University of Strathclyde Glasgow

Fraser of Allander Institute

Economic Commentary

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Foreword

With the UK economy having entered a technical recession in the second half of 2023, it wouldn't be unreasonable to suggest that 2024 dawned amidst a climate of economic uncertainty.

And despite some positive headlines surrounding the UK Government's Spring Budget, with the Chancellor stressing the ideological importance of a high growth and lower tax economy, the headwinds that have continued to plague the nation's sluggish economy – geopolitical crises, elevated energy prices and continued concern over interest rates and inflation – have not dissipated.

Forecasts from The Office for Budget Responsibility (OBR) published alongside the Spring Budget were mixed, with the UK economy expected to grow this year, but only by 0.8%. With a General Election looming, this provides a challenging set of circumstances for the Government, with political stakes running particularly high.

However, soundings on borrowing and inflation were welcomed, with inflation predicted to drop below the Bank of England's 2% target earlier than expected and disposable incomes set to recover after one of the biggest hits to living standards in recent memory.

This quarter's Commentary highlights that, unlike the rest of the UK, Scotland narrowly avoided a technical recession in the latter half of 2023, growing by 0.4% in Q3 and contracting by -0.6% in Q4. While this is undoubtedly positive for Scotland and does offer hope, the bigger economic picture remains disappointing, with growth in the Scottish economy lacklustre in 2023.

It's no secret that our economic landscape continues to be overshadowed by persistent challenges, with underlying issues on tax, public spending and debt casting doubt on sustained growth and prosperity. While this Commentary shows that consumer sentiment has risen 4.8% over the last quarter and 23% over the last year, consumers remain historically downbeat about their own finances, reflecting the challenging economic and financial pressures facing households.

This explains why attention is now turning towards the cumulative impact the last few years have had on individuals, households and businesses, with my colleague Ian Stewart recently noting that there has been "no breathing space from crises".

Published last month, Deloitte's latest State of the State report, which explores attitudes towards Government and public services, found that infrastructure and the availability of affordable housing have risen up the Scottish public's list of priorities.

Indeed, this quarter's Commentary looks closely at the Scottish housing market. The volume of property sales increased towards the latter parts of 2023 and early 2024 while prices have also been rising. Demand is high, but shortcomings in meeting this demand are driving prices upwards.

Compared to other parts of the UK, the Institute finds that affordability is less of an issue in Scotland, but concerns around the supply of housing and shortcomings in the number of new homes being built remain for both private and social housing. Three local authorities have declared housing emergencies since June last year and more are expected to follow. This chimes with our State of the State findings, with 46% of the Scottish public surveyed noting the availability of affordable housing as a top priority for Government, and 57% expecting the availability of affordable housing to worsen in the years ahead.

While this paints a more negative picture, it's worth noting the resilience the Scottish property market has shown in recent years. The potential high unemployment, financial stress and big company failures that faced the property industry a couple of years ago have not materialised. The housing market has held up, withstanding expectations of sharply lower house prices and providing reason for cautious optimism.

This quarter's Commentary sees the introduction of a real-time earnings tracker for Scotland, which will delve into trends and ascertain if forecasts from the Scottish Fiscal Commission (SFC) hold true in the forthcoming financial year.

Data from HMRC's real-time information (RTI) system shows that there has been growth in total employee pay in Scotland above that for the UK as a whole, growing year-on-year at 9% in Scotland, compared to 8.1% in the UK.

This was particularly prevalent in the Health and Social Work sector, likely due to pay settlements in the wake of inflationary pressures and minimum wage increases in the social care sector. Average pay has also grown considerably more in Scotland, in sectors including finance, information and agriculture, at 7.8% compared to 6.2% in the UK.

With the National Minimum Wage and the National Living Wage set to increase at the start of April, attention now turns towards the cohorts who will fare better than others.

And, despite inflationary pressures beginning to ease across the economy, with data from the Office for National Statistics showing UK inflation has dropped to its lowest level in over two years, some sectors may find that this is offset by rises in wage costs, with industries that have a higher proportion of employees earning the National Minimum Wage most affected.

As we look to the year ahead, the future of the UK's economy will be shaped by the prospect of potential new leadership. What is clear is that a serious fiscal hangover remains, which points towards a challenging long-term prognosis for whoever takes the reins after the next General Election.

For Scotland, addressing structural issues while fostering resilience will be imperative, ensuring that despite the hurdles, the country paves the way for sustainable growth and prosperity.

Douglas Farish, Head of Tax for Scotland at Deloitte

March 2024

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ECONOMIC COMMENTARY

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Summary

Economic data in early 2024 is showing that the economy is likely to be recovering hesitantly as expected, following the contractions in growth in the final part of 2023.

We have, therefore, left our forecasts unchanged in this edition of the commentary. We are forecasting growth of 0.6% in 2024, 1.1% in 2025 and 1.2% in 2026.

Bright spots for the UK as a whole can be seen in inflation data, with the latest showing that Consumer Price Inflation fell to 3.4% in February, adding to hopes that interest rate cuts are likely to be coming over the course of 2024. January GDP data for the UK also shows growth after a poor end to 2024.

Less positively, the growth expected is fragile and may be blown off course by events, particularly given geopolitical uncertainty this year.

In Scotland, consumer sentiment has risen 4.8 points over the last quarter and 23 points over the year, indicating a significant improvement in sentiment across Scotland. However, most indicators remain in negative territory (i.e. more people being negative than positive about their circumstances) reflecting the challenging economic and financial pressures facing households.

In this edition of the Commentary, we include a real-time earnings tracker to focus on what the latest data is telling us about earnings in Scotland (including compared to other regions of the UK). This is important not just for us to understand the trend in Scottish living standards, but is also important given the implications for the income tax tae in Scotland (and therefore, impact on the Scottish Government's budget).

We also focus on the implications of the changes to the national minimum wage being introduced in April 2024, and an analysis of the major public policy priorities for citizens in Scotland. These include health care and the NHS, inequality & poverty, housing and cost of living.

One fiscal event is over, but we are not far from another in Scotland! This edition includes the implications of the UK Budget on 6th March for Scotland, including the second National Insurance cut, the impact of the overall tax burden, and the impact of UK Government spending decisions on the Scottish Government's Budget.

The lack of significant changes on resource and capital departmental spending further confirms the tough fiscal environment for the Scottish Government, and this will become apparent again when Deputy First Minister Shona Robison presents the Medium-Term Financial Strategy (MTFS) on 30 May – our next date for the fiscal calendar.

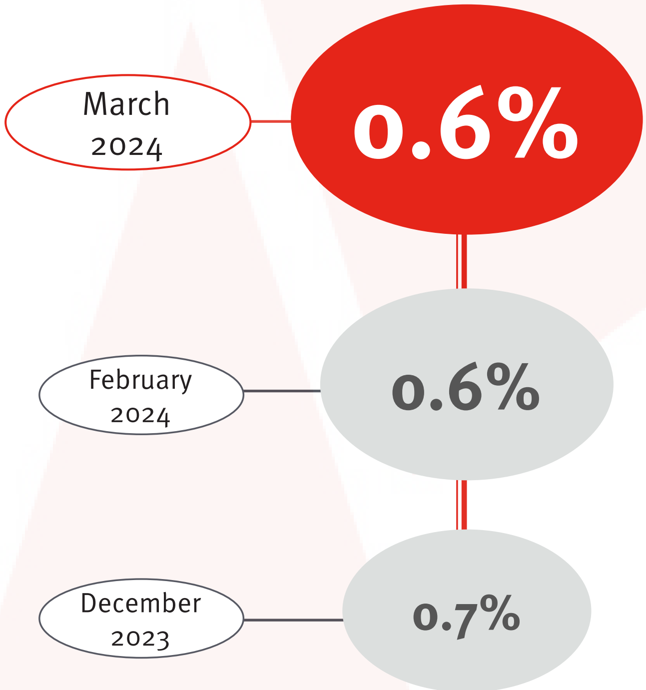
The 2023 MTFS had a £2.4 billion shortfall in funding built in for 2025-26, and with so much of the £1.5 billion shortfall in 2024-25 being filled by delaying projects, more difficult decisions are likely to be on the way.

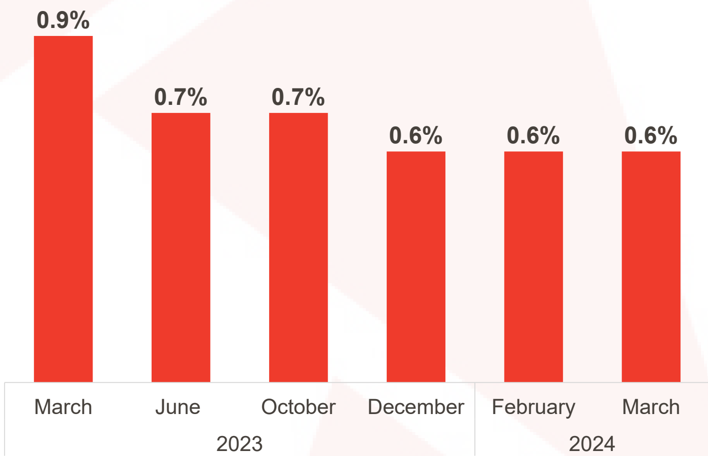
Fraser of Allander Institute
March 2024

Fraser of Allander Institute Economic Forecasts

March 2024

Point forecast





	2023	2024	2025	2026
FAI *March 2024*	0.2%	0.6%	1.1%	1.2%
FAI *February 2024*	0.2%	0.6%	1.1%	1.2%
SFC *December 2023*	0.1%	0.7%	1.1%	1.3%

"This quarter we've held our economic forecasts from February 2024 at 0.6%. With recent announcements by the OBR that inflation will likely return to the BofE target of 2% earlier than expectations, the outlook for economic growth may improve."

Professor Mairi Spowage
Director, Fraser of Allander Institute

Scottish Economy Dashboard

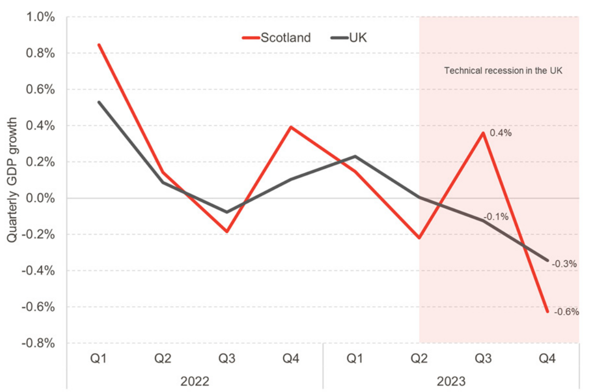
The outlook and appraisal of Scotland's economic indicators

Our Scottish Economy Dashboard aims to provide a snapshot of the latest economic data, pulling out the key themes and findings from the latest data available for the Scottish and UK economy.

Unlike the UK, Scotland avoided a technical recession in the latter half of 2023, growing by 0.4% in Q3 and contracting by -0.6% in Q4.

However, big picture growth in the Scottish economy has been lacklustre from the start of 2023 onwards, with average quarterly growth of 0.1%.

Chart 1: Scottish and UK Quarterly GDP Growth, Q1 2022 – Q4 2023

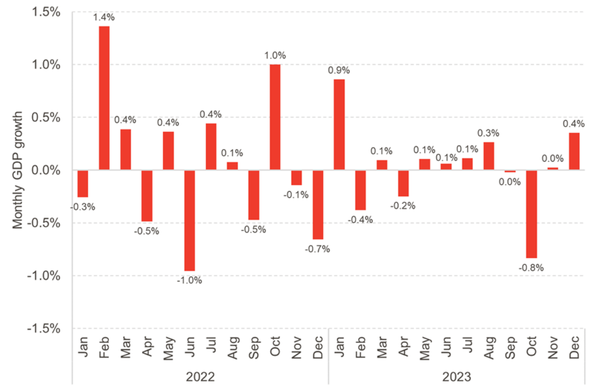


Source: *Scottish Government*

Looking closer at the 2023 data for Scotland, October marked a -0.8% contraction in the economy as a whole, with growth of 0.4% in December partly offsetting this fall in economic activity.

Q4 2023 saw the largest decline in economic output of the Scottish manufacturing sector since the onset of the COVID-19 pandemic, shrinking by -3.7%. Meanwhile, the services sector in Scotland performed comparatively better, shrinking by -0.1% over the quarter.

Chart 2: Scottish monthly GDP growth, January 2022 – December 2023

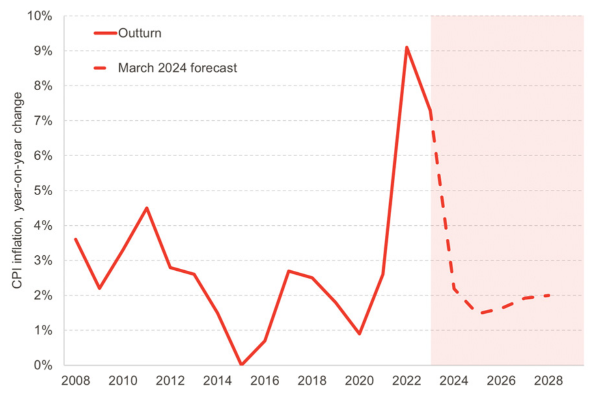


Source: *Scottish Government*

Inflation peaked in Q4 of 2022 at 10.7%. Since then, inflation has fallen steadily, sitting at 3.4% for the latest month, February 2024.

Looking to the future, inflation is expected to fall faster than previously expected, descending below the Bank of England's target rate of 2% in the second quarter of 2024.

Chart 3: CPI inflation outturn and OBR March, 2024 forecast, 2008 – 2028

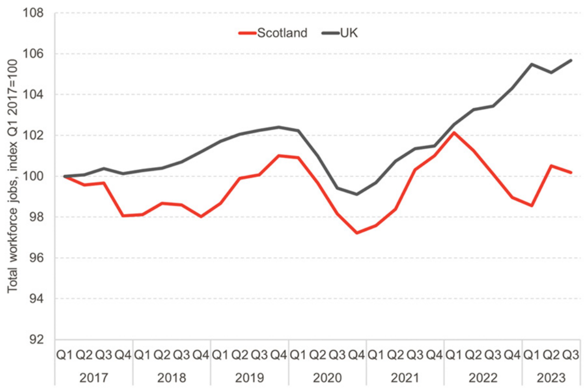


Source: *OBR*

In Q3 of 2023, there were 2.8 million workforce jobs across the Scottish economy – a number that contracted -2% relative to the previous quarter.

More broadly, there has been a significant deviation in employment across Scotland and the UK since the start of 2022. During this period, employment in the UK grew by 3.1%, whereas employment in Scotland contracted by -1.9%.

Chart 4: Total workforce jobs in Scotland and the UK, Q1 2017 – Q3 2023

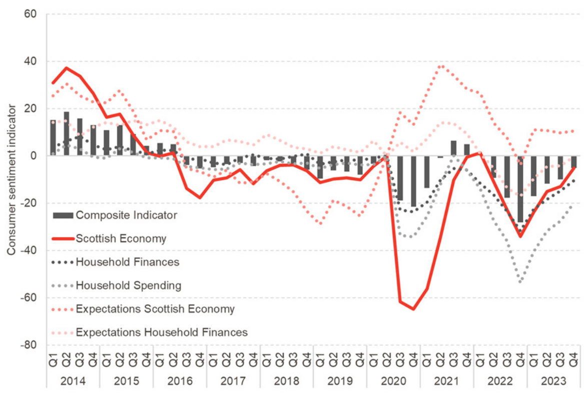


Source: *ONS*

Consumer sentiment has risen 4.8 points over the last quarter and 23 points over the year, indicating an improvement in sentiment across Scotland.

Yet, most indicators remain in negative territory, reflecting the challenging economic and financial pressures facing households.

Chart 5: Scottish Consumer Sentiment Indicators, Q1 2014 – Q4 2023



Source: *Scottish Government*

Productivity in the UK fell by -0.6% in the final quarter of 2023 and was -0.3% lower this quarter compared to the year prior.

Compared to other countries across the G7, productivity in the UK was 13% lower than France and 18% lower than the US and Germany, yet 4% above Italy and 6% above Canada.

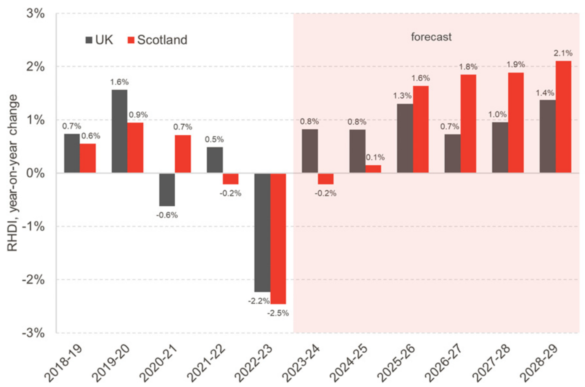
Chart 6: Flash estimates of UK labour productivity, Q4 2022 – Q4 2023

Source: *ONS*

Following a significant cut in disposable incomes in both Scotland and the UK in 2022-23, RHDI – a measure often associated with living standards – is forecasted to improve in the UK from 2023-24 onwards and in Scotland from 2024-25 onwards.

Looking ahead, living standards in the UK are projected to see faster growth in the short-term compared to Scotland, while living standards in Scotland are expected to advance comparatively better over the medium term.

Chart 7: Real household disposable income (RHDI) per person, Scotland and UK, 2018-29 to 2028-29



Source: *OBR*

Real-time Earnings Tracker

As we highlighted in our previous commentary, the Scottish Fiscal Commission (SFC) dedicated a large part of their December 2023 Economic and Fiscal forecasts on the data on earnings.

In particular, the evidence on faster earnings growth in Scotland when compared to the rest of the UK and why this is likely to continue into 2024-25.

The introduction of this new earnings tracker in our commentary seeks to explore these trends in real-time earnings.

Data from HMRC's real-time information (RTI) system shows there has been growth in total employee pay in Scotland above that for the UK as a whole.

Total employee pay grew 8.7% year-on-year in Scotland in the first six months of 2023-24, which is higher than the UK, 8.1%

This was particularly prevalent in the Health and Social Work sector, in both Scotland and the UK, with spending on wages and salaries the largest contributor.

Average pay has also grown considerably more in Scotland, however, despite the number of jobs in the health and social work sector growing more slowly.

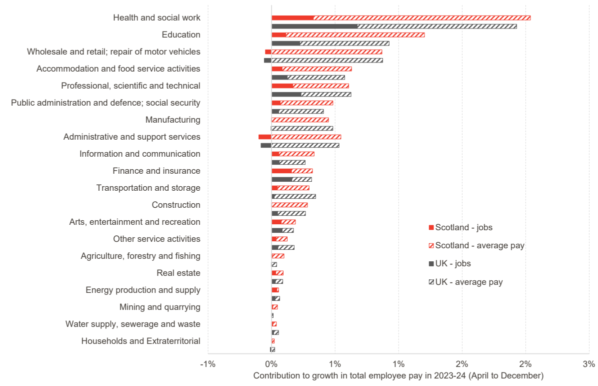
The main differences in contributions to growth in wages continues, however, come from industries where the public sector is concentrated, such as education and public administration.

Salaries in education grew annually at 8.3% in Scotland in the first 9 months of this financial year, compared to 6.6% in the UK as a whole.

This was similar to the Public Administration sector, with growth in wages of 7.8% in Scotland, compared to 7.3% in the UK.

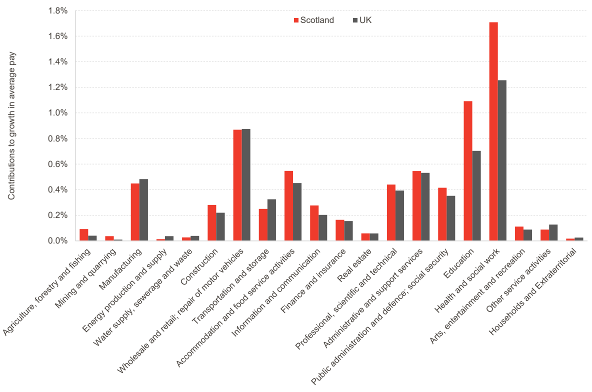
Looking across the regions of the UK, Scotland ranked 4th across the regions of the UK. Despite this, Scotland saw faster total pay growth year-on-year to December 2023 than all other regions of the UK.

Chart 8: Contributions to growth in total pay in Scotland and the UK by Industry



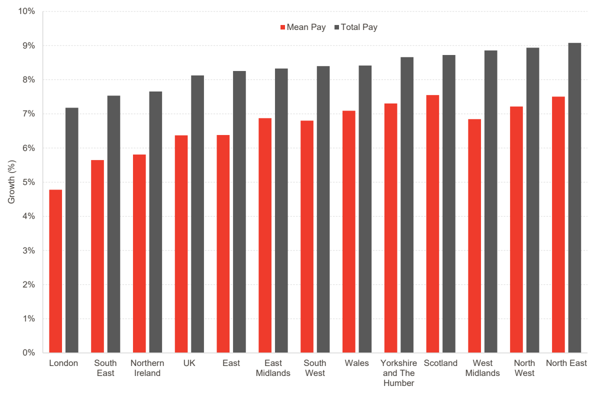
Source: *HMRC, ONS, FAI Calculations*

Chart 9: Contributions to growth in average pay, Scotland vs UK, YTD (Apr-Dec), 2022-23 vs 2023-24



Source: *HMRC, ONS, FAI Calculations*

Chart 10: Growth in mean pay and total pay, UK regions, YTD (Apr-Dec), 2022-23 vs 2023-24



Source: *HMRC, ONS, FAI Calculations*

The implications of changes to the national minimum wage

The National Minimum and Living Wage is set to rise in April, following the chancellor's announcement in his 2023 Autumn statement.

These changes will see the extension of the National Living Wage (NLW) to include workers aged 21-22, in addition to increasing the NMW rates across all age bands, affecting all NMW employees and employers across the UK.

Table 1 outlines the new rates of NMW.

Table 1: National Minimum Wage rates, April 2021 - April 2024

	Apprentice	Under 18	18 to 20	21 to 22	23 and over
April 2021	£4.30	£4.62	£6.56	£8.36	£8.91
April 2022	£4.81	£4.81	£6.83	£9.18	£9.50
April 2023	£5.28	£5.28	£7.49	£10.18	£10.42
	Apprentice	**Under 18**	**18 to 20**	**21 to 22**	**23 and over**
April 2024	£6.40	£6.40	£8.60	£11.44	-

Source: *UK Government*

These changes will affect National Living Wage employers in two ways:

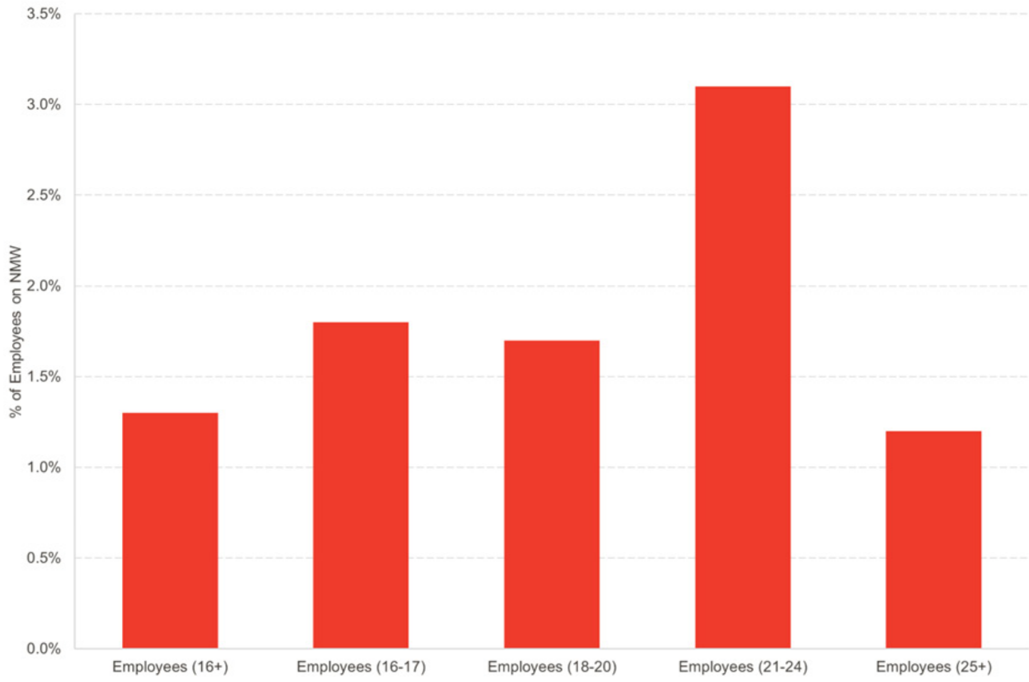
- Increased wage costs for all employees earning NMW.
- Additional increases in wage costs for employees employing higher numbers of individuals aged 21-22.

For example, a 23-year-old worker, working 37.5 hours per week earning NLW will see an increase in their annual pay (prior to any adjustments) of just under 10%. However, workers aged 21-22 working the same hours will see an increase of over 12%, as they begin to earn the NLW.

Given this, the expectation is that industries where employment of those aged 21 and 22 years is more concentrated, are likely to face much higher wage and salary costs, given the changes to the National Living Wage.

In 2023 there were approximately 366,000 employees in the UK earning the National Living Wages, with those aged 21–24-year-olds more likely to be earning NMW compared to any other age group, at 3.1%. See Chart 11.

Chart 11: Share of employment on National Minimum Wage by Age, 2023



Source: *ONS*

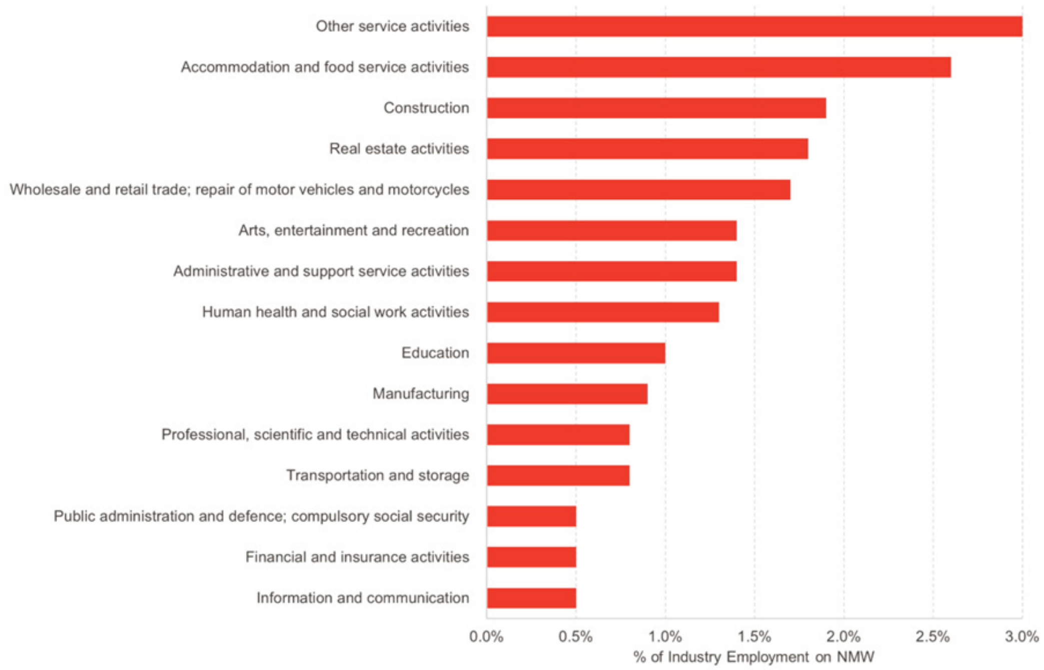
Certain industries will also have a higher prevalence of employees earning the National Minimum Wage, and so will experience a greater increase in wage and salary costs from the upcoming changes in NMW.

These include hospitality and service industries, construction, real estate and retail, as shown in Chart 12.

However, industries that employ a large share of 21–22-year-olds on NMW will be most affected by these changes.

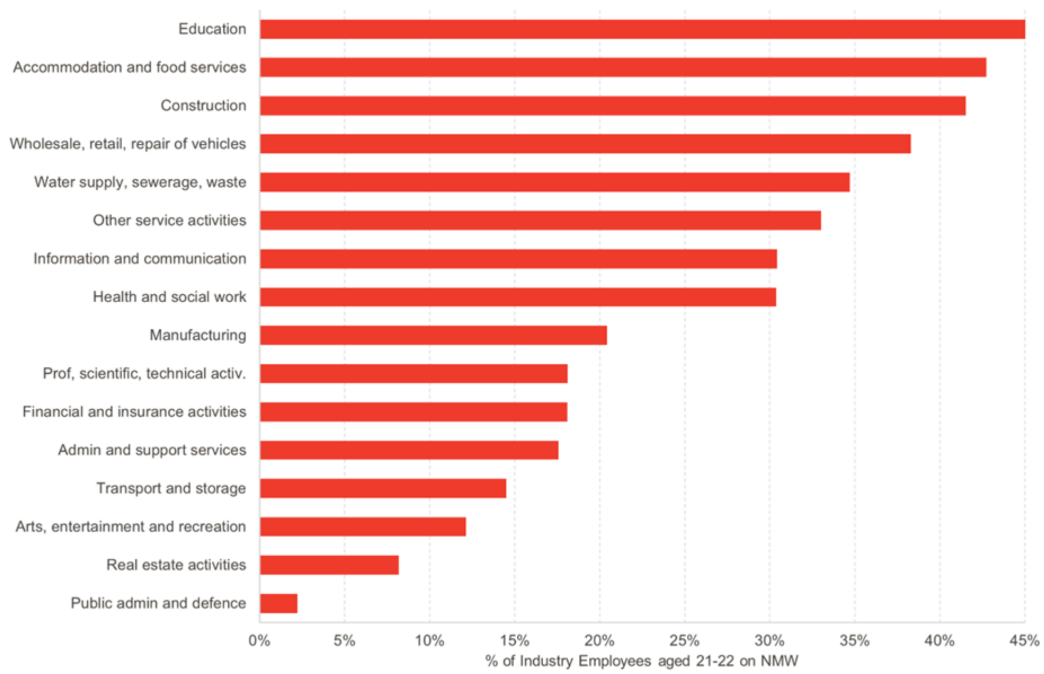
Initial analysis using Annual Population Survey data provides some insight into NMW employment by age and industry. We found 21–22-year-olds earning NMW were most likely to be employed in the education, hospitality, construction or retail sectors. See Chart 13.

Chart 12: Share of Employment earning National Minimum Wage by Industry, UK, 2023



Source: *ONS*

Chart 13: Share of employment aged 21–22-year-olds by industry, UK, 2023



Source: *Annual Population Survey, FAI Calculations*

These findings, in addition to the ONS data presented above, provide insight as to the industries that are likely more impacted by the upcoming changes to the National Minimum Wage.

In particular, employers in more consumer facing industries, such as hospitality and retail, are likely to see more increased wage and salary costs.

These sectors have also been more heavily impacted as a result of the higher inflationary pressures in recent years, with high food, fuel and electricity prices already substantially increasing their costs.

The concern, therefore, is that despite many of the inflationary pressures beginning to ease across the economy, these sectors may find that any easing of inflationary cost pressures may be offset by equivalent rises in wage and salary costs.

The emerging public priorities for Scotland

With the challenging conditions facing Scotland's economy beginning to ease, much of the emerging research has pivoted its focus to the impact that the past few years has had on individuals and households.

As well as this, the turn into a likely election year brings about questions as to what issues the general public feel are the most prevalent in the economy currently and therefore what should be the priorities for any new government.

This includes the more recent State of the State Scotland report published by Deloitte for 2024, which aims to examine public sentiment towards government and public services.

In this, the research found that issues such as the cost of living and the National Health Service were of most concern to the Scottish public, with concerns surrounding infrastructure and housing also prevalent.

At the beginning of March, the David Hume Institute also published their latest Understanding Scotland's Economy Tracker. The survey, produced quarterly, provides insight as to the economic attitudes and spending intentions of over 2000 members of the Scottish population.

In the report, key results included findings that over two-thirds of individuals had reduced spending on non-essential purchases, with 64% and 62%, of individuals respectively cutting back on energy use and leisure activities. As well as this, more notably, their findings also suggested that 58% of Scots thought the country was headed in the wrong way.

Both of these reports found that very similar issues were of concern to the Scottish public, highlighting to us the need to better understand the economic landscape surrounding these areas of society.

Of interest to us was the findings on what the general public perceived as priority areas across the Scottish Economy. Some of the key priorities identified in these reports included:

- Healthcare and the NHS
- Inequality and Poverty
- Housing
- Cost of Living and Inflation

We analyse each of these priority areas throughout this section.

Healthcare and the NHS

What is clear from both Deloitte's and The David Hume Institutes reports is that health care and the National health Service are of the utmost concern to the Scottish public.

The National Health Service is facing significant pressure, in part given the longer-term effects of the Covid-19 pandemic, however also more emergent issues related to staff shortages and pay disputes.

This ultimately means that both in Scotland and across the wider UK, the health service is performing relatively poorly against its own targets.

Referral to treatment time (RTT) refers to the time taken between an individual being referred for treatment and receiving it. In Scotland, the target RTT time is 18 weeks, or approximately 4 months.

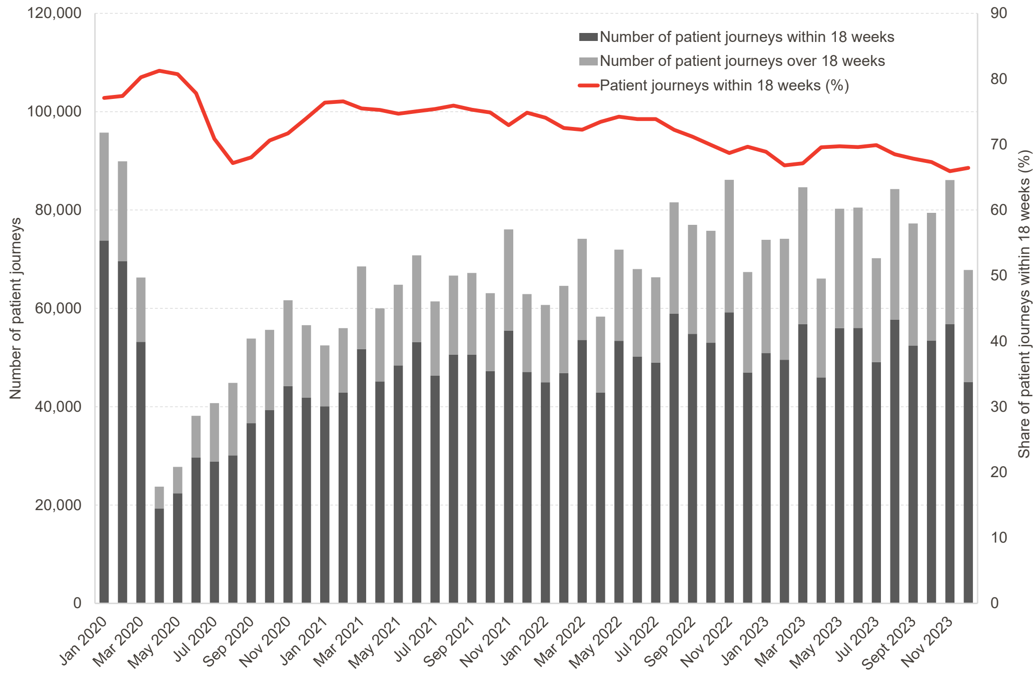
As of December 2023, 66% of patient journeys met this target, with the remaining 34% taking more than 18 weeks.

The share of journeys completed within 18 weeks has gradually declined on pre-pandemic levels, with the share around 10 percentage points lower in December 2023 than in January 2020.

Put simply, this means that over the past few years, the health services performance against this target has worsened, despite a lower number of patient journeys as of December 2023.

The concern, therefore, is that until the NHS can recover its hospital activity back to pre-pandemic levels, it is highly likely that both waiting lists and times will continue to grow.

Chart 14: Number of patient journeys within and over 18 weeks vs share of patient journeys within 18 weeks, Scotland, January 2020 – December 2023



Source: *Public Health Scotland*

As previously mentioned, one of the key concerns, beyond the issue of ensuring that individuals are able to receive the treatments they require, is the implications for the labour market that having higher individuals receiving treatments causes.

In particular, where individuals require procedures to see them return to full health and having them inactive in the labour market, and the likely implications for productivity this has.

In our recent productivity index, published in collaboration with the Confederation of British Industries, our analysis highlighted that the share of Scotland's economic activity due to long-term sickness had risen, marginally, to 31.7%.

This was above the UK average of 25.8%, however was still lower than both Wales' (34%) and Northern Ireland (34.2%).

As well as this, the percentage of hours lost to sickness absence had risen from 2.1% to 3% in 2022, suggesting a significant rise in short-term sickness absence, which remains above pre-pandemic levels of 2%.

Whilst the issue surrounding longer waiting times is of clear concern, the Scottish Government have committed to reducing waiting lists. When the First Minister spoke at his party conference in October 2023, he outlined a proposal to spend an extra £100m per year on reducing NHS waiting lists.

As well as this, improving the NHS and healthcare is a priority area set by The Scottish Government as part of its budget setting process.

In the latest budget for 2024-25, The Scottish Government committed over £19.5bn billion to Health and Social Care, which included over £13.2bn allocated to frontline NHS boards to help improvement healthcare in their communities.

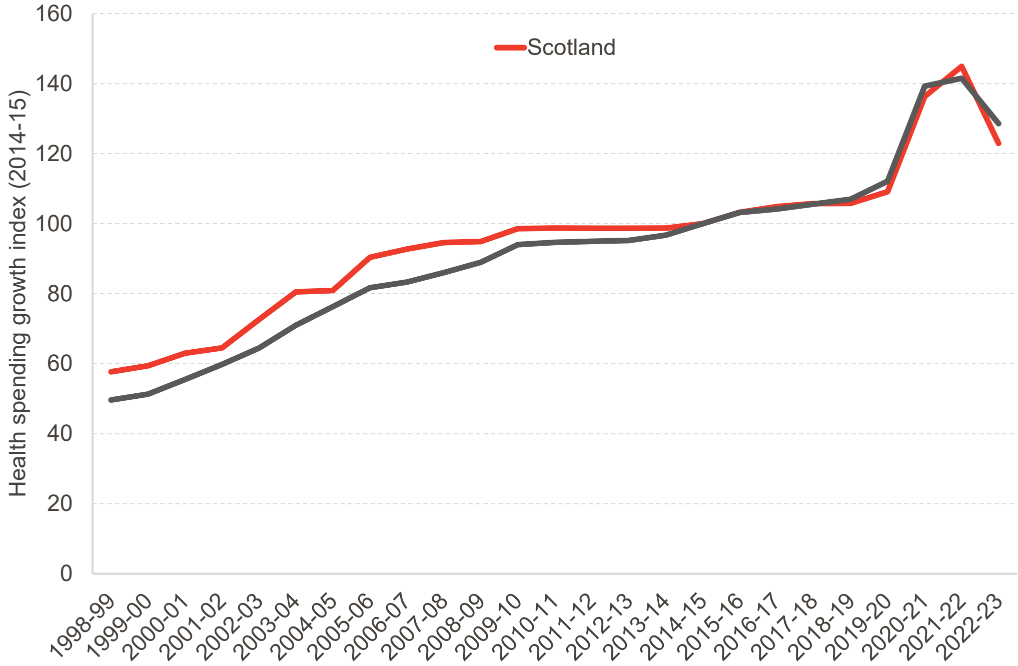
Health has always been one of the most prominent spending portfolios for the Scottish and UK Government and is the largest area of spend for the Scottish Government to date.

Chart 15 highlights that growth in spend on health in Scotland has followed a very similar trend to that of the UK since the Scottish Parliament was established, and hence healthcare devolved, in 1999.

Despite these levels of record spending, projections by the Scottish Fiscal Commission estimate that in order for Scotland to meet the future demands of its healthcare service, real terms health spending will need to increase by around 3% per year in the late 2020's and 2030's.

This is due to the significant demographic challenges facing the Scottish population over the coming reasons, with a more rapidly ageing, and less healthy population likely to place more demand on many health services.

Chart 15: Growth in real terms spending on health (2014/15=100), Scotland and UK



Source: *Government Expenditure and Revenue Scotland*

In their response report to the 2024-25 Scottish Budget, the Institute for Fiscal Studies highlighted that Scottish health spending per person has grown significantly in real terms, from £1,659 per head in 1999-2000 to £3,073 in 2022-23.

Further to this, the number of staff working in the Scottish NHS increased substantially since the beginning of the pandemic, with increases in the number of consultants, junior doctors and nurses, of 11%, 16% and 8%, respectively.

Despite this, it is the poorer recovery of measured hospital activity post-pandemic that appears to be driving NHS productivity, with lower elective day-case patients, emergency admissions, outpatient appointments and elective inpatient admissions when compared to pre-pandemic levels.

Whilst NHS employment is at record highs, staff shortages have been reported across the majority of health boards. This includes concerns expressed by the British Medical Association towards the end of 2023 that staffing levels were at dangerously low levels across Scotland[1].

These staff shortages, as well as the widespread industrial action seen over the past year are seen to be stalling some of the services ability to reduce backlogs.

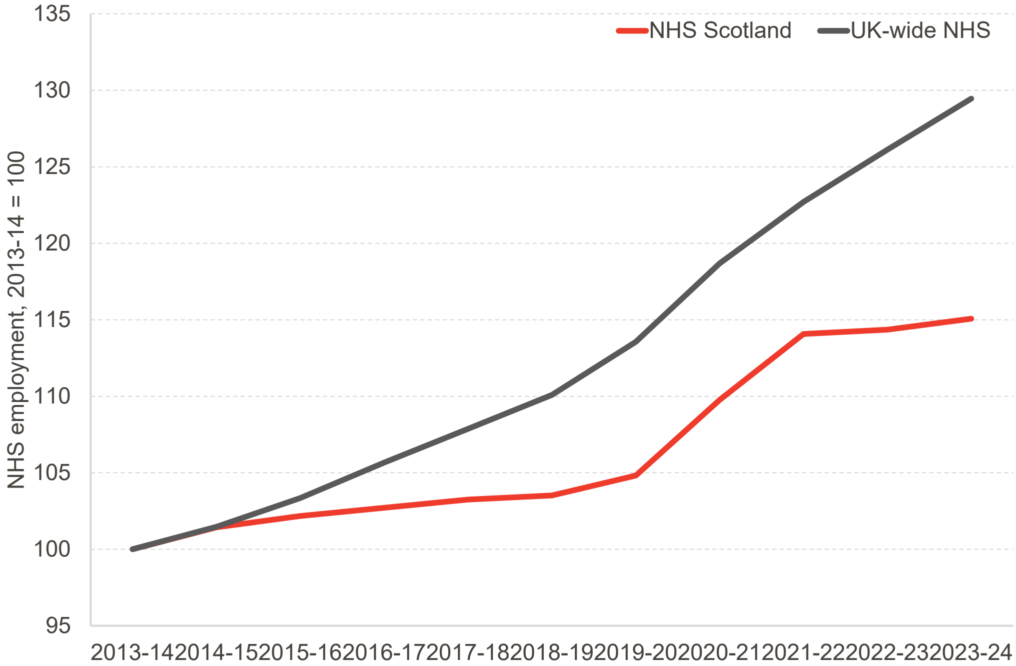
In our most recent budget report, published in December 2023, we highlighted that NHS employment has grown at 1.4% a year for the past decade, making it one of the fastest growing sectors of devolved and local government sectors.

However, despite this, the growth is still lower than the combined four health sectors of the UK, with UK-wide NHS employment growing 2.6% per year over the past 10 years.

This means that the current Scottish NHS workforce is 15.1% higher than it was a decade ago, however across the UK, cumulative growth was 29.5%, with the higher growth seen during the pandemic years in Scottish NHS employment only enough to match that trend in the UK as a whole.

1 See BMA

Chart 16: Growth in NHS employment since 2013-14, Scotland and UK



Source: *Scottish Government, ONS, FAI calculations. 2023-24 are half-year numbers*

Even with record levels of spending and employment, it is clear that the NHS is facing significant pressures.

With increases in spending likely to be allocated to increasing the NHS workforce, the Scottish Government's health and social care workforce plan sets out only a 1% increase in NHS staffing by 2027.

Helping the National Health Service to recover is key for the Scottish Government, not only to ensure that health services can meet the demands of the population, ensuring everyone has access to the care they require.

However, also to ensure that the implications for the labour market are reduced, to ultimately reduce many of the staff shortages in the economy and boost productivity.

Poverty and Inequality

Poverty and inequality are significant concerns for the Scottish public.

In general terms, poverty occurs when an individual or household doesn't have enough income to meet their basic needs, which limits their active participation in society.

More technically, poverty can be defined as having less than 60% of the average income for comparable household types.

Over the past few years, a prominent concern has been the unequal impacts of inflationary pressures across different income groups, in particular, the higher prices of food and energy, both of which tend to make up higher shares of lower income household expenditure.

With inflation continuing to fall, and recent forecasts by the OBR suggesting that inflation will be below the Bank of England's target of 2% earlier than expected, the hope is that many of the financial pressures facing households will continue to ease.

As well as this, much of the data now suggests that the impacts of higher prices are coming down to relatively equal levels across the income distribution.

Despite this, there remains a longer-term concern surrounding the impact that first the Covid-19 pandemic, and more recently the inflationary pressures in the economy, and the implications that has had for more structural poverty and inequality across the UK.

What are the governments child poverty targets?

Within Scotland, Child Poverty is of significant concern, particularly given its ability to affect other outcomes such as education, health, and societal outcomes for children.

The government have four child poverty targets:

- Relative Poverty
- Absolute Poverty
- Low Income and Material Deprivation
- Persistent Poverty

When we published our article back in July of last year, it was clear that despite tackling child poverty being a stated priority for the Scottish Government, the data suggested little progress towards eradicating poverty in Scotland.

Last week, a new set of headline statistics on household incomes and poverty were released, covering the financial year 2022-23.

It is first important to note some of the technical definitions surrounding data on incomes on poverty in Scotland. Data on poverty in Scotland is usually presented as a three-year average, however the pandemic severely affected the quality of data in 2020/21, and so the Scottish Government have advised against using it.

This means that for any three-year period that includes the year 2021-22, there are only 2 years of data used to produce that average.

Despite this, child poverty targets are set against a single-year of data and therefore for comparability, we will refer to the single-year estimate throughout this section.

Further to this, for the year 2022-23, it is the first year of data post-pandemic and therefore support available during the pandemic, such as furlough payments and the uplift in Universal Credit have been removed.

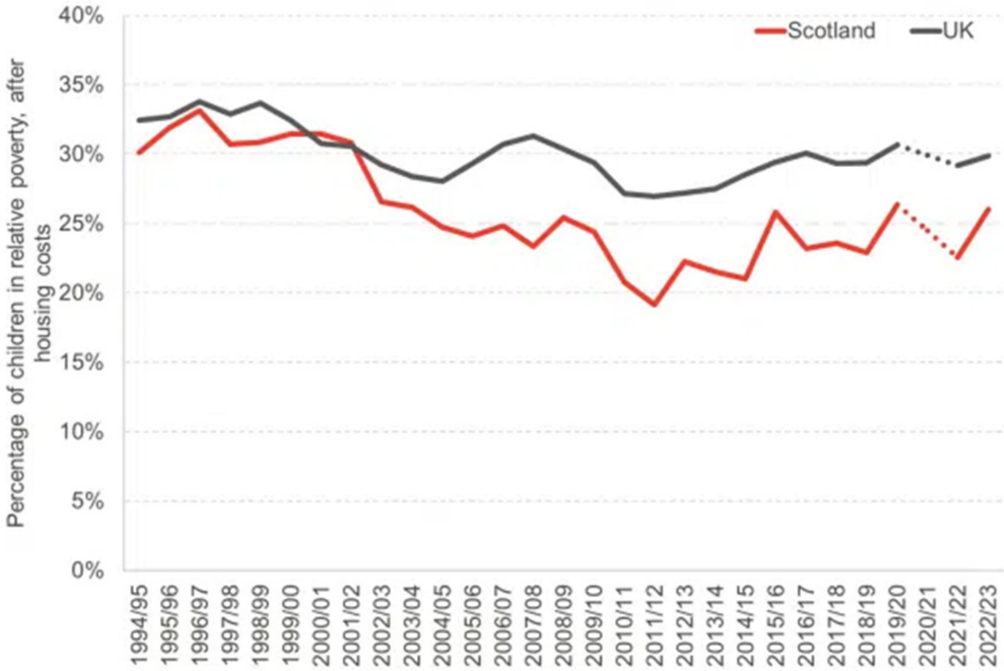
This is important given that some of the changes in estimates will likely reflect the loss of this support, and not necessarily changes to income and poverty driven by 'normal' factors.

Chart 17 shows the relative poverty rate in Scotland when compared to the UK average.

The relative child poverty rate in both Scotland and the UK average rose in 2022/23.

When looking over time, the relative child poverty rate has been flat, with little divergence between Scotland and the UK.

Chart 17: Relative child poverty in Scotland- and UK, 1994/95 - 2022/23



Source: *Family Resources Survey*

The most recent estimate of relative child poverty in Scotland was 26%, well above the Scottish Governments interim target of 18% by 2023-24.

A similar story held for absolute child poverty in Scotland, with the rate 23% for the latest year, and again, well above the government's target of 14% by next year.

These results did not match expectations for the latest year, with the hope that the introduction of the Scottish Child Payment would have had a more significant impact on child poverty in Scotland.

The Scottish Child Payment was fully implemented in 2022-23, with the first payments beginning in February 2021 at the rate of £10 a week for each child under 6.

In November 2021, the payment was doubled to £20, and a system of bridging payments was introduced for children between 6 and 16 ahead of full roll-out. In November 2022, the payment increased to £25, and eligibility was formally extended to all under 16s.

This means the 2022/23 period does cover the increase to £20 for under 6s and should capture these bridging payments.

As yet, the impact of the Scottish Child Payment does not seem to be making an impact on the poverty figures. This may be due to issues with the quality of the data collected or could be due to other offsetting issues that are impacting on household incomes.

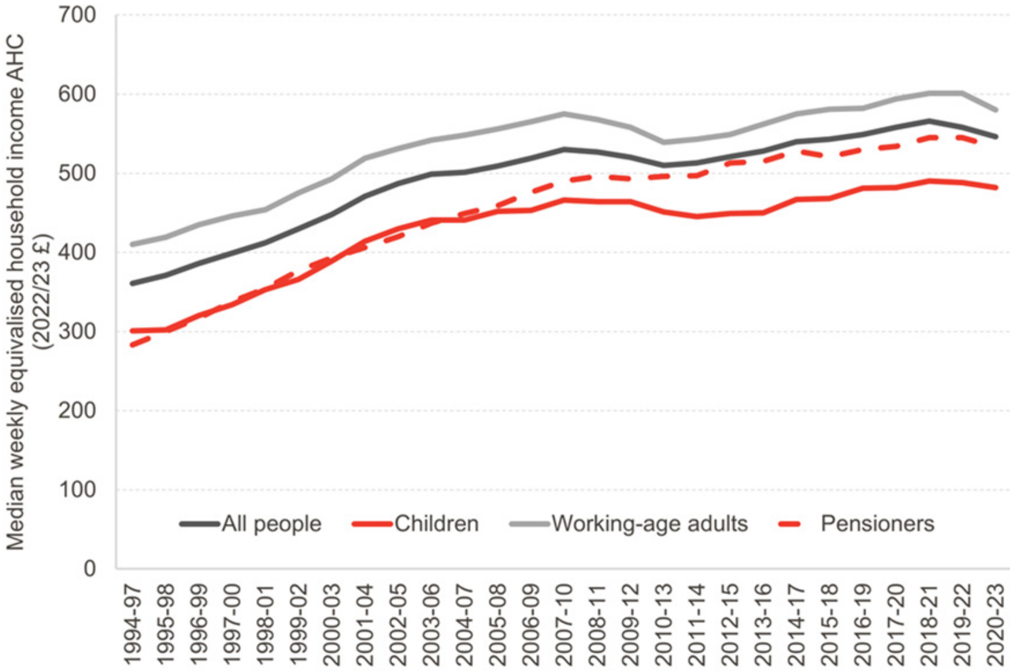
The concern, therefore, is that whilst the ambition of the government to reduce poverty is clear, and some progress evident, the policies put in place are not having their desired impact.

With no announcements on further policies being explored or implemented by the government, it is difficult to see how the Scottish Government will meet its overall targets to reduce child poverty in Scotland especially given the tight fiscal environment that will prevail over the next few years.

Household Incomes

These statistics also cover average and median household incomes. Median income has fallen slightly for all groups in 2019-22 and 2020-23, reflecting at the least stagnant growth in incomes over that period.

Chart 18: Median income after housing costs (AHC) by group, Scotland, 2020-23



Note: Median incomes are usually calculated over three years of data. Collection of the FRS was disrupted in 2020-21 by the Covid-19 pandemic and the survey is not considered representative in that year. As a result, statistics from 2018-21 through 2020-23 are calculated over only two years of the survey data.

Source: *Scottish Government*

Measures of income inequality have risen from 2019-22 levels, reflecting greater real income inequality in Scotland. One measure, the Palma ratio, indicates that in 2019-22 households in the top ten percent of the income distribution had 38% more real income than those in the bottom forty percent after housing costs. The same metric rose to 53% in 2020-23.

These measures typically fluctuate, though, so it is difficult to tell if the increase is a significant change or simply another fluctuation. If the change is the start of a new trend, it is likely to be at least partially driven by the cost-of-living crisis.

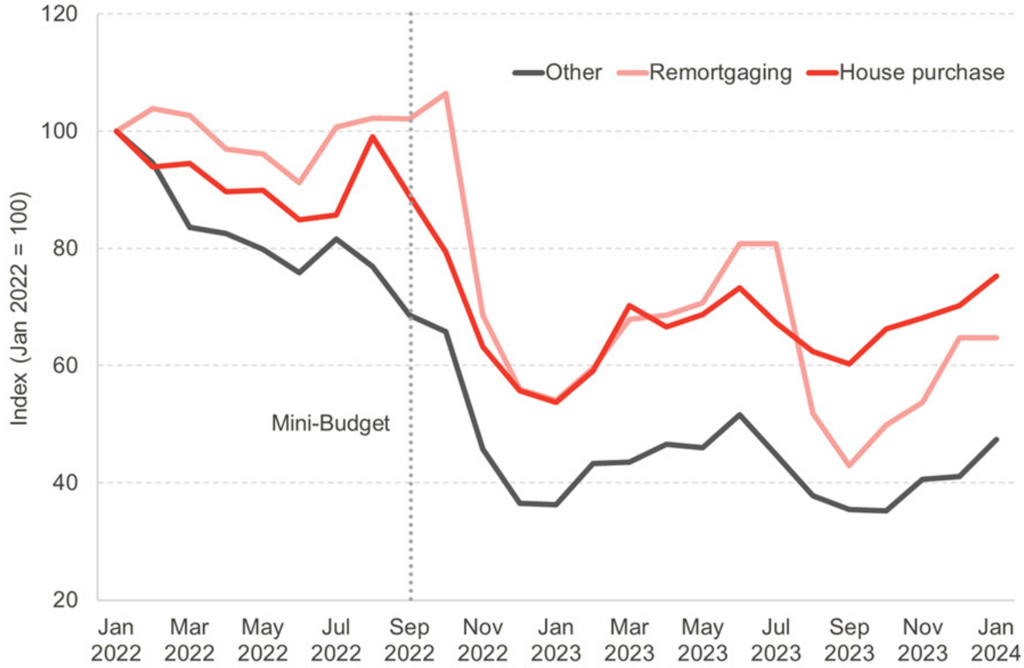
Housing

The UK housing market has faced a number of challenges over the past few years.

For more than a year, the squeeze from elevated borrowing costs has hit home buyers hard, with mortgage approvals notably subdued. Recent data, however, indicates a recovery is on the way.

Lower borrowing costs appear to have lured back buyers with net approvals rising from 51,500 in December to 55,200 in January – the highest level since October 2022.

Chart 19: Approvals of loans secured on dwellings, UK, January 2022 – January 2024



Source: *Bank of England*

Nonetheless, rates are still significantly higher than in recent years, no longer at the exceptionally low levels that have distorted expectations for some time.

High property prices and cost-of-living pressures have also made it particularly difficult for people to get on the property ladder. In 2023, the number of first-time buyers who bought a home with a mortgage fell to its lowest level in a decade.

Amid such conditions, the length of time in which individuals are borrowing has grown substantially over the long term.

For past generations, 25-year mortgages were very much the norm. Today, loans of more than 30 years now account for more than a third of first-time buyer deals as longer terms reduce monthly payments, ultimately easing financial pressures.

However, affordability is still challenging for many individuals who would previously have had the ability to borrow, even with the longest possible mortgage terms.

In Scotland, the housing market has been experiencing something of a paradox over the past year or so, with not only strong price growth but also a high volume of property sales.

Such an anomaly suggests that demand is considerably high, and despite the supply of available properties increasing, it is still not being met, causing prices to rise.

Compared to other parts of the UK, affordability is much less of a concern in Scotland. However, there remains an issue with the supply of housing and shortcomings in the number of new homes being built, both for private and social housing.

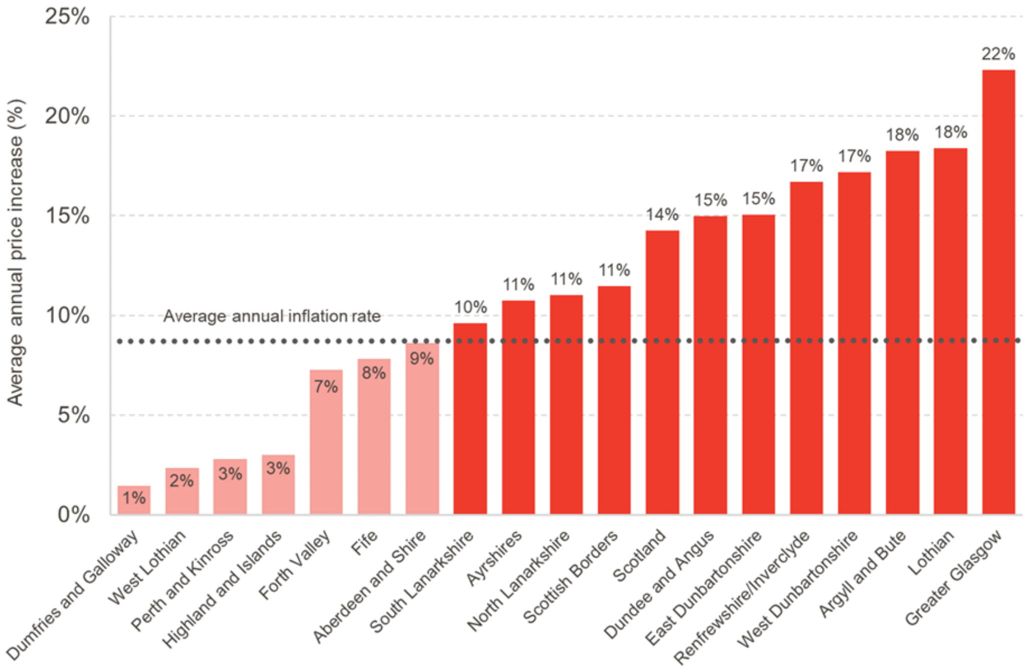
Since June last year, three local authorities – Argyll and Bute, Glasgow and Edinburgh – have declared housing emergencies, with more expected to follow.

In the six months to September 2023, homelessness applications reached over 30,000 – a 10% increase on the year. Meanwhile, Homes for Scotland found that 28% of Scottish households were facing some sort of housing need – around 693,000 households in Scotland.

Conditions in the private rented sector are also poor. In the year to September 2023, average rents for 2-bedroom properties – the most common size in the sector – increased in all 18 broad rental market areas of Scotland compared with the previous year.

In 11 of these areas, price rises were above the average 12-month UK CPI inflation rate of 9.0%, ranging from 9.6% (£59 per month) in South Lanarkshire up to 22.3% (£191 per month) in Greater Glasgow. See Chart 20.

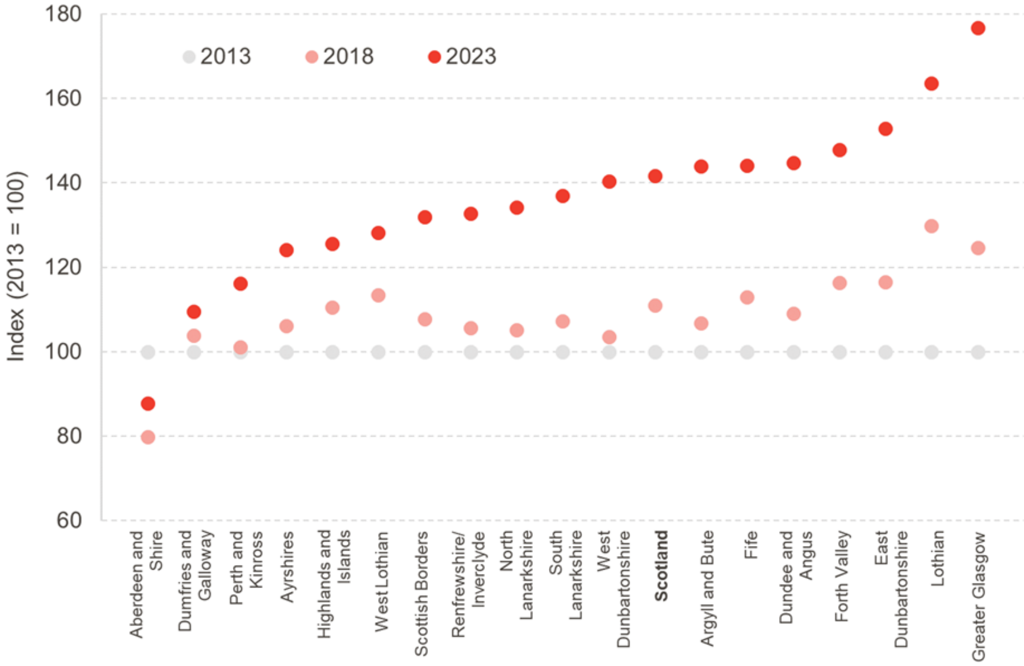
Chart 20: Average annual price change on the year for 2-bedroom private rents, by Broad Rental Market Area, Scotland, 2023



Source: *Scottish Government*

Chart 21 highlights how much private rents have increased over the past decade.

Chart 21: Average annual price change on the year for 2-bedroom private rents, by Broad Rental Market Area, Scotland, 2023



Source: *Scottish Government*

The cost of living in households

As well as this key issues highlighted in the previous sections, one of the most prevalent concerns identified in both of these reports remained the cost of living and the impact of inflationary pressures in the economy.

Using data provided by the Smart Data Foundry, we can understand the impacts that more recent economic conditions have had on households, in particular, those looking to overdrafts as a means to spend outside of regular incomes.

This data provides insight as to bank related data for consumers across Scotland, in particular, those NatWest across the UK and also RBS customers in Scotland.

There was 5.4 million NatWest Group users for the latest quarter of data. Of this, 8% were in Scotland, with the majority likely utilising Royal Bank of Scotland services, see Chart 22.

The data provides insight as to the number of individuals within these user groups that use their overdraft within the given period.

Chart 23 shows that the number of overdraft users in Scotland was higher than the UK average throughout our period of analysis.

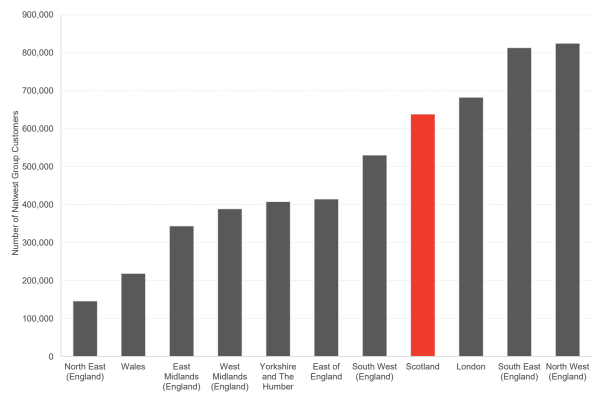
The number of overdraft users had fallen slightly across both Scotland and the UK at the beginning of the pandemic period but had gradually risen through the several waves of lockdown.

Despite this, the number of overdraft users had remained relatively stable towards the end of 2023, and in fact, the number of users dropped significantly in Scotland and across the UK into the first quarter of this year.

When looking across the regions of the UK, Chart 24 shows that the trend in overdraft levels over the past few years has followed a very similar trend, with around 14% on users on average in the UK using their overdraft since 2020 Q2.

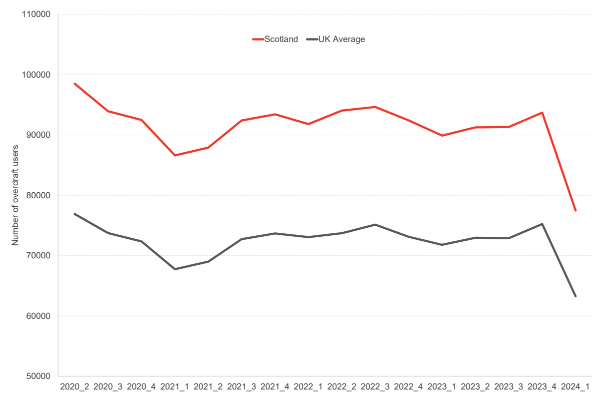
You can learn more about The Smart Data Foundry here.

Chart 22: Numbers of Natwest Group Customers by region, 2024 Quarter 12



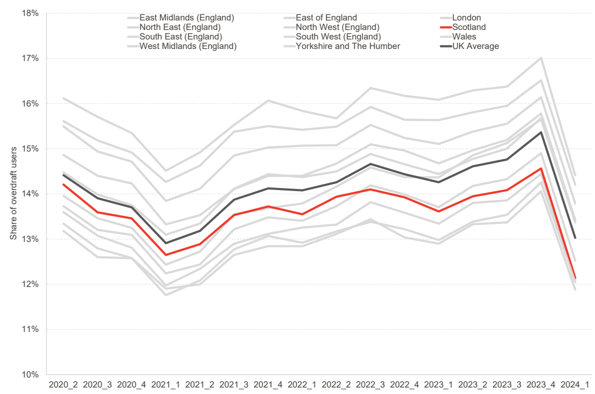
Source: *Smart Data Foundry*

Chart 23: Number of overdraft users in a group, Scotland vs UK average, 2020 Q2 – 2024 Q1



Source: *Smart Data Foundry*

Chart 24: Share of overdraft users within group by UK region, 2020 Q2 – 2024 Q1



Source: *Smart Data Foundry*

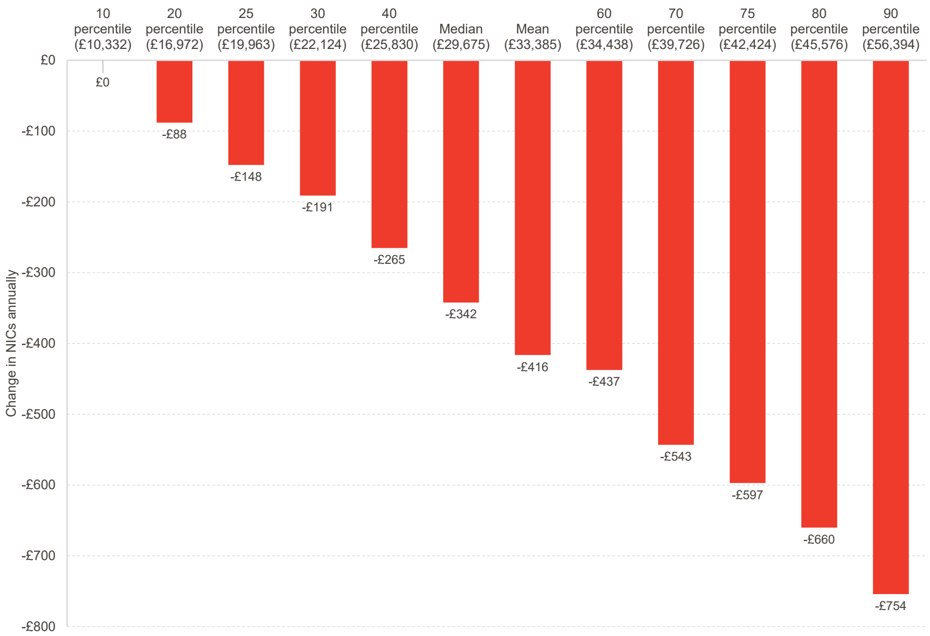
Spotlight on: *The implications of the UK budget for Scotland*

As with recent fiscal events, this was a Budget where the main announcements were trailed well in advance. The Chancellor confirmed a 2p cut to National Insurance Contributions to both employees and self-employed.

Changes to National Insurance Contributions (NICs) apply in Scotland as a matter of course, as they are reserved. This means that it reduces liabilities for Scottish taxpayers, but has no direct effect on the Scottish Budget.

The Office for Budget Responsibility (OBR) estimates that this cut to NICs will cost £10 billion a year. Using data on Scottish earnings, we estimate it will reduce taxes paid by the median Scottish employee by £342 a year.

Chart 25: Change in NICs annual liability for Scottish employees across the income distribution



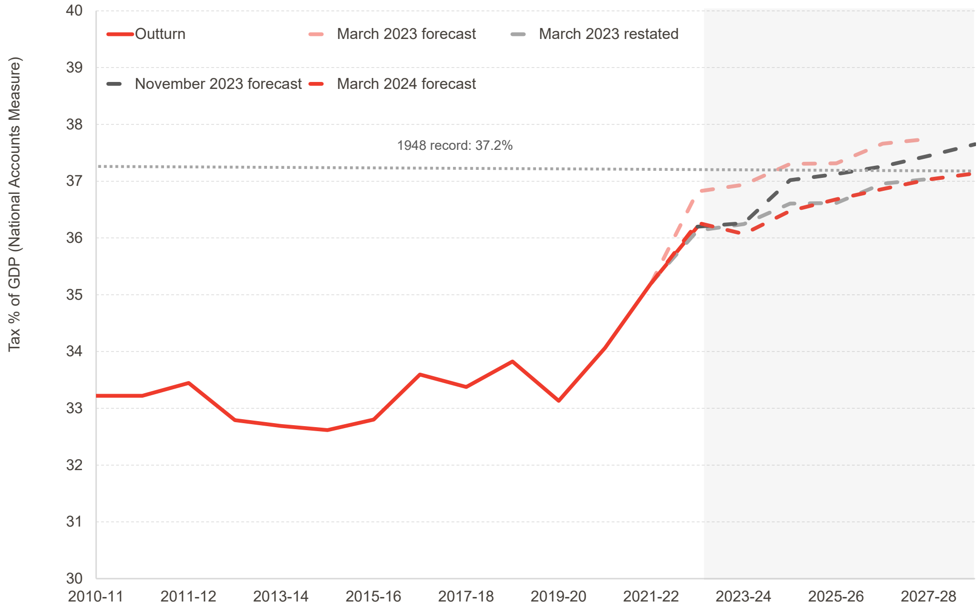
Source: *ONS, FAI calculations*

This was a repeat of the big-ticket announcement of the Autumn Statement, except without the element of surprise. In fact, the lack of surprises was entirely the theme of the Budget, with essentially the whole of the speech's contents leaked out in advance.

But even with the renewed cut to NICs, taxes as a share of national income are still going up from year from 2024-25 onwards – just by less than in the OBR's November forecast and by less than before accounting for the Chancellor's measures. The tax-to-GDP ratio is expected by the OBR to hit 37.1% by 2028-29, coming just under the 1948 record-high of 37.2%.

This is partly because the Chancellor has used also done some targeted tax increases such as the abolition of the 'non-doms' regime and a new excise duty on vaping.

Chart 26: Tax-to-GDP ratio



Source: *OBR*

But more broadly, the fact that taxes are still going up significantly illustrates the bind the Treasury finds itself in, and the cognitive dissonance required by this Budget. Headline tax rate reductions while increasing the share of taxpayers' income in scope of higher rates is reminiscent to what happened to corporation tax during the 2010s to some extent. But it is a significant departure from the approach of successive Chancellors on personal taxes since 2010, a time during which thresholds have generally been raised significantly, taking more and more people out of paying income tax or NICs.

With thresholds continuing to be frozen, the Chancellor has managed a 'stealth' tax increase of around £41 billion – nearly double the amount that the Autumn Statement and Budget measures reduce taxes by. There will be 3.7 million more people brought into paying income tax than would if the personal allowance had been indexed with inflation – a 10% increase in taxpayers.

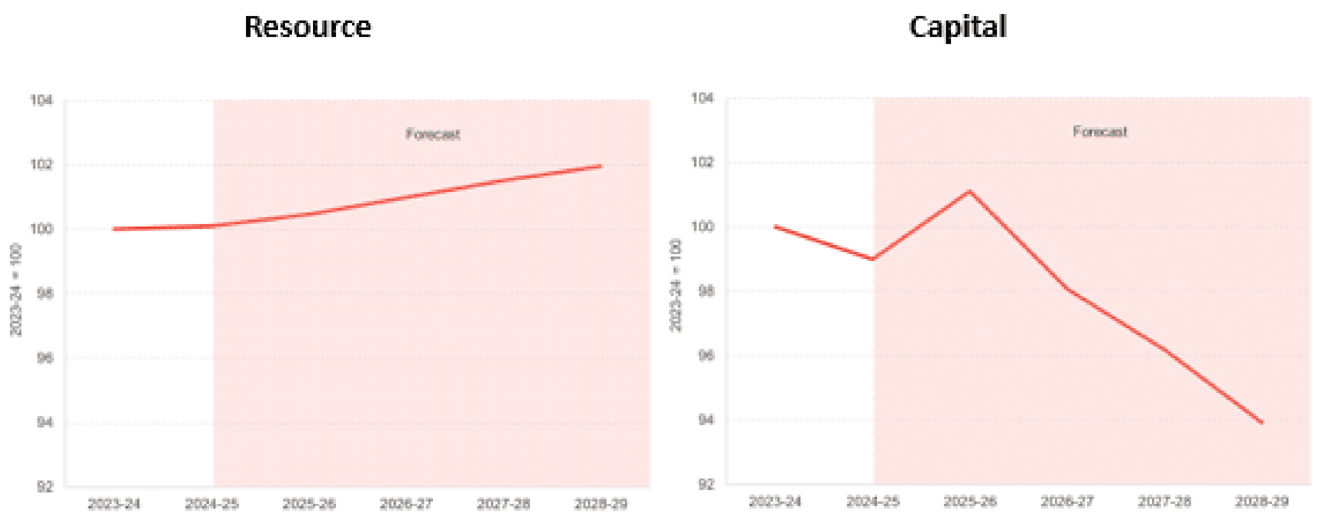
These tax increases contribute to the Chancellor meeting his self-imposed fiscal rule, although with essentially no room to spare – and on the back of pretty questionable assumptions. Before accounting for measures, the Chancellor already had limited headroom (£12.2bn) against his self-imposed fiscal rule of debt falling in the final year of the forecast. This is virtually wiped out by the measures in this Budget, especially after accounting for the freezing of fuel duty which we expect will continue to happen as it has in every year since 2011.

In that case, headroom would be £4.5bn against what is already a very loose fiscal rule. Such a small amount of headroom is essentially zero – even a small downward movement in the economy would mean the rule being broken.

And even the meeting of the fiscal rule in the OBR's central forecast is predicated on what are generally held to be implausible future spending plans. There were rumours in the run-up to the Budget that resource and capital departmental allocations would be squeezed further into the next Parliament – and while that has not proved to be the case, the plans are pretty restrictive already, and they have been made worse still by a larger population than previously projected.

Resource spending is forecast to grow by only 2% across the whole forecast; capital, meanwhile, is projected to be cut by 8% in real terms over the next 5 years. It is hard to see how this can be sustained throughout the next Parliament – hence why they were so criticised by the Chair of the OBR at the House of Lords Economic Affairs Committee.

Chart 27: UK Government real DEL plans per person



Source: *OBR, FAI Analysis*

These spending assumptions have very real consequences for Scotland. They are the result of UK Government decisions about not only reserved areas, but also devolved services in England (or sometimes, England and Wales). As a consequence, they also set the path for the Scottish Block Grant through the mechanical Barnett formula.

The lack of significant changes on resource and capital departmental spending further confirms the tough fiscal environment for the Scottish Government, and this will become apparent again when Deputy First Minister Shona Robison presents the Medium-Term Financial Strategy (MTFS) on 30 May. The 2023 MTFS had a £2.4 billion shortfall in funding built in for 2025-26 (£1.4 billion on resource and £1 billion on capital), and with so much of the £1.5 billion shortfall in 2024-25 being filled by delaying projects, more difficult decisions are likely to be on the way.

This is not to say that the Scottish Government will not receive any additional spending consequentials from the UK Budget in 2024-25. In fact, these come to £295m in 2024-25, largely due to higher spending on the NHS in England (£237m) and a larger settlement for English local government (£48m), with the latter already committed to partially pay for the council tax freeze.

There was nothing additional on capital apart from small amounts from 2025-26 (less than £80m a year). But the Scottish Government does have the ability to switch any resource spending it wants into capital spending. For example, it could decide to fund affordable housing, which the DFM suggested would be the first priority if more money were to be allocated when she appeared at the Finance and Public Administration Committee. Or even if she decided to keep money from health consequentials within the health portfolio, she could use it to restart NHS capital projects which were stopped in February. We will see whether any of the additional funds are in fact used for capital spending.

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