**Finance and Public Administration Committee**
**20th Meeting, 2025 (Session 6),**
**Tuesday 10 June 2025**

# Scottish Fiscal Commission's Economic and Fiscal Forecasts – May 2025

## Purpose

1. The Committee is invited to take evidence from the following witnesses from the Scottish Fiscal Commission (SFC) in relation to its publication Scotland's Economic and Fiscal Forecasts (SEFF) - May 2025—

    - Professor Graeme Roy, Chair, SFC,
    - Professor Domenico Lombardi, Commissioner, SFC,
    - Michael Davidson, Head of Social Security and Devolved Taxes, SFC, and
    - John Ireland, Chief Executive, SFC.

2. This paper highlights some key issues raised in the SEFF, along with wider context to this publication. Further detail on the SEFF is included in the SPICe blog Updated forecasts set the context for pre-budget scrutiny published on 30 May, which is attached as an Annexe to this paper.

## Context

3. On 6 May 2025, the Cabinet Secretary for Finance and Local Government wrote to the Committee and separately to the SFC to advise that publication of the Scottish Government's Medium-Term Financial Strategy (MTFS) and Fiscal Sustainability Delivery Plan (FSDP) would be deferred from the original publication date of 29 May. The Cabinet Secretary later confirmed the date of publication would be Wednesday 25 June.

4. The MTFS sets out the Scottish Government's expectations and broad financial plans and projections for at least five years ahead on a rolling basis, informed by the SFC's SEFF. The MTFS and SEFF are usually published together in May each year and are intended to inform committees' pre-budget scrutiny. The FSDP is a new document to accompany the 2025 MTFS[1], which will "set out the Government's plans to achieve and deliver sustainable public finances within the overall approach that is set out in the MTFS".

5. In his response of 7 May 2025 to the Cabinet Secretary's 6 May letter, the Chair of the SFC, Professor Graeme Roy, said "it is my intention that we publish our updated economic and fiscal forecasts alongside commentary on the funding implications of these forecasts, on 29 May, as originally planned". He explained—

[1] This was announced during a debate on Fiscal Sustainability on 29 October 2024.

> "It is my view that publishing the core economic, tax and social security forecasts as planned on 29 May supports transparency and I see no reason for delay. All the necessary forecasting analysis, and engagement with the Government, has taken place. Publication at this time also fulfils our commitment to providing timely updates to the Committee on the outlook for Scotland's economy, tax and social security commitments."

6. Professor Roy went on to say that the SFC will also publish a follow-up report alongside the MTFS on 25 June that provides "further detail and commentary on the Government's funding position, and our formal assessment of the reasonableness of the Government's borrowing plans, post the UK Spending Review". This follow-up report "will include a restatement of our forecasts from 29 May, thereby fulfilling our duty to publish forecasts to accompany the MTFS".

7. The IFS note that the UK Government has already committed to the overall growth of the spending envelope; 1.2% real terms growth in resource spending, and 1.3% real terms growth in capital spending. The UK Spending Review will allocate this across departments. In the May 2025 forecast, the SFC has assumed that growth in devolved policy areas will mirror the growth of the total spending envelope. Should the UK Government plan to increase spending in devolved areas by more or less than these headline rates, then this will impact the forecast funding available to the Scottish Government.

8. As with last year, the SFC also intends to publish a Fiscal Update in late August reflecting developments since June.

9. During evidence to the Committee on 20 May 2025, the Cabinet Secretary advised that—

    - the Scottish Government will publish a Framework for a Scottish Spending Review (SSR) as part of the MTFS on 25 June[2],
    - she is considering announcing outcomes of the SSR alongside the Scottish Budget 2026-27 in December 2025,
    - the expected Public Service Reform Strategy will be published in June, although the exact publication date is still to be confirmed, and
    - consideration is being given to publishing the Infrastructure Investment Plan pipeline refresh in December 2025 to reflect "key funding information from the UK Government following its own spending review".

[2] The Session 7 Budget Process Agreement between the Committee and the Scottish Government states that "at a Spending Review, the Scottish Government will publish a framework document setting out the economic and fiscal context, the criteria which will govern the assessment of budgets and the process and timetable for review". This Framework is expected to be published before summer recess "to allow sufficient time for parliamentary scrutiny and input to the Spending Review".

## Scotland's Economic and Fiscal Forecasts – May 2025

10. As noted above, the SFC published its May 2025 SEFF independently of the MTFS, on 29 May. The SEFF includes projections for the Scottish economy, devolved tax revenues, and social security spending up to 2030-31. These forecasts use the latest public information on the Scottish Government's policy approach and the latest assumptions for UK departmental spending from the Office for Budget Responsibility (OBR)[3]. Key elements of the Forecasts include—

- Total Scottish Government funding in 2025-26 is £59.6 billion, almost £0.8 billion higher than the December 2024 forecast. The SFC explains that this increase is because of additional UK Government funding and the Scottish Government now drawing down from the Scotland Reserve. Total funding is forecast to grow in both nominal and real terms in each of the next five years.

- In relation to capital spending, the UK Budget 2024 led to a significant increase between 2024-25 and 2025-26. (In nominal terms this increase is now 18.7%.) The SFC states that "other than in 2026-27, capital funding still grows in nominal terms over the forecast horizon […]. however, after accounting for inflation we expect real terms reductions in the last three years of the forecast, as growth in UK Government funding slows while we assume Scottish Government borrowing plans are held constant at £300 million a year".

- Over the period 2025-26 to 2030-31, resource funding is expected to grow by nearly 18% in nominal terms, or 7% adjusted for inflation. Devolved social security takes up an increasing share of the resource budget, leading to lower real terms growth of 5% over the next five years for all other areas of resource spending.

- The Scottish Government's policy to mitigate the two-child cap, together with policy changes announced by the UK Government this year, reduces Block Grant Adjustment (BGA) funding to the Scottish Government by £400 million per year. The cost of delivering social security in Scotland is expected to exceed social security BGAs by over £2 billion per year by 2029-30.

- Pay and workforce "are major and immediate pressures on the Scottish Budget", with pay deals agreed so far in 2025-26 being above the Scottish Government's Public Sector Pay Policy of 3% in 2025-26 (9% over three years). This, the SFC suggests "is likely to create a pressure for pay awards to be higher than planned for other workforces still negotiating".

- Scottish nominal earnings growth in 2025-26 is broadly unchanged from December 2024 figures, however the latest OBR forecasts for

[3] EFOs - Office for Budget Responsibility

growth for the UK has been revised upward by 0.8 percentage points. While the net income tax position remains positive, it is around £180 million a year lower than the December 2024 forecasts, largely due to the BGA being updated as a consequence of the latest OBR forecasts.

- There has been little change to the economic forecast for Scotland. Growth expected in 2025 is slightly weaker reflecting the global slowdown since December 2024. A modest increase is expected in 2026, but by historic standards growth remains low over the forecast period.

- Inflation has increased in the year ending April 2025, and the SFC expects that it will remain above the Bank of England’s 2% target for the remainder of the year before falling back to around 2% for the remainder of the forecast period.

- The latest labour market trends publication from the Scottish Government shows that the estimated unemployment rate for January to March 2025 rose to 4.5%. The SFC forecasts that this rate will remain above 4% throughout 2025-26 and remain relatively static throughout the forecast period.

- Real earnings growth remains positive though it is expected to sit at around or just below 1% throughout the forecast.

11. The Fraser of Allander Institute (FAI), in its blog on Scottish fiscal forecasts and SHERU research themes published on 30 May highlighted that the main development in terms of the economy since December 2024 has been the increase in volatility. This, the FAI suggests, “contributes to weaker short-term growth in the SFC’s forecasts, and the effects could be larger were tariffs to be maintained over the long run”. The FAI goes on to say that “the SFC’s scenario analysis points to the productivity shock that permanent tariffs would bring about a reduction in GDP of 0.3% over the long term, similar to the UK’s hit as whole presented in the OBR’s publication a couple of months ago”.

12. The FAI further argued that—

> “[…] the Scottish Government’s planning ought to include an allowance for what looks like a substantial negative income tax reconciliation in 2027-28, relating to the 2024-25 Budget. The current projection is -£851 million, which is above what the Scottish Government can borrow for this purpose, and which would mean reducing spending on public services in that year to pay for it".

## Pre-budget 2026-27 scrutiny

13. On April 2025, the SFC published its second full Fiscal Sustainability Report which analyses how changes in the size and age structure of the population will affect economic growth and the Scottish Government’s spending and funding up to 2074-75. The report has a particular focus on health and discusses trends in

spending on health, social care and disability payments. The report also shows how different scenarios of Scottish population health could affect public finances.

14. The SFC suggests that "the Scottish Government will face significant challenges funding devolved public services in the future", including as a consequence of projections that Scotland's population will age earlier than in the rest of the UK in the next twenty-five years. The Committee explored these issues in more detail at an evidence session with the SFC on 29 April.

15. Drawing on the SFC's findings, the Committee has agreed to focus its pre-budget 2026-27 scrutiny on Responding to Long-Term Fiscal Pressures. The SFC's May 2025 SEFF and the Government's key budgetary documents, such as the MTFS, will also inform this work. Key areas of focus for the Committee are likely to include assessing the Scottish Government's approach to medium- and longer-term financial planning and public service reform and assessing the Scottish Government's approach to increasing productivity and economic inactivity and supporting growth sectors in Scotland.

16. The Committee plans to launch its inquiry call for views in late June and expects to start holding oral evidence sessions in September/October.[4]

## Next steps

17. The Committee will use the SFC's May 2025 SEFF to inform its pre-budget 2026-27 scrutiny, which is expected to take place between June and October/November 2025.

Committee Clerking Team
June 2025

[4] More broadly, the Committee will publish the report of its inquiry into how the budget process has operated in practice this parliamentary session in June 2025.

**ANNEXE**

# SPICe Spotlight Blog on Updated forecasts set the context for pre-budget scrutiny

Over the next month there will be several publications which will inform pre-budget scrutiny in the Scottish Parliament. Yesterday, the Scottish Fiscal Commission (SFC) published the first of these - their updated economic and fiscal forecasts. This forecast sets out how the expected performance of the Scottish economy will feed through to the Scottish Budget, and cover the period to 2030-31.

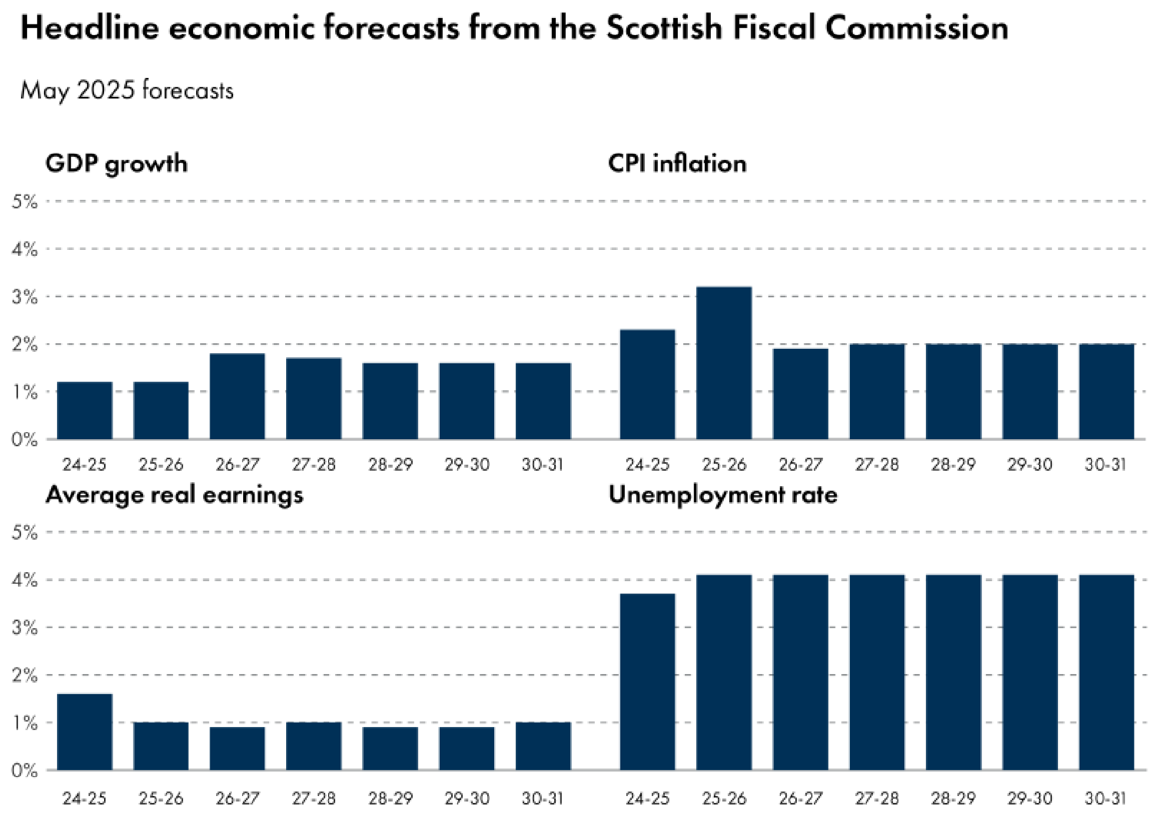
These forecasts were originally planned to accompany the Scottish Government's medium term financial strategy, but the MTFS has been delayed until 25 June to follow the UK Spending Review on 11 June, as explained in a recent SPICe blog. These forecasts are therefore based on current policy, and will be updated next month to account for any policy changes outlined in the MTFS.

This blog will give an overview of the key messages, looking in particular at the outlook for funding for the Scottish budget, the net tax position and social security spending.

## What do the new economic forecasts tell us?

The SFC forecasts cover 4 main areas;

- Scotland's economy and how average earnings are expected to change,
- the performance of devolved taxes (Non-savings, non-dividend Income Tax, Land and Buildings Transaction Tax, and Scottish Landfill Tax),
- how the performance of devolved taxes feeds through to public finances; and
- the outlook for social security spending (which assumes that current and announced Scottish Government policy is delivered).




Economic growth is expected to remain fairly muted in 2025, with only a small pick up in 2026-27. Over the forecast period, GDP growth remains low compared to historic levels.

Inflation has already increased during 2025-26, largely driven by the impact of increasing consumer bills in April, such as energy bills which rose for many due to Ofgem increasing the price cap, as well as annual increases to bills like council tax. The SFC expect it to remain above the Bank of England 2 per cent target for the remainder of the year, before reducing to 1.9 per cent in 2026-27 and thereafter remaining around the 2.0 target.

The outlook for real earnings growth remains muted – while positive it hovers around or just below 1 per cent throughout the forecast.

The latest labour market trends publication from the Scottish Government shows that the estimated unemployment rate for January to March 2025 rose to 4.5%. The SFC forecast that it will remain above 4 per cent throughout 2025-26, and remain relatively static throughout the forecast period.

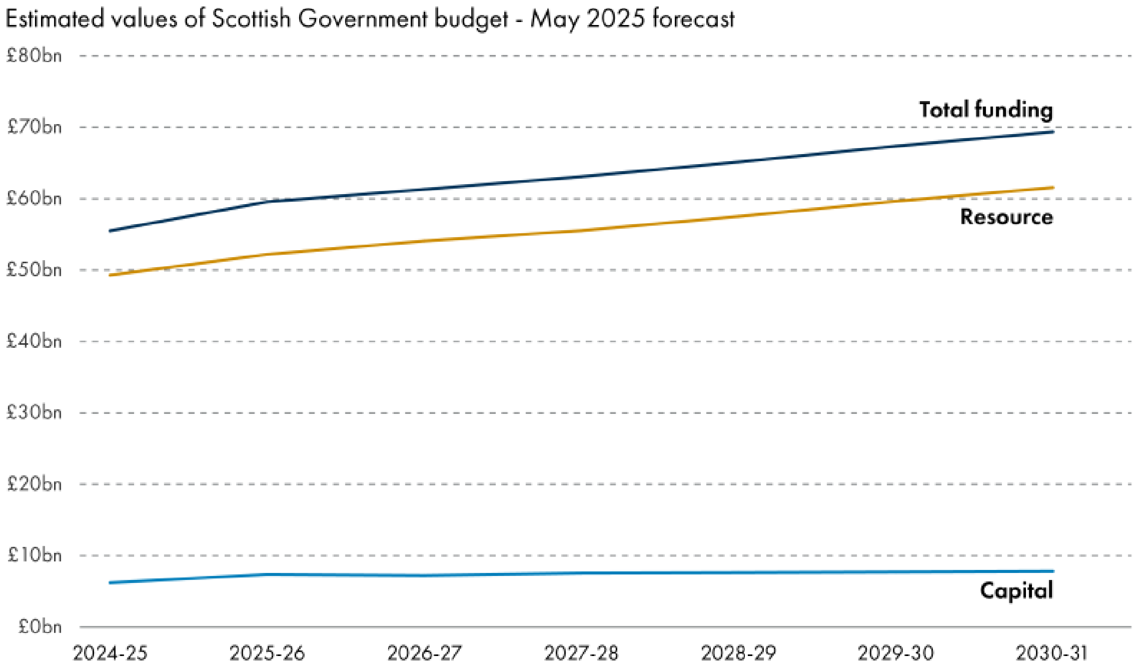
## What about the fiscal outlook?

Funding available to the Scottish Government is determined by the policy decisions and performance of devolved taxes, as well as decisions made by the UK Government. This forecast is therefore sensitive to forthcoming changes that will be announced at the UK Spending Review, and in the MTFS, both of which will be published next month. On the funding allocations to be announced in the UK Spending Review, the SFC notes that:

> "We have had to make some assumptions to update the funding position in future years. The UK Spending Review on 11 June 2025 will confirm how the UK Government plans to allocate spending between departments. We have assumed that spending in devolved areas grows broadly in line with planned total growth in departmental budgets, with an adjustment to capital spending for announcements on defence spending. However, should the UK Government choose to allocate less to devolved areas, such as by further prioritising defence, it will result in funding being lower than we forecast."

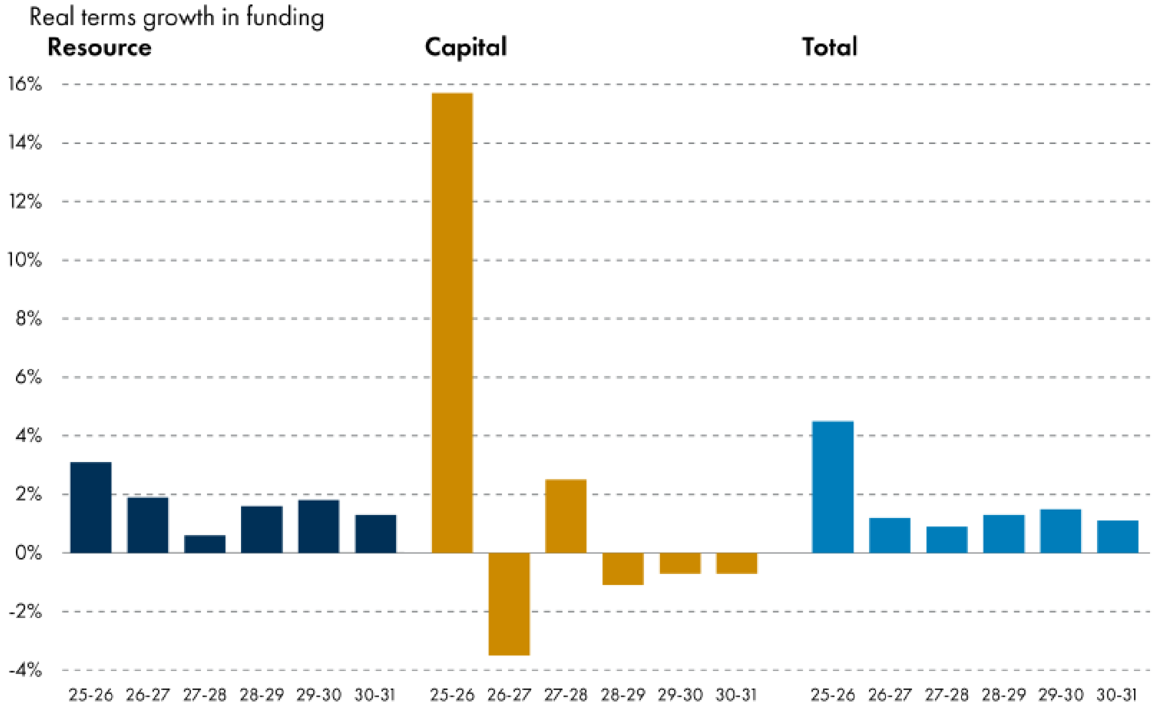
Resource funding grows in each year, although slows in 2027-28 due to a larger anticipated income tax reconciliation (this relates to the 2024-25 budget year). Reconciliations take place when actual tax receipts turn out to be different from the forecast receipts that were factored into the budget when it was set.

**Total funding is forecast to grow steadily over the forecast period, although this is largely due to growth in resource funding; capital remains fairly flat**



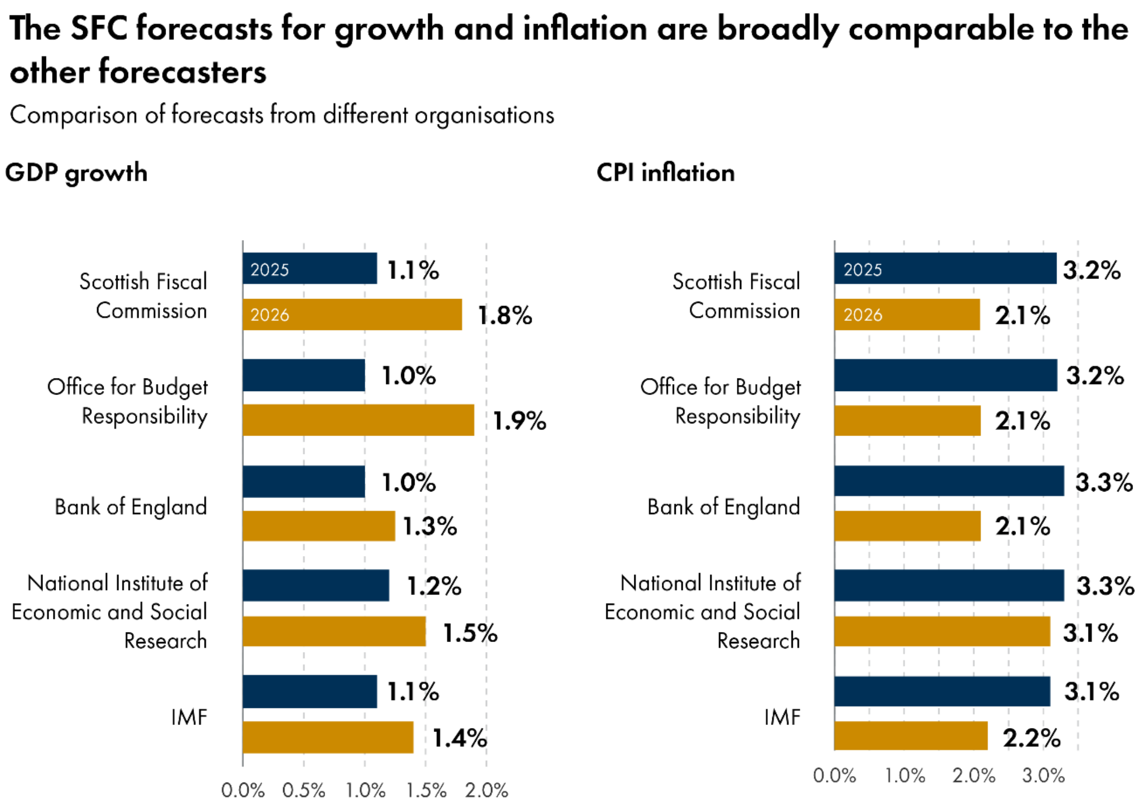

The SFC notes that the outlook for capital funding is more variable. Capital funding is more reliant on decisions made by the UK Government – around 85% of the 2025-26 capital budget is the core Barnett settlement. In total, the capital budget is projected to grow by just under 6% between 2025-26 and 2030-31 in cash terms. While the capital budget grew significantly between 2024-25 and 2025-26 (15.7% growth in real terms), it is then expected to decline in four of the next five years in real terms.

**In real terms, resource funding grows by almost 2% per year, other than in 2027-28. Capital funding declines in real terms in 4 of the 5 forecast years.**




## How do the economic forecasts compare to other forecasters?

There have been several recent forecasts of the UK economy; from the Office for Budget Responsibility (OBR) in March 2025 to accompany the UK Spring Statement, from the Bank of England in their May Monetary Policy Report, from the National Institute of Economic and Social Research (NIESR) in their UK economic outlook (May), and from the International Monetary Fund (May).




Looking across these forecasts, there is a broad consensus that growth in 2025 is likely to be relatively muted in Scotland and the UK, and recent forecasts expect this to pick up slightly in 2026. On inflation, the forecasters expect a slight reduction throughout 2025 following the increase in April, with most forecasters expecting inflation to fall to closer to the Bank of England's 2 per cent target by the end of 2026.

The SFC forecasts for Scotland look broadly comparable to these UK forecasts; economic growth is expected to be marginally higher than the OBR and the Bank of England expect for the UK in 2025, and both the SFC and the OBR expect slightly higher growth in 2026 than the Bank, NIESR or the IMF, and the SFC's inflation expectations (for the UK) are consistent with most of the other forecasts for the UK.

## What are the key changes since the last forecast?

The economic outlook for Scotland has not changed significantly since the last forecast, which was published alongside the Scottish Budget in December 2024. There is a slight reduction in expected growth during 2025, reflecting slightly weaker data at the end of 2024 and early in 2025. There are a few more significant changes though:

- The OBR forecasts for average earnings in the UK have changed, and are now more in line with the SFC projections for Scotland. This reduction in the difference between Scottish and UK performance has implications for the tax forecast, and importantly the block grant adjustment (BGA), which is the amount by which the Scottish Government's block grant is adjusted to reflect devolved tax and social security powers. The improved outlook for earnings growth in the UK means that the block grant adjustment will be larger than anticipated at the time the 2024-25 Budget was set, which means there will be a reconciliation in the 2027-28 Budget.

- The SFC now expects greater social security spending compared to social security BGAs, particularly in the later years of the forecast. £0.2 billion is due to the cost of the Scottish Government's policy to mitigate the two child cap, and £0.4 billion is due to reduction in the BGA following changes announced to UK welfare policy this year. If the UK Government changes any decisions that have been announced – for example to the two child cap or winter fuel allowance – this would affect the mitigation costs and the net position on social security.

- Total funding in 2025-26 is nearly £0.8 billion higher than assumed in December, because of additional UK Government funding and an increase in drawing down from the Scotland reserve (£200 million was added to Scotland reserve in the 2024-25 Spring Budget Revision which will be drawn down in 2025-26).

## Budget net tax position

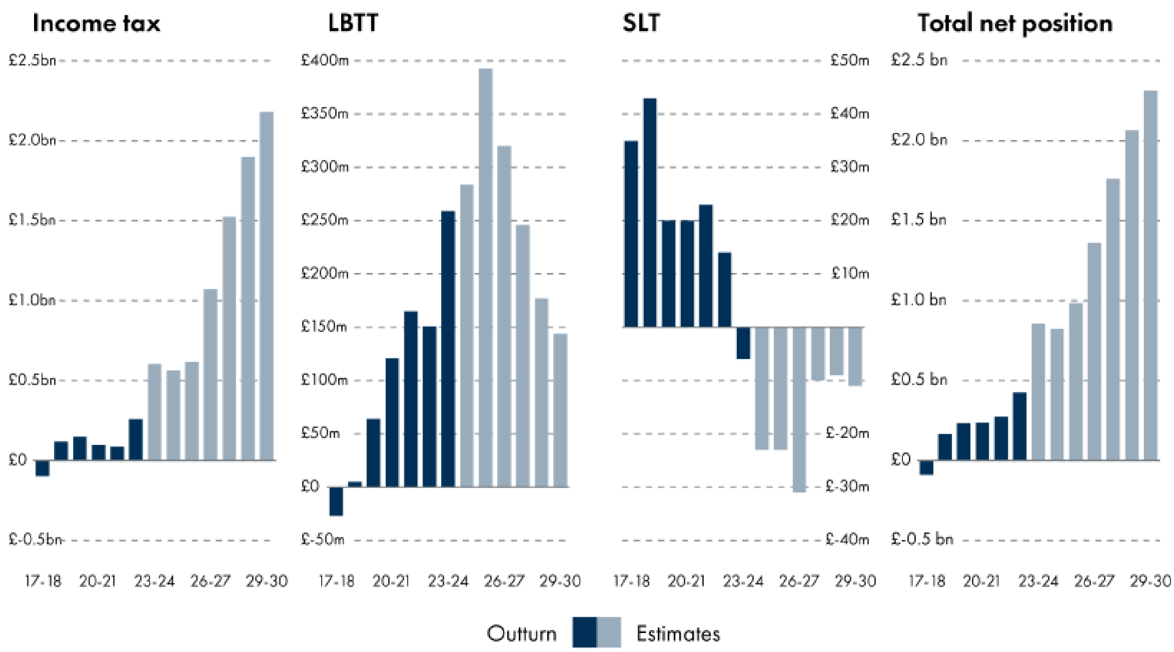
One of the important features in the operation of the fiscal framework is the economic performance of Scotland relative to the UK, as set out in a previous SPICe blog. The SFC forecast will set out how much is expected to be raised by devolved taxes in Scotland, while the OBR forecast will set the amount by which the Scottish budget will be reduced through the block grant adjustment for devolved taxes.

While the resources available in budgets are set using forecasts, when actual (outturn) data is available this is reconciled. The SFC forecasts the net tax positions in future years using the latest assumptions from the OBR.

Of course, it isn't just relative economic performance that affects the revenues raised by devolved taxes – policy choices do as well. Since 2017-18, the Scottish Government has increased the number of bands and changed the rates in Scotland, with the net effect that while most taxpayers will pay less than they would in the UK, higher earners will pay more.

**The net tax position is forecast to grow significantly over the period, largely driven by income tax. The LBTT net position is forecast to grow initially then decline, while the SLT net position is forecast to be negative.**

Devolved taxes - net position




As noted above, one of the main differences between the latest SFC forecasts and its December 2024 forecast is the relative improvement in the OBR's forecast for earnings growth in the UK. The impact of this is to reduce the difference that existed at the time of the previous SFC forecasts which informed the 2024-25 and 2025-26 Scottish Budgets. A smaller positive difference means that the Scottish Government should have had fewer resources available than was assumed, and so this difference will impact future budgets. The SFC explain that:

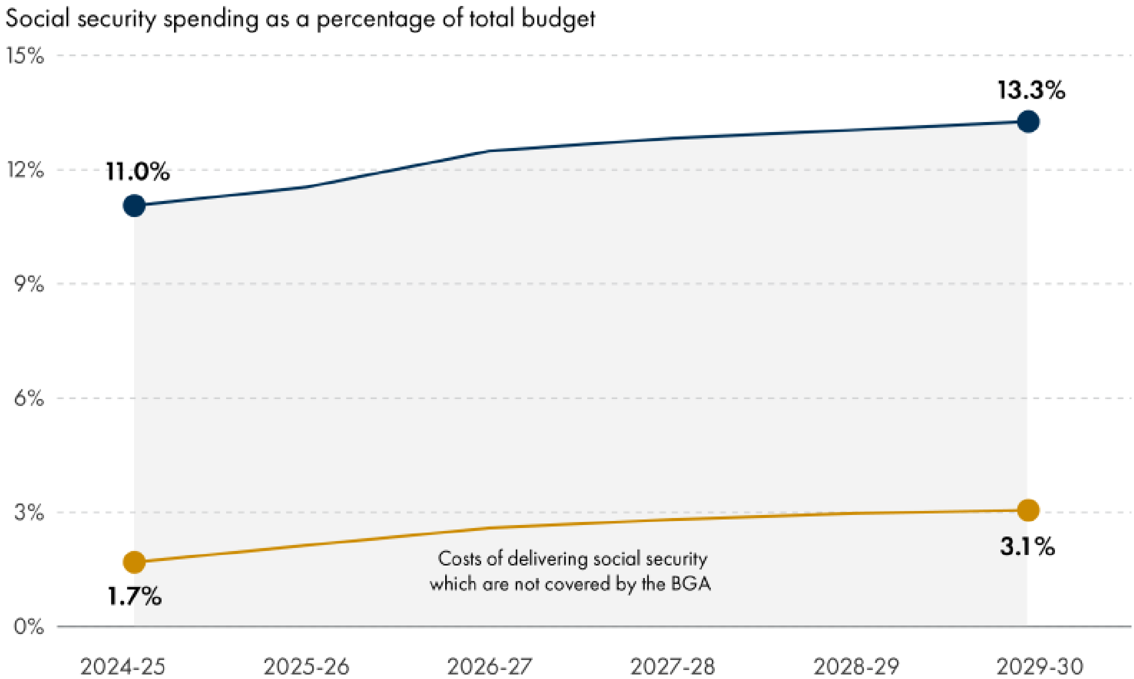
> "There is a large negative reconciliation of £851 million currently projected for 2027-28 relating to the 2024-25 Income Tax net position. This is largely because the Block Grant Adjustment (BGA) has increased by substantially more than our Scottish Income Tax forecast since the 2024-25 Budget was set in December 2023. The reconciliation has become more negative since December 2024 when we projected it at minus £701 million. If a reconciliation of this scale materialises, it will exceed the borrowing limit, which is currently forecast to be £663 million. Therefore, resource funding in 2027-28 may be reduced even if the Scottish Government makes full use of its borrowing powers."

## Social security expected to account for an increasing proportion of resources

Following the Scotland Act 2016, aspects of social security have been devolved to the Scottish Parliament. From a fiscal point of view, this operates in a similar way to the tax reconciliation. The OBR calculates what expenditure on social security would be in Scotland if there was no policy divergence, and this determines the block grant adjustment. The Scottish Parliament then sets social security policy, and any differences in the cost of delivery compared to the BGA must be covered from elsewhere in the Scottish Budget.

The Scottish Government has adopted policy which has broadly increased access to existing social security payments, introduced new policies such as the child payment, and spent or committed to spend to offset the impact of certain UK policies such as the two-child cap and winter fuel payment. As a result, the costs of delivering social security policy in Scotland have consistently been higher than the BGA, and the SFC forecasts that this gap will continue to grow.  However, as noted above, any changes to UK policy in these areas would have implications for the gap between BGAs and Scottish social security spend.

**Social security spending rises as a proportion of total funding over the forecast period. The difference between total spending on social security in Scotland and the block grant adjustment also increases, reflecting policy divergence between the Scottish and UK Governments.**




This chart shows that as a proportion of total spending, social security is expected to rise from 11.0% in 2024-25 to 13.3% in 2029-30. Meanwhile, the difference between the social security BGA and the costs of delivery in Scotland is expected to increase from £922 million in 2024-25 to over £2 billion by the end of the forecast period – accounting for over 3% of all spending.

## How will the Scottish Government respond to this fiscal pressures?

The Scottish Parliament must balance its budget, which means fiscal pressures such as lower than expected revenues from devolved taxes, relatively stronger economic performance in the rest of the UK, or pressure to increase spending in areas such as social security will require trade-offs with other policy areas.

In recent fiscal sustainability reports, the SFC has highlighted two long term challenges which will increase the pressure on the Scottish Budget – the transition to net zero with the significant investment required (alongside the costs of adapting to an already changing climate), and the demographic challenge that Scotland and other developed countries face through aging populations.

The updated forecast from the SFC sets out the financial context for the remainder of this parliamentary session, and suggest that the final Scottish Budget before the election will face some difficult trade offs. Next month's publication of the MTFS and the Fiscal Sustainability Delivery Plan should provide us with more information on where the Scottish Government intend to prioritise funding, and how they plan to address the medium term challenges.

**Andrew Feeney-Seale, Senior Researcher, Financial Scrutiny Unit, and Andrew Aiton, Data Visualisation Manager**