

FRASER OF ALLANDER INSTITUTE

Economic Commentary

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FOREWORD

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This issue of our quarterly economic commentary presents a mixed view on Scotland's economy: on one hand, we've seen consistent GDP growth across seven consecutive quarters, with Q4 2025 outpacing UK-wide GDP growth for the first time in two years. At the same time, inflation ticked up slightly in December, whilst the number of people in payrolled employment dropped.

The majority of jobs lost in Scotland have been in hospitality, retail, and education, echoing issues with these industries seen elsewhere in the UK. On top of that, businesses in many sectors have indicated that they struggle to recruit people into roles that are often physically demanding or that don't allow for remote work, which means that they are likely not accessible for a significant proportion of people who are not employed.

Our Scottish Business Monitor, published on 2 February, also echoes these challenges, with more businesses reporting a lower volume of business activity, lower levels of employment, and lower levels of investment in Q4 2025 compared to Q3. For the first time, in Q4, we also asked questions about AI adoption, finding that businesses in all industries have taken it up, most notably in service sectors.

Finally, this issue marks our fourth entry in our series on Social Security in Scotland, looking at the types of benefits available to people above pension age.

Our next major event will be the Scottish Parliamentary elections, which are set to take place on 7 May. This means that the election period officially kicks off on 26 March, with Scottish Parliament dissolving on 9 April.

Forecasts

**The
Scottish
Economy**

**Labour
Market**

**Business
Monitor**

**Social
Security**

FORECASTS

1.3%
2025 forecast

1.1%
2026 forecast

1.2%
2027 forecast

Scottish GDP Growth Forecasts

	2025	2026	2027
FAI February 2026	1.3%	1.1%	1.2%
FAI October 2025	1.0%	1.0%	1.1%
SFC January 2026	1.2%	1.3%	1.4%
OBR November 2025 (UK)	1.5%	1.4%	1.5%

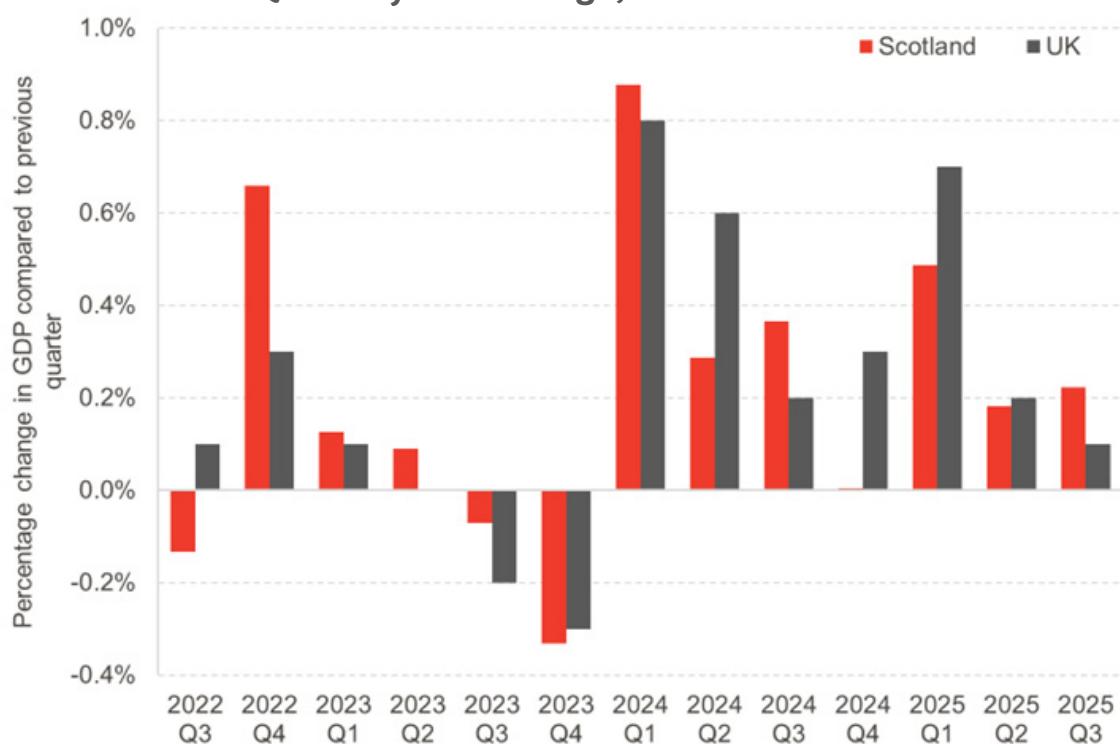
Source: FAI, [SFC](#), [OBR](#)

We have revised our 2025 forecast to show a more significant growth than previously expected, reflecting consistent growth throughout the first three quarters of 2025.

Scottish GDP growth between Q2 and Q3 2025 outpaced the rest of the UK for the first time since Q3 2024, growing by just over 0.2% between July and September.

This marks the seventh consecutive quarter of GDP growth for both Scotland and the UK as a whole.

Quarterly GDP Change, Scotland vs UK



Source: [ONS](#), [Scottish Government](#)

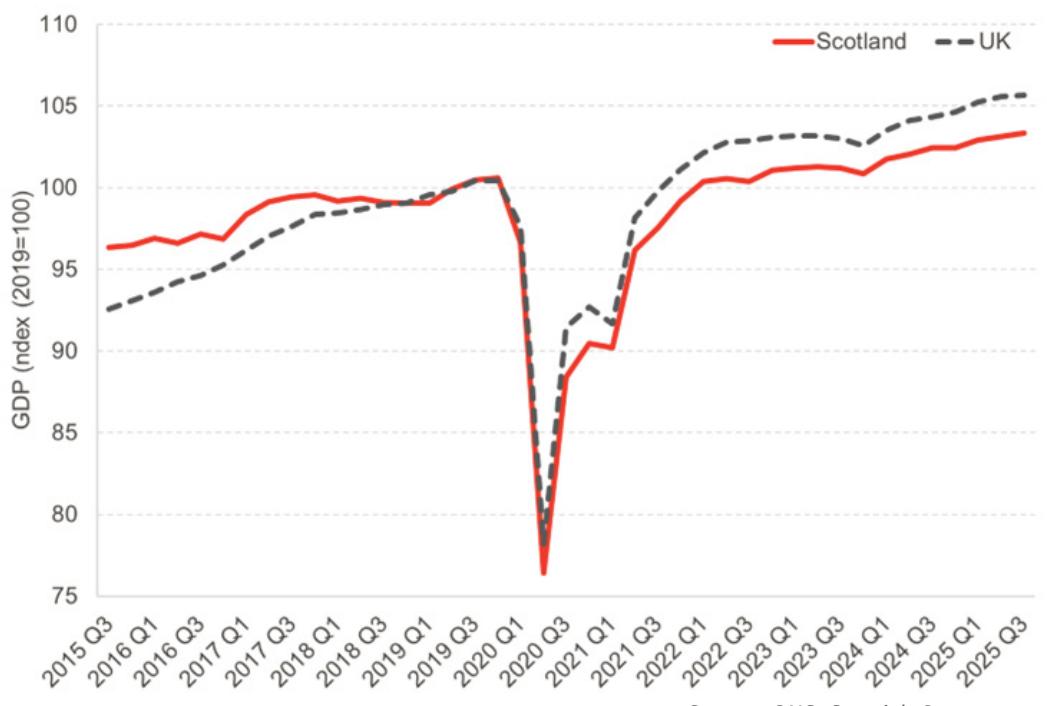


GDP

In Scotland, growth has been concentrated across services sectors, which includes hospitality, retail, transport, communication, business services, finance, and government.

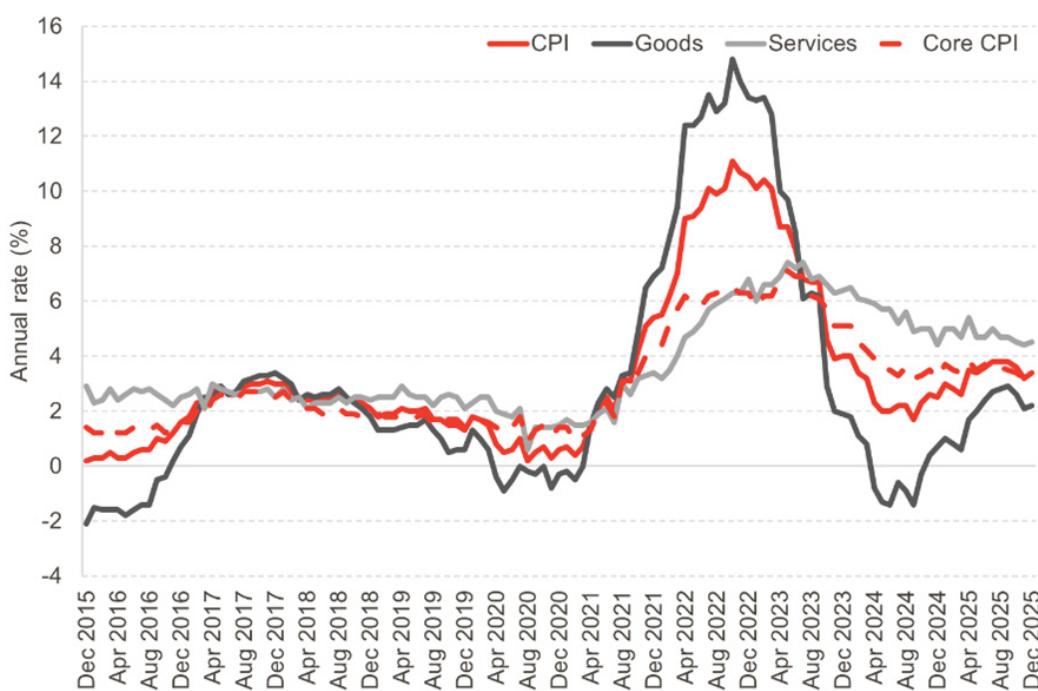
Compared to Q3 2024, GVA in these industries grew by 1.8% whilst the production sector (consisting of mining, manufacturing, energy, waste management, and construction, among others) fell by 3.6%.

Scottish and UK Quarterly GDP (2019 = 100)



Source: [ONS](#), [Scottish Government](#)

Inflation rates in the UK



Source: [ONS](#)

Core CPI inflation stood at 3.2% in the 12 months to December. Although this rate has been recorded previously, core inflation has not fallen below 3.2% since September 2021, when it was 2.9%.

Monetary Policy Committee members keep a close eye on core CPI rates – declining rates may signal a hold on interest rates in the near future.

Inflation

The 12-month Consumer Price Index (CPI) inflation rate rose to 3.4% in December, up from 3.2% in the year to November.

While headline CPI inflation increased over the course of 2025, core inflation - which excludes more volatile components such as energy, food, alcohol and tobacco - moved in the opposite direction.

Labour Market

The Labour Market

In our last [Economic Commentary](#), we discussed issues with labour market data across the UK, which has been increasingly unreliable in the years since the pandemic, due largely to falling responses to the labour market surveys that underpin this data.

Headline labour market statistics, produced by the Labour Force Survey (LFS), indicate that Scotland's employment rate grew by 0.4 percentage points over the previous quarter, in spite of falling payrolled employment levels and a rising number of people taking up unemployment-related benefits.

Using these alternative data sources, our modelled employment rate stands at around 73.5% for Q4 2025, just slightly short of official LFS estimates.

Headline Labour Market Statistics

	Employment Rate (age 16-64)	Economic Inactivity Rate (age 16-64)	Unemployment Rate
FAI Modelled estimates (Q4 2025)	73.5%	23.8%	3.7%
Labour Force Survey estimates (Sept-Nov 2025)	74.1%	22.3%	3.7%

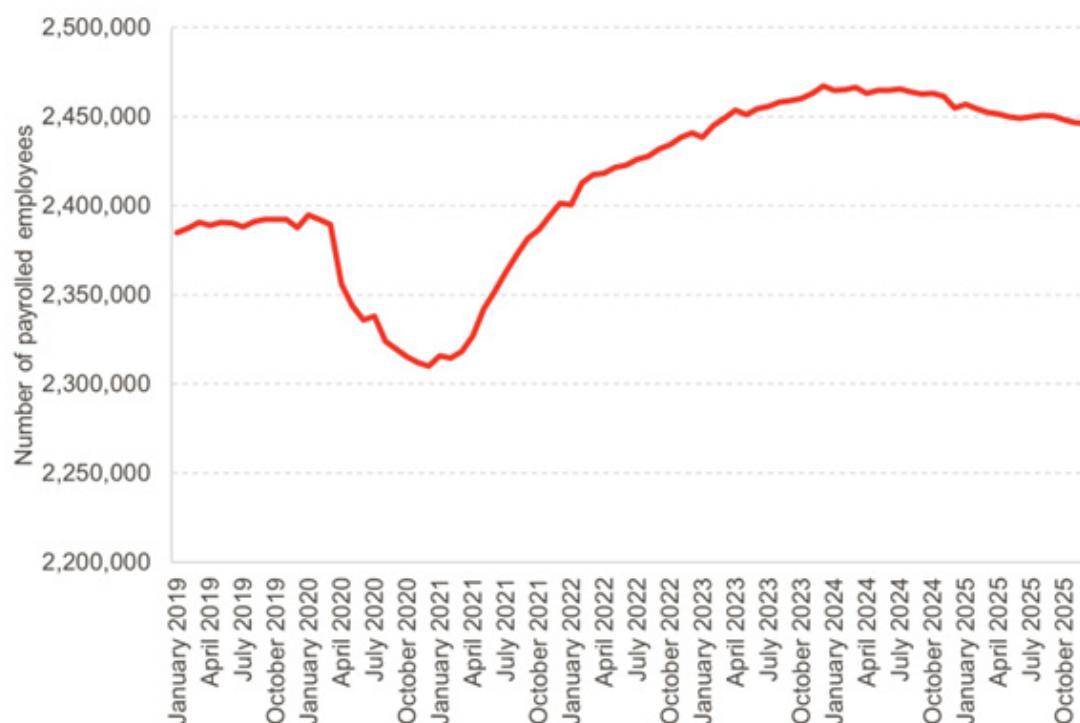
Source: [Scottish Government](#), FAI/SHERU analysis

Employment levels

Payrolled employment in Scotland has been declining steadily since peaking in mid-2024 but remains higher than either pre- or immediate post-pandemic levels of employment.

Preliminary estimates for December 2025 estimate that there were 8,700 fewer payrolled employees in Scotland compared to December 2024.

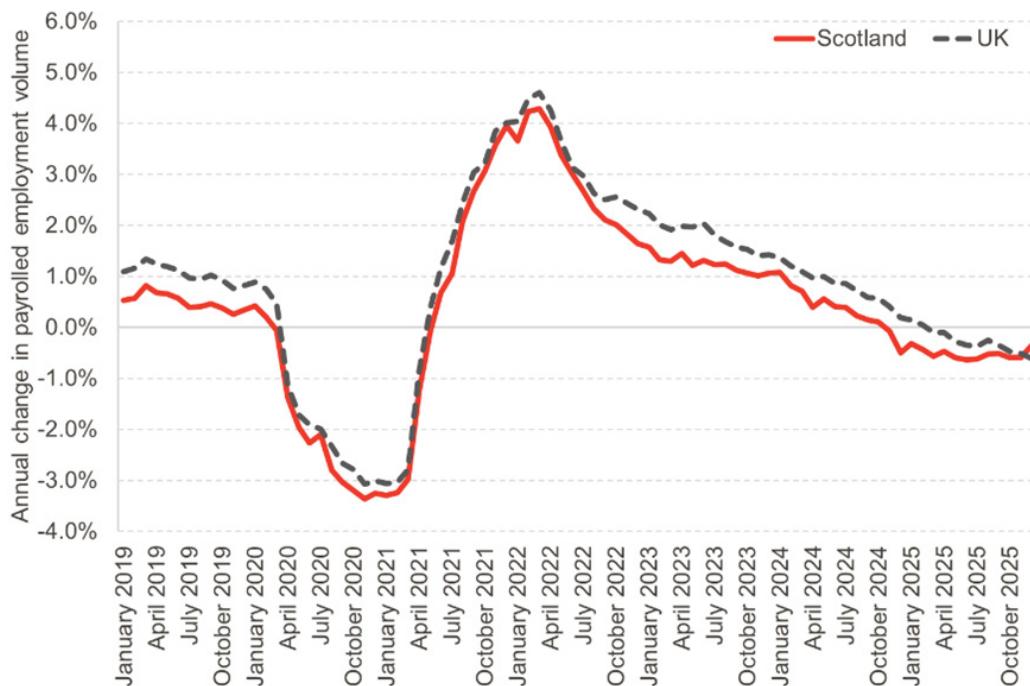
Payrolled employment in Scotland



Source: [HMRC PAYE RTI \(SA\)](#)



Changes in employment in Scotland vs the UK



Source: [HMRC PAYE RTI \(SA\)](#)

Payrolled employment changes

Since the pandemic, Scotland has seen lower growth in payrolled employment compared to the UK as a whole.

Since October 2024, Scotland has seen a larger proportionate drop in payrolled employment volume compared to the previous year, although preliminary data for December 2025 indicates that this fall in employment has slowed in Scotland.

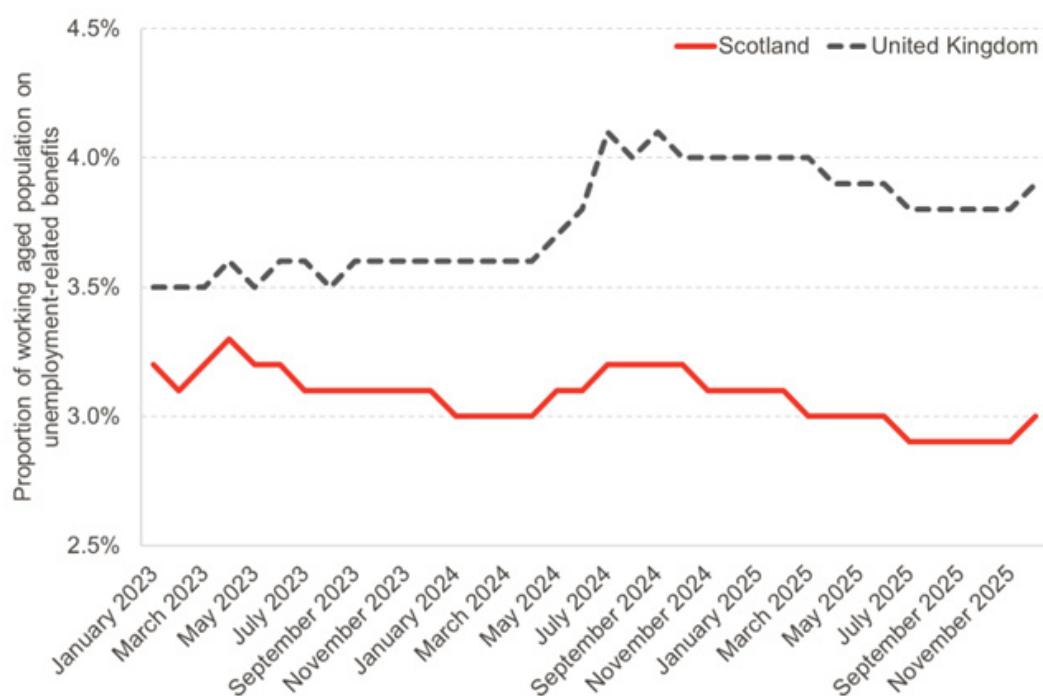
Out-of-work benefits

The number of people on unemployment related benefits grew from July to December 2025 but remains lower than in 2024.

Scotland has a lower proportion of working aged adults on unemployment related benefits compared to the UK.

At the same time, Scotland has historically had a higher proportion of the population on health-related benefits compared to England and Wales, as we discussed in a previous [economic commentary](#).

The proportion of the working-age population on unemployment-related benefits

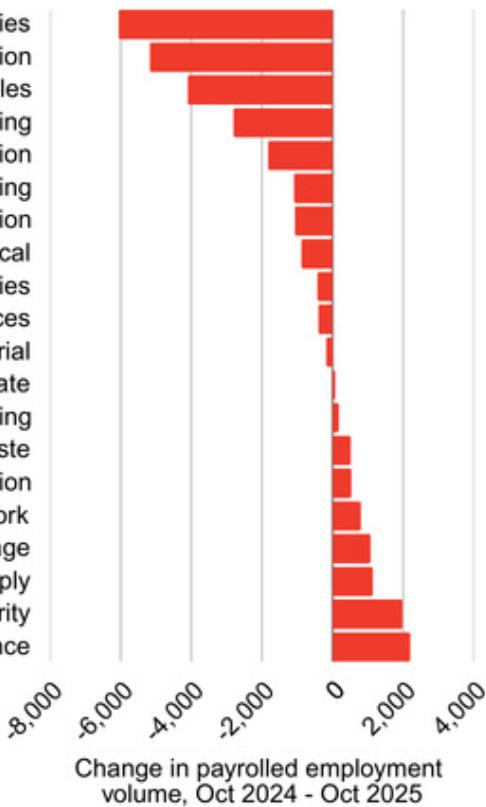


Source: ONS via Nomis

Labour Market

Changes in payrolled employment by sector

Accommodation and food service activities
Education
Wholesale and retail; repair of motor vehicles
Manufacturing
Information and communication
Mining and quarrying
Construction
Professional, scientific and technical
Other service activities
Administrative and support services
Households and Extraterritorial
Real estate
Agriculture, forestry and fishing
Water supply, sewerage and waste
Arts, entertainment and recreation
Health and social work
Transportation and storage
Energy production and supply
Public admin., defence, social security
Finance and insurance



Source: [HMRC PAYE RTI \(SA\)](#)

Payrolled employment by sector

Hospitality, education, and retail accounted for the majority of this decline across 2025; hospitality in particular had 6,000 fewer employees in Scotland in October 2025 (the most recent period for sectoral payrolled employment data) compared to October 2024. Changes in these three sectors point to larger challenges for the UK as a whole.

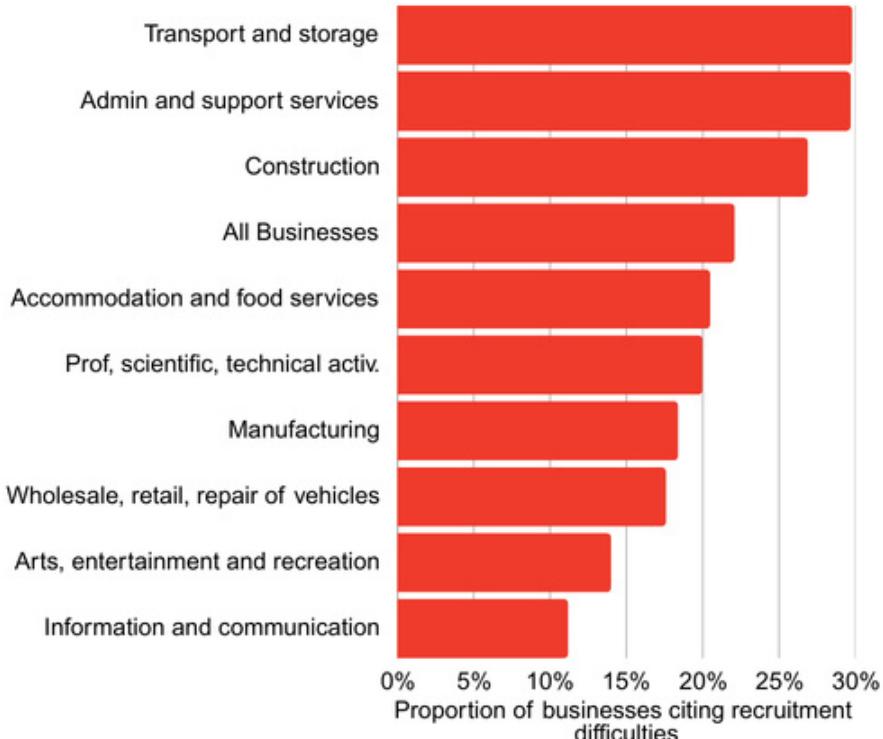
In recent years, hospitality and retail have noted particular challenges with costs, especially staff costs and energy. Within the education sectors, universities in particular have faced significant issues with financial sustainability, due largely to rising costs and falling international student demand. This has resulted in well-publicised layoffs, especially at the Universities of Dundee and Edinburgh.

Recruitment Challenges

Businesses cited skilled, manual, or technical labourers as the most difficult to recruit, followed by semi-skilled or unskilled employees (this terminology indicates that a low amount of training or education is needed to perform these jobs).

This is a challenge for Scotland: increasing employment among people with health conditions is a high priority, especially given the recent fall in payrolled employment. At the same time, key recruitment challenges are concentrated in roles that are often more physically demanding or unsuitable for remote work.

Sectors citing recruitment challenges



Source: [BICS](#)

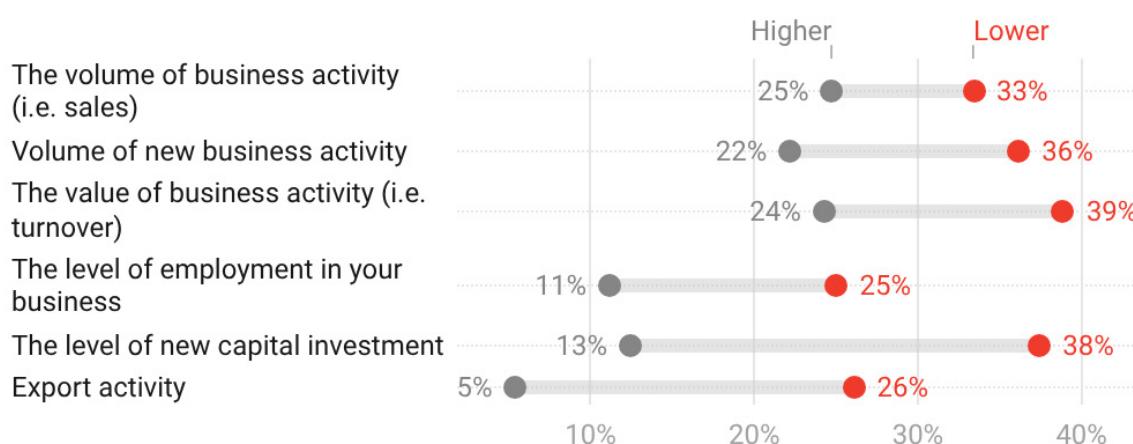


Labour market concerns from the Scottish Business Monitor

The Scottish Business Monitor, which covers Q4 2025, also echoes these labour market concerns. Businesses were more likely to respond negatively when assessing changes over the last 3 months across a range of dimensions. Notably, 25% of businesses said that over Q4 2025, employment levels decreased, with only 11% saying that their business levels were likely to increase.

It is also important to note that this was the fifth consecutive quarter in which all six headline indicators were negative; employment levels have been generally negative since Q4 2024, aligning with the period in which payrolled employment levels began to fall in Scotland overall.

Thinking about your company's current business activities, excluding any seasonal variation, how would you assess the change over the past 3 months in:

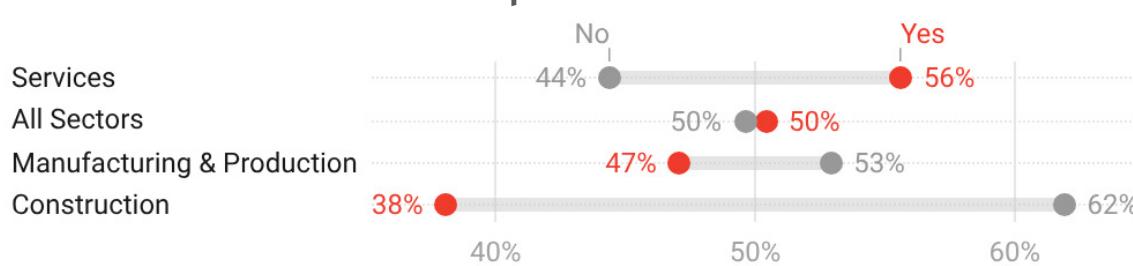


Artificial intelligence

This edition of the business monitor also covers the use of AI, with approximately half of respondents reporting AI use in the final quarter of 2025. Sector-level analysis reveals that whilst firms in the services industry are most likely to have used AI, adoption of the technology is not confined to this industry. Construction, Manufacturing, and Production all reported notable levels of AI use, alluding to a broad diffusion of the technology across sectoral distinctions.

At this stage, there is not a clear relationship between the uptake of AI and job losses: wholesale and retail, manufacturing, construction, and hospitality made up over half of all job losses between October 2024 and October 2025 but have very different rates of AI uptake according to this survey.

In the past 3 months, has your business used artificial intelligence (AI) in its operations?



Source: FAI



Social security is an important source of income for many households, and is crucial to understanding Scotland's economy and fiscal policy. Transfers through social security support higher spending in the economy and may have implications for the labour market through their impact on labour supply decisions.

The specifics of the social security system carry significant fiscal implications for the Scottish Government. Spending on reserved benefits affects the Scottish block grant, while higher spending on devolved benefits necessitates either lower spending on other areas or raising more revenue through devolved tax powers.

This is the final part of our Economic Commentary series explaining different parts of the social security system in Scotland. Previous entries have explored disability and carer's benefits; reserved benefits for working-age people; and benefits aimed at children. In this edition, we cover benefits received by pensioners.

Please note that the state pension age used to be 65 for men and 60 for women, with the women's pension age raised to 65 by 2018. Since 2020, it is 66 for both men and women. Throughout this section, we use benefit statistics for people over the age of 65 to maintain consistency over time and match the age bands that are typically available in the data.

What benefits can pensioners receive?

Those above the state pension age are generally assumed to receive most of the publicly-funded support they need from State Pension. Other benefits aimed at this group are therefore often much more specific. These include support for the additional costs of disability (many of which are now being devolved), help with housing costs and Council Tax, age-specific support for heating and health costs, and one-off support for things like bereavement and funerals.

This table shows a breakdown of the reserved and devolved benefits that may be claimed by someone over the pension age.

Reserved and devolved benefits available to pensioners

Category	Reserved	Devolved
Pension-related	<ul style="list-style-type: none"> State Pension Pension Credit 	
Disability, health, and caring	<ul style="list-style-type: none"> Attendance Allowance (being replaced by Pension Age Disability Payment) 	<ul style="list-style-type: none"> Adult Disability Payment (continuing claims) Pension Age Disability Payment Scottish Adult Disability Living Allowance Carer Support Payment Additional support available for those claiming other benefits
Housing & heating	<ul style="list-style-type: none"> Housing Benefit Warm Home Discount Scheme 	<ul style="list-style-type: none"> Discretionary Housing Payment Support for Mortgage Interest Council Tax reduction Pension Age Winter Heating Payment Winter Heating Payment
One-off support and other benefits	<ul style="list-style-type: none"> Budgeting Loan (repaid from low-income benefits) Bereavement Support Payment, other bereavement benefits 	<ul style="list-style-type: none"> Scottish Welfare Fund Funeral Support Payment (replaced Funeral Expense Payment)

Some benefits are not specifically designed for those over pension age but may allow some to qualify. For example, those over the state pension age do not qualify for Universal Credit on their own but must apply for UC rather than Pension Credit or Housing Benefit if their partner qualifies.

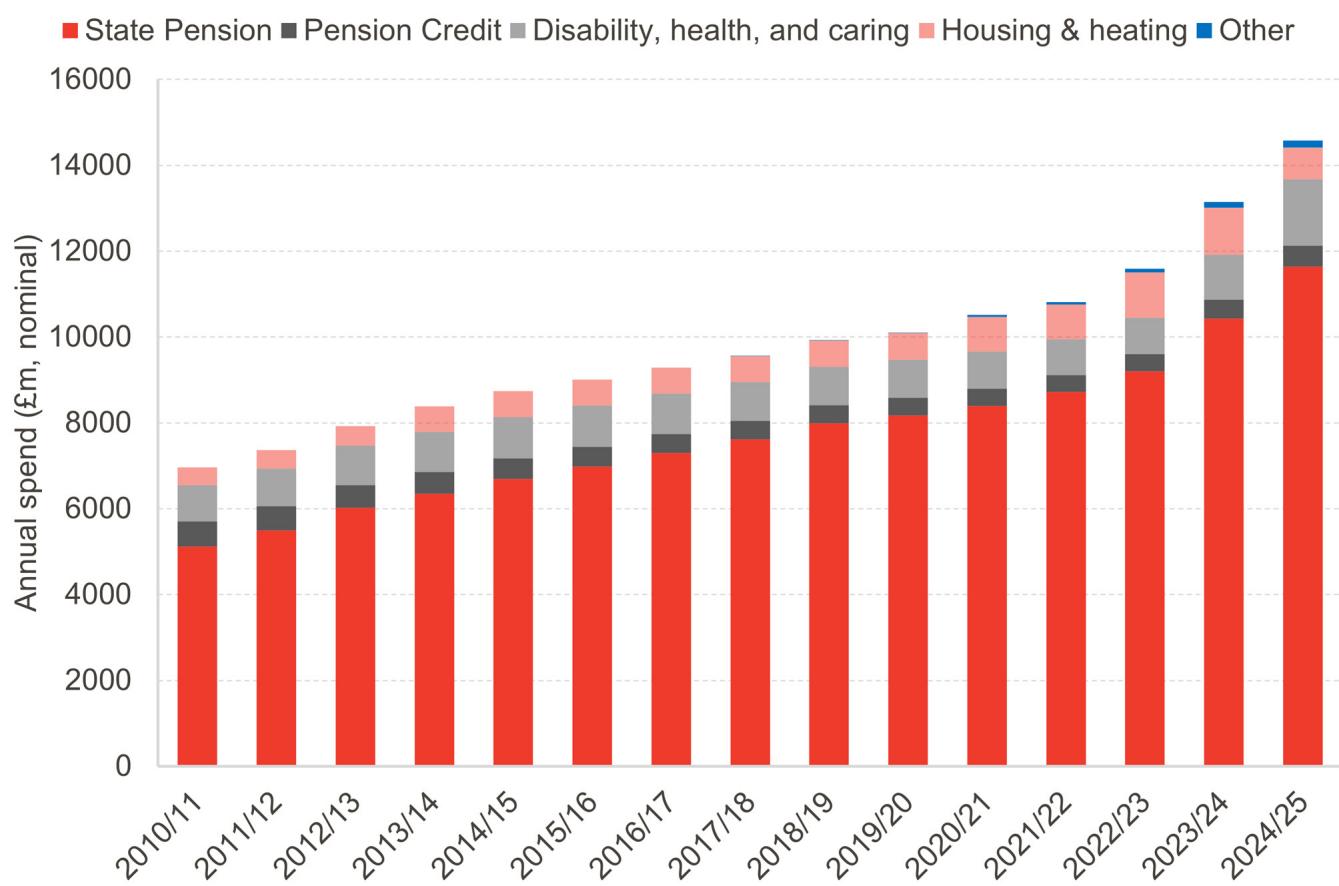


Spending on benefits for pensioners

In 2024/25, over £14 billion was spent on benefits for pensioners in Scotland.

State Pension and Pension Credit together accounted for 83% of benefits spending on those over 65 in 2024/25, £12.1 billion in total.

Annual benefit spending on people aged 65+, Scotland, 2010/11 – 2024/25



Source: DWP Stat X-plore, Social Security Scotland, Scottish Government, Ofgem

Notes: Some benefits available to pensioners do not report statistics by age of the claimant and are not shown here. These include: Funeral Support Payment, Discretionary Housing Payment, Scottish Welfare Fund, Budgeting Loan, and Support for Mortgage Interest. The 'Other' category includes bereavement-related benefits and Universal Credit.

For context, total spending on Universal Credit for all ages in Scotland was £5 billion in 2024/25. The next-largest category of benefit spending on pensioners is on benefits related disability, health, and caring, encompassing Attendance Allowance, Pension Age Disability Payment, Adult Disability Payment, Scottish Adult Disability Living Allowance, Disability Living Allowance, Carer Support Payment, and Carer's Allowance.

Spending on other categories and a more thorough exploration of these benefits are in the following sections.



State Pension and Pension Credit

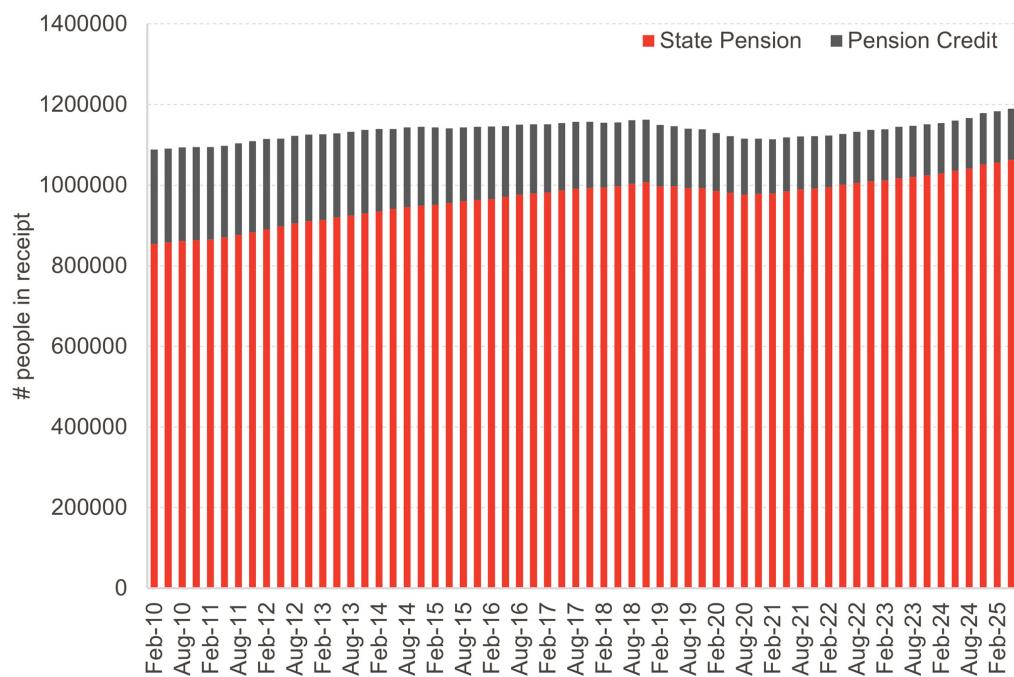
State Pension is a non-means-tested individual payment received by those who have a minimum number of qualifying years on their National Insurance record. Qualifying years can come from working and paying National Insurance, or from credits or voluntary contributions in some cases. The required number of qualifying years depends on whether a person qualifies for the basic or new State Pension.

Those in low-income households who do not qualify for State Pension may receive Pension Credit instead. Pension Credit is means-tested based on household income. It is a qualifying benefit for other benefits like Housing Benefit and Winter Heating Payment.

As of May 2025, about 1.1 million people in Scotland were receiving State Pension, and about 130 thousand were receiving Pension Credit, as shown in the chart below.

State Pension and Pension Credit together account for 83% of benefits spending on pensioners in Scotland, about £12 billion total. State Pension accounts for 95% of that amount.

Number of people age 65+ receiving State Pension and Pension Credit, Scotland



Source: DWP Stat X-plore

Disability and health-related benefits

Pensioners receive some cash benefits related to disability and health. Many of these are now devolved. These accounted for 11% of benefit spending on pensioners in 2024/25.

Those with a continuing health condition or disability can receive support for the costs of disability through either Pension Age Disability Payment (devolved from Attendance Allowance), Adult Disability Payment (for continuing claims), or Scottish Adult Disability Living Allowance (replacing Disability Living Allowance). Which benefit a person will receive depends on their age when they apply and whether or not they are transitioning from another health-related benefit.

In Scotland, 307 thousand pensioners received one of these disability benefits as of May 2025.

Those who provide care for 35 hours a week or more to someone claiming disability benefits and have earnings below a set threshold can claim Carer Support Payment. In May 2025, 34 thousand pensioners claimed CSP or Carer's Allowance (the reserved version of CSP, which has now been almost fully replaced).



Housing costs and heating

Pensioners can receive support for housing costs through Housing Benefit, Council Tax Reduction, Discretionary Housing Payment (DHP), and Support for Mortgage Interest (SMI).

Housing Benefit provides support for rent to low-income pensioners, while Council Tax Reduction provides a discount on Council Tax for those with incomes below a certain level. In Scotland in August 2025, 115 thousand people over 65 claimed Housing Benefit. 164 thousand pensioners claimed Council Tax Reduction as of March 2025.

Due to the way the statistics are reported, we were unable to estimate a 65+ caseload or spending on pensioners for DHP and SMI.

There are various benefits that support heating costs for pensioners, with conditionality on age or income. Pension Age Winter Heating Payment (PAWHP), which replaced Winter Fuel Payment in 2024/25, is aimed specifically at pensioners, while Winter Heating Payment (WHP) and the Warm Home Discount Scheme (WHDS) are more generally available to low-income households.

In 2024/25, 125 thousand pensioners received PAWHP and 138 thousand received WHP. Statistics are not yet available for the WHDS in 2024/25, but in 2023/24, 91 thousand pensioners benefited from Core Group payments of £150 for the winter.

Benefits for one-off support

Pensioners can also access one-off support in specific circumstances. These are typically not aimed only at pensioners, and are means-tested. Statistics by age of the recipient are not available for any of these payments.

Funeral Support Payment helps low-income households with funeral costs. Scottish Welfare Fund gives grants to help with unexpected emergencies and to help with the costs of independent living.

Budgeting Loan is also available to pensioners on low-income benefits, and is repaid from future benefit payments.

Fiscal sustainability

The [OBR's forecasts](#) show UK spending on pensioner benefits rising by 7% between 2024/25 and 2025/26. This is driven largely by growth in spending on State Pension, which is subject to the triple lock: it is always uprated by CPI inflation, the rate of average earnings growth, or 2.5% - whichever is highest.

The triple lock and a growing pensioner population [are expected to drive a slight increase](#) in State Pension spending as a proportion of GDP from the present to 2030/31.

While State Pension is reserved, growth in benefit spending on pensioners is also potentially of concern for devolved fiscal sustainability.

The number of disability benefit claimants over 65 fell over the decade from 237 thousand in mid-2012 to 182 thousand in mid-2022. This number has since risen to 307 thousand in mid-2025.

This rise has mirrored a rise in disability benefits receipt among working-age people, raising concerns about the sustainability of the trend.