FRASER OF ALLANDER INSTITUTE

Economic Commentary

Vol 50 No 1

FOREWORD

April 2025

The world has changed - so said the Chancellor of the Exchequer.

And indeed, the first quarter of 2025 paints a complex and uncertain picture for the Scottish economy. While some indicators show modest growth, the broader outlook is overshadowed by mounting domestic and global headwinds.

UK and Scottish output slowed in late 2024, as both business and consumer confidence waned. The beginning of 2025 has seen growing unease as firms prepare for rising costs and escalating geopolitical tension - most notably, the introduction of trade tariffs by US President Donald Trump.

Our latest forecasts reflect this more subdued landscape. We now expect Scottish GDP to grow by 0.9% in 2025, followed by modest growth of 1.1% in both 2026 and 2027. These are downward revisions from our previous estimates, underscoring ongoing concerns over global economic fragility, tighter UK fiscal policy, and lingering inflationary pressures.

Headline inflation fell to 2.8% in February - welcome news, but unlikely to bring significant relief to Scottish households. Service inflation remains elevated at 5%, and further price increases are expected to strain household budgets. Meanwhile, businesses are preparing for a squeeze as the increase in Employers' National Insurance takes effect in April. Nearly three-quarters of firms surveyed in our Business Monitor expect this change to significantly impact their operations. Coupled with new US tariffs, it points to a challenging few months ahead for both firms and consumers.

The latest data on poverty and inequality presents a mixed picture. While there has been progress - especially in reducing child poverty - rates of persistent poverty remain high, and the Scottish Government's interim targets have been missed. Median incomes remain below pre-pandemic levels, and inequality continues to challenge efforts toward inclusive growth. The Scottish Child Payment appears to be making a positive impact, but more ambitious action will be needed to meet the statutory targets for 2030.

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In this edition, we also begin a series exploring Scotland's evolving social security landscape. We focus on disability and carer benefits, which now support over 800,000 people across the country and are projected to cost £7.7 billion annually by the end of the decade. These benefits are a vital income source for individuals and families - but also represent a growing fiscal pressure for the Scottish Government, particularly as recent UK reforms reduce the block grant adjustment over time.

Finally, we reflect on the UK Chancellor's Spring Statement. Despite being framed as a modest fiscal update, it introduced substantial changes, including departmental spending cuts and reforms to disability benefits that will have long-term implications for devolved budgets. While the Chancellor remains committed to meeting her fiscal rules, the margin for error is slim. With global risks intensifying, even a small shock could force a return to the drawing board by the Autumn.

As we look further into 2025, the central challenge for policymakers - here in Scotland, across the UK, and around the world - will be how to navigate the delicate balance between growth, security, equity, and fiscal sustainability in an increasingly uncertain landscape.

Fraser of Allander Institute
April 2025

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FORECASTS

0.9%

2025 forecast

1.1%

2026 forecast

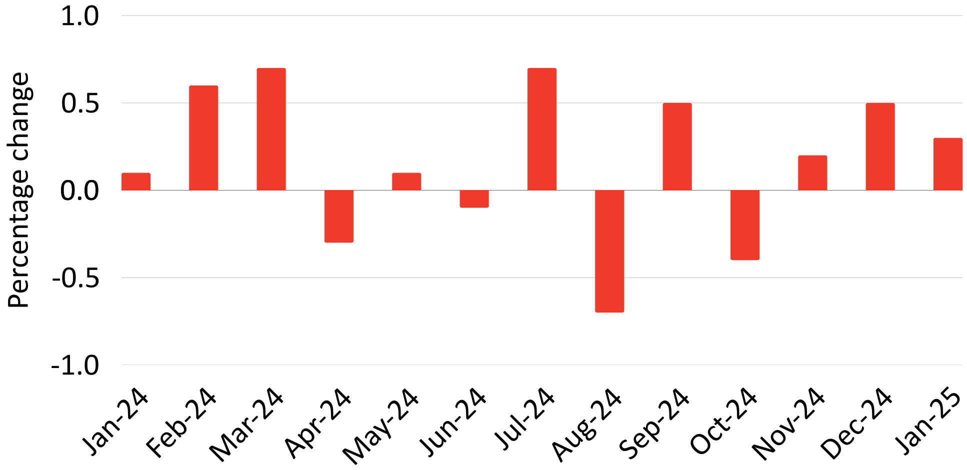
1.1%

2027 forecast

The Scottish economy continued its lacklustre performance at the start of 2025, with onshore GDP experiencing positive but marginal growth of 0.5% in the three months to January 2025.

Scotland's onshore GDP grew at a slower month-on-month rate of 0.3% in January 2025, compared to a revised 0.5% growth in December 2024.

Scottish Monthly Change in GDP



The Scottish Fiscal Commission (SFC) upgraded its 2024 GDP growth forecast for Scotland from 0.7% to 1.0%, with actual growth slightly exceeding expectations at 1.1%. The forecasts for 2025 and 2026 were also raised to 1.5% and 1.6%, up from 1.1% and 1.3%, indicating increased optimism about Scotland's economic prospects.

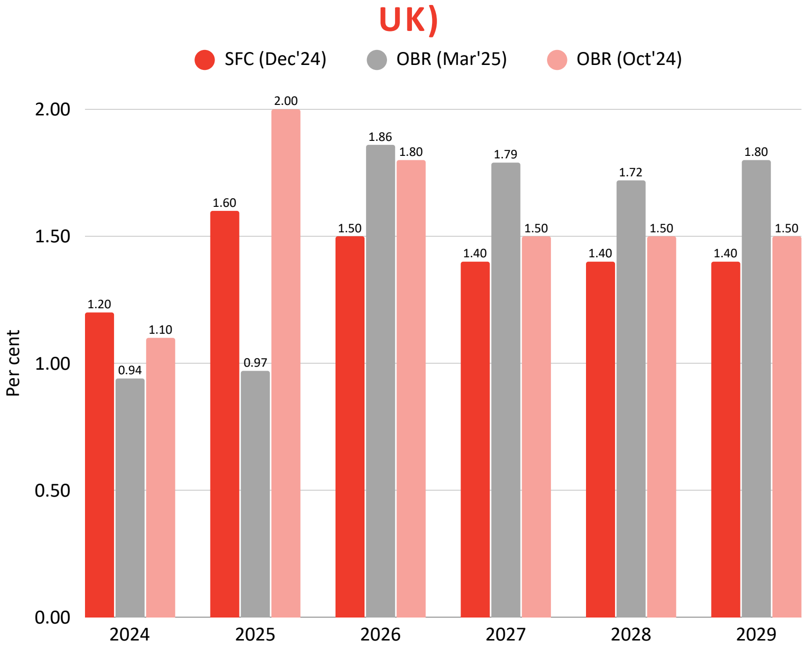
In March, the UK's Office for Budget Responsibility (OBR) revised its 2025 growth forecast downwards from 2% to under 1%, reflecting concerns about global debt markets, geopolitical risks, fluctuating energy prices, and inflation, all of which also impact Scotland. However, from 2026 onwards, the OBR anticipates modest growth improvements, expecting eased monetary policies and lower energy prices. The full effects on Scotland's economy will be clearer with the SFC's next update in May.

Scottish GDP Growth Forecasts

The FAI forecasts for 2025 and 2026 have been downgraded to reflect economic conditions in both the UK and the world economy. We expect growth in 2025 to now be similar to growth in 2024 at 0.9%, before increasing to 1.1% in 2026 and 2027.

	2025	2026	2027
FAI April 2025	0.9%	1.1%	1.1%
FAI Jan 2025	1.3%	1.2%	-
SFC Dec 2024	1.5%	1.6%	-

Real GDP Growth Forecasts (Scotland & UK)



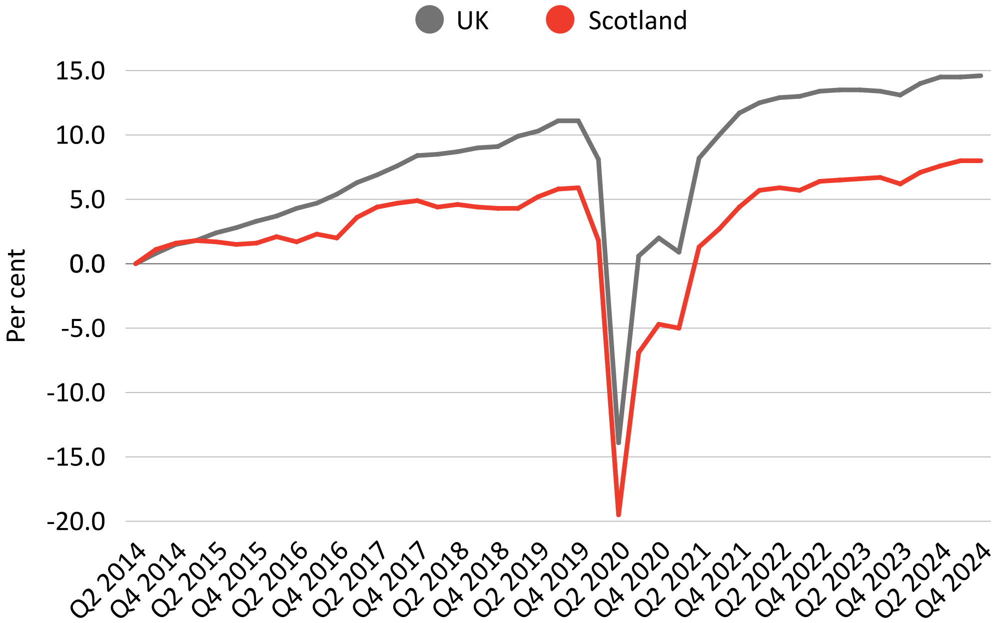
Source: Scottish Government, SFC, OBR

THE SCOTTISH ECONOMY

Modest but Positive Growth for the Scottish Economy

Scotland's economy is estimated to have grown by 1.1% in 2024 compared to 2023. Over the same period UK GDP grew by 0.9%. Most of this momentum came in the first half of the year, with Q4 2024 growth remaining flat (0.0% change), after growing 0.4% in Q3.

Scottish and UK Quarterly GDP (2014=0)



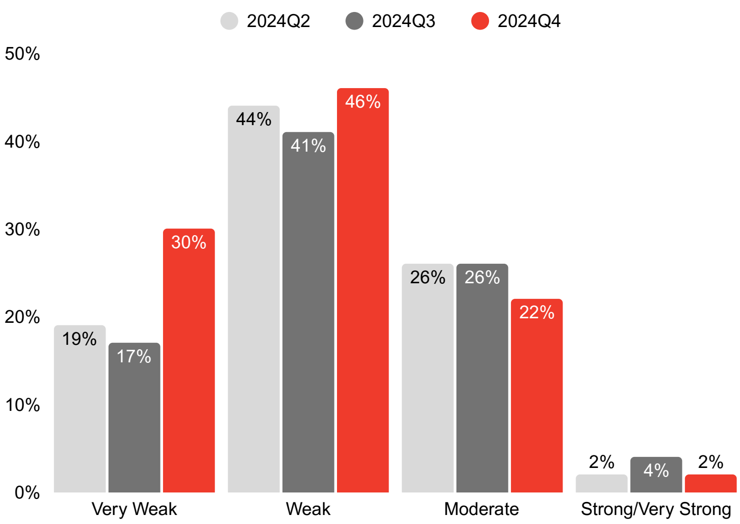
Viewed in historical context, however, these figures appear less encouraging. Before the 2008 global financial crisis, the Scotland's average annual growth rate stood at 2.2% (or 2.7% for the UK).

With employer National Insurance increases taking effect in April, there are growing concerns that economic growth could remain sluggish in the near term.

Growing Business concerns ahead of National Insurance increases

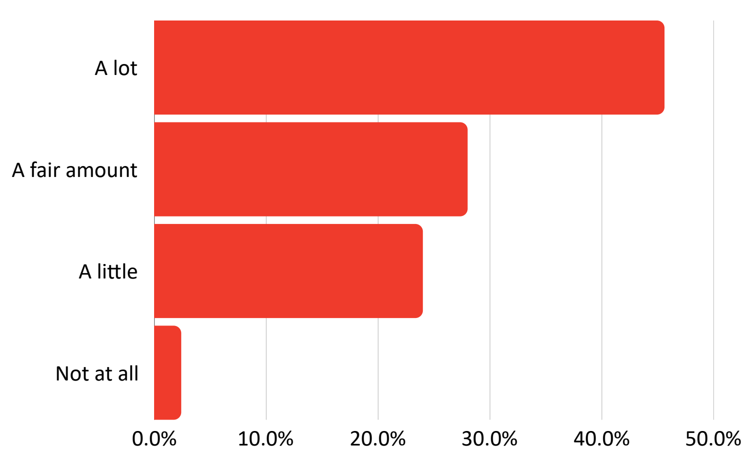
Findings from our Q4 Scottish Business Monitor reveal that firms are feeling increasingly pessimistic about the year ahead. 3 in 4 firms surveyed are expecting weak or extremely weak economic growth over 2025. Other findings showed that cost pressures also remain an ongoing concern with 94% of businesses surveyed expect higher total business costs over the first half of 2025.

Firms' Outlook for Growth



Business NICS Concerns

To what extent do you believe the NICS rise will affect your business?



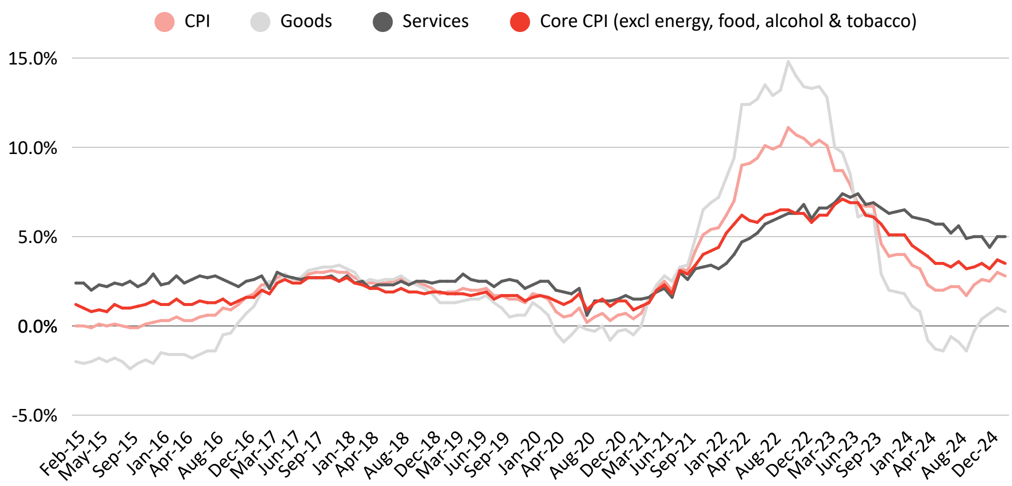
Changes to employer National Insurance contributions announced in the UK Government Budget are putting added pressure on the business climate. Three out of four businesses surveyed said they expect these changes to have a significant impact on their operations in 2025.

Source: ONS, Scottish Government, FAI

INFLATION

The 12-month Consumer Price Inflation rate unexpectedly fell to 2.8% in February, down from 3% in January. While this drop, said to be driven by a fall in clothing prices, is a welcome one, the latest forecasts from the OBR warn of tougher times ahead.

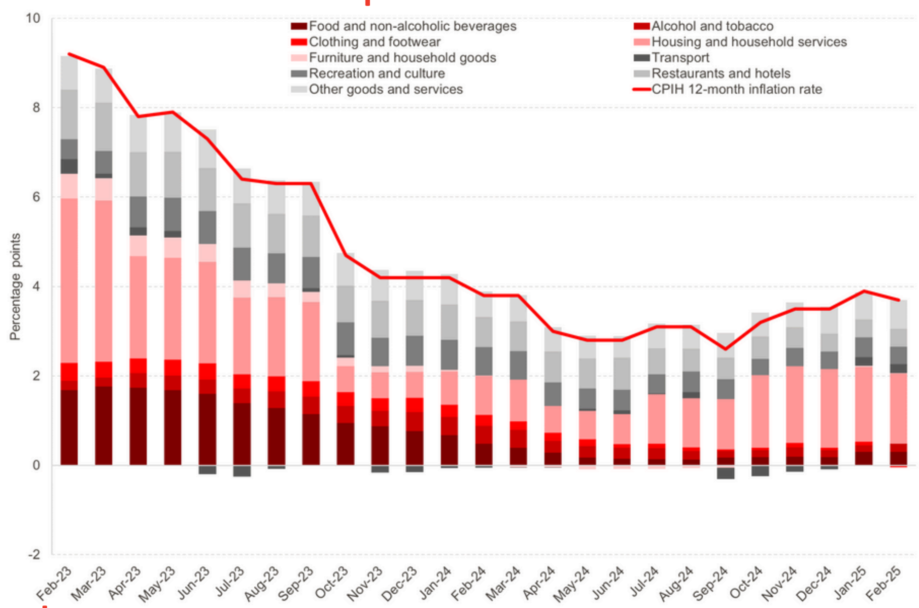
CPI Inflation



The fall in CPI and Core CPI in February has been goods-driven, meanwhile, service inflation remains high at 5%.

This will likely mean that the Bank of England will remain cautious about making any drastic cuts to the bank rate.

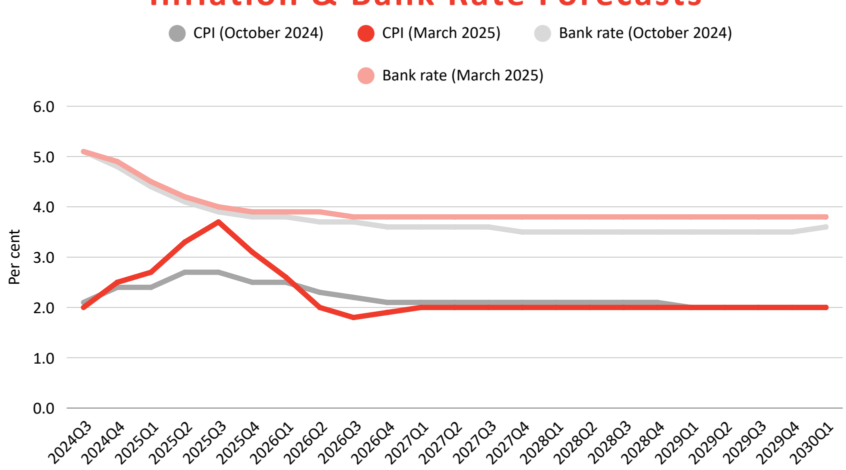
Components of CPIH



The reduction in inflation has primarily been driven by a fall in clothing prices, while prices of other commodities only marginally increased or stabilised.

The differing inflation trends between goods and services warrant close observation as they could have significant implications for future monetary policy decisions

Inflation & Bank Rate Forecasts



The OBR's latest forecasts for the bank rate and CPI indicate a drastic rise in inflation and a modest rise in the bank rate.

While expected to settle towards the 2% target by early 2027, inflation is forecasted to reach 3.7% in Q3, following increases to employer national insurance contributions, household energy bills and council tax; all of which take effect in April.

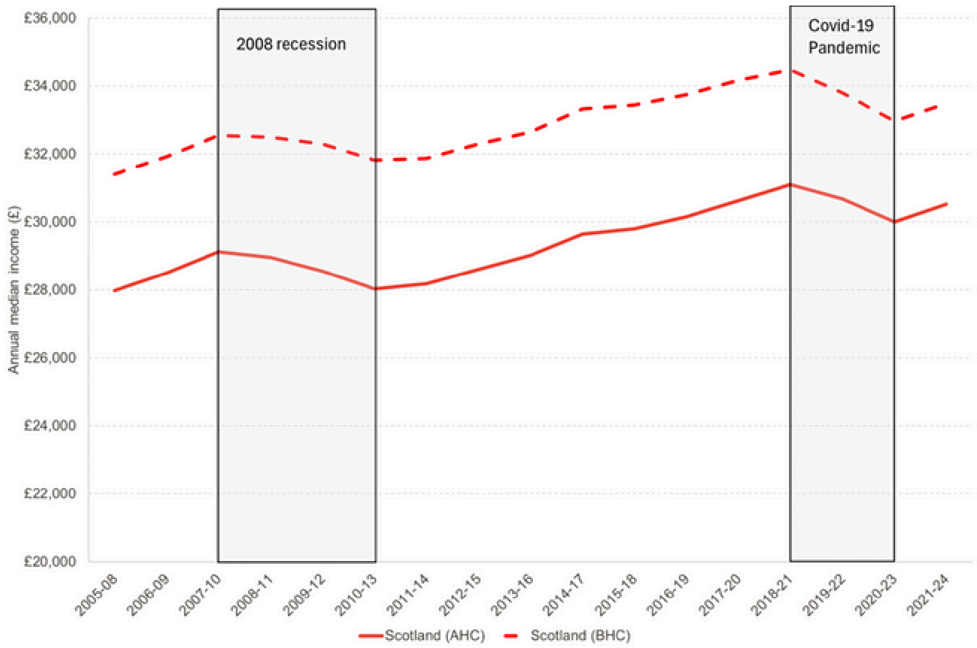
The near-term upward revisions feed into the sentiment that February's unexpected drop merely represents the 'calm before the storm'. While the longer term outlook remains optimistic, rising household costs and uncertainty surrounding President Trump's tariffs cast a shadow of uncertainty for the months that lie ahead for the remainder of 2025 and the beginning of 2026.

Source: ONS, OBR

POVERTY & INEQUALITY

Poverty falling in Scotland but median incomes remain below pre-pandemic levels and interim child poverty targets have been missed. New statistics were released in March on poverty and incomes in the UK and Scotland covering the financial years 2021-24. This summary looks at some of the key trends.

UK and Scotland Median Income, Before and After Housing Costs



Data on median incomes provides us with a snapshot of average living standards. The most recent data shows that median income remained below pre-pandemic levels in Scotland.

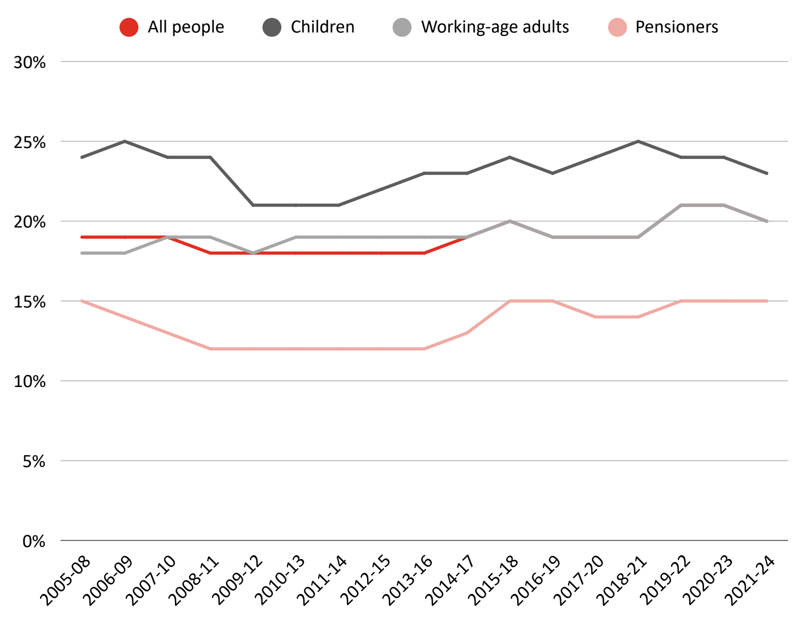
Over the three year period 2021-24, median income, before housing costs are taken into account, was around £33,500.

Notes: Median income captures income from earnings, social security and investment income (before housing costs measure), minus housing costs (after housing cost measure). 2023/24 prices. Presented as 3-year averages. Years that include financial year 2020-21 only include 2 years of data due to issues with data quality.

Data on relative poverty shows how those with lower incomes are faring. Overall poverty rates in Scotland are on a downwards trend, with the exception of pensioners who saw an increase.

Despite the falls in child poverty, the data released this week confirmed that Scottish Government missed their interim poverty targets. The fall in the most recent period is likely to be attributable to the first full year of the Scottish Child Payment which provides additional income to lower income households with children.

Relative Poverty After Housing Costs



Notes: Relative poverty is defined by having income below 60% of the UK median. Presented as 3-year averages. Years that include financial year 2020-21 only include 2 years of data due to issues with data quality.

Source: Scottish Government, HBAI DWP

SOCIAL SECURITY

Disability & Carer Benefits in Scotland

Social security provides a key source of income for hundreds of thousands of families in Scotland and is a key part of understanding how Scotland's economy functions. Transfers from the government to households through social security boost spending in the economy, and the level and conditionality of social security can also have implications for labour market supply. Additionally, in the case of devolved social security, the design of the system has fiscal implications. Over the next few editions of our Economic Commentary, we will explain different parts of the social security system in Scotland and will provide regular monitoring of changes over time. In this edition, we look at disability and carer benefits.

Across the UK, disability benefits are available to people whose poor health or disability leads to additional living costs - such as needing taxis instead of public transport or specialist equipment at home. These benefits are not means-tested and can be claimed regardless of income or employment status. This is separate from incapacity benefits (like the health element of Universal Credit), which support those unable to work due to illness or disability and are not covered in this edition.

Disability benefits have been devolved to the Scottish Government, meaning they have responsibility for how these benefits are designed and delivered. People on disability benefits in Scotland are gradually being moved on to new, Scottish, disability benefits. This process has taken time due to the scale and complexity of the change, as well as some deliberate administrative changes that the Scottish Government are making. As a result, it can be challenging to determine exactly how many people in Scotland receive these benefits and what the total cost is - or will be in the future.

We have produced estimates of caseload and cost using data from the Department for Work and Pensions (DWP), Social Security Scotland (SSS), and the Scottish Fiscal Commission (SFC). These figures include both UK- and Scottish-administered benefits, grouped under the Scottish benefit names to allow for consistent comparisons over time as people are being gradually moved over to the new system. It's worth noting that the SFC highlights ongoing uncertainty in forecasting due to the relative newness of the Scottish system and its different approach. Recent changes to PIP have added an extra layer of uncertainty to the estimates that follow.

What are Disability & Carer Benefits in Scotland?

- **Adult Disability Payment (ADP)** – replaces Personal Independence Payment (PIP), supporting adults with disabilities or long-term health conditions.
- **Child Disability Payment (CDP)** – replaces Disability Living Allowance (DLA) for children, supporting families with the extra costs of caring for a child with a disability.
- **Pension Age Disability Payment (PADP)** – replaces Attendance Allowance, supporting pensioners with disabilities.
- **Scottish Adult Disability Living Allowance (SADLA)** – a legacy benefit for people still receiving DLA and not yet transitioned to ADP. It only exists to support the transfer of existing DLA recipients from the UK system to the Scottish one, in line with a prior UK Government commitment.

SOCIAL SECURITY

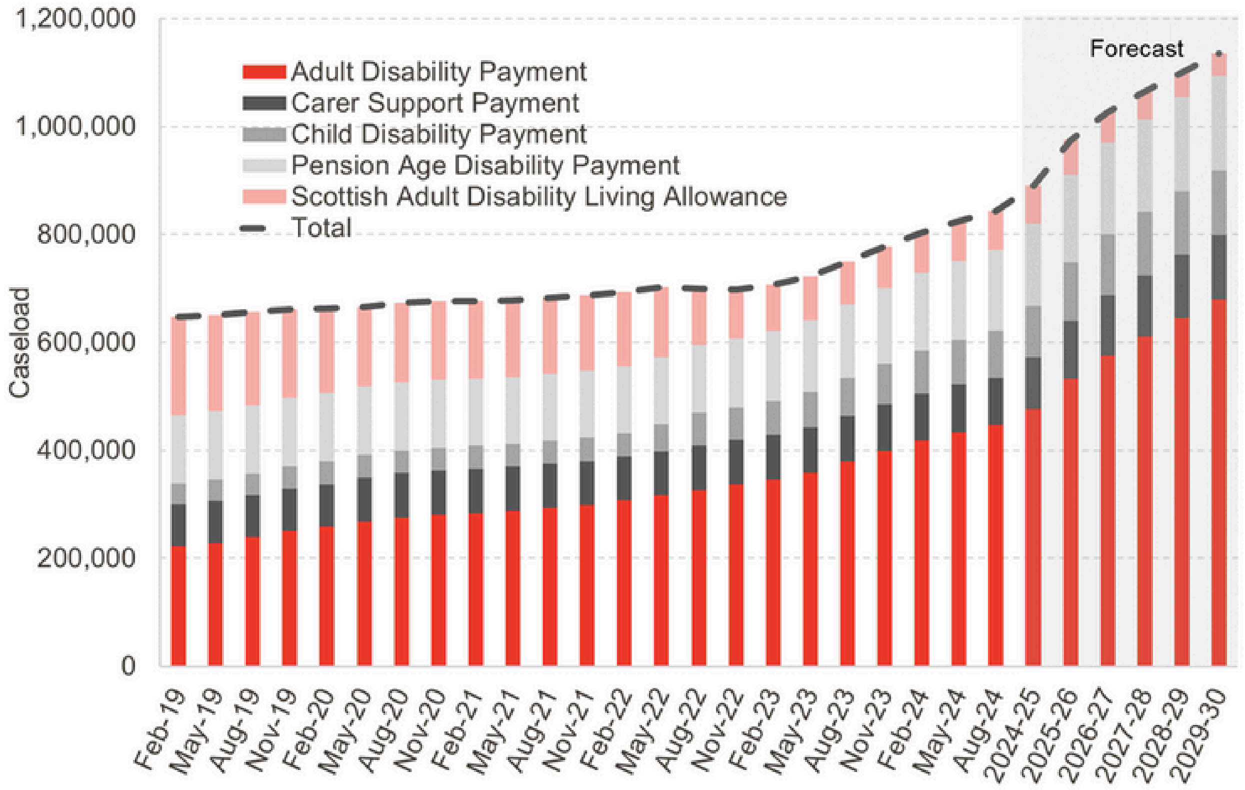
For all of these benefits, the amount a person receives depends on their individual circumstances, particularly the level of help they need with daily living or mobility. Each benefit typically has two rates: a higher and lower, depending on the severity of need.

Carers of people with disabilities may also be entitled to:

- **Carer Support Payment -** replaces Carer's Allowance in Scotland, and provides income to people who provide regular and substantial care to someone receiving a disability benefit.

Carers benefits they operate slightly differently to disability benefits. There is an earnings limit and is paid at a flat rate, currently £81.90 per week. In addition, carers in Scotland who receive Carer Support Payment are also eligible for the Carer's Allowance Supplement – an extra lump-sum payment made twice a year, worth £288.60 per payment in 2024.

How Many People Receive Disability & Carer Benefits in Scotland?* **



** Figures include spending on UK administered benefits until case transfer is complete, e.g. Adult Disability Payment figures include people receiving Personal Independence Payment; Carer Support Payment figures include people receiving Carer's Allowance; Child Disability Payment figures include children receiving Disability Living Allowance (Child); Pension Age Disability Payment (PADP) figures include people receiving Attendance Allowance, which PADP will replace. Scottish Adult Disability Living Allowance figures include people receiving Disability Living Allowance*
***Not shown - Severe Disablement Allowance*

The number of people receiving a form of disability benefits (including carer benefits) in Scotland has been steadily increasing and is forecast to continue rising sharply, from 648,000 in February 2019 to over 1.13 million by 2029–30.

While the caseload for disability benefits is growing across the UK, it is rising more rapidly in Scotland. The reasons behind this trend are complex, and there is no single explanation. Some possible contributing factors are outlined below.

Source: StatXplore, Social Security Scotland, Scottish Fiscal Commission

SOCIAL SECURITY

Why are Disability Benefit Caseloads Growing Across the UK?

Several overlapping factors are likely contributing to rising disability benefit claims:

- The working-age population is ageing, leading to more health-related issues.
- Increasing financial pressures may be driving more people to apply for benefits to maximise household income.
- Claims related to mental health conditions have risen significantly, but increases are also seen across a range of physical health conditions.
- There is uncertainty around the long-term impact of long COVID and the broader health consequences of the COVID-19 pandemic.

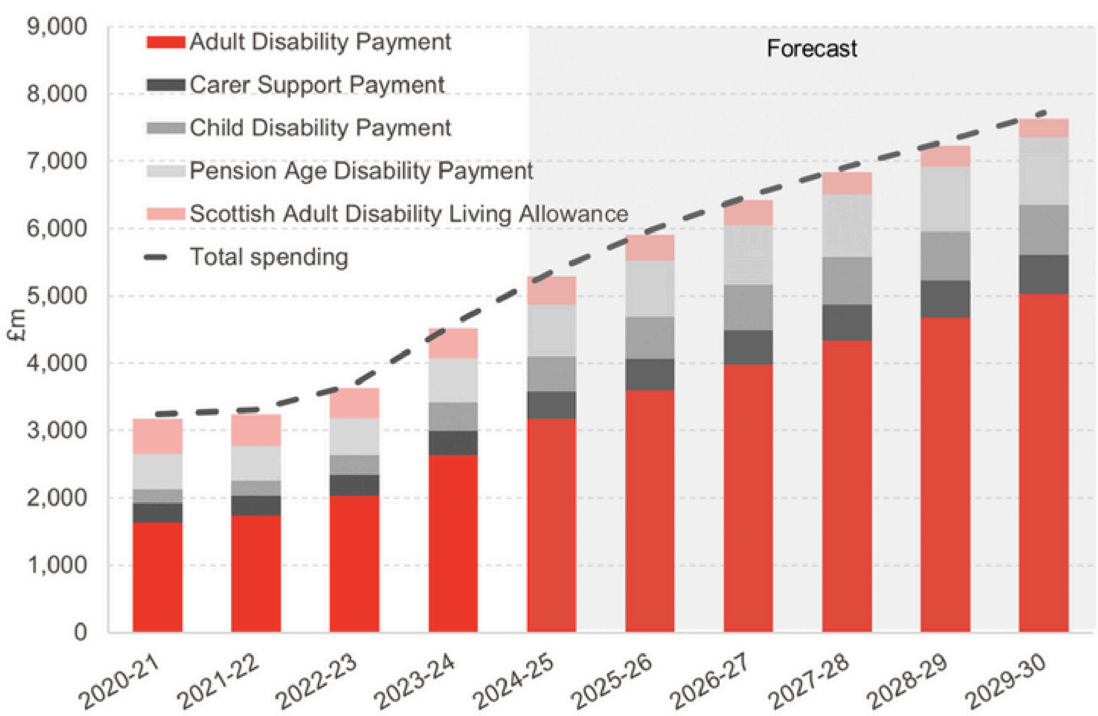
Why is Growth Faster in Scotland?

While eligibility criteria remain broadly similar to the UK system, Scotland's system is also seen as more accessible, with simpler application & review process. In Scotland, the two disability benefits driving most of the recent growth are:

- Adult Disability Payment (ADP) has led to more applications and fewer people losing benefits at review. This is because Scotland has introduced a "light-touch" review process, where claimants can confirm their condition remains the same without needing to provide extensive new evidence.
- Similarly, Child Disability Payment (CDP) is increasing sharply because more children are being approved for benefits. The number of children receiving CDP in Scotland has grown faster than in England and Wales, partly because children in Scotland can remain on CDP until age 18, while those in the rest of the UK must transition to PIP at 16.

For more detail, see this FAI blog, this IFS paper and this paper from our sister organisation the Scottish Health Equity Research Unit (SHERU).

How Much do we Spend on Disability & Carer Benefits in Scotland?* **



** Figures include spending on UK administered benefits until case transfer is complete as in previous chart.*
***Not shown - Severe Disablement Allowance or Carer Support Allowance*

Source: Scottish Fiscal Commission

SOCIAL SECURITY

In 2023-24, Scotland spent £4.6 billion on disability related benefits in Scotland.

Spending on disability-related benefits in Scotland has been rising steadily since 2020–21 and is forecast to continue increasing sharply over the next several years. Total spending is expected to grow from £3.2 billion in 2020–21 to £7.7 billion by 2029–30; more than doubling over the decade.

Adult Disability Payment (ADP) is the largest and fastest-growing area of disability benefit spending. Costs rose from £1.6 billion in 2020–21 to £2.6 billion in 2023–24, and are forecast to reach £5 billion by 2029–30.

The forecast also includes the introduction of Scottish Adult Disability Living Allowance (SADLA), which will allow some current Disability Living Allowance (DLA) recipients to remain on a similar benefit instead of moving to Adult Disability Payment (ADP). It is a closed benefit, meaning no new claims can be made and therefore caseload/cost will fall over time. It only exists to support the transfer of existing DLA recipients from the UK system to the Scottish one, in line with a prior UK Government commitment.

How are Disability & Carer Benefits Funded, and What do the UK Government's Changes Mean for Scotland?

The Scottish Government meets the costs of disability benefits. To offset this, it receives a transfer from the UK Government through the block grant adjustment (BGA). This amount is calculated based on what the UK Government would have spent in Scotland if the benefits had remained reserved and had grown in line with per capita spending in England and Wales. However, If Scottish spending rises faster — for example, due to policy choices or higher demand — the Scottish Government must cover the difference from its own budget.

At the Spring Statement, it was confirmed that the UK Government is reducing spending on Personal Independence Payment (PIP). In the short term, these UK Government changes won't directly affect how disability benefits are delivered in Scotland. However, they will place greater financial pressure on the Scottish Government. The associated block grant adjustment will fall to reflect the lower UK-wide spending, to reflect the lower UK-wide spending. The current forecast points to the PIP reforms reducing the block grant adjustment for social security devolution by increasing amounts, from £177 million in 2027-28 to £455 million in 2027-28.

If Scottish ministers choose to maintain current benefit levels, they will need to find additional funding from elsewhere in the Scottish Budget to make up the shortfall.

Any decision to reduce disability benefits in Scotland would come with significant fiscal and social risks. Cutting support for people with existing health conditions or disabilities could worsen health outcomes, increase pressure on public services, and lead to greater long-term reliance on other forms of state support.

More detailed projections will become available in May, when the Scottish Fiscal Commission publishes updated forecasts, along with revised figures for block grant adjustments.

Source: Scottish Fiscal Commission

Spring Statement Reaction: A Second Fiscal Event of the Year After All

The Chancellor may have tried to portray it otherwise, but her words in the Commons and the length of the scorecard of measures published by the OBR tell a different story: this really was a fiscal event, and a significant one at that.

It was also one where the forecasting process was nowhere near as smooth as we hoped it might be, given how much hay the Chancellor made out of strengthening the role of the OBR in the Autumn. Instead, we have seen a number of measures either uncertified or included only on a provisional basis, and with no time to evaluate their supply-side effects.

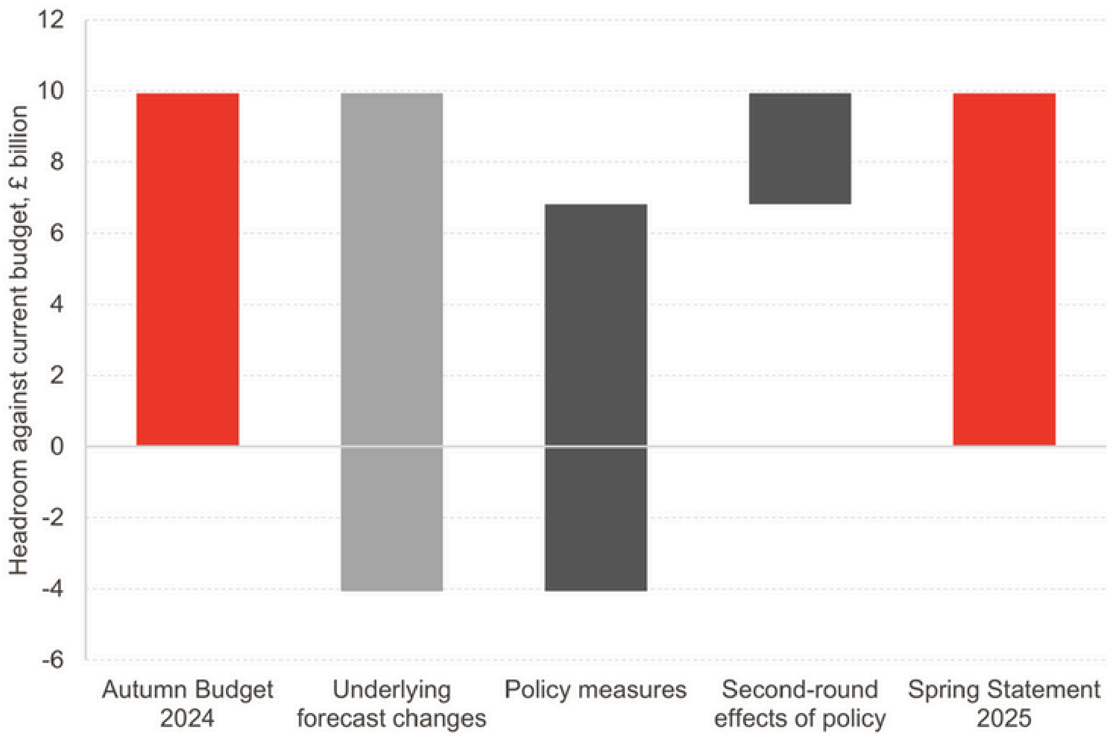
Given how long these measures have been speculated on, the last-minute tweaks and the scramble to announce further welfare reforms to make the sums add up to the £5bn in savings are somewhat disheartening. It also makes us wonder about the reasons for announcing the headline amounts last week, before ultimate certification by the OBR.

It is not credible that the Chancellor or the Work and Pensions Secretary were not aware of the OBR's concerns at the time of the announcement, and so we are left to wonder why figures that weren't final were banded about beforehand instead of being left for the appropriate fiscal event.

The Underlying Picture Deteriorated Significantly, and so Spending Cuts have Filled the Gap.

As widely predicted, the Chancellor would have seen her fiscal rules broken had she not made significant policy decisions, which collectively cut current spending by nearly £9 billion a year by 2029-30.

How the Chancellor Restored Her Headroom



Source: OBR

UK SPRING STATEMENT

What do the Announcements Mean for the Scottish Budget?

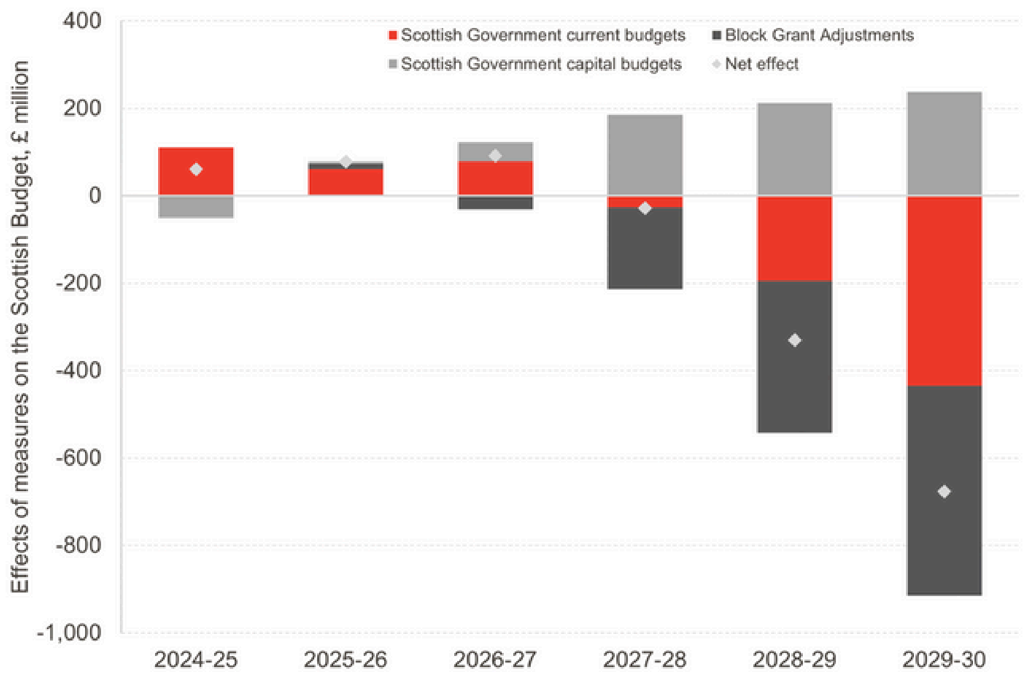
In the very short term, there is a small amount of additional funding (£28 million) for the Scottish Government in 2025-26 due to a small increase in departmental spending at UK Government level.

Towards the end of the forecast, however, the picture is significantly more challenging in terms of what it means for Holyrood's finances. The cuts in departmental budgets announced by the UK Government – even after accounting for some consequentials from employment support programmes and DWP delivery of welfare reforms – mean significant reductions in funding for the Scottish Government relative to what was previously included in the forecasts. Of particular significance are the £200 million and £435 million cuts in implied funding for the Scottish Budget in 2028-29 and 2029-30.

The current forecast points to the PIP reforms reducing the block grant adjustment for social security devolution by increasing amounts, from £177 million in 2027-28 to £455 million in 2029-30. This is in line with what we discussed in recent blogs.

Put together, and in the absence of any other changes, the Scottish Budget would be around £900 million worse off on the current side in 2029-30 than previously projected. On the other hand, some additional capital spending on areas which are devolved in Scotland – so aside from the defence spending increases - are expected to raise the Scottish Government's capital budget by nearly £250 million by 2029-30 relative to current plans.

Effects of the Spring Statement Measures on the Scottish Budget



See the rest of our analysis on the Spring Statement in our full blog.

Source: OBR