ECONOMIC VIEWPOINT

New Federal Immigration Plans: What Will Be the Economic Impact?

By Randall Bartlett, Senior Director of Canadian Economics

Highlights

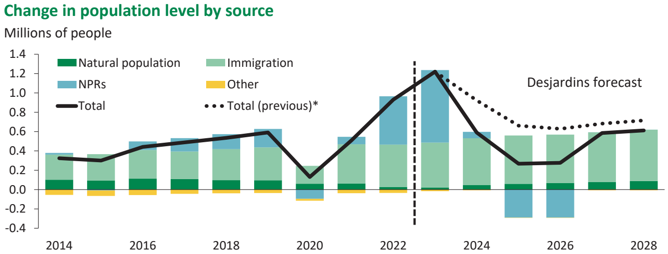
- On March 21, the federal government announced a planned reduction in non-permanent residents of about 500K people by the end of 2026. This has forced us to reevaluate our Canadian economic forecast and think about how it could change if these policies are implemented in full.
- The proposed changes are meant to address affordability and will likely increase labour productivity, real GDP per capita and average real earnings growth. However, by dramatically reducing the pace of population growth, real GDP and employment should advance more slowly, weighing on inflation. This solidifies our base case for rate cuts to start in June, and reinforces our outlook for more rate cuts than expected by the consensus of economists.

We released our latest Economic and Financial Outlook (EFO) on the morning of Thursday, March 21, 2024. However, by 1pm that day, new information was released with material implications for the outlook. That's when the federal government announced plans to reduce the number of non-permanent residents (NPRs) in Canada from about 2.5M today to around 2.0M in three years' time. (Please note that the update to our official forecast will be released in mid-April, and that the work presented here should be considered a scenario.)

The number of net NPRs would need to contract for at least a couple of years to meet the federal government's stated objective (graph 1). That means more NPRs would need to leave than enter Canada. A decline in net NPRs of this magnitude would be unprecedented, even when compared to past recessions and oil price shocks (graph 2).

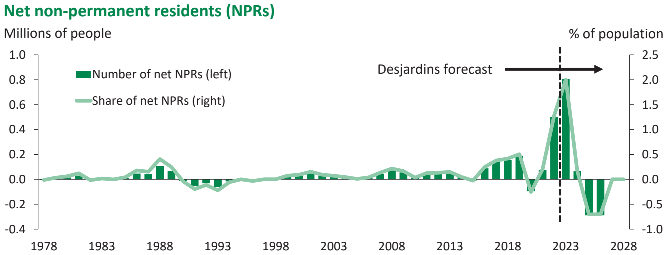
Given the outsized role that net NPRs have played in driving population gains in recent years, this planned contraction has forced us to revise our population growth forecast dramatically lower (graph 3 on page 2). Working-age population growth is likely to be only modestly lower than previously projected in 2024, with most of the adjustment felt in 2025 and 2026. In those two years, we're now projecting growth of 0.7% on average annually, down from 1.7% previously. For more details on our previous population projection, which was

Graph 1
NPRs May Need to Turn Negative to Hit the Government's Targets



NPR: Net non-permanent resident; *Basis for the population projection in our most recent Economic and Financial Outlook
Statistics Canada, Immigration, Refugees and Citizenship Canda and Desjardins Economic Studies

Graph 2
Proposed Reductions in NPR Admissions Will Be Unprecedented



NPR: Net non-permanent resident
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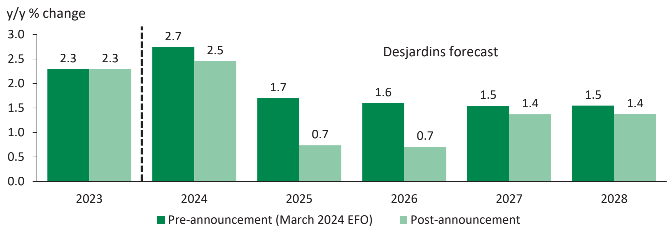
Graph 3
Changes to NPR Admissions Will Sharply Reduce Population Growth

Growth in population 15 years and over



EFO: Economic and Financial Outlook; NPR: Net non-permanent resident
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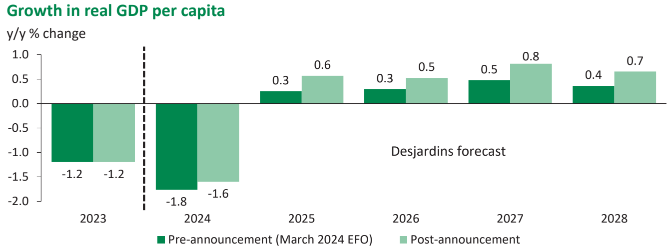
broadly benchmarked to the Bank of Canada's outlook, please see our Economic Viewpoint from earlier in 2024.

While slower population growth will weigh on overall economic activity, we expect that real GDP per capita will be stronger than was previously projected (graph 4). That's in part because productivity growth is likely to be higher.

However, aggregate real GDP growth should be lower than our prior projection, as greater productivity growth is unlikely to be enough to offset lower population growth (graph 5). And since potential GDP growth isn't likely to slow by as much as real GDP growth, the forecast output gap is even more negative than previously presented.

Graph 4
Changes to NPR Admissions Should Increase Real GDP per Capita

Growth in real GDP per capita



EFO: Economic and Financial Outlook; NPR: Net non-permanent resident
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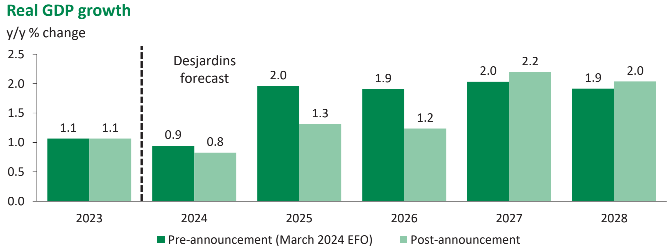
Graph 5
Lower Population Growth Should Reduce Overall GDP Growth

Real GDP growth



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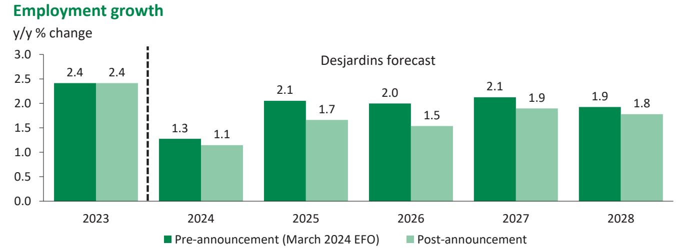
This weakness in real GDP growth will be similarly reflected in the labour market, with employment growth likely to underperform the outlook presented in our latest EFO (graph 6). That said, the impact on employment growth should be more modest than for real GDP. Even though total employment is lower under the reduced NPR scenario, the employment rate would be higher. That's because we'd expect the population to fall more than employment. Moreover, ongoing labour shortages coming out of the pandemic—increasing the need for NPRs—could reasonably be expected to persist to some extent as the population ages.

Graph 6
Lower Population and GDP Growth Means Lower Employment

Employment growth



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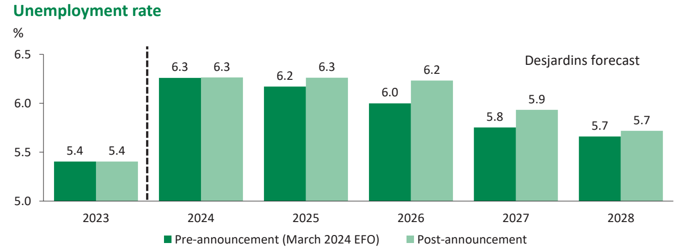
Although the employment rate increases under our reduced NPR scenario, so does the unemployment rate (graph 7). That's because NPRs have a lower likelihood of being unemployed than other population groups. So removing them from the labour force entirely means unemployed Canadians could make up a larger share of people either working or looking for work. The larger negative output gap doesn't help either. That said, we do think the unemployment rate will be slightly lower by 2030 than in our prior projection as a result of the proposed policy changes. Older Canadians will make up a larger share of the working-age

Graph 7
Weaker Economic Activity Pushes the Unemployment Rate Higher

Unemployment rate



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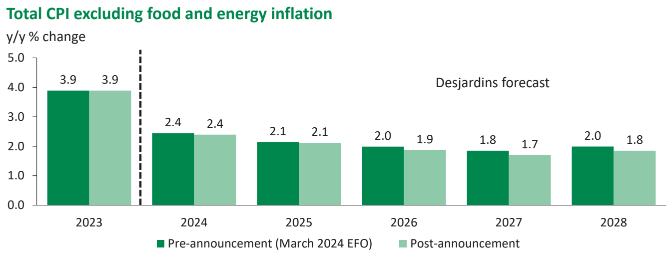
population at that time and have historically been much less engaged in the labour force.

The more modest economic activity and higher unemployment rate should put additional downward pressure on core CPI inflation in Canada (graph 8). Total inflation won't be immune either, albeit diminished by less than core inflation as food and energy prices are less susceptible to cyclical swings in the domestic economy (graph 9).

Graph 8
Core CPI Inflation Will Likely Be Weaker Along with the Economy



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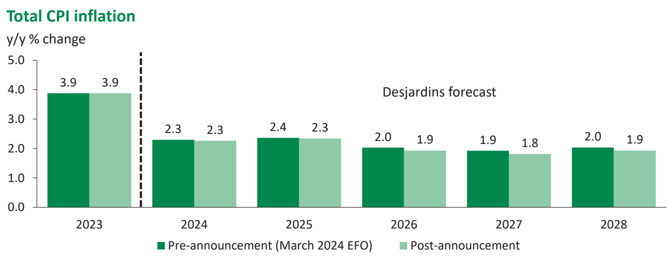
Graph 9
Lower Core Inflation Will Be Reflected in Total CPI Inflation



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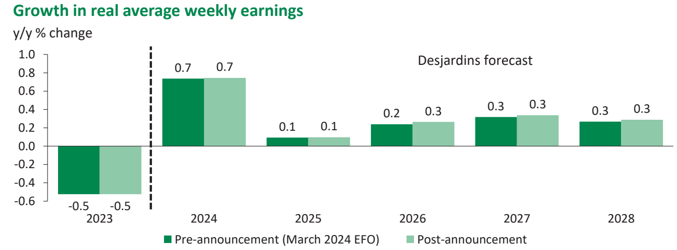
The Bank of Canada is likely to respond to the economic weakness and lower inflation resulting from fewer NPRs by reducing the overnight policy rate. This solidifies our base case for rate cuts to start in June. It also suggests that if developments in the economy unfold as presented in this scenario, our base case for more rate cuts than expected by the consensus of economists is even more likely to materialize.

Lower inflation should provide a modest tailwind to real earnings growth, helping Canadians to regain more of the ground lost during the pandemic (graph 10). For individual households, this will be welcome news. But for the economy as a whole, it won't be enough to offset the drag on consumption coming from the slower pace of population growth.

Graph 10
Lower Inflation Should Modestly Boost Real Wage Growth



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It should be noted that the bottom line of the federal government is likely to be adversely impacted by this change in policy. That's because slower growth in nominal GDP weighs on revenues by more than it and lower interest rates reduce spending. Expect the Government of Canada to run larger deficits and rack up more debt as a result. For provincial governments, the implications will be more mixed due to the differential impact on program expenses, e.g., lower health care costs in the near term combined with a potential need to increase post-secondary education funding due to lower revenues from international student tuition fees. But in the long run, our analysis suggests that aging will be an inescapable drag on provincial finances and reducing the number of NPRs will only exacerbate pressures on public finances, absent a material boost in productivity. (Look for additional analysis on provincial economic and fiscal implications in the coming weeks.)

In conclusion, while slower population growth will help alleviate demand pressures on housing and the delivery of public services, it will also have adverse consequences for the economy. If population growth is what largely kept Canada out of recession in 2023, that tailwind to growth is about to largely disappear. And while rate cuts may be coming soon, pent-up demand for housing and still-constrained supply mean affordability likely won't improve much in the foreseeable future. A tidal wave of mortgage renewals at higher rates are just around the corner as well. It has yet to be seen how this will play out in an environment of lower economic activity and higher unemployment.