

# University of Strathclyde

# Quarterly Economic Commentary



FRASER OF ALLANDER INSTITUTE



**FOREWORD** 

October 2025

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This quarterly commentary arrives amidst continued challenging economic circumstances. While our 2025 forecast has been uprated from 0.8% to 1.0%, this is nothing to write home about. Weak growth at the beginning of 2024 means our economic outlook is comparatively better than the previous year, but we have seen contractions in several areas. We take a deeper dive into contractions in the manufacturing industry, with an accompanying perspective on the differences between UK and Scottish manufacturing.

This publication provides you with a sneak peek into tomorrow's Scottish Business Monitor release. Business activity remains mixed with last quarter's tentative recovery having stalled, and economic outlook has worsened – 4 in 5 businesses now expect weak or very weak growth in the Scottish economy over the next 12 months.

Uncertainty prevails, and not just for businesses — we have seen significant issues with the reliability of labour market statistics in recent months, which we explore in this publication. Our colleagues at the Scottish Health Equity Research Unit (SHERU) have provided modelling at the Scotland level to understand the challenges in tracking inactivity.

And finally, we continue our series on Social Security in Scotland by taking a look at benefits available to children. While reserved (UK) spending on benefits for children has reduced over the last five years, this has been offset by increased devolved (Scot Gov) spending, particularly the Scotlish Child Payment.

Our next major fiscal event will be the Scottish Budget for 2026-27, which is due to be released in January 2026. This will be the last budget before the Holyrood Elections in May 2026.

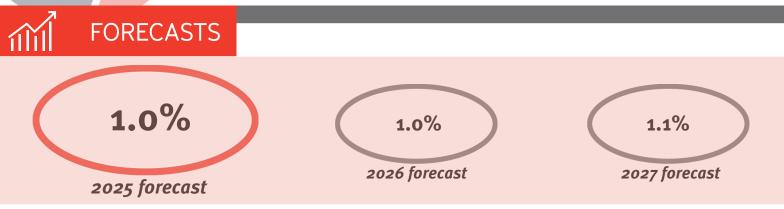
Fraser of Allander Institute October 2025 Forecasts

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### **Scottish GDP Growth Forecasts**

The FAI forecast for 2025 has been revised upwards since the previous quarter to reflect stronger growth in the year to date compared to the relatively poor economic performance in early 2024. Our views on the medium term have remained the same, with relatively modest growth expected in 2026 and 2027.

|                        | 2025 | 2026 | 2027 |
|------------------------|------|------|------|
| FAI October 2025       | 1.0% | 1.0% | 1.1% |
| FAI June 2025          | 0.8% | 1.0% | 1.1% |
| SFC May 2025           | 1.1% | 1.8% | 1.7% |
| OBR March 2025<br>(UK) | 1.0% | 1.9% | 1.8% |

Source: FAI, SFC and OBR

Scotland's GDP grew by 0.2% between quarter 1 and quarter 2 of 2025, a decrease on the last quarter where growth was 0.4%. GDP has grown by 0.9% in total since Q2 of 2024.

The latest monthly figures show growth of 0.7% in June and contraction of 0.3% in July, driven primarily by growth in production in June followed by shrinkage in July.

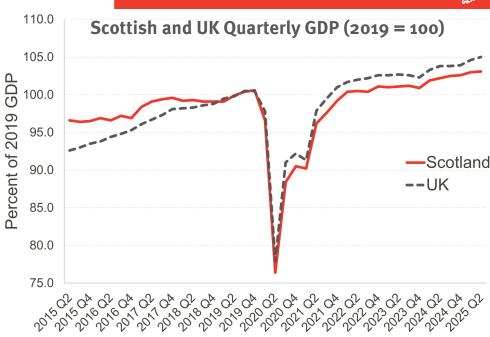
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Source: ONS, Scottish Government

### **The Scottish Economy**

Scottish real GDP grew by 0.2% in the second quarter of 2025, compared to growth of 0.3% across the UK. We continue to see weaker growth in Scotland compared to the UK since the pandemic.

Growth in Scotland was 0.9% compared to the same quarter last year. Production contracted 1.9% while services grew 1.4% on the year.



Source: ONS, Scottish Government



### **Shrinkage in Manufacturing**

Scotland's Manufacturing sector shrank by 2.9% between Q1 and Q2 of 2025 - dropping below 2019 levels for the second time since COVID-19. All manufacturing sub-sectors saw a drop except for the computer, electrical, electronic, and optical equipment subsector which saw an increase of around 0.9%. Chemical and petroleum manufacturing saw the quarterly dip across manufacturing sub-sectors - falling by 13.3% this quarter.

Source: Scottish Government

During the summer the FAI was joined by Economic Futures work placement Megan Howes. Megan wrote extensively on the role of manufacturing in the Scottish economy, including an analysis of divergent Scottish and UK manufacturing growth rates that gained attention at the start of the year.

For more detail on how the composition of manufacturing varies between Scotland and the UK and how that might impact their relative exposure to wider economic forces across the globe, read Megan's work published as a perspective piece alongside this edition of the economic commentary. While recent quarterly estimates vary from the time of writing, the analysis contained in the perspective remains informative. In particular, the long-term analysis provides valuable insights about manufacturing's place in the Scottish Economy.

### THE SCOTTISH ECONOMY



### **Scottish Business Monitor Preview**

This summary presents the key results from the latest Fraser of Allander Institute's (FAI) Scottish Business Monitor for the third quarter of 2025. The full report will be published tomorrow (9th October 2025).

Over 200 businesses from 31 of Scotland's 32 local authorities participated in the survey, revealing businesses' relationship with the Scottish Government, preparedness for the Net Zero transition, current business activity, and expectations for the economy over the next year.

Business activity remains mixed with last quarter's tentative recovery having stalled. Sales and employment saw modest improvements from last quarter, with net balance up o.6 percentage points and 1.4 percentage points, respectively. Export activity also showed some improvement. However, the net balance for all six of the Scottish Business Monitor's key indicators remains deep in negative territory.

Businesses continue to face a challenging environment, with rising costs, subdued investment, and displays of increasingly cautious sentiment:

- **Cost pressures** have eased slightly but are still a significant issue. 78.4 percent of respondents reported higher total business costs this quarter. Looking ahead, cost pressures are expected to persist, with 80.1 percent expecting total business costs to increase in the next 6 months.
- **Total employee costs** remain the most significant component of cost pressure in Q<sub>3</sub>, and energy costs are expected to become a rising cost pressure over the next two quarters.
- **Uncertainty dominates** ahead of the UK Government's Autumn budget. Economic and political uncertainty ranked as more concerning than traditional elements, such as staff and credit availability.

Economic outlook has worsened, with 4 in 5 businesses expecting weak or very weak growth in the Scottish economy over the next 12 months (this outlook was only expressed by 3 in 4 businesses in Q2). No respondents expected very strong growth, and only 1.5 percent expected strong growth. This reflects optimism from businesses falling throughout 2025 and the expression of increasingly cautious sentiment.

Tomorrow's publication will also include insight into businesses' relationship with the Scottish Government and readiness for the Net Zero transition.



### **Updates on Labour Market Statistics**

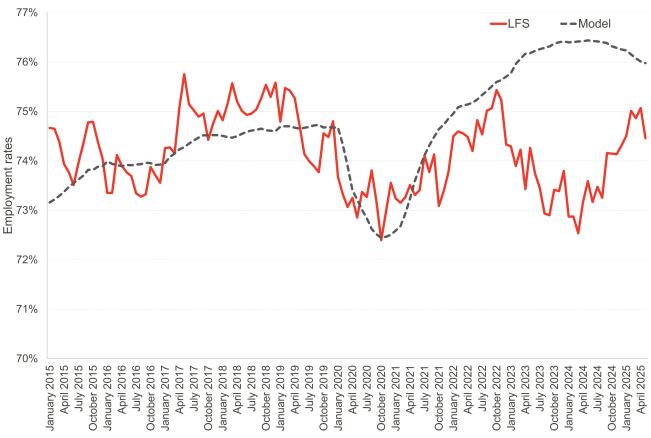
In our last few commentaries, we've avoided discussing headline labour market statistics: employment, unemployment, and economic activity. There are two reasons for this: one, these statistics are readily available and discussed in multiple other publications from Scottish Government and beyond. Two — and more pressingly — because of the quality of labour market survey data, which has declined substantially since 2019. The ONS actually suspended these statistics entirely between October 2023 and February 2024, when Labour Force Survey (LFS) responses for Great Britain fell below 15,000 households. By comparison, prior to 2019, more than 30,000 households regularly responded.

This led to a confusing trend in years since the pandemic. Official statistics showed that employment in the UK (and Scotland) was falling, and that inactivity – where people are neither in work nor actively looking for work – was rising. Yet administrative tax data showed the opposite: that employment was rising, meaning that fewer people would necessarily be out of work.

To understand these trends in Scotland, our colleagues at SHERU replicated <u>a UK-based employment model from the Resolution Foundation</u>. In recent months, modelled employment rates and LFS employment rates have begun to converge in Scotland. Coincidentally (or not), in recent months, <u>LFS response rates have increased, nearing a goal of 25,000 responding households in Great Britain</u>.

This means that while the LFS shows an increase of around 30,000 workers from May-July 2024 to May-July 2025 (the most recent period), our model actually showed a slight drop of around 15,000 workers year-on-year (see below chart).



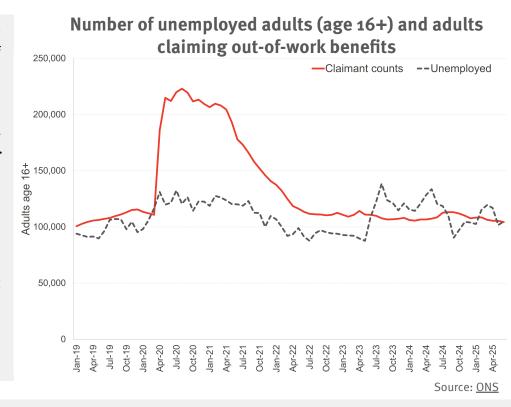


Source: ONS, SHERU

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There is no data, outside of the LFS, that can supplement our understanding of unemployment or inactivity. However, in recent years, LFS unemployment rates have actually tracked closely to the number of people claiming out-of-work benefits in Scotland (see chart on right).

Not all unemployed people will receive these benefits, however, nor will all people receiving these benefits be technically unemployed. But it does give us some confidence in the LFS' unemployment rates (which stood at 3.6% of the working age population in the most recent data), giving us some additional confidence in our modelled inactivity figures.

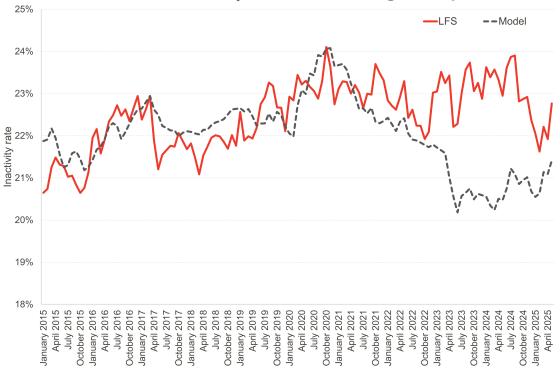


What we found is that recent inactivity levels in Scotland have increased slightly. In the immediate post-pandemic period, when survey responses were at their lowest, inactivity levels seem to have dropped. This means that, when policymakers were most concerned about rising economic inactivity, inactivity was – in actuality – falling.

More recently, inactivity rates have fallen year-on-year from their peak according to LFS data. Our model shows the opposite. Inactivity has risen slightly year-on-year — by about 32,000 people or just under 1 percentage — although it remains lower among working-aged adults than at any point since 2016 (see below chart).

As the Resolution Foundation very succinctly put it, "This suggests that the ONS's Labour Force Survey is currently correct about the level of economic inactivity but wrong about the trend."





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For their part, the Scottish Government considers headline economic activity figures to be robust and stated that they have "high confidence" in employment and inactivity rates for Scotland as a whole. At the same time, average sample sizes for these indicators in 2024 were around 40% lower than they were in 2019. Furthermore, publications on the labour market in regions of the UK (of which Scotland is one) has yet to regain its statistical accreditation, indicating that the Office for Statistics Regulation has ongoing concerns about its current quality.

However, headline statistics are not the only thing that we rely upon the LFS for. For instance, the picture for local authority data – which is central to delivering a variety of programmes, such as employability funding – is even worse, with sample sizes decreasing by more than 60% on average.

Arguably, the central question from a policy perspective would be: how many people in Scotland do not have a job, but would like to? Where are they? And, if they'd like one, why don't they have one?

Unfortunately, with our current data situation, these answers remain evasive.



### Social Security Series Part 3: An Overview of Child Benefits

Social security plays an important role in the Scottish economy. It forms an important source of income for thousands of families, boosting spending in the economy and potentially affecting labour supply decisions through means-testing and other conditionality.

One of the key challenges of fiscal policy is the balance between meeting assessed needs (even when not explicitly means-tested) and keeping spending within a fixed budget envelope — particularly when levels of need vary over time. This is complicated in Scotland by devolution, where changes to devolved social security payments at UK level have implications for the Scottish block grant. Additionally, if the Scottish Government chooses to spend proportionally more on devolved benefits than elsewhere in the UK, it must balance this against either higher tax revenues or reduced spending in another area.

This is the third part in our Economic Commentary series exploring the social security system in Scotland and monitoring trends over time. Previous entries have covered disability benefits and reserved working-age benefits like Universal Credit and legacy benefits. In this edition, we look at benefits available to children in Scotland.

### What benefits are available to children in Scotland?

Some benefits for children are reserved, meaning that they are administered by the Department for Work and Pensions or HMRC across Great Britain or the UK. These include:

- Universal Credit (child element and child disability element) (replaces Child Tax Credit)
- · Child Benefit
- Disability Living Allowance replaced by Child Disability Payment (see below).

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Other benefits are devolved following the Social Security (Scotland) Act 2018, and are therefore administered by Social Security Scotland. These include:

- The Five Family Payments:
  - Best Start Grants Pregnancy and Baby Payment; Early Learning Payment; School Age Payment
  - Best Start Foods
  - Scottish Child Payment
- · Child Winter Heating Payment
- · Young Carer Grant
- Child Disability Payment

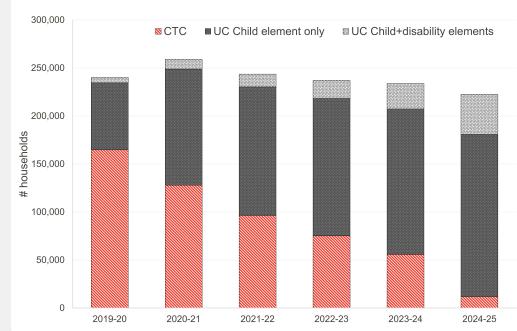
We covered Disability Living Allowance, Young Carer Grant, and Child Disability Payment in our first edition of this series. In this edition, we'll focus on the other benefits for children in Scotland.

### Reserved benefits

There are both means-tested and non-means-tested benefits available to children across the UK.

Universal Credit is means-tested and has both a child element and a child disability element. It replaces Child Tax Credit, which was a means-tested benefit for families with children. CTC also had additional elements for child disability and severe disability. As of April 2025, CTC is no longer available in the UK.

### Child Tax Credit and UC child elements caseload



Source: DWP Stat-Xplore, HMRC, FAI calculations.

Notes: CTC = Child Tax Credit; UC = Universal Credit. The annual number of households receiving UC is averaged from monthly counts across the financial year.

Just prior to the pandemic, around 240,000 households in Scotland were receiving either CTC or the child-related elements of UC. This number rose to nearly 260,000 in 2020-21, reflecting the impact of the Covid-19 pandemic.

The caseload has since fallen, with 223,000 households in receipt of CTC or the child-related elements of UC in 2024-25. This may be due in part to different criteria for UC compared to CTC. However, the proportion of households receiving a child element of UC who also receive a child disability element has risen from 8% in 2019-20 to 20% in 2024-25.

Child Benefit is available to those responsible for bringing up a child under 16, or under 20 if they are in certain education or training programmes. It pays a set amount per week for the first child (currently £26.05) and a different amount for each subsequent child (£17.25). There is no limit on the number of children that can be claimed. The benefit is not directly means-tested, but recipients pay some of the

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benefit back through a tax charge if they earn over £60,000 individually unless they opt out of receiving it.

As of August 2024, there were 842,650 children for whom Child Benefit was received in Scotland across 515,150 families. This will include the majority of households receiving the UC child element or CTC. From a peak of around 620,000 families, the Child Benefit caseload fell each year from 2013, when the tax charge was introduced at a threshold of £50,000 which remained frozen until April 2024.

### **Devolved benefits**

A group of devolved benefits aimed at children in Scotland is called the Five Family Payments. These consist of the Scottish Child Payment, Best Start Foods, and three Best Start Grants: Pregnancy and Baby, Early Learning, and School Age. There is significant overlap between these benefits in terms of eligibility criteria, with UC acting as the main qualifying benefit.

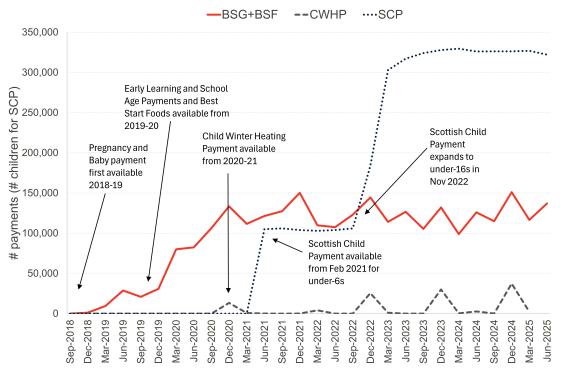
The **Scottish Child Payment** is available to households with children under 16. They receive a weekly amount per week, per child (currently £27.15).

The **Best Start Grants** are intended to help support households at key transition times during their children's lives. They are one-off payments that can be applied for during pregnancy or within six months of a child's birth (Pregnancy and Baby Payment), when a child is a toddler (Early Learning Payment), or when a child starts school (School Age Payment).

**Best Start Foods** is paid monthly from pregnancy until the child turns three.

In addition to the Five Family Payments, households with disabled children can receive support for heating bills through the **Child Winter Heating Payment**. The child must be in receipt of a disability benefit to receive CWHP.





Source: Social Security Scotland (Best Start Grants & Best Start Foods; Child Winter Heating Payment; Scottish Child Payment).

### Notes:

BSG = Best Start Grant;

BSF = Best Start Foods;

SCP = Scottish Child Payment;

CWHP = Child Winter Heating Payment.

BSG+BSF and CWHP figures represent total number of payments over the quarter, calculated by aggregating monthly figures. SCP figures represent number of children in receipt of the benefit on the last day of the quarter, counting only children in the household who attracted a payment ("actively benefiting"). Families may be in receipt of more than one of these benefits.

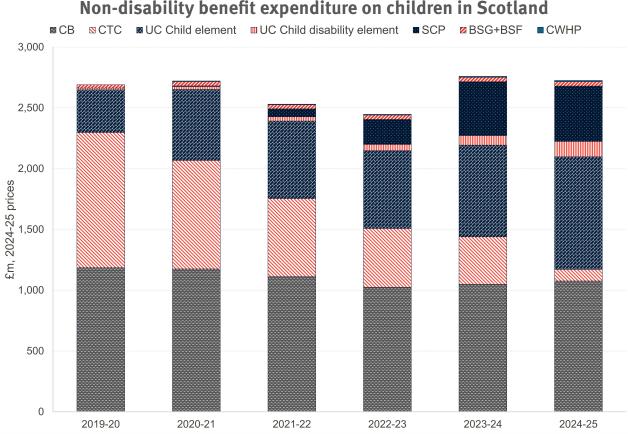
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Best Start Grants and Best Start Foods started between 2018 and 2019. They have tended to pay between 100,000 and 150,000 claims each quarter, usually with spikes in winter and summer.

Scottish Child Payment became available in February 2021 for children under 6. Between the second quarter of 2021 and the third quarter of 2022, about 100,000 children were receiving Scottish Child Payment. In November 2022, the payment was extended to children under 16. Since about mid-2023, around 325,000 children have been receiving SCP.

### Spending on non-disability benefits for children in Scotland

The figure below shows how much is spent on reserved and devolved non-disability benefits for children in Scotland and how this has changed since 2019-20.



Source: FAI calculations from Social Security Scotland; DWP Stat-Xplore; <u>HMRC Child Benefit Statistics</u>; and <u>DWP Benefit expenditure and caseload tables</u>.

Notes: CB = Child Benefit; UC = Universal Credit; SCP = Scottish Child Payment; BSG = Best Start Grant; BSF = Best Start Foods; CWHP = Child Winter Heating Payment. CTC spending calculated as payments to families receiving CTC only plus number of families receiving CTC+WTC multiplied by the average payment to families receiving CTC only. UC spending calculated as Scotland's caseload share of each element in GB multiplied by the amount spent in GB on that element. GB UC figures are based on entitlement before any reductions, e.g. for earnings, receipt of other benefits or sanctions. CB spending calculated as Scotland's caseload share in UK in August of each year multiplied by the amount spent in UK. GB/UK spend figures for 2024-25 are forecasted.

Real spending on reserved benefits for children has declined in the last five years, from around £2.7 billion in 2019-20 to £2.2 billion in 2024-25. This is consistent with both a lower number of households receiving benefits and potentially with a lower average amount received per household in real terms, although it is difficult to tell from available statistics.

The decline has been offset by increases in devolved spending, with total expenditure on non-disability benefits for children returning to around £2.7 billion. This has primarily been driven by the Scottish Child Payment, which paid nearly £500 million in 2024-25.