OPENING REMARKS: SFC MEDIA CONFERENCE 31 MAY 2019

Good morning and thank you for coming along to our fourth media briefing. We're across the road from our usual venue, but we wanted to stay close to the parliament as we know it suits many of you.

As always, we'll start with a few words from me, then I'll hand over to John Ireland our Chief Executive who'll make a short presentation, followed by time for questions. I hope we'll finish in just under an hour.

I'm joined this morning by two of my fellow Commissioners, Professor Francis Breedon and Professor Alasdair Smith. Our colleague Professor David Ulph is unable to join us today and he sends his apologies.

I'm also joined by two of the Commission's senior staff, Claire Murdoch and David Stone.

I hope you've all had a minute to look at the report or the summary we published yesterday afternoon. I've often remarked on the growth in the size of our reports over time as the Commission's responsibilities have grown. So, for the absence of doubt, you should know that even though we've slimmed down this report by over 100 pages, our remit remains the same as it was last December.

We publish our forecasts twice a year, to support the Scottish Government's Medium Term Financial Strategy in May and their Budget in December. The report contains our economy, tax and social security forecasts as usual. What's different this time around is that we've put our analysis of the key issues facing the Scottish budget together in a new chapter on the Fiscal Overview.

This is because the Scottish Budget is becoming more complicated. It depends on two forecasts, our revenue forecasts and the Block Grant Adjustment, or BGA, forecasts. Forecasts are inherently wrong, as we know, and the budget has to be based on the best possible estimates of what will be raised and spent. As an independent fiscal institution, we're well placed to provide these.

Everyone's attention at budget time in winter is focused on the tax and spending plans for the year ahead. What's good about May is that, with the immediate pressure of setting a budget behind us, we can spend time thinking about the longer term. Our forecasts look ahead over the next five financial years. We also take the opportunity in May to add an additional financial year to our forecasts – this time that's 2024-25.

In our report we've highlighted two longer term risks for the Scottish budget. The first arises from the devolution of further social security benefits in April 2020. Our estimate of the spend on social security next year is £3.5 billion, compared with the £447 million we expect to be spent this year. The forthcoming benefits are demand-led. In other words, anyone who applies and is eligible must be paid. So the Government will need to be able to manage any difference between the forecast and actual spend.

By way of context, the Government's entire spend this year on its justice portfolio, including police, fire, court and prison services, is £2.7 billion. So you can see that £3.5 billion for social security is a great deal of money. What makes this trickier is that forecasting the spend on *new* benefits, to be administered in a distinctively Scottish way and possibly around different eligibility rules, is by its nature much harder in the first few years when we don't have an established baseline to work from.

The second risk we highlight is the adjustments the UK Treasury will begin to make to reflect *actual* income tax collected. We estimate that these adjustments, or "reconciliations" to use the technical language of the Fiscal Framework, will reduce the Scottish budget by £229 million next financial year and by £608 million the year after. Shortly, John will talk you through exactly how these figures came about shortly.

The important thing is how this volatility is managed. The Government can borrow and use its reserves to help deal with these reconciliations and can consider adjusting its spending plans.

Finally, I'd like to turn to the prospects for the Scottish economy. In December I said that Brexit was at the front of our minds. That has continued to be the case. When we started working on our forecast back in March we thought hard about how we dealt with Brexit.

Our forecast is based – as it was in December – on a broad assumption of an orderly negotiated exit from the EU. We now assume that exit will be in October rather than in March. The terms on which the UK may leave the EU are still highly uncertain and we have made a number of broad brush assumptions to capture a range of possible outcomes. A no-deal exit is not captured in our central assumptions and is a significant downside risk to our forecasts.

We followed the many twists and turns on Brexit as we put our forecast together. We finalised our approach at the start of May when the Government needed our final forecasts. While things have moved on since then – particularly last weekend with the Prime Minister's resignation - we still believe that our Brexit assumptions are reasonable.

I'm going to hand over to John now to take you through some of the forecast in more detail. That should take about ten minutes. After that we'll take your questions.

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