

Rebecca Evans AS/MS  
Y Gweinidog Cyllid a Llywodraeth Leol  
Minister for Finance and Local Government



Llywodraeth Cymru  
Welsh Government

Our Ref: RE/736/22

Peredur Owen Griffiths MS  
Chair of Finance Committee  
Welsh Parliament  
Cardiff Bay  
CF99 1NA

14 July 2022

Dear Peredur,

In order to support the forward financial planning for directly funded bodies, I have previously agreed to write at this time of year setting out various factors to inform future budget planning, including the Government's best assessment of the level of funding available in future years.

Looking first at the overall UK fiscal situation, the £144 billion deficit in the public finances in 2021-22 was less than half that in the previous year, but still high by historical standards. The Office for Budget Responsibility's (OBR's) March forecast shows the deficit falling to £99 billion in 2022-23. However, the first 2 month's data for the current financial year suggest that forecast may be too low. The outlook for UK economic growth has deteriorated since March, which is also likely to have an adverse effect on the public finances.

The Welsh Government's plans for 2022-23 were set out in the Final Budget in March this year. These were updated in the recent First Supplementary Budget, with relatively few changes compared to supplementary budgets over the last two years. There was additional funding for the Welsh Government's response to the war in Ukraine and some technical changes to take account of International Financial Reporting Standard 16 on leases.

The UK Government's 3 year spending review last Autumn enabled the Welsh Government to publish a multi-year budget, with indicative plans for 2023-24 and 2024-25 alongside the 2022-23 allocations. This provides a clearer picture for short term budgetary prospects than has been possible in recent years. However, we still face considerable uncertainties over the next few years.

Canolfan Cyswllt Cyntaf / First Point of Contact Centre:  
0300 0604400

Bae Caerdydd • Cardiff Bay  
Caerdydd • Cardiff  
CF99 1SN

[Correspondence.Rebecca.Evans@gov.wales](mailto:Correspondence.Rebecca.Evans@gov.wales)  
[Gohebiaeth.Rebecca.Evans@llyw.cymru](mailto:Gohebiaeth.Rebecca.Evans@llyw.cymru)

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There is little growth in cash terms in those indicative plans for 2023-24 and 2024-25 relative to the current year. This is driven by the profile of the Welsh Government's spending review settlement. That low growth has been further exacerbated by the worsening outlook for inflation. At the time of the OBR's March 2022 forecast the Welsh Government's settlement was already worth £600 million less than in Autumn 2021 as a result of higher-than-expected inflation. It is possible that the Welsh Government's resource budget in both 2023-24 and 2024-25 will be worth less in real terms than in the current year.

The increasingly bleak outlook for both inflation and economic growth is likely to generate additional pressures right across the Welsh Government's budget, from the wage bill to procurement of goods and services to the capital programme. It is possible that the UK Government will make further announcements which affect the Welsh Government's settlement for future years. However, these could result in reductions as well as increases. We have already seen a reduction of £30m in our capital settlement this year to help finance military equipment for Ukraine.

Turning to prices and pay, the OBR's March forecast shows the GDP deflator increasing by 4.1% in the current financial year, 2.4% next year and then around 2% each year beyond that. The Consumer Prices Index (CPI) is expected to see a bigger increase of 8.0% in 2022-23 according to the OBR's March forecast. (The latest Bank of England assessment shows CPI inflation peaking at around 11% later this year.) UK average earnings are expected to increase by 5.1% in the current financial year and 2.4% next year. It should be noted that we are not expecting any increases in our settlement to finance increases in public sector pay – the pay bill will have to be managed within existing resources.

We have a settlement covering 3 years, which provides a clearer picture of the short-term prospects for the Welsh Government Budget than we have been used to in recent years. This shows the Welsh Government will see very little growth in resources over the next two years. In addition to that, the economic outlook is uncertain and has probably deteriorated since the OBR's March forecast. With that in mind, we cannot be sure that the settlement we have will be maintained, with the possibility of the UK Government diverting further resources away from programmes which are devolved in Wales.

Yours sincerely,



**Rebecca Evans AS/MS**

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