ECONOMIC VIEWPOINT

What's the Right Number of Newcomers to Welcome to Canada?

By Randall Bartlett, Senior Director of Canadian Economics

Highlights

- What's the right number of newcomers to welcome to Canada? Well, it depends. Immigration is imperative for Canada's long-term economic success but can lead to short-term challenges. As such, there are several considerations policymakers should keep in mind.
- One such consideration is near-term economic and labour market conditions. Sustained labour demand suggests that the current pace of permanent and non-permanent resident admissions may be warranted, at least for now.
- We can also look at how quickly the working-age population (those 15 to 64) would need to grow to stabilize the old-age dependency ratio (OADR), thereby offsetting the impacts of aging. It would need to increase just over 2% annually, slightly faster than the 2022 pace and roughly triple the 5-year pre-pandemic average. To push the OADR lower would require even more immigration.
- Economic immigrants also raise potential GDP growth by being highly productive and engaged in the labour force. Other newcomers have more mixed impacts on potential GDP. But in aggregate, our research shows that higher immigration will do more to raise real GDP per capita and, by extension, living standards and incomes in the long run.
- However, as population growth continues to drive up home prices and erode affordability in the near term, the federal government must address this in its immigration policy, particularly regarding non-permanent residents. It must marry immigration policy with immediate action to increase the housing supply.

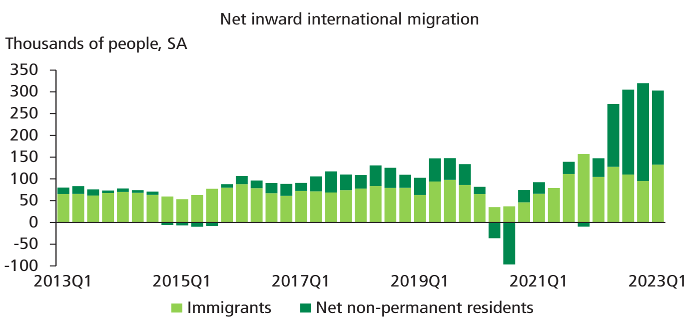
What's the optimal level of immigration to Canada? This can be a tough question to answer, as "optimal" is in the eye of the beholder. It depends on the policy objective that immigration is meant to achieve.

Looking at this question from an economic perspective, there are a few things to consider. One is the current state of the economy. Another is the long-run impact of immigration on Canada's economic potential through higher productivity and a larger workforce. The latter is a particularly pressing issue as the baby boomers have already begun to retire. And as people age, their individual healthcare costs rise exponentially, putting significant pressure on government finances, especially in the provinces. As such, there may be an optimal level of immigration that works to offset the impact of aging on potential GDP growth while also ensuring the sustainability of public health services and finances. But adding to the population doesn't come without costs, particularly when it's done quickly. We're seeing this most acutely in the Canadian housing market, where some of the biggest cities in the country have seen a sharp resurgence in activity recently despite elevated borrowing costs. Indeed, while newcomers add much needed labour supply, they also add to aggregate consumer demand.

Is the Current State of the Economy and Labour Market Driving Immigration?

Before getting into the relationship between immigration and the state of the economy, it's important to distinguish between the different types of newcomers to Canada. According to Immigration, Refugees and Citizenship Canada, "A permanent resident is someone who has been given permanent resident status by immigrating to Canada, but is not a Canadian citizen. Permanent residents are citizens of other countries." In contrast, "non-permanent residents include temporary foreign workers, international students and asylum seekers, who all have the right to live in Canada temporarily." ([CIC News, 2023]) And it's the latter group that now makes up a majority of newcomers to Canada (graph 1).

GRAPH 1
Most Newcomers Are Non-permanent Residents (NPRs)

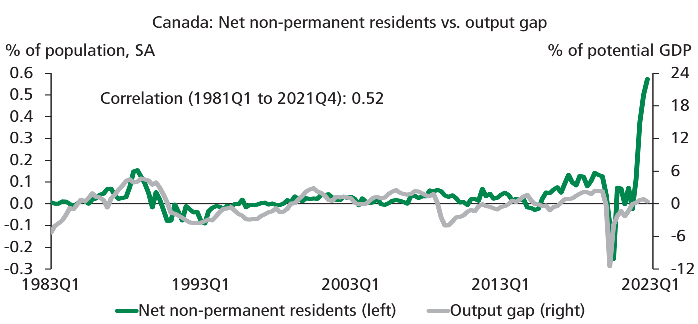


SA: Seasonally adjusted
Sources: Statistics Canada and Desjardins Economic Studies

This begs the question: Why are so many non-permanent residents coming to Canada? One would assume that it reflects the state of the economy. And historically there has been a positive relationship between the state of the economy as estimated by the output gap and the share of non-permanent residents in the population. However, the rate at which non-permanent residents have come to Canada in the last four quarters is much higher than warranted by the output gap (graph 2).

The labour market gives a clearer indication of what might be happening. Specifically, the number of job vacancies was nearly 800K in April 2023, below the 1M+ vacancies in the first half of 2022 but still well above the 2019 figure, which was just shy of 550K. And while the number of unemployed people per job vacancy has trended higher over the past year to a seasonally adjusted 1.3, it remains well below the 2.2 average in 2019 (graph 3). Notably, without the recent surge in newcomers to Canada filling job vacancies, this ratio would be even further away from its pre-pandemic average.

GRAPH 2
More NPRs Are Coming than Warranted by the Output Gap



SA: Seasonally adjusted
Sources: Statistics Canada and Desjardins Economic Studies

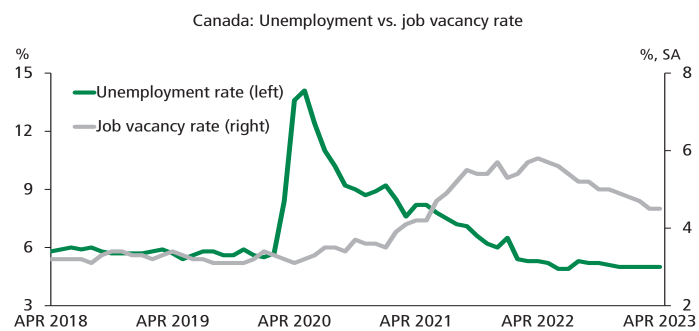
And while the job vacancy rate[1] has fallen to a seasonally adjusted 4.5% from nearly 6% in April 2022, the unemployment rate has barely budged from its near-record low of around 5% (graph 4). This makes sense as most of the newcomers to Canada are non-permanent residents, many of whom are coming at the request of an employer to satisfy a specific labour market need. As such, it seems reasonable that the current admissions are justified by demands in the labour market.

Importantly, as we highlighted in our recent [Economic and Financial Outlook], the Canadian economy is expected to slow and the unemployment rate to rise along with it (graph 5 on page 3). Typically, this should lead to a reduction in the rate of

GRAPH 3
Unemployment Remains Low Relative to Job Vacancies

SA: Seasonally adjusted
Sources: Statistics Canada and Desjardins Economic Studies

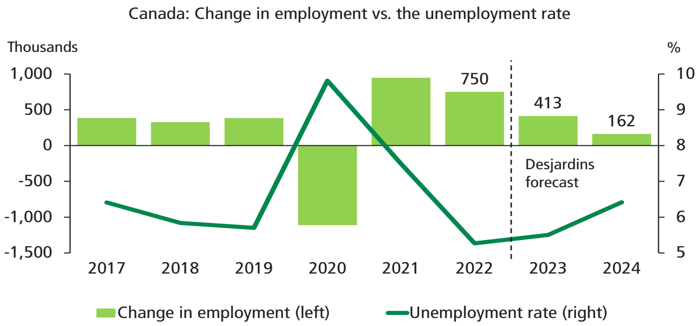
GRAPH 4
Unemployment Remains Low and the Job Vacancy Rate Elevated



SA: Seasonally adjusted
Sources: Statistics Canada and Desjardins Economic Studies

[1] The job vacancy rate is the number of job vacancies expressed as a percentage of labour demand; that is, all occupied and vacant jobs.

GRAPH 5
The Job Market Is Expected to Slow Along with the Economy



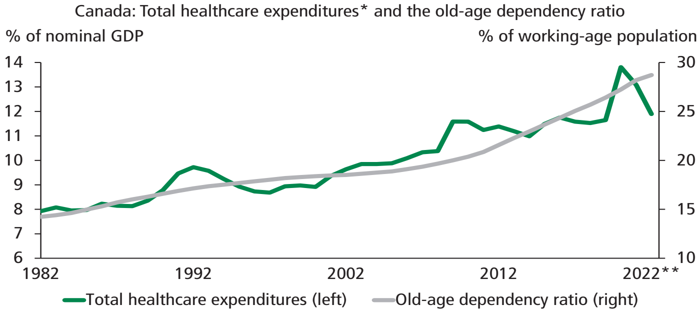
Sources: Statistics Canada and Desjardins Economic Studies

non-permanent resident admissions, as the economy would be operating below its potential and labour demand would be falling.

How Much Immigration Do We Need to Offset the Impact of Aging?

Short-term labour market demands appear to largely justify the current rate of newcomer admissions, but what could be the long-term economic implications? Aging is central to this discussion, as an aging population weighs on economic activity while driving up healthcare costs (graph 6). Indeed, according to the Parliamentary Budget Officer's most recent Fiscal Sustainability Report, provincial government healthcare spending per capita is expected to nearly double between 2020 and 2040, eventually topping $10,000 per person per year. This increase is well beyond the anticipated rise in the Consumer Price Index over the same period and may require an increase in revenues and/or reduction in spending on other priorities to avoid debt-financing this rising cost.

GRAPH 6
Aging Is a Key Driver of Healthcare Spending in Canada

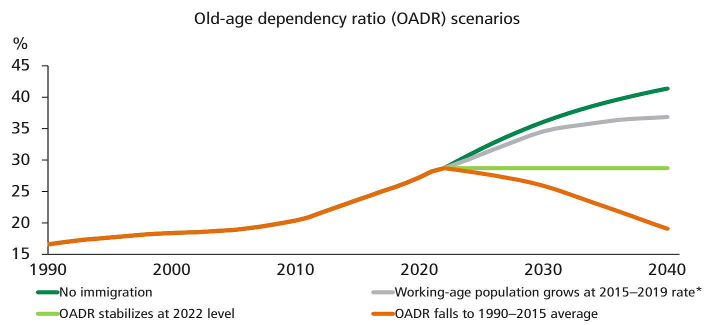


*Includes public and private spending; **2021 and 2022 healthcare expenditures are forecasts
Sources: Canadian Institute for Health Information, Statistics Canada and Desjardins Economic Studies

This suggests there may be a certain old-age dependency ratio (OADR)—the ratio of people ages 65 and over to those ages 15 to 64—that could offset the impacts of aging by growing the working-age population. This could allow for a still-rising standard of living while also ensuring the sustainability of public finances. But while pinpointing an "optimal" OADR is beyond the scope of this short note, we can at least get a sense of the sensitivity of the OADR to different rates of growth in the working-age population. To do that, we take a couple of different approaches.

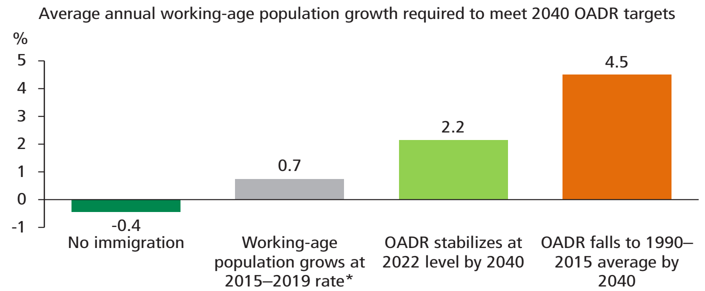
The first approach is to hold the OADR constant at the most recent level, which was 28.7% in 2022 (graph 7). To keep the OADR at 28.7% through 2040, the working-age population would have to increase 2.2% on average annually (graph 8).[2] But the working-age population wouldn't need to expand at the same rate every year to hold the OADR constant. In 2023 it would have to rise around 3.5%, but in 2040 it would be closer to 1% as the baby boomers transition through retirement. To put this growth rate in perspective, that's well above the 1.6% increase in the working-age population in 2022, which was the

GRAPH 7
The OADR Is Expected to Continue Rising



*Corresponds to Statistics Canada's M1 (medium-growth) scenario, updated for history
Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 8
Working-Age Population Growth Would Need to Increase to Reverse the Impact of Aging on the OADR



*Corresponds to Statistics Canada's M1 (medium-growth) scenario, updated for history
OADR: Old-age dependency ratio
Sources: Statistics Canada and Desjardins Economic Studies

[2] This and subsequent scenarios assume aging in line with Statistics Canada's M1 (medium-growth) projection scenario.

fastest pace of growth since 1989. The last time growth in this age group topped 2% on a sustained basis was the early 1970s. Notably, working-age population growth in 2022 was entirely driven by a surge in immigration and temporary foreign workers.

The second approach is to determine a rate of growth in the working-age population that would lead the OADR to gradually move toward a predetermined level. One option would be to target a historical average. For instance, the OADR was relatively stable from 1990 to 2015, when it averaged 19.1% (graph 7 on page 3). To reach this level by 2040 would require average growth in the working-age population of 4.5% annually (graph 8 on page 3). The growth rate would need to be much higher to reach the target any earlier.

Under the various scenarios we devised, population gains would need to far exceed historical norms. This suggests that even at the current elevated pace of immigration, the OADR should continue to rise for the foreseeable future. Indeed, at this rate the OADR could at best return to its 2022 level by 2040 after cresting at over 30% around 2030. In contrast, returning working-age population growth to its 2015–2019 average of 0.7% annually would lead the OADR to rise consistently to between 35% and 40% by 2040 (graphs 7 and 8 on page 3). Shutting the door to immigration altogether would cause an even more rapid and sustained increase in the OADR.

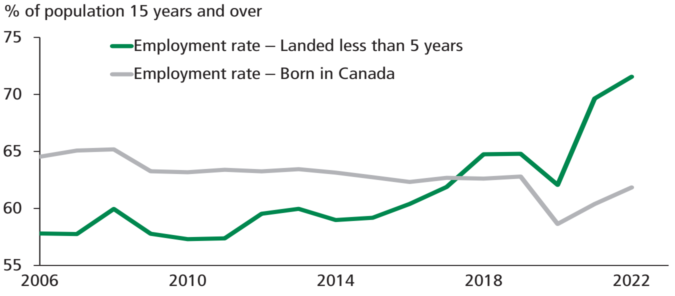
What Are the Implications of Immigration on Canada's Potential GDP?

As we have demonstrated previously (here and here), attracting newcomers to Canada increases potential GDP growth and potential GDP per capita relative to the alternative. This is in part because new Canadians are more likely to be employed than people born in Canada—a phenomenon that started before the pandemic (graph 9). That's largely because older workers have a tendency to work less and newcomers to Canada are generally younger.

Just considering the scenarios outlined earlier, if the pace of immigration were to be high enough to keep the OADR constant, potential GDP growth would be 1.0 percentage point higher on average annually through 2040 than in the scenario where the working-age population grows at its pre-COVID average (graph 10). If the pace of immigration were to be high enough to return the OADR to its 1990–2015 average by 2040, potential GDP growth would be 3.1 percentage points higher on average annually. And finally, if there were no immigration going forward, potential GDP growth would be 1.1 percentage points lower than in the scenario where the working-age population grows at its pre-COVID average, albeit still slightly positive as a result of productivity growth. It should be noted that this analysis doesn't assume any further improvement in the employment outcomes of newcomers to Canada relative to Canadian-born workers after 2022. This would buck the longstanding trend of improving outcomes observed over the past 15 to 20 years.

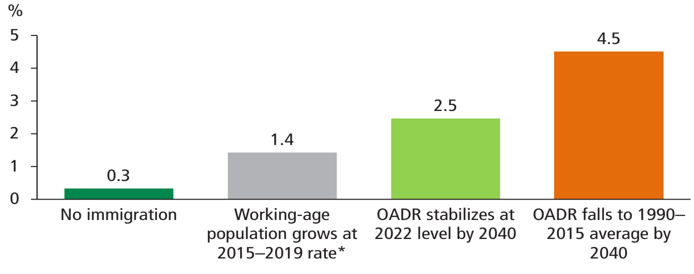
Importantly, productivity growth is assumed to be the same in all scenarios. It's hard to determine the level of productivity of the average foreign-born and Canadian-born worker as we don't have great data on the sectors they work in. But the information we do have points to a higher prevalence of foreign-born workers in manufacturing, finance and insurance, as well as professional, scientific and technical services. Our recent analysis on real GDP per capita in Canada identified these sectors as having above-average productivity. Immigrants are also more likely to become entrepreneurs and run businesses that engage in international trade than people born in Canada. (See our recent note on the economics of youth for more information.) Further, if real wages are a proxy for the relative productivity of different groups, it's evident that economic immigrants in particular are outperforming the typical Canadian (graph 11 on page 5). This is important, as it not only means economic immigrants—the largest group of immigrants to Canada—are more likely to be employed, but their higher real wages suggest they could also be more productive as a group. As such, they appear to be punching above their weight in terms of their contribution to potential GDP. And while this is not generally the case for

GRAPH 9
Recent Immigrants to Canada Have Positive Employment Outcomes



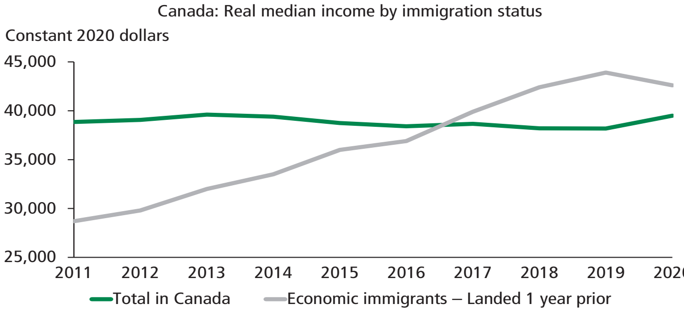
Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 10
Immigration Boosts the Working-Age Population and Potential GDP



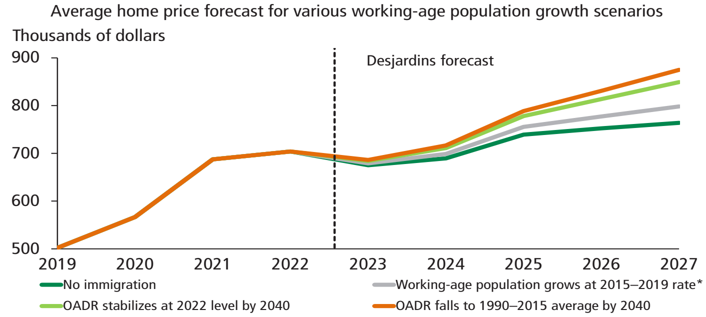
*Corresponds to Statistics Canada's M1 (medium-growth) scenario, updated for history
OADR: Old-age dependency ratio
Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 11
Economic Immigrants Earn More than the National Median Real Income



Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 12
The Faster the Pace of Immigration, the More Home Prices Will Rise



*Corresponds to Statistics Canada's M1 (medium-growth) scenario, updated for history
Sources: Canadian Real Estate Association and Desjardins Economic Studies

immigrants of other admission categories, such as refugees and immigrants sponsored by family, these non-economic immigrants make up a minority of overall admissions to Canada. Unfortunately, the data are even worse for non-permanent residents. That said, the recently announced Tech Talent Strategy is an example of measures being taken to encourage highly productive non-permanent residents to move to Canada for work on a temporary basis.

But It's Not as Simple as Population Addition and Subtraction

As evidenced above, the current rate of growth in the working-age population is required to keep the OADR broadly stable through 2040. On its own, it would also boost the rate of potential GDP growth. But given the rapid erosion of affordability in all types of housing, it's not clear how sustainable the current pace of immigration is. According to our analysis from earlier this year, housing starts would need to increase by 100,000 units annually to offset the home price impact of a higher number of permanent residents. This is in part because housing starts are down and are expected to fall further due to high interest rates and input costs as well as a decline in presales. (See our recent housing market outlook.) However, this now looks to be an underestimate given the surge in non-permanent residents. Indeed, our housing market forecast, which is partly constructed based on the Bank of Canada's framework, suggests that a sustained increase in the population would lead to a more rapid appreciation in the average home price, as housing starts are unable to keep up with existing home sales (graph 12).[3] Absent a substantial increase in housing supply, this would put further pressure on shelter inflation, either through the direct effect of higher prices for new homes or the indirect effect of exacerbated pressures on rents.

But there is only so much the federal government can do to incent provinces and municipalities to build more housing. It is therefore incumbent on all levels of government to get more housing built. As such, the federal government also needs to listen to other levels of government when it comes to their capacity to house newcomers in the near term. Otherwise, there is a risk that a lack of adequate housing may deter talented workers from settling in Canada, weigh on potential GDP growth and reduce the openness of Canadians to immigration more broadly.

Conclusion

What's the optimal level of immigration to Canada? It depends on the policy objective that immigration is meant to achieve. Immigration is imperative for Canada's long-term economic success. Foreign-born workers help to meet short-term labour market needs, which are currently very acute. We also need immigration to maintain or—better yet—increase long-term potential GDP growth while at the same time ensuring the sustainability of government finances. This is particularly true in the provinces, which are responsible for providing health services to a rapidly aging population.

But the short-term strains of surging population growth are beginning to show, particularly in the housing market. The federal government could tighten up the requirements for non-permanent residents tomorrow. This would provide some relief in the erosion of housing affordability. A slowing pace of temporary foreign workers entering Canada could also encourage companies to increase real wages and/or invest in productivity-enhancing technologies. But that would dramatically constrain growth in the working-age population, leading to a more rapid uptick in the old-age dependency ratio and raising fiscal sustainability concerns. It's a difficult balance to strike, and it speaks to the need for the federal government to marry Canada's immigration policy with a results-driven approach aimed at increasing the affordability of all types of housing.

[3] We assume there is no interest rate response to changing home price activity relative to our baseline.