ECONOMIC VIEWPOINT

Fewer NPRs Will Slow Inflation but Likely Not by Much

By Randall Bartlett, Senior Director of Canadian Economics

Highlights

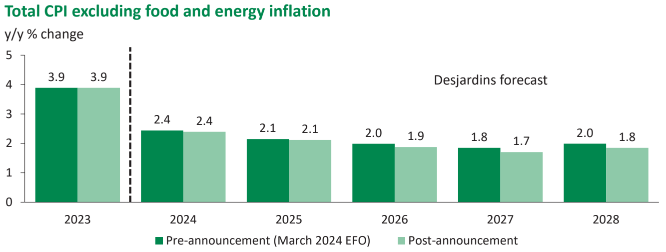
- Following the recent announcement that the federal government will be capping the number of non-permanent residents (NPRs) admitted to Canada, we published analysis showing how this will act to lower our forecast for real GDP growth and inflation relative to our prior outlook.
- More subdued shelter prices should be the primary driver of the slower pace of price growth resulting from fewer NPR admissions. However, it's unlikely to have an outsized impact on headline inflation, largely because of little change in mortgage interest cost, barring a major shift in the outlook for rate cuts. In contrast, rent inflation is expected to slow considerably relative to our prior projection but not enough to materially move the needle on aggregate price gains.
- Taken together, while fewer NPRs will help to improve housing affordability and take pressure off inflation, the impact is likely to be modest and less than some might have expected. Instead, a meaningful increase in housing supply is needed to get a sustained slowing in shelter inflation.

Following the recent announcement that the federal government will be capping the number of non-permanent residents (NPRs) admitted to Canada, we published analysis showing how this will act to lower our forecast for real GDP growth and inflation (graph 1). At the same time, the drag from slower population growth should be partly, but not entirely, offset by gains in labour productivity, real GDP per capita and inflation-adjusted wages. As a result of these competing factors, the impact on total CPI inflation excluding food and energy (referred to as "core CPI inflation") was more moderate than we might have expected.

Unpacking our forecast for core CPI inflation, relatively lower shelter prices are likely to be the primary driver of the slower pace of price growth resulting from fewer NPR admissions (graph 2). However, the impact should be modest. The peak difference between our pre- and post-NPR announcement shelter inflation forecasts never quite reaches 0.5 percentage points.

The reason for the more modest change in the shelter inflation forecast than might be expected is largely because of mortgage interest cost (MIC) (graph 3 on page 3). MIC is essentially a very long-term moving average

Graph 1
Fewer NPRs Should Cause Core Inflation to Be Lower than Forecast



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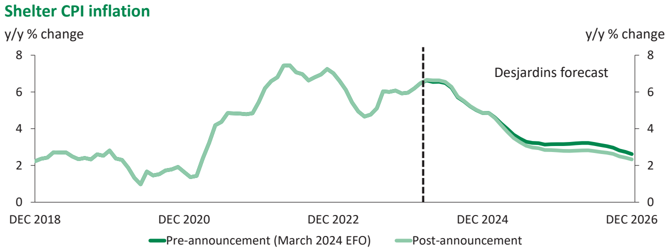
Graph 2
The Drag from Lower NPRs on Shelter Inflation Should Be Modest



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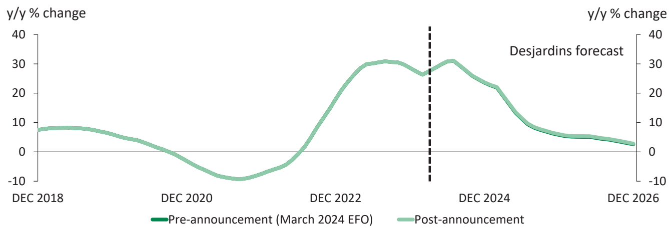
of interest costs based on new and used home prices and sales volumes as well as interest rates. And given we have not adjusted our already below-consensus interest rate forecast in response to the impending slower population growth, our MIC forecast is little changed.

Graph 3
MIC Forecast Should Change Little without a Sharp Drop in Rates

Mortgage interest cost (MIC) CPI inflation



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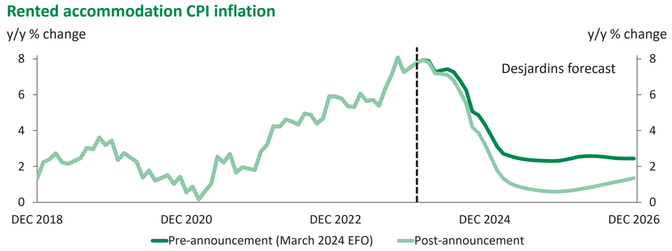
In contrast, rent inflation is expected to slow considerably relative to the projection used in our [March 2024 Economic and Financial Outlook] (graph 4). That's because the single most important factor propelling this price category is population growth. However, again, the limited impact of interest rates and other more minor inputs means the deceleration will not be as substantial as it would otherwise be. The weight of rented accommodation in the CPI basket is also only about 40% that of owned accommodation, further minimizing the impact on overall inflation.

Graph 4
Rent Inflation Should Slow Considerably Due to Fewer NPRs

Rented accommodation CPI inflation



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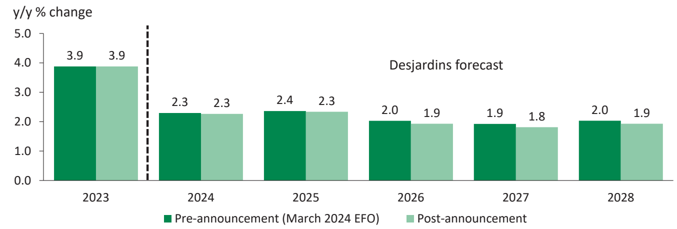
While shelter isn't the only CPI category that will be impacted by lower population growth, the impact on the other more than 70% percent of the basket should be broadly a wash. For instance, some categories like food and fuel shouldn't be impacted much, if at all, by a lower level of NPRs. The evolution of global supply chains won't be affected by population growth in Canada either. As a result, the headline inflation outlook should be lower to a similar degree as the core inflation forecast (graph 5).

Graph 5
Lower Core Inflation Will Be Reflected in Total CPI Inflation

Total CPI inflation



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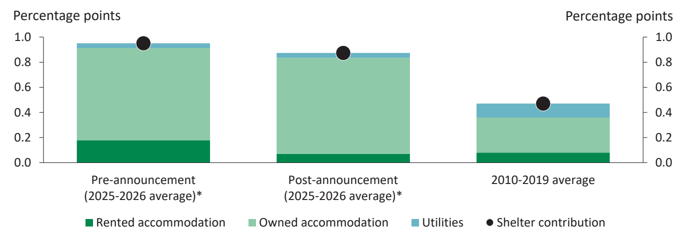
Taken together, while fewer NPRs will help to improve housing affordability and take pressure off inflation, the impact is likely to be modest. Without more aggressive rate cuts than currently anticipated, affordability and mortgage interest cost inflation should be little improved going forward relative to our prior forecast (graph 6). As such, the impact of the cap on NPRs on the outlook for headline CPI inflation is expected to be muted.

Graph 6
Slower Rent Growth Should Be the Primary Cause of Lower Inflation

Contribution of shelter CPI to total CPI inflation



*Forecast
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But this is just one scenario, and there are other options available to policymakers that could help to further reduce shelter inflation. For instance, if the Bank of Canada came to believe there were more downside risks to the economic outlook in the wake of the reduction in NPRs, it could choose to cut rates more quickly and/or deeply than currently expected. Further, we don't make any assumptions about the effectiveness of the current deluge of government policies to increase the supply of housing in Canada. If they prove as effective as policymakers hope, a ramp-up in homebuilding could take pressure off Canada's supply-constrained housing market. As we have previously discussed, the NPR reduction only addresses one side of the demand-supply imbalance. If Canadians hope to get meaningful shelter inflation relief, it's going to have to come via the supply side.