economic growth.

To maintain infrastructure investment despite lower public capital spending, the government is increasingly relying on alternative financing vehicles, including Public-Private Partnerships (PPPs), the National Infrastructure Fund, and securitization. These instruments seek to mobilize private capital, reduce immediate pressure on public finances, and sustain investment in strategic infrastructure despite fiscal constraints. However, they are not substitutes for sound fiscal management. Their success will depend on strong project selection and preparation, transparent procurement and governance, appropriate allocation of risks between the public and private sectors, and strong oversight to ensure value for money while minimizing contingent fiscal liabilities.

The budget FY 2026/27 approved budget partly align with IPF's Annual National Shadow Budget's (ANSB) recommendations to protect priority social sectors during fiscal adjustment. The increased allocation to the health sector supports ANSB's call for increased funding for primary healthcare and SHIF implementation. However, the reduction in health development spending may constrain investments in health infrastructure and medical equipment, limiting long-term service improvements. Similarly, the FY 2026/27 Approved Budget falls short of the ANSB recommendation to substantially expand social safety nets. Compared to FY 2025/26, allocations for cash transfers to older persons declined from KSh 25.68 billion to KSh 25.0 billion, the Hunger Safety Net Programme fell from KSh 4.91 billion to KSh 4.3 billion, funding for orphans and vulnerable children decreased marginally from KSh 8.98 billion to KSh 8.9 billion, while allocations for persons with severe disabilities remained unchanged at KSh 1.5 billion. These allocations largely sustain existing programmes rather than expanding support for vulnerable households.

Overall, the budget reflects a deliberate shift towards protecting essential social services during fiscal consolidation. However, financing these priorities through sustained reductions in development expenditure may weaken long-term economic growth and revenue generation. Fiscal space should be strengthened through realistic revenue projections that minimize revenue shortfalls and the resulting need for unplanned borrowing. Alternative financing avenues, including Public-Private Partnerships (PPPs), the National Infrastructure Fund, and securitization, should also be leveraged to finance commercially viable infrastructure projects.

3 Conclusion

The FY 2026/27 Approved Budget appears to show efforts towards fiscal consolidation by containing expenditure growth below revenue growth and narrowing the fiscal deficit. However, the fiscal framework remains vulnerable to optimistic revenue assumptions, likely in-year upward revision in spending, rising interest payments, and continued compression of development expenditure, which may undermine long-term economic growth and infrastructure development. Sectoral reallocations appropriately prioritize education, health and governance, broadly aligning with the Annual National Shadow Budget (ANSB) recommendations, but the modest increase in social protection and declining development allocations leave room for further improvement. Based on these observations, we recommend:

a. The National Treasury should adopt realistic revenue projections during the preparation of the annual Budget Policy Statement (BPS) and budget estimates, anchoring forecasts on historical revenue performance (approximately 8 percent annual growth) to improve budget credibility and support sustainable fiscal consolidation.

b. The National Treasury and Parliament should continue to protect priority social spending while financing commercially viable infrastructure through fiscally sustainable PPPs, the National Infrastructure Fund, and securitization. These financing avenues should be implemented transparently, in accordance with the rule of law, and supported by strong accountability and oversight to safeguard value for money and fiscal sustainability. Where public financing is required, limited fiscal space should be prioritized for high-impact infrastructure and agriculture by reallocating resources from low-priority projects and improving expenditure efficiency to support long-term growth without undermining fiscal consolidation.

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